Final Course

(Revised Scheme of Education and Training)

Study Material

(Modules 1 to 4)

Paper 7

Direct Tax Laws and International Taxation

Part – II: International Taxation

Module – 4

(Relevant for May, 2020 and
November, 2020 examinations)

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This study material has been prepared by the faculty of the Board of Studies. The objective of the study material is to provide teaching material to the students to enable them to obtain knowledge in the subject. In case students need any clarifications or have any suggestions for further improvement of the material contained herein, they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the study material has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

Permission of the Institute is essential for reproduction of any portion of this material.

© ***The Institute of Chartered Accountants of India***

All rights reserved. No part of this book may be reproduced, stored in a retrieval system, or transmitted, in any form, or by any means, electronic, mechanical, photocopying, recording, or otherwise, without prior permission, in writing, from the publisher.

Edition	:	October, 2019
Website	:	www.icai.org
E-mail	:	bosnoida@icai.in
Committee/ Department	:	Board of Studies
ISBN No.	:	
Price (All Modules)	:	₹
Published by	:	The Publication Department on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi 110 002, India.
Printed by	:	

CONTENTS

PART I : DIRECT TAX LAWS

MODULE – 1

Chapter 1 : Basic Concepts

Chapter 2 : Residence and Scope of Total Income

Chapter 3 : Incomes which do not form part of Total Income

Chapter 4 : Salaries

Chapter 5 : Income from House Property

Chapter 6 : Profits and Gains of Business or Profession

Chapter 7 : Capital Gains

Chapter 8 : Income from Other Sources

Chapter 9 : Income of Other Persons included in assessee's Total Income

Chapter 10 : Aggregation of income; set-off, or carry forward and set-off, of Losses

MODULE – 2

Chapter 11 : Deductions from Gross Total Income

Chapter 12 : Assessment of Various Entities

Chapter 13: Assessment of Charitable or Religious Trusts or Institutions, Political Parties and Electoral Trusts

Chapter 14 : Tax Planning, Tax Avoidance & Tax Evasion

MODULE – 3

Chapter 15 : Deduction, Collection and Recovery of tax

Chapter 16 : Income-tax Authorities

Chapter 17 : Assessment Procedure

Chapter 18 : Appeals and Revision

Chapter 19 : Settlement of Tax Cases

Chapter 20 : Penalties

Chapter 21 : Offences and Prosecution

Chapter 22 : Liability in Special Cases

Chapter 23 : Miscellaneous Provisions

PART II: INTERNATIONAL TAXATION

MODULE - 4

Chapter 1 : Transfer Pricing & Other Anti-Avoidance Measures

Chapter 2: Non-resident Taxation

Chapter 3 : Double Taxation Relief

Chapter 4 : Advance Rulings

Chapter 5 : Equalisation levy

Chapter 6 : Application and Interpretation of Tax Treaties

Chapter 7 : Fundamentals of Base Erosion and Profit Shifting

Chapter 8 : Overview of Model Tax Conventions

DETAILED CONTENTS : MODULE - 4

CHAPTER 1 - TRANSFER PRICING AND OTHER PROVISIONS TO CHECK AVOIDANCE OF TAX

Learning Outcomes 1.1

Contents:

1.1 Introduction 1.3

1.2 Meaning of the term “Arm’s Length Principle” 1.3

1.3 Significance of Arm’s Length Principle 1.4

1.4 Practical difficulties in application of ALP 1.5

1.5 The Indian Scenario 1.6

1.6 Transfer of income to Non-residents [Section 93] 1.72

1.7 Transactions in securities [Section 94] 1.74

1.8 Introduction of specific anti-avoidance measures in respect of transactions with persons located in notified jurisdictional area [Section 94A] 1.76

1.9 Limitation of interest deduction in certain cases [Section 94B] 1.79

Exercise 1.82

CHAPTER 2 – NON RESIDENT TAXATION

Learning Outcomes 2.1

Contents:

2.1 Introduction 2.2

2.2 Residential status and scope of total income 2.2

2.3 Exempt income of Non-residents 2.43

2.4 Presumptive taxation for Non-residents 2.51

2.5 Capital gain taxation for Non-residents 2.63

2.6 Special provisions prescribed under Chapter XII-A 2.66

2.7 Determination of tax in certain special cases [Chapter XII] 2.72

2.8 Special Provisions Relating to Conversion of Indian Branch of a Foreign Bank into a subsidiary Company [Chapter XII-BB] 2.82

2.9 Withholding Tax provisions for Non-Residents 2.86

2.10 Miscellaneous provisions 2.89

Exercise 2.92

CHAPTER 3 – DOUBLE TAXATION RELIEF

Learning Outcomes 3.1

Contents:

3.1 Concept of Double Taxation Relief 3.2

3.2 Types of Relief 3.2

3.3 Double Taxation Relief provisions under the Income-tax Act, 1961 .... 3.3

3.4 Concept of Permanent Establishment. 3.11

3.5 Taxing Foreign Income 3.14

3.6 Taxation of Business Process Outsourcing Units in India 3.15

Exercise 3.17

CHAPTER 4 – ADVANCE RULINGS

Learning Outcomes 4.1

Contents:

4.1 Introduction 4.2

4.2 Definitions 4.2

4.3 Authority for Advance Rulings [Section 245-O] 4.4

4.4 Qualifications, terms and conditions of service of Chairman, Vice Chairman and Members [Section 245-OA] 4.5

4.5 Vacancies, etc., not to invalidate proceedings [Section 245P] 4.7

4.6 Application for advance ruling [Section 245Q] 4.7

4.7 Procedure on receipt of application [Section 245R] 4.8

4.8 Applicability of Advance Ruling [Section 245S] 4.9

4.9 Advance Ruling to be void in certain circumstances [Section 245T].................. 4.10

4.10 Powers of the Authority [Section 245U] 4.10

4.11 Procedure of Authority [Section 245V] 4.10

Exercise 4.12

CHAPTER 5 – EQUALISATION LEVY

Learning Outcomes 5.1

Contents:

5.1 Growth of e-commerce and concerns emerging therefrom 5.2

5.2 Taxation issues relating to e-commerce 5.2

5.3 OECD Recommendations under Action Plan 1 of the BEPS project 5.2

5.4 Equalisation Levy - Chapter VIII in the Finance Act, 2016.................................. 5.3

Exercise 5.15

CHAPTER 6 – APPLICATION AND INTERPRETATION OF TAX TREATIES

Learning Outcomes.. 6.1

Contents:

6.1 Introduction.. 6.2

6.2 Double Taxation and Connecting Factors.. 6.3

6.3 Overview of Tax Treaties.. 6.4

6.4 Application and Interpretation of Tax Treaties 6.7

6.5 Role of Vienna Convention in Application and Interpretation of Tax Treaties 6.16

Exercise 6.21

CHAPTER 7- FUNDAMENTALS OF BASE EROSION AND PROFIT SHIFTING

Learning Outcomes 7.1

Contents:

7.1 Background 7.2

7.2 Overview of BEPS 7.3

Action Plan 1 – Addressing the challenges of the digital economy 7.7

Action Plan 2 – Neutralise the effects of Hybrid Mismatch arrangements 7.10

Action Plan 3 – Strengthen Controlled Foreign Company (CFC) Rules 7.13

Action Plan 4 – Interest deductions and other financial payments 7.14

Action Plan 5 – Counter harmful tax practices 7.15

Action Plan 6 – Preventing treaty abuse 7.16

Action Plan 7– Prevent the artificial avoidance of Permanent Establishment (PE) status 7.17

Action Plan 8-10-Transfer Pricing Outcomes in line with Value Creation/ Intangibles/Risk and Capital and other high-risk transactions 7.19

Action Plan 11 – Measuring and monitoring BEPS 7.20

Action Plan 12 – Disclosure of aggressive tax planning arrangements 7.21

Action Plan 13 – Re-examine transfer pricing documentation 7.21

Action Plan 14 – Making dispute resolution more effective 7.24

Action Plan 15 – Developing a multilateral instrument 7.24

Exercise 7.28

CHAPTER 8 – OVERVIEW OF MODEL TAX CONVENTIONS

Learning Outcomes 8.1

Contents:

8.1 Introduction 8.2

8.2 Comparative Analysis of some of the Significant Articles of OECD and UN Model Conventions 8.5

Exercise 8.25

CHAPTER 1

TRANSFER PRICING AND OTHER PROVISIONS TO CHECK AVOIDANCE OF TAX

LEARNING OUTCOMES

After studying this chapter, you would be able to -

❑ **appreciate** the need for incorporation of transfer pricing provisions in the Income-tax Act, 1961;

❑ **comprehend** the meaning and significance of arm's length principle and the practical difficulties in application of arm's length principle;

❑ **appreciate** the meaning and significance of the terms "associated enterprise", "international transaction" and "specified domestic transaction";

❑ **determine** the arm's length price using different methods prescribed under the income-tax law;

❑ **appreciate** the meaning of safe harbour and rules for safe harbor incorporated in the income-tax law;

- **appreciate** the benefits of entering into advance pricing agreements;
- **identify** the cases where secondary adjustments have to be made;
- **pinpoint** the responsibilities of a person entering into an international transaction to keep and maintain prescribed information and documents;
- **identify** the circumstances when the Assessing Officer can invoke the power to determine the arm's length price;
- **comprehend and appreciate** the country-by-country reporting requirements and related matters incorporated in the income-tax law in compliance with BEPS Action Plan 13;
- **appreciate** the specific anti-avoidance measures incorporated in the Income-tax Act, 1961 in respect of transactions with persons located in notified jurisdictional areas;
- **appreciate** the provisions incorporated in the Income-tax Act, 1961 restricting interest deduction claimed by an entity in respect of borrowings from an associated enterprise in line with BEPS Action Plan 4.

1.1 INTRODUCTION

In the present age of commercial globalisation, it is a universal phenomena that Multinational Companies (MNCs) have branches/ subsidiaries/ divisions operating in more than one country. In such a situation, it is a common event for MNCs to transfer goods produced by a branch in one tax jurisdiction to an associate branch operating in another tax jurisdiction. While doing so, the MNC concerned has in mind the goal of minimizing tax burden and maximizing profits but the two tax jurisdictions/countries have also the consideration of maximizing their revenue while making laws that govern such transactions. It is an internationally accepted practice that such 'transfer pricing' should be governed by the Arm's Length Principle (ALP) and the transfer price should be the price applicable in case of a transaction of arm's length. In other words, the transaction between associates should be priced in the same way as a transaction between independent enterprises.

The principles governing the taxation of MNCs are embodied in the OECD Model Tax Convention on Income and Capital (OECD Model Convention), which serves as the basis for the bilateral income-tax treaties between OECD member countries and between OECD member and non-OECD member countries. According to these guidelines, "Transfer prices" are the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises. Two enterprises are "associated enterprises" if one of the enterprises participates directly or indirectly in the management, control or capital of the other or if both enterprises are under common control. Since international transfer pricing involves more than one tax jurisdiction, any adjustment to the transfer price in one jurisdiction requires a corresponding adjustment in the other jurisdiction. If a corresponding adjustment is not made, double taxation will result.

1.2 MEANING OF THE TERM "ARM'S LENGTH PRINCIPLE"

The Arm's Length Price (ALP) of a transaction between two associated enterprises is the price that would be paid if the transaction had taken place between two comparable independent and unrelated parties, where the consideration is only commercial.

The Arm's Length Principle, in the context of taxation, is explained in the OECD Model Tax Convention as under:

"Where conditions are made or imposed between two associated enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

The OECD transfer pricing guidelines provides guidance on the application of the arm's length principle in order to arrive at the proper transfer pricing range between associated enterprises. Market forces determine business relations between independent parties. The arm's length principle seeks to adjust the profits between two associated enterprises by comparing the same as if the transaction is carried out between two independent enterprises. It treats each enterprise as a separate independent entity rather than as inseparable parts of a single unified business.

1.3 SIGNIFICANCE OF ARM'S LENGTH PRINCIPLE

There are several reasons as to why the OECD member countries and other countries have adopted the arm's length principle.

Parity between MNCs and independent enterprises – A major reason is that the ALP provides broad parity of tax treatment for MNCs and independent enterprises. Since the ALP puts associated and independent enterprises on a more equal footing for tax purposes, it avoids the creation of tax advantages and disadvantages that would otherwise distort the relative competitive positions of these entities. The ALP, thus promotes the growth of international trade and investment by removing these tax considerations from economic decisions.

Determines real taxable profits - The transfer price adopted by a multinational has a direct bearing on the proportional profit it derives in each country in which it operates. If inadequate or excessive consideration is paid for the transfer of goods, services or intangible property between the members of an MNC group, the income calculated for each of those members will be inconsistent with their relative economic contributions. An 'arm's length' price – a price two independent firms operating at arm's length would agree on – is needed to determine taxable profits earned in each country. The arm's length doctrine permits the taxing authorities to rectify the accounts of the enterprise so as to reflect correctly the income that the establishment would have earned if it were an independent enterprise.

Reduction of artificial price distortion - If the ALP is not followed, an MNC will sell goods/ provide services to a controlled entity in a high tax regime at a high price (which exceeds the market price) and to an entity in a low-tax regime or a tax haven at a low price (which is lower than the market price). This would result in extreme price distortion of goods and services in the international market.

Minimization of double taxation – The ALP is an international concept and it represents the international norm. The potential for double taxation is minimized, since in international transfer pricing, adjustment to the transfer price in one tax jurisdiction requires a corresponding adjustment in the other tax jurisdiction.

Accurate measurement of economic contribution – The ALP provides accurate measurement of the fair market value of the economic contribution units of an MNC. The focus of the ALP is to ensure that the proper amount of income is attributed to where it is earned. This result in each unit of the MNC earning a return commensurate with its economic contribution and risk assumed.

1.4 PRACTICAL DIFFICULTIES IN APPLICATION OF ALP

There are, however, certain practical difficulties in applying the ALP, which are described hereunder:

True comparison difficult in certain cases – The commercial and financial conditions governing a transaction between independent enterprises are, by and large, never similar to those existing between associated enterprises. As a result, there cannot be a true comparison. The economies of scale and integration of various business activities of the associated enterprise may not be truly appreciated by arm’s length principle. Further, associated enterprises may enter into transactions which independent enterprises may not enter into, like say, licensing of valuable intangible or sharing the benefits of research. The owner of an intangible may be hesitant to enter into licensing arrangements with independent enterprises for fear of the value of the intangible being degraded. In contrast, he may be prepared to offer terms that are less restrictive to associated enterprises because the use of the intangible can be closely monitored. Further, there is no risk to the overall group’s profit from a transaction of this kind between members of an MNC group. In such situations, where independent enterprises seldom undertake transactions of the type entered into by associated enterprises, the ALP is difficult to apply because there is little or no direct evidence of what conditions would have been established by independent enterprises.

Availability of data and reliability of available data – There may be difficulty in getting adequate and reliable information and data in order to apply arm’s length principle. The comparison of controlled and uncontrolled transactions between associated and independent enterprises usually requires a large quantum of data. Easily accessible information may be incomplete and difficult to interpret while the relevant and required information may be difficult to obtain due to geographical constraints or secrecy and confidentiality aspects. In other cases, information about an independent enterprise which could be relevant may not exist at all. Due to these difficulties, the tax administration and tax payers may have to exercise reason and judgment when applying the ALP.

Absence of market price - There must be a reasonably reliable and comparable uncontrolled market price. The ALP does not meet this condition because of the nature of the market place. A market price is an outcome of unique negotiations. It may be possible to know the price range, but it is very difficult to know the actual market price unless a market transaction actually takes place.

Absence of comparable market price for “intangible” transactions - The ALP reaches a comparable uncontrolled market price that is reasonably reliable for standard transactions where the price range is narrow and market price is certain. However, the ALP generally fails to achieve a comparable market price for transactions involving intangibles because they are unique. The unique nature of these transactions creates a very wide price range.

Administrative burden - In certain cases, the arm’s length principle may result in an administrative burden for both the taxpayer and the tax administrations of evaluating significant numbers and types of cross-border transactions.

Time lag - Although an associated enterprise normally establishes the conditions for a transaction at the time it is undertaken, at some point the enterprise may be required to demonstrate that these are consistent with the arm's length principle. The tax administration may also have to engage in the verification process perhaps some years after the transactions have taken place. It may result in substantial cost being incurred by the tax payer and the tax administration. It is also difficult to appreciate the business realities which prevailed at the time when the transactions were entered into. This may lead to bias against the tax payer.

In spite of the practical difficulties listed above, OECD member countries are of the view that the ALP does provide a sound basis to appreciate the transfer pricing between associated enterprises. It has so far provided acceptable solutions to both taxpayers and the tax administrations. The experience gained so far should be effectively used to remove the practical difficulties and improve the administration.

1.5 THE INDIAN SCENARIO

(1) Transfer pricing in relation to International Transactions

In order to provide a statutory framework empowering the tax authorities to determine reasonable, fair and equitable profits and tax in respect of cross-border transactions, sections 92 to 92F had been included in Chapter X of the Income-tax Act, 1961, through the Finance Act, 2001, providing for a transfer pricing mechanism based on computation of income from cross-border transactions. The following conditions must be satisfied in order to attract the special provisions of Chapter X relating to avoidance of tax:

(i) There must be an international transaction;

(ii) Such international transaction should be between two or more associated enterprises either or both of whom are non-residents;

(iii) Such international transaction should be in the nature of:

(a) purchase, sale or lease of tangible or intangible property; or

(b) provision of service; or

(c) lending or borrowing money; or

(d) any other transaction having a bearing on the profits, income, losses or assets of such enterprise.

(iv) Further, such transaction may also involve allocation or apportionment of, or any contribution to any cost or expenses incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of the associated enterprises on the basis of mutual agreement or arrangement between such associated enterprises.

(v) Such international transaction must be done at arm's length price and if such international transaction has been done at less than the arm's length price, it shall require determination of income or apportionment of cost or expense on the basis of arm's length price.

(vi) The above adjustment should either result in an increase of income or decrease of loss returned by the assessee. In other words, the adjustment should not have the effect of reducing the income chargeable to tax or increasing the loss.

The Finance Act, 2001, has introduced provisions relating to pricing of international transaction between the assessee and associated enterprises. These provisions are contained in sections 92 to 92F of the Income-tax Act, 1961. These provisions apply to international transactions entered into with effect from 1st April, 2001. Rules 10A to 10E have been inserted in the Income-tax Rules, 1962 by a notification dated 21st August, 2001. These sections and rules of the Income-tax Act, 1961 and the Income-tax Rules, 1962, respectively, will affect all non-corporate and corporate assessees who have dealings with non-residents for import or export of goods, properties or services. In other words, price paid for import of goods, properties or services and price received for export of goods, properties or services will be subject to scrutiny by the Assessing Officer. Therefore, it is necessary to make a detailed study of these provisions. All assessees who have such dealings with non-residents will have to keep detailed records as prescribed under the Rules and will have to furnish audit report every year with the return of income about their international transactions.

The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing. There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue. Therefore, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

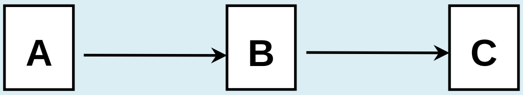
I. Computation of income from transaction with non-resident [Section 92]: Section 92 provides that any income arising from an "international transaction" shall be computed having regard to "the arm's length price". For this purpose, the allowance for any expense or interest shall be determined on the basis of arm's length price. The section further provides that in an international transaction between two or more 'associated enterprises" when there is a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expenses in connection with a benefit, service or facility provided to any one or more of such enterprises, the allocation of cost, expenses etc. shall be determined having regard to arm's length price of such benefit, service or facility. Similarly, the price received for exports and amounts received for services rendered to associated enterprise will be determined on the basis of arm's length price. It will be noticed that in the international transaction, the income or expense will have to be at arm's length price, if the transaction is between associated enterprises.

The objective of transfer pricing provisions is to protect the tax base of India and to ensure that due to inter-company transactions, there is no reduction in the taxable profits or the taxes paid by the Indian taxpayer. The reverse, however, does not hold true.

While determining arm's length price under the provisions of transfer pricing regulations, if the income works out to a figure lower than the income shown in the books of accounts, the provision of transfer pricing regulations will not apply.

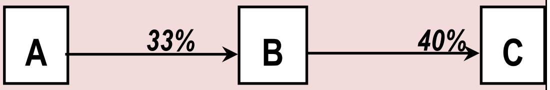
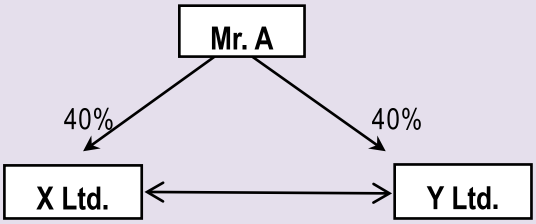
The Assessing Officer will have wide powers to determine what is an arm's length price for such transactions and make adjustments for computation of income. The keywords in section 92 are (i) associated enterprises, (ii) international transactions and (iii) arm's length price. These terms are defined in sections 92A, 92B and 92C.

II. Associated Enterprises [Section 92A]: The term "associated enterprise" in relation to another enterprise is defined in section 92A(1).

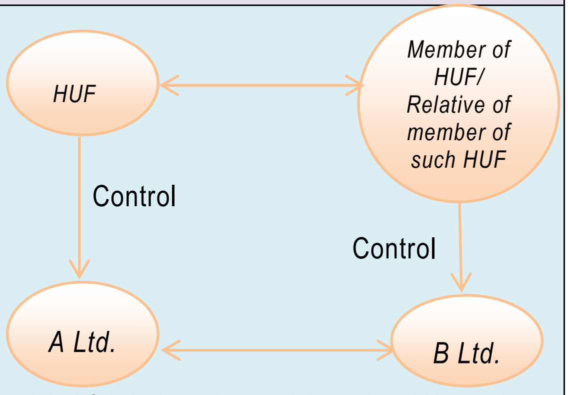
Associated Enterprises [Section 92A(1)]		
	Condition	**Example**
(1)	An enterprise which participates, directly or indirectly, or through one or more intermediaries, in: • Management of the other enterprise, or • control of other enterprise, or • capital of other enterprise	*Where A Ltd. directly participate in management of B Ltd. and B Ltd. directly participate in management of C Ltd. In such situation, A Ltd. has direct participation in management of B Ltd. but has an indirect participation in management of C Ltd.*  *In such scenario, both B Ltd. and C Ltd. would be Associated Enterprises of A Ltd.*
(2)	If one or more persons participates, directly or indirectly, or through one or more intermediaries in: • *management* of the two different enterprises • control of two different enterprises	*Mr. A directly has control in A Ltd. and B Ltd. In such a scenario, both A Ltd. & B Ltd. are Associated Enterprises since they have a common person i.e. Mr. A, who controls both entities A Ltd. & B Ltd.*

	• capital of two different enterprises Then, those two enterprises are AEs.	

Section 92A(2) provides that two enterprises shall be deemed to be associated enterprises for the purposes of sub-section (1) if, at any time during the previous year –

Deemed Associated Enterprises [Section 92A(2)]		
Condition	**Situation**	**Example**
Substantial Voting Power	**One enterprise holds 26% or more of the Voting Power,** directly or indirectly, in the **other enterprise.**	*A Ltd. holds 33% of Voting Power in B Ltd. and B Ltd. holds 40% Voting Power in C Ltd.*  *In above situation, A Ltd. holds 33% of Voting Power in B Ltd. directly and 40% of Voting Power in C Ltd. indirectly (i.e. through B Ltd.). Therefore, both B Ltd. & C Ltd. are deemed Associated Enterprises of A Ltd.*
Substantial Voting Power in two entities by common person	Any person or enterprise **holds 26% or more of the Voting Power power,** directly or indirectly, in each of **two different enterprises.**	*Mr. A holds 40% of shareholding in both X Ltd. and Y Ltd. where neither X Ltd. has any holding in Y Ltd. nor Y Ltd. has any holding in X Ltd.*  *In this situation, since Mr. A directly holds 40% of shareholding in both X Ltd. and Y Ltd., X Ltd. & Y Ltd. will be deemed Associated Enterprises.*
Advancing of substantial sum of money	One enterprise advances loan to the other enterprise of an amount of **51% or more** of the book value of **the total assets of other enterprise**	*Book Value of total assets of Y Ltd. is ₹ 100 crores. X Ltd. advances loan of ₹ 60 crores to Y Ltd.* *Since, in this case, X Ltd. advances loan which is 60% of the Book Value of total assets of Y Ltd., X Ltd. & Y Ltd. are deemed Associated Enterprises.*
Guaranteeing borrowings	One enterprise guarantees **10% or more** of the **total**	*P Inc. has total loan of 1 million dollars from XYZ Bank of America. Out of that, A Ltd., an*

	borrowings of the **other enterprise**.	*Indian company, guarantees 20% of total borrowings in case of any default made by P Inc. In such case, P Inc. and A Ltd. would be deemed Associated Enterprises.*
Appointment of majority directors of other enterprise	One enterprise appoints **more than half of the board of directors** or members of the governing board, or one or more executive directors or executive members of the governing board of **other enterprise**.	*X Ltd. has 15 directors on its Board. Out of that, Y Ltd. has appointed 8 directors. In such case, X Ltd. and Y Ltd. would be deemed Associated Enterprises.*
Appointment of majority directors of two different enterprises by same person(s)	**More than half of the directors** or members of the governing board, or one or more of the executive directors or members of the governing board of each of the **two** enterprises are appointed **by the same person(s).**	*Mr. A appointed 9 directors out of 15 directors of X Ltd. and appointed 2 executive directors on the board of Y Ltd. In such case, since a common person i.e. Mr. A appointed more than half of the directors in X Ltd. and appointed 2 executive directors in Y Ltd., both X Ltd. and Y Ltd. are deemed Associated Enterprises.*
Dependence on intangibles w.r.t which other enterprise has exclusive rights	The **manufacture or processing of goods** or articles or business carried out by one enterprise is **wholly dependent (i.e. 100%) on the know-how**, patents, copyrights etc., or any data, documentation, drawing or specification relating to any patent, invention, model etc. of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights.	
Dependence on raw material supplied by other enterprise	**90% or more of raw materials and consumables** required for the manufacture or processing of goods or articles or business carried out by one enterprise, **are supplied by the other enterprise**, or by persons specified by the other enterprise, where the prices and other conditions relating to the supply are influenced by such other enterprise.	
Dependence on sale	The **goods or articles manufactured** or processed by one enterprise, **are sold to the other enterprise** or to persons specified by the other enterprise, and the **prices and other conditions** relating thereto are **influenced by such other enterprise.**	

Control by common individual	Where **one enterprise is controlled by an individual**, the **other enterprise** is also **controlled by such individual** or his relative or jointly by such individual and his relatives.	*Mr. A and Mr. B are relatives. Mr. A has control over X Ltd. and Mr. B has control over Y Ltd. In such a case, both X Ltd. and Y Ltd. would be deemed Associated Enterprises.*
Control by HUF or member thereof	Where one enterprise is **controlled by an HUF** and the **other enterprise is controlled** by a **member** of such HUF or by **relative of a member** of such HUF or jointly by such member and his relative.	 HUF Member of HUF/ Relative of member of such HUF Control Control A Ltd. B Ltd. *A Ltd & B Ltd are deemed Associated Enterprises*
Interest in a firm, AOPs or BOIs	Where one enterprise is a firm, AOPs or BOIs, the **other enterprise** holds **10% or more interest** in **firm/HUF/BOI**.	
Mutual interest relationship	There exists **b/w the two enterprises**, any **relationship of mutual interest**, as may be **prescribed**.	

Section 92A(1) lays down the circumstances when two enterprises can be considered as associated enterprises. The mere fact of participation by one enterprise in the management, control or capital of the other enterprise, or participation by one or more persons in the management, control or capital of both the enterprises is not sufficient unless the tests laid down in section 92A(2) are fulfilled. In other words, the deeming tests contained in section 92A(2) are exhaustive and should be applied to determine the association between two or more enterprises.

Meaning of Enterprise: The term "enterprise" is defined in section 92F to mean a person (including its certain specified Permanent Establishment) who is, or has been, or is proposed to be, engaged in any activity,

- relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copy rights, trade-marks, licences, franchises or any other business or commercial rights of similar nature or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or

- the provision of services of any kind, or in carrying out any work in pursuance of a contract, or in investment, or providing loan or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate,

whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places.

Meaning of Permanent establishment: "Permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

III. Definition of International Transaction [Section 92B]

❑ **International Transaction [Section 92B(1)]**: As per section 92B of the Act, an international transaction means:

(i) a transaction between two or more associated enterprises, either or both of whom are non-residents; and

(ii) transaction in the nature of:

(a) sale/ purchase/ lease of tangible property; or

(b) sale/ purchase/ lease of intangible property; or

(c) provision of services; or

(d) lending/ borrowing money; or

(e) any other transaction having a bearing on profits, income, losses or assets of such enterprises; or

(f) mutual agreement or arrangement between two or more associated enterprise for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

❑ **Deemed International Transaction [Section 92B(2)]:** Where, in respect of a transaction entered into by an enterprise with a person other than an associated enterprise (hereinafter referred to as "other person"),

♦ there exists a prior agreement in relation to the relevant transaction between the other person and the associated enterprise **or**,

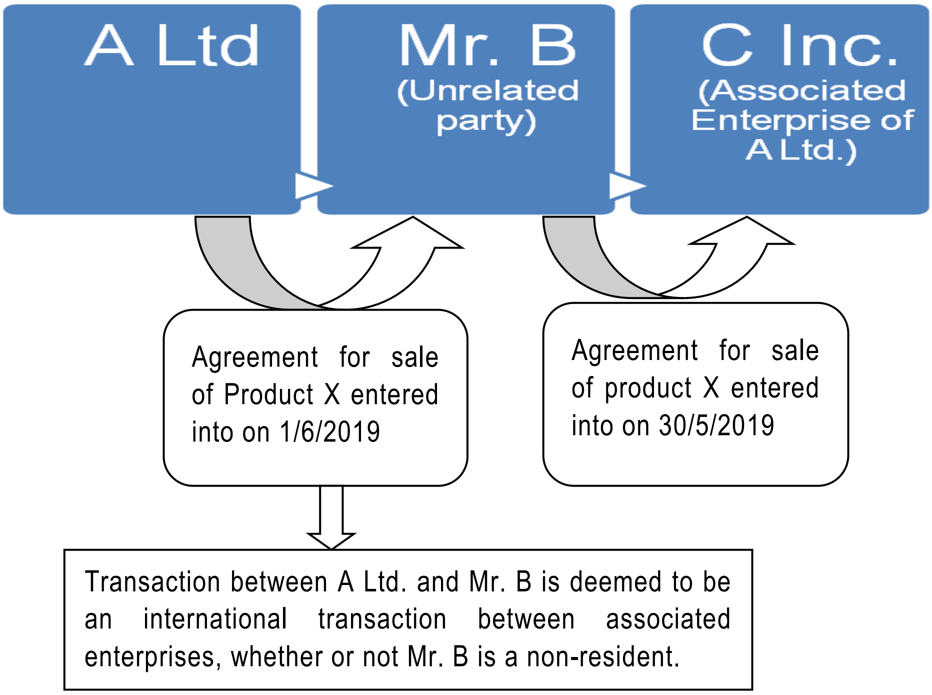
♦ where the terms of the relevant transaction are determined in substance between such other person and the associated enterprise; **and**

♦ either the enterprise or the associated enterprise or both of them are non-residents,

then such transaction entered into between the enterprise and the other person shall be deemed to be an **international transaction** entered into between two associated enterprises, **whether or not such other person is a non-resident.**

Example:

If A Ltd., an Indian company, has entered into an agreement for sale of product X to Mr. B, an unrelated party, on 1/6/2019 and Mr. B has entered into an agreement for sale of product X with C Inc., a non-resident entity, which is a specified foreign company in relation to A Ltd., on 30/5/2019, then, the transaction between A Ltd. and Mr. B shall be deemed to be an international transaction entered into between two associated enterprises, irrespective of whether or not Mr. B is a non-resident.



Agreement for sale of Product X entered into on 1/6/2019

Agreement for sale of product X entered into on 30/5/2019

Transaction between A Ltd. and Mr. B is deemed to be an international transaction between associated enterprises, whether or not Mr. B is a non-resident.

***Note** – C Inc. is deemed to be an associated enterprise of A Ltd. since it is a specified foreign company in relation to A Ltd., which means that A Ltd. holds 26% or more in the nominal value of the equity share capital of C Inc.*

❑ The scope of **"international transaction"** shall include:

	Transactions	**Amplification of scope of terms used**
(1)	Purchase, sale, transfer, lease or use of tangible property	Tangible property includes - • building, • transportation vehicle, • machinery, equipment, tools, plant, • furniture, • commodity or

		• any other article, product or thing;
(2)	Purchase, sale, transfer, lease or use of intangible property, including transfer of ownership or the provision of use of certain rights	"Use of certain rights" refer to – • land use, • copyrights, patents, trademarks, licences, franchises, • customer list, marketing channel, brand, commercial secret, • know-how, • industrial property right, • exterior design or practical and new design or • any other business or commercial rights of similar nature.
(3)	Capital financing	• any type of long-term or short-term borrowing, • lending or guarantee, • purchase or sale of marketable securities or • any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business.
(4)	Provision of services	• provision of market research, • market development, • marketing management, • administration, • technical service, • repairs, • design, • consultation, • agency, • scientific research, • legal or accounting service.
(5)	Business restructuring or reorganization entered into by an enterprise with an associated enterprise	All such transactions are included in the definition of "international transaction", whether or not it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date.

- ❑ The expression "**intangible property**" shall include:

	Type of intangible asset in relation to	**Examples of each type of intangible asset**
(1)	Marketing	• Trademarks • trade names • brand names • logos
(2)	Technology	• Process patents • patent applications • technical documentation such as laboratory notebooks • technical know-how
(3)	Artistic	• literary works and copyrights • musical compositions • copyrights • maps • engravings
(4)	Data processing	• proprietary computer software • software copyrights • automated databases • integrated circuit masks and masters
(5)	Engineering	• industrial design • product patents • trade secrets • engineering drawing and schematics • blueprints • proprietary documentation
(6)	Customer	• customer lists • customer contracts • customer relationship • open purchase orders
(7)	Contract	• favourable supplier • contracts,

		• licence agreements • franchise agreements • non-compete agreements
(8)	Human	• trained and organised work force • employment agreements • union contracts
(9)	Location	• leasehold interest • mineral exploitation rights • easements • air rights • water rights
(10)	Goodwill	• institutional goodwill • professional practice goodwill • personal goodwill of professional • celebrity goodwill • general business going concern value
(11)	methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, or technical data;	
(12)	any other similar item that derives its value from its intellectual content rather than its physical attributes.	

❑ **Transaction:** The word "transaction" has been defined in section 92F to include an arrangement, understanding or action in concert

(i) whether or not such arrangement, understanding or action is formal or in writing; or

(ii) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings."

Section 92F(v) provides an inclusive definition of the term "transaction". Based on the reading of the section, it is evident that it is not necessary that for a transaction undertaken between two enterprises there needs to be a formal written agreement between them. It is only relevant whether a transaction has been entered into in substance. The section also negates the requirement as to the legal enforceability of agreement or understanding.

It may be noted that one of the parties to the international transaction should be a non-resident. Therefore, transactions between a resident assessee ("A" Ltd.) and its foreign branches or between its two or more foreign branches will not be considered as international transactions. This is for the reason that when "A" Ltd. is a resident in India, all its foreign branches will be deemed to be resident in India and transactions between Head Office and branches or between branches *inter se* will be considered as transactions between residents. Even otherwise there can be no avoidance of income in the transactions between Indian Head Office and foreign branches.

On the other hand, if an Indian branch of a foreign company ("B" Ltd.) is having a transaction with the head office the same will be covered by the definition of international transaction between associated enterprises. This is because the Indian branch (permanent establishment of "B" Ltd.) will be liable to tax in India in respect of its Indian operations and, therefore, any transaction between the Indian branches of "B" Ltd. with its head office in foreign country or with any of the branches of "B" Ltd. outside India will be considered as an international transaction and it will have to establish that the transaction is at an arm's length price. This will be the position even in respect of transactions between a parent company ("A" Ltd.) and its foreign subsidiary and, therefore, such transactions will have to comply with the provisions of transfer pricing regulations.

IV. Arm's Length Price [Section 92C]: "Arm's length price" is defined in section 92F(ii) to mean price which is applied or proposed to be applied in a transaction between persons other than associated enterprises in uncontrolled conditions. Section 92C deals with the method for determining arm's length price and the factors which are to be considered for applicability or non-applicability of a particular method to a given situation. The factors as well as methods incorporated in this section are not exhaustive and the CBDT may prescribe further factors and methods. It provides that the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely -

(a) comparable uncontrolled price method;

(b) resale price method;

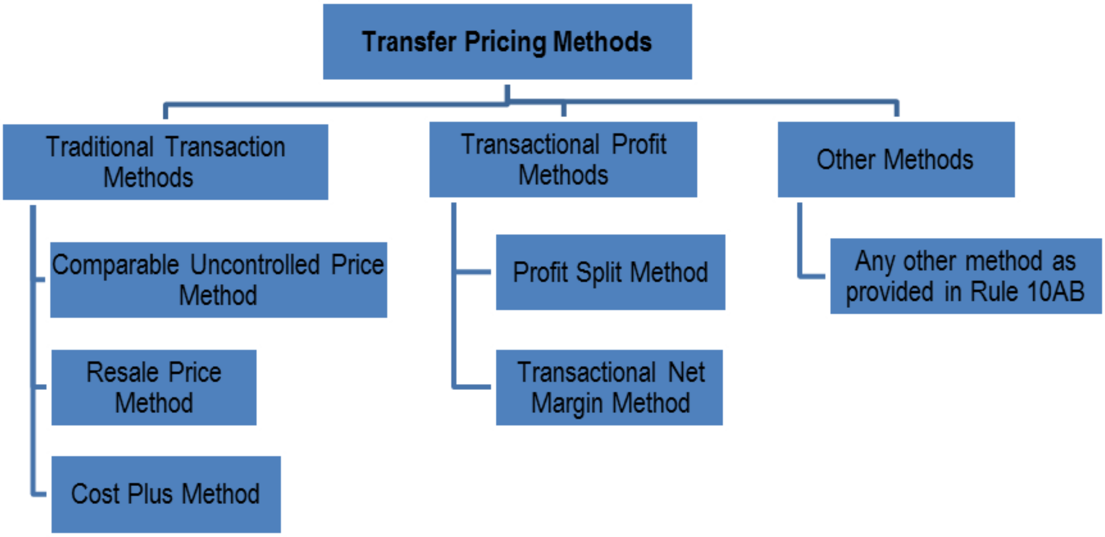
(c) cost plus method;

(d) profit split method;

(e) transactional net margin method;

(f) such other method as may be prescribed by the Board.

Accordingly, the Board has prescribed that the other method for determination of arm's length price in relation to an international transaction shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts. [Rule 10AB].


Transfer Pricing Methods
Traditional Transaction Methods
Transactional Profit Methods
Other Methods
Comparable Uncontrolled Price Method
Resale Price Method
Cost Plus Method
Profit Split Method
Transactional Net Margin Method
Any other method as provided in Rule 10AB

Section 92C(2) provides that the most appropriate method out of the above methods has to be applied for determination of arm's length price, in the prescribed manner.

Rule 10B(1) prescribed the manner to determine the arm's length price under the five methods as stated in above diagram in respect of any goods, property or services purchased or sold under any international transaction.

(i) Comparable Uncontrolled Price Method

(a) Under this method the price charged or paid for property transferred or services provided under any comparable uncontrolled transaction or transactions should be identifiable.

(b) Adjustment to account for differences between the international transaction and comparable uncontrolled transactions or between the enterprises entering into such transactions which could materially affect the price in the open market can be made.

(c) The adjusted price as worked out under (b) will be considered as an arm's length price in respect of the property transferred or services provided in the international transaction.

(ii) Resale Price Method

(a) Under this method, the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise should be identifiable.

(b) The following adjustments can be made to such resale price.

- For normal gross profit margin

- For expenses incurred in connection with the purchase of property or obtaining of services.
- For functional and other differences, including differences in accounting practices which could materially affect the gross profit margin in the open market.

(c) The adjusted price as stated in (b) above will be considered as the arm's length price.

(iii) Cost Plus Method

(a) Under this method, the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise should be determined.

(b) The amount of a normal gross profit mark-up to such costs arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise in comparable uncontrolled transaction or transactions should be determined.

(c) The above normal gross profit mark-up can be adjusted to take into account the functional and other differences which could materially affect such profit mark-up in the open market.

(d) Costs referred to in (a) above should be increased by the adjusted profit mark-up as stated in (c) above and the price so arrived at will be considered as the arm's length price.

(iv) Profit Split Method

(a) This is a method which may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction.

(b) Under this method, combined net profit of the associated enterprises arising from the international transactions in which they are engaged is first determined.

(c) The relative contribution of each associated enterprise to the earning of such combined net profit is then evaluated on the basis of the functions performed, assets employed and risks assumed by each enterprise. This evaluation is to be made on the basis of reliable external market data which can indicate how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances.

(d) The combined net profit is then split amongst the enterprises in proportion to their relative contributions. The profit thus apportioned to the assessee is taken into consideration to arrive at an arm's length price in relation to the international transaction.

(e) In certain cases the combined net profit referred to in (b) above may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction in which it is engaged. This has to be determined with reference to market returns achieved for similar types of transactions by independent enterprises. Thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises as stated in (c) and (d) above. In such a case the aggregate of net profit allocated in the first instance together with the residual profit apportioned should be considered for arriving at the arm's length price of the international transaction.

(v) Transactional Net Margin Method

(a) In this method, the net profit margin realised by the enterprise from an international transaction with an associated enterprise is computed having regard to costs incurred or sales effected or assets employed or having regard to any other relevant base.

(b) The net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction by applying the same base as in (a) above is computed. This profit margin is adjusted to take into account the differences which could materially affect the net profit margin in the open market having regard to international transaction and comparable uncontrolled transactions or having regard to the enterprise entering into such transactions.

(c) If the net profit margin realised by the enterprise as in (a) above is established to be the same as the net profit margin as in (b) above, then the same is taken into consideration to arrive at an arm's length price in relation to the international transaction.

(v) Other Method as may be prescribed by the CBDT

The Other method allows the use of 'any method' which takes into account

(i) the price which has been charged or paid or

(ii) would have been charged or paid for the same or similar uncontrolled transactions with or between non-associated enterprises, under similar circumstances.

The various data which may possibly be used for comparability purposes under this method could be third party quotations, valuation reports, tender/Bid documents, documents relating to the negotiations, standard rate cards, commercial & economic business models; etc.

For applying the above methods, the comparability of the international transaction with an uncontrolled transaction is to be judged with reference to the following factors:

(i) The specific characteristics of the property transferred or services provided in either transaction;

(ii) The functions performed, taking into account assets employer or to be employer and the risks assumed, by the respective parties to the transactions;

(iii) The contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(iv) Conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

Rule 10B(3) provides that an uncontrolled transaction shall be comparable to an international transaction

- if none of the differences between the transactions being comparable or between the enterprises entering into such transactions is likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market or
- reasonably accurate adjustments can be made to eliminate the material effects of such differences.

Data to be used for analyzing the comparability of an uncontrolled transaction with an international transaction

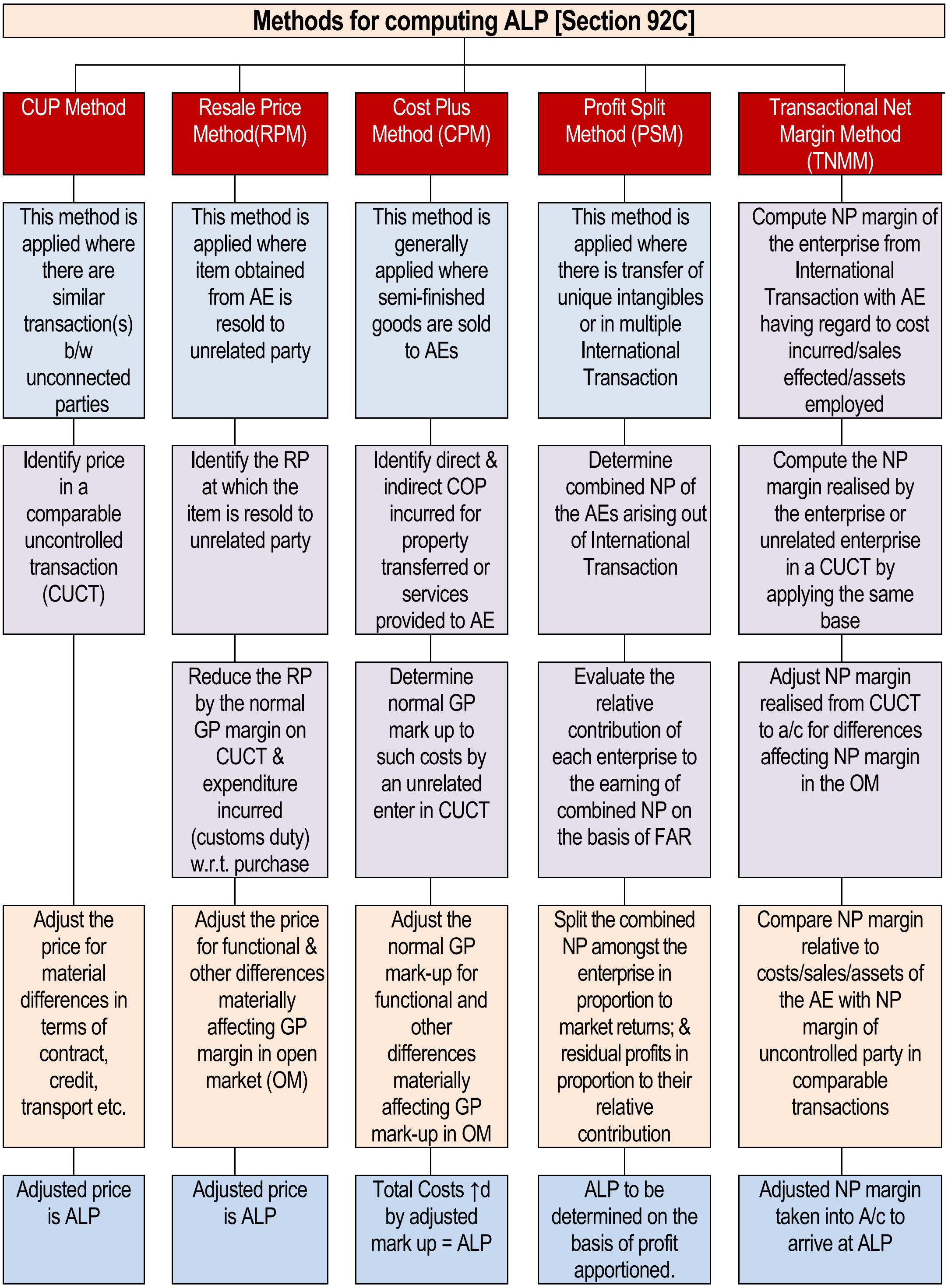
The data to be used for analyzing the comparability of an uncontrolled transaction and an international transaction should relate to the financial year (current year) in which the international transaction has been entered into.

In case the most appropriate method for determination of ALP of a transaction entered into on or after 1.4.2014 is the **resale price method** or **cost plus method** or **the transactional net margin method**, then, the data to be used for analyzing the comparability of an uncontrolled transaction with an international transaction shall be –

(a) the data relating to the current year; or

(b) the data relating to the financial year immediately preceding the current year, if the data relating to the current year is not available at the time of furnishing the return of income by the assessee, for the assessment year relevant to the current year.

However, where the data relating to the **current year is subsequently available** at the time of determination of arm's length price of an international transaction **during the course of any assessment proceeding** for the assessment year relevant to the current year, then, **such data shall be used** for such determination **irrespective of the fact that the data was not available** at the time of furnishing the return of income of the relevant assessment year.



Methods for computing ALP [Section 92C]

CUP Method	Resale Price Method(RPM)	Cost Plus Method (CPM)	Profit Split Method (PSM)	Transactional Net Margin Method (TNMM)
This method is applied where there are similar transaction(s) b/w unconnected parties	This method is applied where item obtained from AE is resold to unrelated party	This method is generally applied where semi-finished goods are sold to AEs	This method is applied where there is transfer of unique intangibles or in multiple International Transaction	Compute NP margin of the enterprise from International Transaction with AE having regard to cost incurred/sales effected/assets employed
Identify price in a comparable uncontrolled transaction (CUCT)	Identify the RP at which the item is resold to unrelated party	Identify direct & indirect COP incurred for property transferred or services provided to AE	Determine combined NP of the AEs arising out of International Transaction	Compute the NP margin realised by the enterprise or unrelated enterprise in a CUCT by applying the same base
	Reduce the RP by the normal GP margin on CUCT & expenditure incurred (customs duty) w.r.t. purchase	Determine normal GP mark up to such costs by an unrelated enter in CUCT	Evaluate the relative contribution of each enterprise to the earning of combined NP on the basis of FAR	Adjust NP margin realised from CUCT to a/c for differences affecting NP margin in the OM
Adjust the price for material differences in terms of contract, credit, transport etc.	Adjust the price for functional & other differences materially affecting GP margin in open market (OM)	Adjust the normal GP mark-up for functional and other differences materially affecting GP mark-up in OM	Split the combined NP amongst the enterprise in proportion to market returns; & residual profits in proportion to their relative contribution	Compare NP margin relative to costs/sales/assets of the AE with NP margin of uncontrolled party in comparable transactions
Adjusted price is ALP	Adjusted price is ALP	Total Costs ↑d by adjusted mark up = ALP	ALP to be determined on the basis of profit apportioned.	Adjusted NP margin taken into A/c to arrive at ALP

Determination of the most appropriate method: Rule 10C deals with the determination of most appropriate method. Under this Rule, the method which is best suited to the facts and circumstances and which provides the most reliable measure of an arm's length price in relation to the international transaction will be considered to be the most appropriate method.

For the purpose of selecting the most appropriate method, the following factors should be taken into account.

(i) The nature and class of the international transaction;

(ii) The class, or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

(iii) The availability, coverage and reliability of data necessary for application of the method;

(iv) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;

(v) The extent to which reliable and accurate adjustments can be made to account for difference, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;

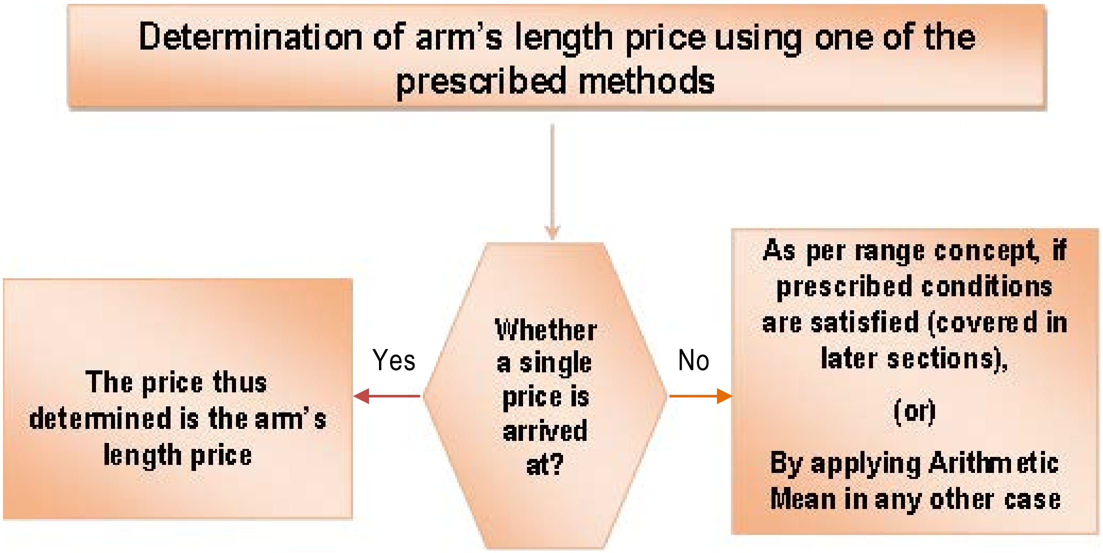
(vi) The nature, extent and reliability of assumptions required to be made in application of a method.

Manner of computation of Arm's length price (Applicable for international transactions and specified domestic transactions undertaken on or after 1.4.2014) [Third proviso to section 92C(2)]

In case of an international transaction or specified domestic transaction[1] undertaken on or after 1.4.2014, where more than one price is determined by the most appropriate method, the ALP shall be computed in the prescribed manner specified in Rule 10CA.

[1] discussed later in this Chapter

Computation of arm's length price in certain cases [Rule 10CA]


Determination of arm's length price using one of the prescribed methods
Whether a single price is arrived at?
Yes
The price thus determined is the arm's length price
No
As per range concept, if prescribed conditions are satisfied (covered in later sections),
(or)
By applying Arithmetic Mean in any other case

Rule 10CA(1) provides that where in respect of an international transaction or a specified domestic transaction, the application of the most appropriate method referred to in section 92C(1) results in determination of more than one price, then, the arm's length price in respect of such international transaction or specified domestic transaction has to be computed on the basis of the dataset constructed by placing such prices in an ascending order as provided in Rule 10CA(2).

Application of multiple year data for construction of dataset

Multiple year data allowed only in cases where determination of ALP is done using TNMM, RPM or CPM

Where the most appropriate method is the resale price method or cost plus method or transactional net margin method and the comparable uncontrolled transaction has been identified on the basis of data relating to the current year and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction or the specified domestic transaction referred to in sub-rule (1)], has in either or both of the two financial years immediately preceding the current year undertaken the same or similar comparable uncontrolled transaction then,-

(i) the most appropriate method used to determine the price of the comparable uncontrolled transaction undertaken in the current year shall be applied in similar manner to the comparable uncontrolled transaction or transactions undertaken in the aforesaid period and the price in respect of such uncontrolled transactions shall be determined; and

(ii) the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the current year and in the aforesaid period preceding it shall be included in the dataset instead of the price referred to in sub-rule (1).

Further, where the most appropriate method is the resale price method or cost plus method or transactional net margin method where the comparable uncontrolled transaction has been identified **on the basis of the data relating to the financial year immediately preceding the current year** and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction or the specified domestic transaction referred to in sub-rule (1)], has in the financial year immediately preceding the said financial year undertaken the same or similar comparable uncontrolled transaction then, -

(i) the price in respect of such uncontrolled transaction shall be determined by applying the most appropriate method in a similar manner as it was applied to determine the price of the comparable uncontrolled transaction undertaken in the financial year immediately preceding the current year; and

(ii) the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the aforesaid period of two years shall be included in the dataset instead of the price referred to in sub-rule (1).

Also, in such cases, where the use of data relating to the current year for determination of ALP subsequently at the time of assessment establishes that,-

(i) the enterprise has not undertaken same or similar uncontrolled transaction during the current year; or

(ii) the uncontrolled transaction undertaken by an enterprise in the current year is not a comparable uncontrolled transaction,

then, irrespective of the fact that such an enterprise had undertaken comparable uncontrolled transaction in the financial year immediately preceding the current year or the financial year immediately preceding such financial year, the price of comparable uncontrolled transaction or the weighted average of the prices of the uncontrolled transactions, as the case may be, undertaken by such enterprise shall **not** be included in the dataset.

Rule 10CA(3) provides that where an enterprise has undertaken comparable uncontrolled transactions in more than one financial year, then for the purposes of sub-rule (2) the weighted average of the prices of such transactions shall be computed in the following manner, namely:-

	Method used to determine the prices	Manner of computation of weighted average of the prices
(i)	The resale price method	By assigning weights to the quantum of sales which has been considered for arriving at the respective prices
(ii)	The cost plus method	By assigning weights to the quantum of costs which has been considered for arriving at the respective prices
(iii)	The transactional net margin method	By assigning weights to the quantum of costs incurred or sales effected or assets employed or to be employed, or as the case may be, any other base which has been considered for arriving at the respective prices.

Range Concept: Rule 10CA(4) provides that where the most appropriate method applied is –

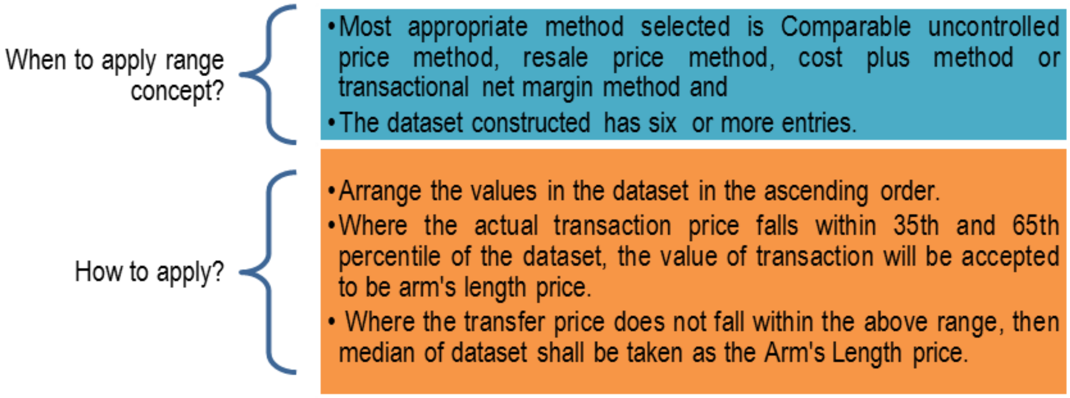
(i) a method other than the profit split method or a method prescribed by the CBDT under section 92C(1)(f); and

(ii) the dataset constructed in accordance with sub-rule (2) consists of six or more entries,

an arm's length range beginning from the thirty-fifth percentile of the dataset and ending on the sixty-fifth percentile of the dataset shall be constructed.

If the price at which the international transaction or the specified domestic transaction has actually been undertaken is within the said range, then, the price at which such international transaction or the specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price [Rule 10CA(5)].

If the price at which the international transaction or the specified domestic transaction has actually been undertaken is outside the said arm's length range, the arm's length price shall be taken to be the median of the dataset [Rule 10CA(6)].



When to apply range concept?

- Most appropriate method selected is Comparable uncontrolled price method, resale price method, cost plus method or transactional net margin method and
- The dataset constructed has six or more entries.

How to apply?

- Arrange the values in the dataset in the ascending order.
- Where the actual transaction price falls within 35th and 65th percentile of the dataset, the value of transaction will be accepted to be arm's length price.
- Where the transfer price does not fall within the above range, then median of dataset shall be taken as the Arm's Length price.

Range concept not applicable:

In a case where the provisions of Rule 10CA(4) are not applicable, the arm's length price shall be the arithmetical mean of all the values included in the dataset. However, if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage not exceeding 3% of the latter, as may be notified by the Central Government in the Official Gazette in this behalf, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price [Rule 10CA(7)].

Meaning of certain terms [Rule 10CA(8)]

	Term	Meaning
(a)	the thirty-fifth percentile of a dataset (having values arranged in an ascending order)	The lowest value in the dataset such that at least 35% of the values included in the dataset are equal to or less than such value. However, if the number of values that are equal to or less than the aforesaid value is a whole number, then, the thirty-fifth percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.
(b)	the sixth-fifth percentile of a dataset (having values arranged in an ascending order)	The lowest value in the dataset such that at least 65% of the values included in the dataset are equal to or less than such value. However, if the number of values that are equal to or less than the aforesaid value is a whole number, then, the sixty-fifth percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.
(c)	the median of the dataset (having values arranged in an ascending order)	The lowest value in the dataset such that at least 50% of the values included in the dataset are equal to or less than such value. However, if the number of values that are equal to or less than the aforesaid value is a whole number, then, the median shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.

V. Reference to Transfer Pricing Officer [Section 92CA]: This section provides for a procedure for reference to a Transfer Pricing Officer (TPO) of any issue relating to computation of arm's length price in an international transaction. The procedure is as under -

(1) The option to make reference to TPO is given to the Assessing Officer. Where the assessee has entered into an international transaction in any previous year and if Assessing Officer considers it necessary or expedient to do so he may refer the computation of the arm's

length price in relation to the said international transaction to the TPO. This option is not, however, available to the assessee.

(2) The Assessing Officer has to take the approval of the PCIT/ CIT before making such a reference.

(3) Any Joint /Deputy/Assistant Commissioner of Income-tax, authorised by CBDT, can be appointed as TPO.

(4) When such reference is made, TPO would serve a notice to the assessee requiring him to produce on a date specified in the notice, any evidence on which the assessee relied in support of the computation of arm's length price made by him in relation to the international transaction.

(5) The TPO can also determine the ALP of other international transactions identified subsequently in the course of proceedings before him as if such transaction is referred to the TPO by the Assessing Officer under section 92CA(1) [Sub-section (2A)].

(6) Where in respect of an international transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the TPO during the course of proceeding before him, the transfer pricing provisions shall apply as if such transaction is referred to the TPO by the Assessing Officer under section 92CA(1) [Sub-section (2B)].

(7) The TPO has to pass an order determining the arm's length price after considering the evidence, documents, etc. produced by the assessee and after considering the material gathered by him. He has to send a copy of his order to Assessing Officer as well as the assessee.

(8) The order of the Transfer Pricing Officer determining the arm's length price of an international transaction is binding on the Assessing Officer and the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer [Sub-section (4)].

(9) In order to provide sufficient time to the Assessing Officer to complete the assessment in a case where reference is made to the Transfer Pricing Officer, section 92CA(3A) provides for determination of arm's length price of international transactions by the Transfer Pricing Officer at least 60 days before the expiry of the time limit under section 153 or section 153B for making an order of assessment by the Assessing Officer. This provision would apply in a case where reference is made on or after 1.6.2007 or in a case where reference is made before that date but the order of the Transfer Pricing Officer is pending on that date [Sub-section (3A)].

(10) In many cases, it becomes necessary to seek information from foreign jurisdictions for the purpose of determining the arm's length price by the TPO. At times, proceedings before the TPO may also be stayed by a court order.

Taking into consideration such cases, it has been provided that where assessment proceedings are stayed by any court or where a reference for exchange of information has been made by the competent authority under an agreement referred to in section 90 or 90A, the time available to the Transfer Pricing Officer for making an order after excluding the time for which assessment proceedings were stayed or the time taken for receipt of information, as the case may be, is less than 60 days, then, such remaining period shall be extended to 60 days.

(11) The TPO has power to rectify his order under section 154 if any mistake apparent from the record is noticed. If such rectification is made, the Assessing Officer has to rectify the assessment order to bring it in conformity with the same.

(12) The TPO can exercise all or any of the powers specified in clause (a) to (d) of section 131(1) or section 133(6) or section 133A for determination of arm's length price once the above reference is made to him.

VI. Safe Harbour Rules for determination of arm's length price in case of international transactions [Section 92CB]

(i) Section 92C provides for adjustment in the transfer price of an international transaction with an associated enterprise if the transfer price is not equal to the arm's length price. This has resulted in a large number of such transactions being subjected to adjustment giving rise to considerable dispute.

(ii) Therefore, section 92CB has been introduced to empower the CBDT to formulate safe harbour rules to determine the arm's length price under section 92C and 92CA. Section 92CB(2) empowers the CBDT to prescribe safe harbour rules[2].

'Safe harbour' means circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee.

VII. Introduction of Advance Pricing Agreements [Sections 92CC & 92CD]

(1) An Advance Pricing Agreement (APA) is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future. They offer better assurance on transfer pricing methods and provide certainty and unanimity of approach.

[2] *The Safe Harbour Rules relevant for A.Y. 2020-21 are yet to be notified by the CBDT as on the date of release of the Study Material. These rules, when notified, will form part of the webhosted Statutory Update.*

(2) Keeping in mind the benefits offered by the APAs, sections 92CC and section 92CD have been introduced in the transfer pricing regime to provide a framework for formulation of APAs between the tax payer and the income-tax authorities.

(3) Section 92CC enables the Board (with the approval of the Central Government), to enter into an APA with any person undertaking an international transaction.

(i) **Purpose of APA:** The APA shall relate to an international transaction to be entered into by such person. The APA shall be entered into for the purpose of determination of the arm's length price or specifying the manner in which arm's length price shall be determined, in relation to such international transaction.

(ii) **Manner of determination of Arm's Length Price in APA:** The manner for determination of arm's length price referred above may include methods referred to in section 92C(1) or any other method with necessary adjustments or variations.

(iii) **Non-applicability of section 92C or section 92CA:** In case an APA has been entered into in respect of any international transaction, the arm's length price in relation to that transaction shall be determined in accordance with that APA notwithstanding any contrary provisions contained in section 92C or section 92CA i.e., the provisions of the APA shall apply overriding the provisions of section 92C or section 92CA, which are normally applicable for determination of arm's length price.

(iv) **Validity of APA:** The APA shall be valid for such period as specified in the agreement, which shall in no case exceed five consecutive previous years.

(v) **Binding nature of APA:** The APA so entered into shall be binding on:

(a) the person in whose case, and in respect of the transaction in relation to which, the APA has been entered into; and

(b) the Principal Commissioner or Commissioner and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.

(vi) **Not binding of APA:** The APA shall not be binding if there is any change in law or facts having bearing on such APA.

(vii) **Conditions to declare APA as *void ab initio*:** In case the Board finds that the APA so entered into has been obtained by the person by way of fraud or misrepresentation of facts, the Board is empowered to pass an order declaring any such APA to be void ab initio, with the approval of Central Government.

(viii) **Consequences of declaration of an APA as *void ab initio*:** As a result of declaration of an APA as *void ab initio*:

(a) all the provisions of the Act shall apply to such person as if such APA had never been entered into.

(b) The period beginning with the date of such APA and ending on the date of order declaring the APA as *void ab initio*, shall be excluded for the purpose of computation of any period of limitation under this Act (for example period of limitation specified in the section 153, 153B etc). This is irrespective of anything contained in any other provision of the Act.

(c) In case the period of limitation after exclusion of the above mentioned period is less than 60 days, such remaining period of limitation shall be extended to 60 days.

(ix) If an application is made by a person for entering into an APA, then, the proceeding, in respect of such person for the purpose of the Act, shall be deemed to be pending.

(x) **Prescribed scheme for APA:** The Board is empowered to prescribe a scheme specifying the manner, form, procedure and any other matter generally in respect of the APA.

Prescribed Advance Pricing Agreement Scheme for the purpose of section 92CC [Rule 10F to 10T]:]: In exercise of the powers conferred in section 92CC(9) read with section 295 of the Income-tax Act, 1961, the CBDT has prescribed rules specifying an Advance Pricing Agreement (APA) Scheme. Some of the important provisions of the scheme are briefed hereunder –

(1) Persons eligible to apply [Rule 10G]: Any person who has undertaken an international transaction or is contemplating to undertake an international transaction, shall be eligible to enter into an agreement under these rules.

(2) Pre-filing Consultation [Rule 10H]:

(a) Any person proposing to enter into an agreement under these rules may, by an application in writing, make a request for a pre-filing consultation in the prescribed form to the Director General of Income-tax (International Taxation).

(b) The pre-filing consultation shall, among other things,-

(i) determine the scope of the agreement;

(ii) identify transfer pricing issues;

(iii) determine the suitability of international transaction for the agreement;

(iv) discuss broad terms of the agreement.

(c) The pre-filing consultation shall –

(i) not bind the Board or the person to enter into an agreement or initiate the agreement process;

(ii) not be deemed to mean that the person has applied for entering into an agreement.

(3) Application for advance pricing agreement [Rule 10-I]

(a) Any person who is eligible to apply may enter into agreement may, if such person desires to enter into an agreement furnish an application in the prescribed form along with proof of payment of requisite fee as specified, to the Director General of Income-tax (International Taxation) in case of unilateral agreement and to the competent authority in India in case of bilateral or multilateral agreement.

(b) The application may be filed at any time -

(i) before the first day of the previous year relevant to the first assessment year for which the application is made, in respect of transactions which are of a continuing nature from dealings that are already occurring; or

(ii) before undertaking the transaction in respect of remaining transactions.

Note - The applicant may withdraw the application for agreement at any time before the finalisation of the terms of the agreement. However, application fees paid shall not be refunded on withdrawal of application by the applicant.

(4) Approval of Central Government: The agreement shall be entered into by the Board with the applicant after its approval by the Central Government.

(5) Terms of the agreement [Rule 10M]

(a) An agreement may among other things, include –

(i) the international transactions covered by the agreement;

(ii) the agreed transfer pricing methodology, if any;

(iii) determination of arm's length price, if any;

(iv) definition of any relevant term to be used in item (ii) or (iii);

(v) critical assumptions i.e., the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement, if any of the factors or assumptions is changed;

(vi) rollback provision referred to in Rule 10MA;

(vii) the conditions, if any, other than provided in the Act or these rules.

(b) The agreement shall not be binding on the Board or the assessee if there is a change in any of critical assumptions or failure to meet conditions subject to which the agreement has been entered into.

(c) The binding effect of agreement shall cease only if any party has given due notice of the concerned other party or parties.

(d) In case there is a change in any of the critical assumptions or failure to meet the conditions subject to which the agreement has been entered into, the agreement can be revised or cancelled, as the case may be.

(6) Furnishing of Annual Compliance Report [Rule 10-O]: The assessee shall furnish an annual compliance report in quadruplicate in the prescribed form to Director General of Income-tax (International Taxation) for each year covered in the agreement, within 30 days of the due date of filing income-tax return for that year, or within 90 days of entering into an agreement, whichever is later.

(7) Compliance Audit of the agreement [Rule 10P]:

(a) The Transfer Pricing Officer having the jurisdiction over the assessee shall carry out the compliance audit of the agreement for each of the year covered in the agreement. For this purpose, the Transfer Pricing Officer may require –

(i) the assessee to substantiate compliance with the terms of the agreement, including satisfaction of the critical assumptions, correctness of the supporting data or information and consistency of the application of the transfer pricing method;

(ii) the assessee to submit any information, or document, to establish that the terms of the agreement has been complied with.

(b) The compliance audit report shall be furnished by the Transfer Pricing Officer within six months from the end of the month in which the Annual Compliance Report is received by the Transfer Pricing Officer.

(8) Revision of an agreement [Rule 10Q]:

(a) An agreement, after being entered, may be revised by the Board either *suo moto* or on request of the assessee or the competent authority in India or the Director General of Income-tax (International Taxation), if –

(i) there is a change in critical assumptions or failure to meet a condition subject to which the agreement has been entered into;

(ii) there is a change in law that modifies any matter covered by the agreement but is not of the nature which renders the agreement to be non-binding ; or

(iii) there is a request from competent authority in the other country requesting revision of agreement, in case of bilateral or multilateral agreement.

(b) Except when the agreement is proposed to be revised on the request of the assessee, the agreement shall not be revised unless an opportunity of being heard has been provided to the assessee and the assessee is in agreement with the proposed revision.

(c) The revised agreement shall include the date till which the original agreement is to apply and the date from which the revised agreement is to apply.

(9) Cancellation of an agreement [Rule 10R]:

(a) An agreement shall be cancelled by the Board for any of the following reasons:

(i) the compliance audit has resulted in the finding of failure on the part of the assessee to comply with the terms of the agreement;

(ii) the assessee has failed to file the annual compliance report in time;

(iii) the annual compliance report furnished by the assessee contains material errors; or

(iv) the assessee is not in agreement with the revision proposed in the agreement or the agreement is to be cancelled under rule 10RA(7);.

(b) The Board shall give an opportunity of being heard to the assessee, before proceeding to cancel an application.

(c) The order of cancellation of the agreement shall be in writing and shall provide reasons for cancellation and for non-acceptance of assessee's submission, if any.

(d) The order of cancellation shall also specify the effective date of cancellation of the agreement, where applicable.

(e) The order under the Act, declaring the agreement as void ab initio, on account of fraud or misrepresentation of facts, shall be in writing and shall provide reason for such declaration and for non-acceptance of assessee's submission, if any.

(10) Mere filing of an application for an agreement under these rules shall not prevent the operation of Chapter X of the Act for determination of arms' length price under that Chapter till the agreement is entered into. [Rule 10T(1)]

(11) The negotiation between the competent authority in India and the competent authority in the other country or countries, in case of bilateral or multilateral agreement, shall be carried out in accordance with the provisions of the tax treaty between India and the other country or countries. [Rule 10T(2)]

(xi) **Provision for Roll back in APA Scheme [Section 92CC]**

(a) In order to reduce current pending as well as future litigation in respect of the transfer pricing matters, section 92CC(9A) provides roll back mechanism in the APA scheme.

(b) Accordingly, the APA may, subject to such prescribed conditions, procedure and manner, provide for determining the ALP or for specifying the manner in which ALP is to be determined in relation to an international transaction entered into by a person during any period not exceeding four previous years preceding the first of the previous years for which the APA applies in respect of the international transaction to be undertaken.

The CBDT has, vide *Notification No.23/2015 dated 14.3.2015*, in exercise of the powers conferred by 92CC(9A) read with section 295, following conditions, procedure and manner for determining the arm's length price or for specifying the manner in which arm's length price is to be determined in relation to an international transaction:

Rule	Particulars	Conditions, Procedure & Manner of determination of ALP
10F(ba)	Definition of Applicant	A person who has made an application.
10F(ha)	Definition of Rollback year	Any previous year, falling within the period **not exceeding four previous years,** preceding the first of the five consecutive previous years referred to in section 92CC(4).
10MA	Roll back of the agreement	The said rule provides the following: 1. The agreement may provide for determining the arm's length price or specify the manner in which arm's length price shall be determined in relation to the international transaction entered into by the person during the rollback year (hereinafter referred as "rollback provision"). **2. Conditions for applying for rollback provisions:** The agreement shall contain rollback provision in respect of an international transaction subject to the following, namely:- (i) the international transaction is same as the international transaction to which the agreement (other than the rollback provision) applies;

		(ii) the return of income for the relevant rollback year has been or is furnished by the applicant before the due date as specified in *Explanation 2* of section 139(1). (iii) the report in respect of the international transaction had been furnished in accordance with section 92E; (iv) the applicability of rollback provision, in respect of an international transaction, has been requested by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant; and (v) the applicant has made an application seeking rollback in Form 3CEDA in accordance with sub-rule (5); 3. **Non-applicability of Rollback provision**: Rollback provision shall not be provided in respect of an international transaction for a rollback year, if,- (i) the determination of arm's length price of the said international transaction for the said year has been subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement; or (ii) the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year. 4. **Manner for determining arm length price to be the same for rollback years and other previous years:** Where the rollback provision specifies the manner in which arm's length price shall be determined in relation to an international transaction undertaken in any rollback year then such manner shall be the same as the manner which has been agreed to be provided for determination of arm's length price of the same international transaction to be undertaken in any previous year to which the agreement applies, not being a rollback year. 5. **Time limit for filling application for rollback provision:** The applicant may furnish along with the

		application for advance pricing agreement, the request for rollback provision in Form No. 3CEDA with proof of payment of an additional fee of ₹ 5 lakh.
10RA	Procedure for giving effect to rollback provision of an Agreement	Rule 10RA has been inserted to provide the "Procedure for giving effect to rollback provision of an Agreement" as follows: (i) The applicant shall furnish modified return of income referred to in section 92CD in respect of a rollback year to which the agreement applies along with the proof of payment of any additional tax arising as a consequence of and computed in accordance with the rollback provision. (ii) The modified return in respect of rollback year shall be furnished along with the modified return to be furnished in respect of first of the previous years for which the agreement has been requested for in the application. (iii) If any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is the subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant before furnishing the modified return for the said year. (iv) If any appeal filed by the Assessing Officer or the Principal Commissioner or Commissioner is pending before the Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement, shall be withdrawn by the Assessing Officer or the Principal Commissioner or the Commissioner, as the case may be, within three months of filing of modified return by the applicant. (v) The applicant, the Assessing Officer or the Principal Commissioner or the Commissioner, shall inform the Dispute Resolution Panel or the Commissioner (Appeals) or the Appellate Tribunal or the High Court, as the case may be, the fact of an agreement containing rollback provision having been entered into along with a copy of the same as soon as it is practicable to do so.

		(vi) In case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled.

Subsequent to the notification of the rules, the CBDT has issued *Circular No. 10/2015 dated 10.6.2015* adopting a Question and Answer format to clarify certain issues arising out of the said Rules. The questions raised and answers to such questions as per the said Circular are given hereunder:

Question 1

Under rule 10MA(2)(ii) there is a condition that the return of income for the relevant roll back year has been or is furnished by the applicant before the due date specified in Explanation 2 to section 139(1). It is not clear as to whether applicants who have filed returns under section 139(4) or 139(5) of the Act would be eligible for roll back.

Answer

The return of income under section 139(5) can be filed only when a return under section 139(1) has already been filed. Therefore, the return of income filed under section 139(5) of the Act, replaces the original return of income filed under section 139(1). Hence, if there is a return which is filed under section 139(5) to revise the original return filed before the due date specified in *Explanation 2* to sub-section (1) of section 139, the applicant would be entitled for rollback on this revised return of income.

However, rollback provisions will not be available in case of a return of income filed under section 139(4) because it is a return which is not filed before the due date.

Note – *A belated return filed under section 139(4) can also be revised under section 139(5). In such a case, the revised return would replace the belated return. Therefore, an applicant would not be entitled for roll back provisions on a revised return which replaces a belated return.*

Question 2

Rule 10MA(2)(i) mandates that the rollback provision shall apply in respect of an international transaction that is same as the international transaction to which the agreement (other than the rollback provision) applies. It is not clear what is the meaning of the word "same". Further, it is not clear whether this restriction also applies to the Functions, Assets, Risks (FAR) analysis.

Answer

The international transaction for which a rollback provision is to be allowed should be the same as the one proposed to be undertaken in the future years and in respect of which the agreement has been reached. There cannot be a situation where rollback is finalised for a transaction which is not covered in the agreement for future years. The term same international transaction implies that the transaction in the rollback year has to be of same nature and undertaken with the same associated enterprise(s), as proposed to be undertaken in the future years and in respect of which agreement has been reached. In the context of FAR analysis, the restriction would operate to ensure that rollback provisions would apply only if the FAR analysis of the rollback year does not differ materially from the FAR validated for the purpose of reaching an agreement in respect of international transactions to be undertaken in the future years for which the agreement applies.

The word "materially" is generally being defined in the Advance Pricing Agreements being entered into by CBDT. According to this definition, the word "materially" will be interpreted consistently with its ordinary definition and in a manner that a material change of facts and circumstances would be understood as a change which could reasonably have resulted in an agreement with significantly different terms and conditions.

Question 3

Rule 10MA(2)(iv) requires that the application for rollback provision, in respect of an international transaction, has to be made by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant. Clarification is required as to whether rollback has to be requested for all four years or applicant can choose the years out of the block of four years.

Answer

The applicant does not have the option to choose the years for which it wants to apply for rollback. The applicant has to either apply for all the four years or not apply at all. However, if the covered international transaction(s) did not exist in a rollback year or there is some disqualification in a rollback year, then the applicant can apply for rollback for less than four years. Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years. Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then it would be denied the benefit of rollback for that rollback year. However, for other rollback years, it can still apply for rollback.

Question 4

Rule 10MA(3) states that the rollback provision shall not be provided in respect of an international transaction for a rollback year if the determination of arm's length price of the *said international transaction for the said year has been the subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement. Further, Rule 10 RA(4) provides that if any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant.*

There is a need to clarify the phrase "Tribunal has passed an order disposing of such appeal" and on the mismatch, if any, between Rule 10MA(3) and Rule 10RA(4).

Answer

The reason for not allowing rollback for the international transaction for which Appellate Tribunal has passed an order disposing of an appeal is that the ITAT is the final fact finding authority and hence, on factual issues, the matter has already reached finality in that year. However, if the ITAT has not decided the matter and has only set aside the order for fresh consideration of the matter by the lower authorities with full discretion at their disposal, the matter shall not be treated as one having reached finality and hence, benefit of rollback can still be given.

There is no mismatch between Rule 10MA(3) and Rule 10RA(4).

Question 5

Rule 10MA(3)(ii) provides that rollback provision shall not be provided in respect of an international transaction for a rollback year if the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year. It may be clarified whether the rollback provisions in such situations can be applied in a manner so as to ensure that the returned income or loss is accepted as the final income or loss after applying the rollback provisions.

Answer

It is clarified that in case the terms of rollback provisions contain specific agreement between the Board and the applicant that the agreed determination of ALP or the agreed manner of determination of ALP is subject to the condition that the ALP would get modified to the extent that it does not result in reducing the total income or increasing the total loss, as the case may be, of the applicant as declared in the return of income of the said year, the rollback provisions could be applied. For example, if the declared income is ₹ 100, the income as adjusted by the TPO is ₹ 120, and the application of the rollback provisions results in reducing the income to ₹ 90, then the rollback for that year would be determined in a manner that the declared income ₹ 100 would be treated as the final income for that year.

Question 6

Rule 10RA(7) states that in case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled. It is to be clarified as to whether the entire agreement is to be cancelled or only that year for which roll back fails.

Answer

The procedure for giving effect to a rollback provision is laid down in Rule 10RA. Sub-rules (2), (3), (4) and (6) of the Rule specify the actions to be taken by the applicant in order that effect may be given to the rollback provision. If the applicant does not carry out such actions for any of the rollback years, the entire agreement shall be cancelled.

This is because the rollback provision has been introduced for the benefit of the applicant and is applicable at its option. Accordingly, if the rollback provision cannot be given effect to for any of the rollback years on account of the applicant not taking the actions specified in sub-rules (2), (3), (4) or (6), the entire agreement gets vitiated and will have to be cancelled.

Question 7

If there is a Mutual Agreement Procedure (MAP) application already pending for a rollback year, what would be the stand of the APA authorities? Further, what would be the view of the APA Authorities, if MAP has already been concluded for a rollback year?

Answer

If MAP has been already concluded for any of the international transactions in any of the rollback year under APA, rollback provisions would not be allowed for those international transactions for that year but could be allowed for other years or for other international transactions for that year, subject to fulfilment of specified conditions in Rules 10MA and 10RA. However, if MAP request is pending for any of the rollback year under APA, upon the option exercised by the applicant, either MAP or application for roll back shall be proceeded with for such year.

Question 8

Rule 10MA(1) provides that the agreement may provide for determining ALP or manner of determination of ALP. However, Rule 10MA(4) only specifies that the manner of determination of ALP should be the same as in the APA term. Does that mean the ALP could be different?

Answer

Yes, the ALP could be different for different years. However, the manner of determination of ALP (including choice of Method, comparability analysis and Tested Party) would be same.

Question 9

Will there be compliance audit for roll back? Would critical assumptions have to be validated during compliance audit?

Answer

Since rollback provisions are for past years, ALP for the rollback years would be agreed after full examination of all the facts, including validation of critical assumptions. Hence, compliance audit for the rollback years would primarily be to check if the agreed price or methodology has been applied in the modified return.

Question 10

Whether applicant has an option to withdraw its rollback application? Can the applicant accept the rollback results without accepting the APA for the future years?

Answer

The applicant has an option to withdraw its roll back application even while maintaining the APA application for the future years. However, it is not possible to accept the rollback results without accepting the APA for the future years. It may also be noted that the fee specified in Rule 10MA(5) shall not be refunded even where a rollback application is withdrawn.

Question 11

For already concluded APAs, will new APAs be signed for rollback or earlier APAs could be revised?

Answer

The second proviso to Rule 10MA(5) provides for revision of APAs already concluded to include rollback provisions.

Question 12

For already concluded APAs, where the modified return has already been filed for the first year of the APA term, how will the time-limit for filing modified return for rollback years be determined?

Answer

The time to file modified return for rollback years will start from the date of signing the revised APA incorporating the rollback provisions.

Question 13

In case of merger of companies, where one or more of those companies are APA applicants, how would the rollback provisions be allowed and to which company or companies would it be allowed?

Answer

The agreement is between the Board and a person. The principle to be followed in case of merger is that the person (company) who makes the APA application would only be entitled to enter into the agreement and be entitled for the rollback provisions in respect of international transactions undertaken by it in rollback years. Other persons (companies) who have merged with this person (company) would not be eligible for the rollback provisions.

To illustrate, if A, B and C merge to form C and C is the APA applicant, then the agreement can only be entered into with C and only C would be eligible for the rollback provisions. A and B would not be eligible for the rollback provisions. To illustrate further, if A and B merge to form a new company C and C is the APA applicant, then nobody would be eligible for rollback provisions.

Question 14

In case of a demerger of an APA applicant or signatory into two or more companies (persons), who would be eligible for the rollback provisions?

Answer

The same principle as mentioned in the previous answer, i.e., the person (company) who makes an APA application or enters into an APA would only be entitled for the rollback provisions, would continue to apply. To illustrate, if A has applied for or entered into an APA and, subsequently, demerges into A and B, then only A will be eligible for rollback for international transactions covered under the APA. As B was not in existence in rollback years, availing or grant of rollback to B does not arise.

(4) Section 92CD provides for the following procedure for giving effect to an APA -

(i) In case a person has entered into an APA and prior to the date of entering into such APA, he has furnished the return of income under the provisions of section 139 in respect of any assessment year relevant to a previous year to which the APA applies, then, such person shall, within a period of three months from the end of the month in which the said agreement was entered into, furnish a modified return, notwithstanding any contrary provision contained in section 139.

(ii) Such modified return shall be in accordance with and limited to the provisions of such APA i.e., modifications can only be made on account of such APA in the return to be filed.

(iii) All other provisions of this Act shall apply as if the modified return is a return furnished under section 139, unless anything to the contrary is provided in this section.

(iv) If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the APA applies have been completed before the expiry of period allowed for furnishing of modified return, the Assessing Officer shall, in a case where modified return is filed in accordance with the provisions of this section, proceed to assess or reassess or re-compute the total income of the relevant assessment year having regard to and in accordance with the APA.

However, with effect from 1.9.2019, Assessing Officer shall pass an order modifying the total income of the relevant assessment year determined in such assessment or reassessment, as the case may be, having regard to and in accordance with the APA, instead of proceeding to assess or reassess the total income.

Such order for assessment or reassessment or re-computation of total income shall be passed within a period of 1 year from the end of the financial year in which the modified return was furnished. This shall apply notwithstanding the period of limitation contained under section 153 or 153B or 144C.

The appeal against such order shall lie to Commissioner (Appeals) [Section 246A]

(v) Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the APA applies, are pending on the date of filing of modified return, the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the APA taking into consideration the modified return so furnished.

In this case, the time period of completion of pending assessment or reassessment mentioned under section 153 or 153B or 144C shall be extended by 12 months. This shall apply notwithstanding the period of limitation contained under section 153 or 153B or 144C.

(vi) The assessment or reassessment proceedings for an assessment year shall be deemed to have been completed where -

(a) an assessment or reassessment order has been passed; or

(b) no notice has been issued under section 143(2) till the expiry of the limitation period provided under the said section.

VIII. Secondary Adjustment [Section 92CE]

(1) Meaning of Primary Adjustment and Secondary Adjustment

"Primary adjustment" to a transfer price means the determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee.

"Secondary adjustment" means an adjustment in the books of accounts of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.

(2) **Forms of Secondary Adjustment** - As per the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD transfer pricing guidelines), secondary adjustment may take the form of constructive dividends, constructive equity contributions, or constructive loans.

(3) **Alignment of economic benefit of the transaction with the arm's length position** - The provisions of secondary adjustment are internationally recognised and are already part of the transfer pricing rules of many leading economies in the world. Whilst the approaches to secondary adjustments by individual countries vary, they represent an internationally recognised method to align the economic benefit of the transaction with the arm's length position.

(4) **Cases where secondary adjustment has to be made** - In order to align the transfer pricing provisions in line with OECD transfer pricing guidelines and international best practices, section 92CE provides that the assessee shall be required to carry out secondary adjustment where the primary adjustment to transfer price:

(i) has been made *suo motu* by the assessee in his return of income; or

(ii) made by the Assessing Officer has been accepted by the assessee; or

(iii) is determined by an advance pricing agreement entered into by the assessee under section 92CC ***on or after 1.4.2017***; or

(iv) is made as per the safe harbour rules framed under section 92CB; or

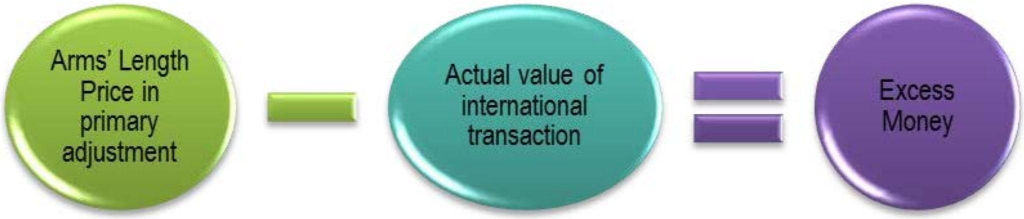
(v) is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or 90A for avoidance of double taxation.

(5) **No requirement of secondary adjustment in certain cases** - Such secondary adjustment, however, shall not be carried out if, the amount of primary adjustment made in the case of an assessee in any previous year does not exceed ₹ 1 crore **or** the primary adjustment is made in respect of A.Y.2016-17 or an earlier assessment year.

(6) **Non-repatriation of excess money by the associated enterprise deemed to be an advance -** Where, as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the assessee, the excess money ***or part thereof, as the case may be***, which is available with its associated enterprise, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed as the income of the assessee, in the prescribed manner.

Such excess money or part thereof may be repatriated from any of the associated enterprises of the assessee which is not resident in India.

*"**Excess money**" means the difference between the arm's length price determined in primary adjustment and the price at which the international transaction has actually taken place.*


Arms' Length Price in primary adjustment
Actual value of international transaction
Excess Money

(7) **Time limit for repatriation of excess money or part thereof**

Rule 10CB(1) prescribes the time limit for repatriation of excess money i.e., on or before **90 days** from the date given in column (3) in the cases mentioned in column (2) of the table below:

	Case	**Date**
(1)	**(2)**	**(3)**
(i)	Where primary adjustments to transfer price has been made *suo-moto* by the assessee in his return of income	the due date of filing of return u/s 139(1)
(ii)	If primary adjustments to transfer price as determined in the order of the Assessing Officer or the appellate authority has been accepted by the assessee	the date of the said order
(iii)	Where agreement for advance pricing has been entered into by the assessee under section 92CD	the due date of filing of return u/s 139(1)
(iv)	Where option has been exercised by the assessee as per the safe harbour rules under section 92CB	the due date of filing of return u/s 139(1)

(v)	Where agreement under the Mutual agreement procedure under a DTAA has been entered into u/s 90 or 90A	the due date of filing of return u/s 139(1)

(8) **Rate of interest for the purpose of computation on interest on excess money or part thereof, if not repatriated within the prescribed time**

Rule 10CB(2) prescribes the rate at which the per annum interest income shall be computed in case of failure to repatriate the excess money within the above time limit. The interest would be computed at the rates mentioned in column (3) in respect of the cases mentioned in column (2) of the table below:

	Case	**Rate**
(1)	**(2)**	**(3)**
(i)	Where the international transaction is denominated in Indian rupee	At the one year marginal cost of fund lending rate of SBI as on 1st April of the relevant previous year + 3.25%
(ii)	Where the international transaction is denominated in foreign currency	At six month London Interbank Offered Rate (LIBOR) as on 30th September of the relevant previous year + 3.00%

(9) ***Option to pay additional income-tax, if the excess money not repatriated:*** *In a case where the excess money or part thereof has not been repatriated within the prescribed time as mentioned above, the assessee has the option to pay additional income-tax @* ***20.9664%*** *(i.e., tax@18%* ***plus*** *surcharge@12%* ***plus*** *cess@4%) on such excess money or part thereof, as the case may be.*

Where additional income-tax is so paid by the assessee, he will ***not*** *be required to make secondary adjustment and compute interest from the date of payment of such tax. This implies that he would, in any case, be required to compute interest upto the date of payment of such additional tax.*

The additional income-tax so paid by the assessee shall be treated as the final payment of tax in respect of excess money or part thereof not repatriated and no further credit would be allowed to the assessee or to any other person in respect of the amount of additional income-tax so paid.

Further, no deduction in respect of the amount on which such additional income-tax has been paid, would be allowed under any other provision of the Act.

IX. **Records to be maintained [Section 92D]:** Transfer pricing documentation is the documentation maintained to review Transfer Pricing arrangements for transactions taking place between different entities of the same group (also known as intra-group transactions). The primary objective of the transfer pricing documentation is to review the arm's length (fair price) nature of the transactions taking place between different entities of an Multi National Company

(1) ***Persons responsible for keeping and maintaining prescribed information and document -*** *Section 92D imposes responsibility on every person*

(i) *who* ***enters into an international transaction*** *to keep and maintain such information and documents in respect thereof as may be prescribed by CBDT*

(ii) *being a* ***constituent entity of an international group****, to keep and maintain the prescribed information and document* ***in respect of an international group****.*

The constituent entity is required to keep and maintain the information and document irrespective of the fact ***whether or not any international transaction is undertaken*** *by such constituent entity.*

The constituent entity has to furnish the information and document to the authority prescribed under section 286(1), i.e., Director General of Income-tax (Risk Assessment) in the prescribed manner, on or before prescribed date

(2) ***Information and documents to be kept and maintained for prescribed period*** *- The CBDT is empowered to prescribe the period for which the information and documents shall be kept and maintained.*

(3) ***Assessing Officer & Commissioner (Appeals) empowered to require persons entering into international transaction to furnish prescribed information and documents*** *- The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceedings under the Income-tax Act, require any person who has entered into an international transaction to furnish any such prescribed information or documents within a period of* ***30 days*** *from the date of receipt of a notice issued in this regard. The requisition period may, on request, be extended further for a period not exceeding thirty days by the Assessing Officer or the Commissioner (Appeals).*

Information to be kept and maintained under section 92D[Rule 10D(1)]

Rule 10D(1) provides for the information and documents to be kept and maintained by the assessee under section 92D(1)(i). Under this Rule, the following information and documents have to be maintained:

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

(ii) 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 have been entered into by the assessee, and ownership linkages among them;

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

(iv) The nature and terms (including prices) of international 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;

(v) 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 transactions;

(vi) 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 entered into by the assessee;

(vii) A record of uncontrolled transactions taken into account for analysing their comparability with the international 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;

(viii) A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;

(ix) A description of the methods considered for determining the arm's length price in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with explanation as to why such method was so selected, and how such method was applied in each case;

(x) 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 to apply the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;

(xi) The assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;

(xii) Details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under the Income-tax Rules and consequent adjustment made to the total income for tax purposes;

(xiii) Any other information, data or documents, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

Threshold limit for maintenance of prescribed information and documents [Rule 10D(2)]

Rule 10D(2) provides that in a case where the aggregate value of international transactions does not exceed ₹ 1 crore, it will not be obligatory for the assessee to maintain the above information and documents.

However, it is provided that in the above cases also the assessee will have to substantiate that the income arising from the international transactions with associated enterprises, as disclosed by the accounts, is in accordance with section 92. This will mean that, even if the aggregate value of the international transactions is less than ₹ 1 crore, the assessee will have to maintain adequate records and evidence to show that the international transactions with associated enterprises are on the basis of arm's length principle.

Information to be supported by authentic documents [Rule 10D(3)]

The information to be maintained by the assessee, is to be supported by authentic documents. These documents may include the following:

(i) Official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country;

(ii) Reports of market research studies carried out and technical publications brought out by institutions of national or international repute;

(iii) Price publications including stock exchange and commodity market quotations;

(iv) Published accounts and financial statements relating to the business affairs of the associated enterprises;

(v) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions;

(vi) Letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;

(vii) Documents normally issued in connection with various transactions under the accounting practices followed.

It is also provided that the information and documents to be maintained should be contemporaneous and should exist latest by the date specified for getting the audit report. In the case of international transactions which continue to have effect over more than one financial year, fresh documents will not be required to be maintained for each year if there are no significant change which may affect the determination of arm's length price.

The above information and documents are required **to be maintained for a period of eight years** from the end of the relevant assessment year.

X. Power of Assessing Officer: Section 92C(3) and (4) gives power to the Assessing Officer to determine the arm's length price under the following circumstances and also empowers the Assessing Officer to re-compute total income of the assessee having regard to arm's length price determined by him. It also provides that deduction under section 10AA and Chapter VI-A shall not be allowed from the additional income computed by him.

For example, if the total income declared by the assessee in his return of income is, say ₹ 7 lakhs and the total income computed by the Assessing Officer applying the arm's length principle is, say ₹ 9 lakhs, the difference of ₹ 2 lakhs will not qualify for deduction under section 10AA or Chapter VI-A.

The Assessing Officer may invoke the power to determine arm's length price if during the course of any proceeding, he is of the opinion that, on the basis of material or information or documents in his possession:

(a) The price charged or paid in an international transaction has not been determined in accordance with section 92C(1) and (2); or

(b) Any information and documents relating to an international transaction has not been kept and maintained by the assessee in accordance with the provisions contained in section 92D(1) and the rules made in this behalf (Rule 10D); or

(c) The information or data used in computation of the arm's length price is not reliable or correct; or

(d) The assessee has failed to furnish within the specified time, any information or documents which he was required to furnish by a notice issued under section 92D(3).

Before invoking the power to determine arm's length price, an opportunity of being heard is to be given to the assessee.

Second proviso to section 92C(4) provides that if the total income of an associated enterprise is computed under this section on the determination of arm's length price paid to another associated enterprise, from which tax is deducted or deductible at source, the income of the other associated enterprise shall not be recomputed on this count.

For example, if "A" Ltd. has paid royalty to "B" Ltd. (Non-Resident) @10% of sales and tax is deducted at source, "B" Ltd. cannot claim refund if the Assessing Officer has determined 8% as arm's length price in the case of "A" Ltd. and disallowed 2% of the royalty amount.

XI. Audit Report [Section 92E]: Under section 92E, every person who enters into an international transaction during a previous year is required to obtain a report from a chartered accountant and furnish such report on or before the specified date on the prescribed form.

Rule 10E provides that the auditor's report shall be in Form No.3CEB. It requires the auditor to state that he has examined the accounts and records of the assessee relating to the international transactions entered into by the assessee during the relevant year. He has also to give his opinion whether the prescribed information and documents relating to the above transactions have been kept by the assessee. Further, he has to state that the particulars stated in the Annexure to his report are true and correct. The Annexure is in two parts.

In the first part of the Annexure, general information of the assessee is required to be reported. In the second part of the Annexure, the particulars about the international transactions are required to be stated. Broadly stated these particulars include list of associated enterprises, particulars and description of transactions relating to purchase, sales, provisions of service, loans, advances, etc

“Specified date” shall have the same meaning as assigned to due date in *Explanation 2* below sub-section (1) of section 139. The due date for filing of transfer pricing report under section 92E in Form 3CEB is 30th November of the assessment year.

XII. Penalties: Stringent penalties are provided in various sections for non-compliance with the above provisions. These are as under:

Penalty for failure to report any international transaction or any transaction deemed to be an international transaction: Under section 270A, penalty@50% of tax payable on under-reported income is leviable. However, the amount of under-reported income represented by any addition made in conformity with the arm’s length price determined by the Transfer Pricing Officer would not be included within the scope of under-reported income under section 270A, where the assessee had maintained information and documents, as prescribed under section 92D, declared the international transactions under Chapter X and disclosed all material facts relating to the transaction.

Failure to report any international transaction or any transaction deemed to be an international transaction or specified domestic transaction to which the provisions of Chapter X applies would constitute **‘misreporting of income’** under section 270A(9), in respect of which penalty@200% would be attracted.

Penalty for failure to keep and maintain information and documentation [Section 271AA]: The penalty provisions in respect of international transaction are broadly covered under section 271BA providing for levy of penalty of ₹ 1 lakh in cases where any person fails to furnish a report from an accountant as required by section 92E. Section 271G which provides for penalty @2% of the value of the international transaction for each failure in case of failure to furnish information or document under section 92D(3).

Further, in order to ensure compliance with the transfer pricing regulations, section 271AA provides that, the Assessing Officer or Commissioner (Appeals) may direct the person entering into an international transaction to pay a penalty@2% of the value of each international transaction entered into by him, if the person:

(1) fails to keep and maintain any such document and information as required by section 92D(1) and section 92D(2);

(2) fails to report such international transaction which is required to be reported; or

(3) maintains or furnishes any incorrect information or document.

The penalty under section 271AA shall be in addition and not in substitution of penalty under section 271BA.

Penalty for failure to comply with TP provisions : A Summary		
Section	**Nature of default**	**Penalty**
270A(9)	Failure to report any International transaction or deemed International transaction to which the provision of Chapter X applies would constitute 'misreporting of income'	200% of the tax payable on under-reported income
271BA	Failure to furnish a report from an accountant as required under section 92E	₹ 1 lakh
271G	Failure to furnish info or doc as required by Assessing Officer or CIT(A) u/s 92D(3) within 30 days from the date of receipt of notice or extended period not exceeding 30 days, as the case may be.	2% of the value of the International transaction for each failure
271AA	(1) Failure to keep and maintain any such docu**ment** and info**rmation** as required by sec**tion** 92D(1)/(2); (2) Failure to report such International transaction which is required to be reported; or (3) Maintaining or furnishing any incorrect info**rmation or document.**	2% of the value of each such International transaction

Notes:

- ***The penalty u/s 271AA shall be in addition and not in substitution of penalty u/s 271BA.***
- ***If the assessee proves that there was reasonable cause for the failure, no penalty would be leviable under section 271BA, 271G and 271AA.***

(2) Furnishing of report in respect of international group in line with BEPS Action Plan – Country by Country Report and Master File

(i) Transfer Pricing provisions under the Income-tax Act, 1961

Chapter X of the Income-tax Act, 1961 comprising sections 92 to 92F contain provisions relating to transfer pricing regime.

Section 92D requires maintenance of prescribed information and document relating to the international transaction and specified domestic transaction.

(ii) Requirements as per OECD report on Action 13 of BEPS Action Plan

The report provides for:

(a) revised standards for transfer pricing documentation; and

(b) a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity.

(iii) Three-tier structure mandated by BEPS

The BEPS report recommends that countries adopt a standardised approach to transfer pricing documentation; it mandates the following three-tier structure:-

	Document	Information
(1)	Master File	Standardised information relevant for all multinational enterprises (MNE) group members
(2)	Local file	Specific reference to material transactions of the local taxpayer
(3)	Country-by-country report	Information relating to the global allocation of the MNE's income and taxes paid; and Indicators of the location of economic activity within the MNE group.

(iv) Advantages of the three tier structure [as per BEPS Report]:

(a) Taxpayers will be required to articulate consistent transfer pricing positions;

(b) Tax administrations would get useful information to assess transfer pricing risks;

(c) Tax administrations would be able to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.

(v) Country-by-country Report: Reporting Requirements of MNEs

The Country-by-Country (CbC) report has to be submitted by parent entity of an international group to the prescribed authority in its country of residence. This report is to be based on consolidated financial statement of the group.

(a) MNEs have to report annually and for each tax jurisdiction in which they do business:

(1) the amount of revenue;

(2) profit before income tax; and

(3) income tax paid and accrued.

(b) MNEs have to report their total employment, capital, accumulated earnings and tangible assets in each tax jurisdiction.

(c) MNEs have to identify each entity within the group doing business in a particular tax jurisdiction and provide an indication of the business activities each entity engages in.

(vi) Master File: Objective & Features

(a) The master file would provide an overview of the MNE groups business, including:

(1) the nature of its global business operations,

(2) its overall transfer pricing policies, and

(3) its global allocation of income and economic activity

in order to assist tax administrations in evaluating the presence of significant transfer pricing risk.

(b) The master file is intended to provide a high-level overview in order to place the MNE group's transfer pricing practices in their global economic, legal, financial and tax context.

(c) The master file shall contain information which may not be restricted to transaction undertaken by a particular entity situated in particular country.

(d) Thus, information in master file would be more comprehensive than the existing regular transfer pricing documentation.

(e) The master file shall be furnished by each entity to the tax authority of the country in which it operates.

(vii) Implementation of international consensus in India

India is one of the active members of BEPS initiative and part of international consensus. For the purpose of implementing the international consensus, a specific reporting regime in respect of CbC reporting and also the master file has been incorporated in the Income-tax Act, 1961. The essential elements have been incorporated in the Income-tax Act, 1961 while remaining aspects would be dealt with in detail in the Income-tax Rules, 1962.

(viii) Elements relating to CbC reporting requirement and related matters which have been incorporated in the Income-tax Act, 1961 [Section 286]

(a) **Threshold limit for applicability of CbC reporting [Sub-section (7)]:** The reporting provision shall apply in respect of an international group for an accounting year, if the total consolidated group revenue as reflected in the consolidated financial statement (CFS) for the accounting year preceding such accounting year is above a threshold to be prescribed i.e., ₹ 5,500 crore.

Where the total consolidated group revenue of the international group, as reflected in the consolidated financial statement, is in foreign currency, the rate of exchange for the calculation of the value in rupees of such total consolidated group revue shall be the telegraphic transfer buying rate (TTBR) of such currency on the last day of the accounting year preceding the accounting year [Rule 10DB(7)].

(b) **Time limit for furnishing CbC report [Sub-section (2)]:** The parent entity of an international group or the alternate reporting entity, if it is resident in India shall be required to furnish the report in respect of the group to the Director General of Income-tax (Risk Assessment) for every reporting accounting year, within a period of twelve months from the end of the said reporting accounting year for which the report is being furnished, in Form No. 3CEAD.

(c) **Details to be furnished by constituent entity resident in India [Sub-section (1):** Every constituent entity resident in India, of an international group having parent entity that is not resident in India, shall notify the Director General of Income-tax (Risk Assessment) at least two months prior to the due date for furnishing Cbc report –

(1) whether it is the alternate reporting entity of the international group; or

(2) the details of the parent entity or the alternate reporting entity, if any of the international group, and the country of territory of which the said entities are resident.

The report shall be furnished in prescribed manner and in the prescribed form i.e., 3CED.

(d) **Details/ information to be included in CbC report [Sub-section (3)]:** It should contain aggregate information in respect of:

(1) the amount of revenue,

(2) profit and loss before income-tax,

(3) amount of income-tax paid and accrued,

(4) details of stated capital, accumulated earnings, number of employees, tangible assets other than cash or cash equivalent in respect of each country or territory along with details of each constituent's incorporation country and residential status, nature and details of main business activity or activities of each constituent entity and any other information as may be prescribed.

This shall be based on the template provided in the OECD BEPS report on Action Plan 13.

(e) **Furnishing of CbC report by resident constituent entity [Sub-section (4):** A constituent entity of an international group resident in India, other than the parent entity or the alternate reporting entity, shall be required to furnish CbC report in Form No. 3CEAE within the **twelve months from the end of the reporting accounting year** to the Director General of Income-tax (Risk Assessment), if the parent entity of the group is resident of a country or territory,-

(1) in which it is not obligated to file report of the nature of CbC report;

(2) with which India does not have an arrangement for exchange of the CbC report; or

(3) there has been a systemic failure of the country or territory i.e., such country is not exchanging information with India even though there is an agreement and this fact has been intimated to the entity by the prescribed authority.

However, in case the parent entity of the constituent entity is resident of a country or territory, where, there has been a systemic failure of the country or territory and the said *failure has been intimated to such constituent entity, the period for submission of the report would be* ***six months from the end of the month in which said systemic failure has been intimated.***

(f) **Nomination of one constituent entity for furnishing CbC report [Proviso to sub-section (4)]:** If there are more than one such constituent entity of the group, resident in India, other than the parent entity or the alternate reporting entity, then the group can nominate (under intimation in writing on behalf of the group to the prescribed authority), then, one constituent entity that shall furnish the report on behalf of the group. This entity would then furnish the report.

(g) **No obligation to furnish CbC report in certain cases [Sub-section (5)]:** If an international group, having parent entity which is not resident in India, had designated an alternate entity for filing its report with the tax jurisdiction in which the alternate entity is resident and such alternate entity has furnished such report on or before the date specified by that country or territory, then, the entities of such group operating in India would not be obliged to furnish report if

- the report is required to be furnished under the law for the time being in force in the said country or territory
- the report can be obtained under the agreement of exchange of such reports by Indian tax authorities
- No systemic failure in respect of the said country or territory has been conveyed to any constituent entity of the group that is resident in India
- the said country or territory has been informed in writing by the constituent entity that it is the alternative reporting entity on behalf of the international group
- the same has been informed to the prescribed authority by the entity in accordance with section 286(1).

(h) **Entity to furnish documents and information called for [Sub-section (6)]:** The DGIT (Risk Assessment) may call for such document and information from the entity furnishing the report as it may specify in notice in writing for the purpose of verifying the accuracy. The entity shall be required to make submission within thirty days of receipt of notice or further period if extended by the prescribed authority, but extension shall not be beyond a further period of 30 days.

(ix) Penalty for non-furnishing of the report by any reporting entity which is obligated to furnish such report [Section 271GB(1) & (3)]

	Period of delay/ b default	Penalty
(a)	Not more than a month	₹ 5,000 per day
(b)	beyond one month	₹ 15,000 per day for the period exceeding one month

(c)	Continuing default even after service of order levying penalty either under (a) or under (b)	₹ 50,000 per day of continuing failure beginning from the date of service of order

(x) Penalty for failure to produce information and documents within prescribed time [Section 271GB(2) & (3)]

	Default	Penalty
(a)	Failure to produce information before prescribed authority within the period allowed u/s 286(6)	₹ 5,000 per day of continuing failure, from the day immediately following the day on which the period for furnishing the information and document expires.
(b)	Continuing default even after service of penalty order	₹ 50,000 per day for the period of default beyond the date of service of penalty order.

(xi) Penalty for submission of inaccurate information in the CBC report [Section 271GB(4)]

If the reporting entity has provided any inaccurate information in the report, the penalty would be ₹ 5,00,000 if,-

(a) the entity has knowledge of the inaccuracy at the time of furnishing the report but does not 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 notice of the prescribed authority under section 286(6).

(xii) Non-levy of penalty if reasonable cause for failure is proved [Section 273B]

Section 273B provides for non-levy of penalty under various sections if the assessee proves that there was reasonable cause for such failure. Section 271GB has been included within the scope of section 273B. Therefore, the entity can offer reasonable cause defence for non-levy of penalties mentioned above.

(xiii) Maintenance and furnishing of Master file: Consequent amendments in the Income-tax Act, 1961

	Section	Provision
(1)	92D(1)(ii)	***Every person, being constituent entity of an international group, has to keep and maintain the prescribed information and document in respect of the international group. Constituent entity has to keep and maintain such prescribed information and document irrespective of the fact whether or not any international transaction is undertaken by such constituent entity***.

		The rules shall, thereafter, prescribe the information and document as mandated for master file under OECD BEPS Action 13 report;
(2)	92D(4)	The information and document shall also be furnished to the prescribed authority u/s 286(1) within such period as may be prescribed and the manner of furnishing may also be provided for in the rules
(3)	271AA(2)	For non-furnishing of the information and document to the prescribed authority, a penalty of ₹ 5 lakh shall be leviable.
(4)	273B	Reasonable cause defence against levy of penalty shall be available to the entity.

(xiv) Meaning of certain terms [Section 286(9)]

<table>
<tr><th></th><th>Term</th><th colspan="2">Meaning</th></tr>
<tr><td rowspan="3">(a)</td><td rowspan="3">Accounting year</td><td>Case</td><td>Accounting year</td></tr>
<tr><td>In a case where the parent entity is resident in India; or</td><td>A previous year</td></tr>
<tr><td>In any other case</td><td>An annual accounting period, with respect to which the parent entity of the international group prepares its financial statements under any law for the time being in force or the applicable accounting standards of the country or territory of which such entity is resident</td></tr>
<tr><td>(b)</td><td>Agreement</td><td colspan="2">A combination of all of the following agreements, namely –
(i) an agreement referred to in section 90(1) or section 90A(1); or
(ii) an agreement for exchange of the CbC report referred to in section 286(2) as may be notified by the Central Government.</td></tr>
<tr><td>(c)</td><td>Alternate reporting entity</td><td colspan="2">Any constituent entity of the international group that has been designated by such group, in the place of the parent entity, to furnish the CbC report in the country or territory in which the said constituent entity is resident on behalf of such group.</td></tr>
<tr><td>(d)</td><td>Constituent entity</td><td colspan="2">(i) any separate entity of an international group that is included in the consolidated financial statement of the said group for financial reporting purposes, or may be so included for the said purpose, if the equity share of any entity of the international group were to be listed on a stock exchange;
(ii) any such entity that is excluded from the consolidated financial statement of the international group solely on the basis of size or</td></tr>
</table>

		materiality; or (iii) any permanent establishment of any separate business entity of the international group included in sub clause (i) or sub clause (ii), if such business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting or internal management control purposes
(e)	Group	This includes a parent entity and all the entities in respect of which, for the reason of ownership or control, a consolidated financial statement for financial reporting purposes,— (i) is required to be prepared under any law for the time being in force or the accounting standards of the country or territory of which the parent entity is resident; or (ii) would have been required to be prepared had the equity shares of any of the enterprises were listed on a stock exchange in the country or territory of which the parent entity is resident.
(f)	Consolidated financial statement	The financial statement of an international group in which the assets, liabilities, income, expenses and cash flows of the parent entity and the constituent entities are presented as those of a single economic entity
(g)	International group	Any group that includes,— (i) two or more enterprises which are resident of different countries or territories; or (ii) an enterprise, being a resident of one country or territory, which carries on any business through a permanent establishment in other countries or territories;
(h)	Parent entity	A constituent entity, of an international group holding, directly or indirectly, an interest in one or more of the other constituent entities of the international group, such that,— (i) it is required to prepare a consolidated financial statement under any law for the time being in force or the accounting standards of the country or territory of which the entity is resident; or (ii) it would have been required to prepare a consolidated financial statement had the equity shares of any of the enterprises were listed on a stock exchange, and, there is no other constituent entity of such group which, due to ownership of any interest, directly or indirectly, in the first mentioned constituent entity, is required to prepare a consolidated financial statement, under the circumstances referred to in sub clause (i) or sub clause (ii), that includes the separate financial statement of the first mentioned constituent entity.

(i)	Permanent establishment	Meaning assigned to it in clause (iiia) of section 92F i.e., includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.
(j)	Reporting accounting year	The accounting year in respect of which the financial and operational results are required to be reflected in the report to be furnished every year by the parent entity or the alternate reporting entity, resident in India, in respect of the international group of which it is a constituent under section 286(2) or by a constituent entity of an international group referred to in section 286(4).
(k)	Reporting entity	The constituent entity including the parent entity or the alternate reporting entity, that is required to furnish a report referred to in section 286(2) and 286(4).
(l)	Systemic failure	Systemic failure, with respect to a country or territory, means that the country or territory has an agreement with India providing for exchange of report of the nature referred to in section 286(2), but— (i) in violation of the said agreement, it has suspended automatic exchange; or (ii) has persistently failed to automatically provide to India the report in its possession in respect of any international group having a constituent entity resident in India

(3) Transfer pricing for Specified Domestic Transactions

(i) **Income from domestic related party transactions to be subject to transfer pricing [Section 92(2A)]:** Section 92 provides that any income arising from an international transaction shall be computed having regard to the arm's length price. In order to provide objectivity in determination of income from domestic related party transactions and determination of reasonableness of expenditure between related domestic parties, the provisions of section 92 have been extended to include within its ambit the specified domestic transactions. Section 92(2A) provides that, any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the specified domestic transaction shall be computed having regard to the arm's length price. However, as per section 92(3), the provisions of this section would not apply if such allowance for expense or interest under section 92(2A) has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be.

(ii) **Meaning of "specified domestic transaction" [Section 92BA]:** Section 92BA provides the meaning of "specified domestic transaction". As per section 92BA, for the purpose of sections 92, 92C (Computation of arm's length price), 92D (Maintenance and keeping of information and documents) and 92E (Furnishing of report from an accountant), in case of an assessee the specified domestic transaction shall mean any of the following transactions, not being an international transaction, namely,-

(1) any transaction referred to in section 80A i.e., inter-unit transfer of goods and services by an undertaking or unit or enterprise or eligible business to other business carried on by the assessee or *vice versa*, for consideration not corresponding to the market value on the date of transfer;

(2) any transfer of goods or services referred to in section 80-IA(8) i.e., inter-unit transfer of goods or services between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods and services;

(3) any business transacted between the assessee carrying on eligible business and other person as referred to section 80-IA(10);

(4) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of section 80-IA(8) or section 80-IA(10) are applicable; or

(5) any other transaction as may be prescribed,

(iii) However, the above mentioned transactions shall not be treated as specified domestic transaction in case the aggregate of such transactions entered into by the assessee in the previous year does not exceed a sum of ₹ 20 crore.

(iv) **Arm's length price and income of a specified domestic transaction to be computed in the same manner as applicable to an international transaction [Sections 92 & 92C]:** In order to determine the arm's length price in respect of the specified domestic transaction, the provisions of section 92 and 92C shall apply to the specified domestic transaction as they apply to the international transaction. Accordingly, the methods of computation of arm's length price for an international transaction would be applicable to a specified domestic transaction also.

(v) **Persons entering into a specified domestic transaction to maintain information and documents and furnish report of an accountant [Section 92D & 92E]:** With a view to create a legally enforceable obligation on assessees entering into a specified domestic transaction to maintain proper documentation and obtain and furnish report of a Chartered Accountant on or before the specified date, the provisions of section 92D and 92E have been made applicable to a specified domestic transaction as they apply to an international transaction.

(vi) **Reference to Transfer Pricing Officer for computation of arm's length price of specified domestic transaction [Section 92CA]:** According to section 92CA, where any person has entered into an international or a specified domestic transaction in any previous year, the Assessing Officer can with the previous approval of the Principal Commissioner or Commissioner, if he considers necessary or expedient to do so, refer the computation of the arm's length price of such transaction to the Transfer Pricing Officer (TPO).

When such reference is made, TPO can call upon the assessee to produce evidence in support of the computation of arm's length price made by him in respect of such transaction.

The TPO has to pass an order determining the arm's length price in respect of the specified domestic transaction after considering the evidence, documents, etc. produced by the assessee and after considering the material gathered by him. He has to send a copy of his order to the Assessing Officer as well as the assessee.

However, the powers available to the TPO to determine the ALP of other international transactions identified subsequently in the course of proceedings before him, is not available in respect of other specified domestic transaction i.e., the TPO can determine the ALP in respect of other international transaction that came to his notice subsequently during the course of proceedings but such power is not available in respect of specified domestic transaction subsequently identified.

(vii) **Penalty provisions to apply to specified domestic transactions as they apply to an international transaction [Sections 271AA, 271BA & 271G]:** The penalty provisions under sections 271AA, 271BA and 271G shall apply to the specified domestic transaction as they apply to an international transaction defined under section 92B.

Failure to furnish the report under section 92E from an accountant would attract penalty of ₹ 1,00,000 under section 271BA.

In addition,

(i) in case of failure to keep and maintain information, document as required under section 92D(1) or 92D(2); or

(ii) failure to report such specified domestic transaction which is required to be reported; or

(iii) maintain or furnishes incorrect information or document

penalty under section 271AA at 2% of the value of each transaction would be attracted.

Penalty@2% of value of specified domestic transaction would be attracted under section 271G for failure to furnish the prescribed information or document as required under section 92D(3) within the period of 30 days from the date of receipt of notice or the extended period not exceeding another 30 days, as the case may be.

(viii) **Market value to be the arm's length price of goods or services in a specified domestic transaction [Section 80A & 80-IA(8)]:** As per the provisions of section 80A(6), in a case where the goods or services held for the purpose of the undertaking or unit or enterprise or eligible business are transferred to any other business carried on by the assessee or where any goods or services held for the purposes of any other business carried on by the assessee are transferred to the undertaking or unit or enterprise or eligible business, the transfer price of such goods and services shall be determined at the market value of such goods or services as on the date of transfer.

Clause (iii) of *Explanation* to section 80A(6) clarifies that "market value" in relation to any goods or services sold, supplied or acquired, means the arm's length price as defined under section 92F of such goods or services, if it is a specified domestic transaction referred to in section 92BA i.e., the aggregate value of all such transaction specified in section 92BA exceeds ***₹ 20 crore***.

Therefore, in case the transfer of goods and services between undertaking or unit or enterprise or eligible business and any other business of the assessee takes place at the arm's length price, such arm's length price shall be the market value for the purpose of section 80A(6), and no further adjustment would be required in respect of the same, if the transaction is a specified domestic transaction.

(ix) Similarly, for the purpose of section 80-IA(8), the market value, in relation to any goods or services transferred between the eligible business and any other business carried on by the assessee, shall mean -

(1) the price that such goods or services would ordinarily fetch in the open market; or

(2) the arm's length price as defined under section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA.

(x) **Profit from transactions between an assessee carrying on "eligible business" and other assessees to be determined as per arm's length price [Section 80-IA(10)]:** Under section 80-IA(10), the Assessing Officer is empowered to make an adjustment while computing the profit and gains of the eligible business on the basis of the reasonable profit that can be derived from the transaction, in case the transaction between the assessee carrying on the eligible business under section 80-IA and any other person is so arranged that the transaction produces excessive profits to the eligible business.

It has been provided that if the aforesaid arrangement between the assessee carrying on the eligible business and any other person is a specified domestic transaction referred to in section 92BA, then, the amount of profit of such transaction shall be determined having regard to arm's length price as defined under section 92F and not as per the reasonable profit from such transaction.

(xi) **Transfer Pricing Rules made applicable to Specified Domestic Transactions as well [*Notification No. 41/2013 dated 10.06.2013*]**

With effect from A.Y 2013-14, the transfer pricing provisions have been extended to Specified Domestic Transactions. Accordingly, the transfer pricing rules prescribed for international transactions have been suitably amended to make the same applicable for specified domestic transactions, as well.

Rule No.	Particulars	Amendment
10A	Meaning of expressions used in computation of Arm's length price	**Definition of "associated enterprise" and "enterprise" included** **"Associated Enterprise"** shall - (i) have the same meaning as assigned to it in section 92A; and (ii) in relation to a specified domestic transaction entered into by an assessee, include - (A) other units or undertakings or businesses of such assessee in respect of a transaction referred to in section 80A or section 80-IA(8); (B) any other person referred to in section 80-IA(10) in respect of a transaction referred to therein; (C) other units, undertakings, enterprises or business of such assessee, or other person referred to in section 80-IA(10) or in respect of a transaction referred to in section 10AA or the transactions referred to in Chapter VI-A to which the provisions of section 80-IA(8) or section 80-IA(10) are applicable; **"Enterprise"** shall have the same meaning as assigned to it in clause (iii) of section 92F and shall, for the purposes of a specified domestic transaction, include a unit, or an enterprise, or an undertaking or a business of a person who undertakes such transaction.
10AB	Other methods of determination of ALP	This Rule provides that for the purpose of section 92C(1)(f), the other method for determination of the arm's length price in relation to an international transaction shall be any method which takes into account the price which has been charged or paid or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts. This Rule has now been made applicable to specified domestic transactions as well.
10B	Determination of ALP under section 92C	The methods for determination of arm's length price specified in this Rule for the purpose of section 92C(2) in relation to an international transaction shall also be made applicable in respect of specified domestic transactions.
10C	Most appropriate	Sub-rule (1) provides that, for the purposes of section 92C(1), the most appropriate method shall be the method which is best

	method	suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length price in relation to an international transaction. Sub-rule (2) specifies the factors to be taken into account in selecting the most appropriate method. This Rule is made applicable in respect of a specified domestic transaction as well.
10D	Information and documents to be kept and maintained under section 92D	Sub-rule (1) requires every person who has entered into an international transaction or specified domestic transaction to maintain the requisite information and documents as detailed thereunder. As per sub-rule (2), maintenance of information and documents shall not apply where the aggregate value of international transactions does not exceed ₹ 1 crore. However, sub-rule (1) shall be applicable for every specified domestic transaction irrespective of its value.
10E	Report from an accountant to be furnished under section 92E	This rule provides for submission of audit report from a chartered accountant by every person who has entered into an international transaction. This provision would also apply to a person entered into a specified domestic transaction as well.

(xii) **Safe Harbour Rules notified for Specified Domestic Transactions [Rule 10TH to Rule 10THD]**

Section 92CB(1) provides that the determination of arm's length price under section 92C or section 92CA shall be subject to safe harbour rules. Section 92CB(2) empowers the CBDT to prescribe safe harbour rules.

Safe harbour means circumstances in which the income tax authorities shall accept the transfer price declared by the assessee.

Accordingly, the CBDT has, in exercise of the powers conferred by section 92CB and 92D, read with section 295, inserted Rules 10TH, 10THA, 10THB, 10THC & 10THD providing the safe harbour rules for specified domestic transactions.

Rule	Rule heading	Particulars
10THA	Definitions: Appropriate Commission →	Meaning assigned to it in section 2(4) of the Electricity Act, 2003. Appropriate Commission means the Central Regulatory Commission referred to in sub-section (1) of section 76 or the State Regulatory Commission referred to in section 82 or the

	Government Company	Joint Commission referred to in section 83, as the case may be, of the Electricity Act, 2003. → Meaning assigned to it in section 2(45) of the Companies Act, 2013. Government company means any company in which not less than 51% of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.
10THA	Eligible assessee	• A person who has exercised a valid option for application of safe harbour Rules in accordance with the provisions of Rule 10THC, **AND** • is a Government company engaged in the business of generation, supply, transmission or distribution of electricity; or • is a co-operative society engaged in the business of procuring and marketing milk and milk products.
10THB	Eligible Specified Domestic Transaction	A specified domestic transaction undertaken by an eligible assessee and which comprises of: (i) supply of electricity; or (ii) transmission of electricity; or (iii) wheeling of electricity; or (iv) purchase of milk or milk products by a co-operative society from its members.
10THC	Safe harbour	(1) Where an eligible assessee has entered into an eligible specified domestic transaction in any previous year relevant to an assessment year and the option exercised by the said assessee is treated to be validly exercised under Rule 10THD, the transfer price declared by the assessee in respect of such transaction for that assessment year shall be accepted by the income-tax authorities, if it is in accordance with the circumstances specified in Rule 10THC(2). (2) The following are the circumstances in respect of the eligible specified domestic transaction.

S. No.	Eligible specified domestic Transaction	Circumstances
1	Supply of electricity, transmission of electricity, wheeling of electricity	The tariff in respect of supply of electricity, transmission of electricity, wheeling of electricity, as the case may be, is determined or the methodology for determination of the tariff is approved by the Appropriate Commission in accordance with the provisions of the Electricity Act, 2003.
2	Purchase of milk or milk products by a co-operative society from its members	The price of milk or milk products is determined at a rate which is fixed on the basis of the quality of milk, namely, fat content and Solid Not Fat (SNF) content of milk; and – (a) the said rate is irrespective of,- (i) the quantity of milk procured; (ii) the percentage of shares held by the members in the co-operative society; (iii) the voting power held by the members in the society; and (b) such prices are routinely declared by the co-operative society in a transparent manner and are available in public domain.

(3) No comparability adjustment and allowance under the second proviso to section 92C(2) shall be made to the transfer price declared by the eligible assessee and accepted by the income-tax authority.

(4) The provisions of sections 92D relating to maintenance and keeping of information and document and section

		92E for submission of report from an accountant in respect of a specified domestic transaction shall apply irrespective of the fact that the assessee exercises his option for safe harbour in respect of such transaction.
10THD	Procedure	**Furnishing of Form 3CEFB** The assessee has to furnish Form 3CEFB, complete in all respects, to the Assessing Officer on or before the due date for furnishing the return of income for the relevant assessment year specified in *Explanation 2* to section 139(1), for exercising the option of safe harbour. The return of income should be furnished on or before the date of submitting the Form 3CEFB. **Verification by the Assessing Officer** Before treating the option for safe harbor by the assessee as validly exercised, the Assessing Officer has to verify whether the assessee exercising the option is an eligible assessee and the transaction in respect of which the option is exercised is an eligible specified domestic transaction. **Furnishing of documents or information required by the Assessing Officer** Assessing Officer may issue a notice to the assessee to furnish such information or documents or other evidence as he may consider necessary. The assessee has to furnish the same within the specified time in such notice. **Circumstances when option exercised can be declared Invalid** The Assessing Officer shall, by order in writing, declare the option exercised by the assessee as invalid and cause a copy of the order to be served on the assessee if – (i) the assessee does not furnish the information or documents or other evidence required by the Assessing Officer (ii) the Assessing Officer finds that the assessee is not an eligible assessee (iii) the Assessing Officer finds that the specified domestic transaction in respect of which option has been exercised is not an eligible specified domestic transaction (iv) the tariff is not in accordance with the circumstances specified in Rule 10THC.

		Order by Assessing Officer The Assessing Officer shall pass the order declaring the option exercised by the assessee as invalid within a period of 3 months from the end of the month in which Form 3CEFB is received by him. No order can be passed declaring the option exercised by the assessee invalid unless an opportunity of being heard is given to him. **Filling of objections against the order of Assessing Officer by the assessee** If the assessee objects to the order of the Assessing Officer declaring the option to be invalid, he may file his objections with the Principal Commissioner or the Commissioner or the Principal Director or the Director, as the case may be, to whom the Assessing Officer is subordinate, **within 15 days of receipt of the order of the Assessing Officer**. On receipt of objection, the Principal Commissioner or Commissioner or Principal Director or Director, as the case may be, shall, after providing an opportunity of being heard to the assessee, pass appropriate order, **within a period of 2 months from the end of the month** in which the objection filed by the assessee is received by him, in respect of the validity or otherwise of the option exercised by the assessee. A copy of the said order has to be served on the assessee and the Assessing Officer. If the Assessing Officer or the Principal Commissioner or the Commissioner or the Principal Director or the Director, as the case may be, does not pass an order within the specified time, then the option for safe harbour exercised by the assessee shall be treated as valid.

(xiii) **Information and documents to be kept and maintained under section 92D in case of an eligible assessee referred to in Rule 10THA in respect of eligible specified domestic transaction [Rule 10D(2A)]:**

Section 92D(1)(i) provides that every person who has entered into an international transaction or specified domestic transaction shall keep and maintain prescribed information and document.

Rule 10D(1) provides for information and documents to be maintained under section 92D. Sub-rule (2A) in Rule 10D provides that nothing contained in Rule 10D(1) in so far as it relates to specified domestic transaction referred to in Rule 10THB, shall apply in the case of an eligible assessee referred to in Rule 10THA.

The information and documents to be maintained by an eligible assessee referred to in Rule 10THA relating to an eligible specified domestic transaction referred to in Rule 10THB are given in Rule 10D(2A) as follows:

Rule	Eligible Assessee	Information and documents to be kept and maintained
10THA(i)	A government company engaged in the business of generation, supply, transmission or distribution of electricity	(i) a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises; (ii) 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; (iii) the nature and terms (including prices) of specified domestic transactions entered into with each associated enterprise and the quantum and value of each such transaction or class of such transaction; (iv) a record of proceedings, if any, before the regulatory commission and orders of such commission relating to the specified domestic transaction; (v) a record of the actual working carried out for determining the transfer price of the specified domestic transaction; (vi) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the transfer price; and (vii) any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the transfer price.
10THA(ii)	A co-operative society engaged in the business of procuring and marketing milk and milk products	(i) a description of the ownership structure of the assessee co-operative society with details of shares or other ownership interest held therein by the members; (ii) description of members including their addresses and period of membership; (iii) the nature and terms (including prices) of specified domestic transactions entered into with each member and the quantum and value of each such

		transaction or class of such transaction; (iv) a record of the actual working carried out for determining the transfer price of the specified domestic transaction; (v) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the transfer price; (vi) the documentation regarding price being routinely declared in transparent manner and being available in public domain; and (vii) any other information, data or document which may be relevant for determination of the transfer price.
The above information should be supported by authentic documents. Both the information and documents must be contemporaneous and should exist latest by the due date of filing return under section 139(1) i.e., 30th November of the assessment year. Such information and documents have to be kept ad maintained for a period of eight years from the end of the relevant assessment year.		

1.6 TRANSFER OF INCOME TO NON RESIDENTS [SECTION 93]

Section 93 hits at transactions which are effected with a view to avoiding liability to taxation. For the purpose, the word “non-resident” also includes a person who is not-ordinarily resident. In order to attract the provisions of this section, all the following conditions must be satisfied:

(a) There is a transfer of assets - whether movable or immovable and whether tangible or intangible.

(b) The transfer is made by any person in India or outside irrespective of his residential status or citizenship.

(c) The transfer is made either alone or in connection with associated operations.

(d) The assets transferred directly yield income chargeable to tax under this Act.

(e) The transfer of assets is effected in such a manner that the income becomes payable to a person outside India who is either a non-resident or a not ordinarily resident in India.

(f) The transferor acquires any right by virtue of which he gets the power to enjoy the income whether immediately or in future.

(g) The Assessing Officer is satisfied that avoidance of liability to tax in India is the purpose of the transfers.

In particular, this section deems any income of a non-resident person which, if it were the income of a resident person, would be chargeable to tax in India (in the absence of this Section), as the income of the resident person in India for all purposes of the Act provided that all the conditions stated above are satisfied. This section also covers a variety of transactions constituting a transfer including cases where assets are transferred to a non-resident person and the transferor indirectly derives income under the guise of obtaining loans or repayment of loans. If the aforesaid conditions are fulfilled, the income from the assets transferred should be treated as the income of the transferor and would accordingly be taxable in his hands. Therefore, where assets are transferred to a body corporate outside India, in consideration of shares allotted by it to the transferor, he (the transferor), will become assessable under this section in respect of the income of the company derived by it from those assets. This section will not, however, apply to cases where it is shown to the satisfaction of the Assessing Officer that (i) neither the transfer nor any associated operation had for its purpose or for one of its purposes the avoidance of liability to taxation or (ii) it is provided to the satisfaction of the Assessing Officer that the transfer was effected for *bonafide* commercial purpose and with no intent to avoid tax.

The income which is deemed to be that of the transferor under this section may also arise as a result of the transfer in connection with associated operations. However, in this case also, the treatment of the income would be the same.

Meaning of "associated operation": The expression 'associated operation," in relation to a transfer, means an operation of any kind effected by any person in relation to:

(i) any of the assets transferred;

(ii) any assets representing, whether directly or indirectly, any of the assets transferred;

(iii) any income arising from such assets;

(iv) any assets representing, whether directly or indirectly, the accumulation of income arising from such assets.

Meaning of "Assets": It includes property or rights of any kind.

Meaning of "transfer": In relation to rights, transfer includes the creation of those rights.

Meaning of "benefit": It includes a payment of any kind.

In order to determine the liability of the assessee in respect of the deemed income it is immaterial if the income or benefits from the transfer (i) are actually received or not or (ii) are received or are receivable in cash or kind or (iii) are receivable directly or indirectly. For purposes of this section, a person is deemed to have the power to enjoy the income of a non-resident if:

(i) the income, in fact, so dealt with by any person as to be calculated at some point of time to enure for the benefit of the transferor, whether in the same form of the income or otherwise;

(ii) the receipt or accrual of the income operates to increase value of any assets held by the transferor or for his direct or indirect benefit;

(iii) the transferor receives or is entitled to receive at any time any benefit out of the income or out of any money available for the purpose by reason of the effect or successive effects of the associated operations on that income and the assets which represent that income;

(iv) the transferor is in a position to obtain for himself the beneficial enjoyment of the income by exercising any power of appointment or power of revocation or otherwise, whether with or without the consent of any other person, or

(v) the transferor is able to control directly or indirectly the application of the income in any manner whatsoever.

However, in determining whether a person has the power to enjoy the income due regard shall be had to the substantial result and effect of the transfer and any associated operations must be taken into consideration irrespective of the nature or form of the benefits.

It may be noted that where an assessee has been charged to tax in respect of a sum deemed to be his income under this section, the subsequent receipt of that sum by the assessee, whether as income or in any other form, shall not be liable to tax in his hands at the time of receipt.

1.7 TRANSACTIONS IN SECURITIES [SECTION 94]

Section 94 aims at preventing avoidance of tax by an assessee by sale or purchase of securities in devices and under different circumstances. In all cases where there is a transfer of shares or securities before the due date of payment of interest whereby the transferor avoids tax or shifts the burden of tax to some other person, the income from the securities transferred shall be deemed to be that of the transferor and shall be assessable in his hands accordingly.

Bond washing transactions: Bond washing transactions, i.e. cases of sale of securities and shares cum-interest or cum-dividend would fall within the provisions of the section. Income by way of interest on securities or dividends does not accrue day by day but on a certain fixed date or on the date of declaration, as the case may be. Accordingly, the seller of securities cum-interest or shares cum-dividends, on accrual of the interest, is not assessable on the interest or dividend income on the securities or shares sold by him since that part of the consideration received would be part of the capital price realised on sale. As a result, if a person, on the eve of payment of interest, sells or otherwise transfers his securities to another and buys back or re-acquires the same after the interest income had been received by the transfer would escape tax thereon. This would amount to either total avoidance of tax or shifting the burden of tax by the transferor indirectly and transactions of this type are commonly known as bond washing transaction. In order to prevent this type of avoidance of tax by the assessee, it has been specifically provided that where the owner of any shares or securities sells or otherwise transfers them and then buys them back or otherwise re-acquires them, the interest received by the transferee shall be the income of the transferor.

Similarly, in cases where shares or securities are sold by the owner of such shares or securities or by a person having beneficial interest therein and, as a result of the sale, the transferor receives either no income or less income from the securities or shares than that which would have been received by him, had the sale not been made, then the income from such securities or shares of such year shall be deemed to be the income of the transferor. Thus, this provision applies only to cases where

(i) the income accrues or falls due periodically and

(ii) the income in question is of a recurring nature, though the interval of time between the two dates of accrual may not equal (e.g., dividends).

However, the notional dividends specified in section 2(22) would not be covered by this section and the assessment of such fictional dividends should be made only in the hands of the person who is entitled to the same and not in the hands of the transferor.

There is however, one exception to both the above provisions given in sub-section (3). According to the exception, the above provisions would not apply (i) if there has been no avoidance of tax, (ii) if the avoidance was exceptional and not systematic and there was no avoidance of income-tax by the assessee during the three years immediately preceding the previous year. It is for the assessee to prove to the satisfaction of the Assessing Officer that there had been no avoidance of tax or that the avoidance of tax is exceptional and not systematic.

Where any person carrying on business, wholly or in part, as a dealer in shares and securities, buys or acquires any security and sells back or re-transfers the same, then, the interest, received or receivable by him in respect of such securities, which is deemed to be the income of the transferor, shall not be taken into account for computing his business income.

The Assessing Officer is empowered to issue a notice in writing requiring any person to furnish to him within a specified time (not being less than 28 days) in respect of all securities of which such person was the owner or in which he had a beneficial interest at any time during the period specified by him in the notice, such particulars at he may consider necessary for purposes of this Section and for the purpose of ascertaining whether tax has been borne in respect of interest or dividends on all those securities or shares.

(a) If any person buys or acquires any securities or unit within a period of three months prior to the record date and

(b) such person sells or transfers –

    (i) such securities within a period of three months after such date, or

    (ii) such unit within a period of nine months after such date and

(c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then, the loss, if any, arising therefrom shall be ignored for the purposes of computing his income chargeable to tax. Such loss should not exceed the amount of dividend or income received or receivable on such securities or unit [Sub-section (7)].

Where

(a) any person buys or acquires any units within a period of three months prior to the record date;

(b) such person is allotted additional units without any payment on the basis of holding such units on such date;

(c) such person sells or transfers all or any of the units referred to in (a) above within a period of nine months after such date, while continuing to hold all or any of the additional units referred to in (b), then –

  (i) the loss on sale of original units sold within a period of 9 months after the record date will be ignored and

  (ii) the amount of such loss will be considered as the cost of purchase or acquisition of the bonus units held by him on the date of such sale or transfer.

For the purposes of this section,-

	Term	Meaning
(i)	Interest	Interest includes dividend
(ii)	Record date	Such date as may be fixed by - (i) A company for the purposes of entitlement of the holder of the securities to receive dividend; or (ii) A mutual fund or the Administrator of the specified undertaking or the specified company as referred to in the *Explanation* to section 10(35), for the purposes of entitlement of the holder of the units to receive income, or additional unit without any consideration, as the case may be.
(iii)	Securities	The term includes stocks and shares.
(iv)	Unit	Unit of a mutual fund specified in section 10(23D) or unit of the Unit Trust of India.

1.8 INTRODUCTION OF SPECIFIC ANTI AVOIDANCE MEASURES IN RESPECT OF TRANSACTIONS WITH PERSONS LOCATED IN NOTIFIED JURISDICTIONAL AREA [SECTION 94A]

The objective of anti-avoidance measures is to discourage assessees from entering into transactions with persons located in countries or territories which do not have effective information exchange mechanism with India. The following are the anti-avoidance measures introduced -

(i) The Central Government empowered to notify any such country or territory outside India as a NJA (Notified Jurisdictional Area), having regard to the lack of effective exchange of information with such country or territory.

> ***Clarification on removal of Cyprus from the list of notified jurisdictional area under section 94A of the Income-tax Act, 1961 – [Circular No. 15/2017, dated 21-04-2017]***
>
> *Cyprus was specified as a "notified jurisdictional area" (NJA) under section 94A of the Income-tax Act, 1961 vide Notification No. 86/2013 dated 01.11.2013. The said Notification No. 86/2013 was subsequently rescinded vide Notification No. 114 dated 14.12.2016 and Notification No. 119 dated 16.12.2016 with effect from the date of issue of the notification.*
>
> *The CBDT has, vide this Circular, clarified that Notification No. 86/2013 has been rescinded with effect from the date of issue of the said notification, thereby, removing Cyprus as a notified jurisdictional area with retrospective effect from 01.11.2013.*

(ii) A transaction where one of the parties thereto is a person located in a NJA would be deemed to be an international transaction then all parties to the transaction to be deemed as associated enterprises, and accordingly, all the provisions of transfer pricing to be attracted in case of such a transaction. However, the benefit of permissible variation between the ALP and the transfer price [provided for in the second proviso to section 92C(2)] based on the rate notified by the Central Government would not be available in respect of such transaction.

(iii) Such transaction may be in the nature of –

(1) purchase, sale or lease of tangible or intangible property or

(2) provision of service or

(3) lending or borrowing money or

(4) any other transaction having a bearing on the profits, income, losses or assets of the assessee. It may include a mutual agreement or arrangement for allocation or apportionment of, or contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided by or to the assessee.

(iv) Person located in a NJA shall include a person who is a resident of the NJA and a person, not being an individual, which is established in the NJA. It would also include a permanent establishment of any other person in the NJA.

(v) Payments made to any financial institution located in a NJA would not be allowed as deduction unless the assessee authorizes the CBDT or any other income-tax authority acting on its behalf to seek relevant information from the financial institution on behalf of the assessee.

(vi) No deduction in respect of any other expenditure or allowance, including depreciation, arising from the transaction with a person located in a NJA would be allowed unless the assessee maintains the relevant documents and furnishes the prescribed information.

(vii) Any sum credited or received from a person located in a NJA to be deemed to be the income of the recipient-assessee if he does not explain satisfactorily the source of such money in the hands of such person or in the hands of the beneficial owner, if such person is not the beneficial owner.

(viii) The rate of TDS in respect of any payment made to a person located in the NJA, on which tax is deductible at source, will be the higher of the following rates –

(1) rates specified in the relevant provision of the Income-tax Act, 1961; or

(2) rate or rates in force; or

(3) 30%.

ILLUSTRATION 1

A Ltd., an Indian company, provides technical services to a company, XYZ Inc., located in a NJA for a consideration of ₹ 40 lakhs in October, 2019. It charges ₹ 42 lakhs for similar services rendered to PQR Inc., which is not located in a NJA. PQR Inc. is not an associated enterprise of A Ltd.

Discuss the tax implications under section 94A read with section 92C in respect of the above transaction of provision of technical services by A Ltd. to XYZ Inc.

SOLUTION

Since XYZ Inc. is located in a NJA, the transaction of provision of technical services by the Indian company, A Ltd., would be deemed to be an international transaction and XYZ Inc. and A Ltd. would be deemed to be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

The price of ₹ 42 lakhs charged for similar services from PQR Inc, being an independent entity located in a non-NJA country, can be taken into consideration for determining the arm's length price (ALP) under Comparable Uncontrolled Price (CUP) Method.

Since the ALP is more than the transfer price, the ALP of ₹ 42 lakhs would be considered as the income arising from the international transaction between A Ltd. and XYZ Inc.

It may be noted that the benefit of permissible variation between the ALP and transfer price is not available in respect of a transaction entered into with an entity in NJA.

ILLUSTRATION 2

Mr. X, a non-resident individual, is due to receive interest of ₹ 5 lakhs during March 2020 from a notified infrastructure debt fund eligible for exemption under section 10(47). He incurred expenditure amounting to ₹ 10,000 for earning such income. Assuming that Mr. X is a resident of a NJA, discuss the tax implications under section 94A, read with sections 115A and 194LB.

SOLUTION

The interest income received by Mr. X, a non-resident, from a notified infrastructure debt fund would be subject to a concessional tax rate of 5% under section 115A on the gross amount of such interest income. Therefore, the tax liability of Mr. X in respect of such income would be ₹ 26,000 (being 5% of ₹ 5 lakhs *plus* health and education cess@4%).

Under section 194LB, tax is deductible @5% (*plus* health and education cess@4%) on interest paid by such fund to a non-resident. However, since X is a resident of a NJA, tax would be deductible@30% (*plus* health and education cess@4%) as per section 94A, and not @5% specified under section 194LB. This is on account of the provisions of section 94A(5), which provides that "**Notwithstanding anything contained in any other provision of this Act,** where a person located in a NJA is entitled to receive any sum or income or amount on which **tax is deductible under Chapter XVII-B,** the **tax shall be deducted at the highest of the following rates**, namely–

(a) at the rate or rates in force;

(b) at the rate specified in the relevant provision of the Act;

(c) at the rate of thirty per cent."

Mr. X can, however, claim refund of excess tax deducted along with interest.

1.9 LIMITATION OF INTEREST DEDUCTION IN CERTAIN CASES [SECTION 94B]

(1) **Preference of debt over equity as a measure to finance businesses**: Debt and equity are the instruments through which a company is generally financed or capitalized. The manner in which a company is capitalized has a major impact on the amount of taxable profit as the tax laws of countries generally provide for a deduction in respect of interest paid or payable while arriving at the taxable profit. However, the dividend paid on equity contribution is not deductible. Therefore, the higher the level of debt in a company, and thus, the amount of interest it pays, the lower will be its taxable income. Due to this reason, debt is considered a more tax efficient method of finance than equity. Multinational groups are often able to structure their financing arrangements to maximize tax benefits.

(2) **Tax Rules to prevent shifting of profits through excessive interest payments**: In order to address this issue, tax rules are in place in each country to fix a ceiling limit on the amount of interest deductible in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, with the objective of protecting a country's tax base.

(3) **Relevant Action Plan of BEPS**: Under the initiative of the G-20 countries, the Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting

(BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in Action Plan 4 and recommended certain measures in its final report.

(4) **Insertion of provision in the Income-tax Act, 1961 in line with BEPS Action Plan 4**: Section 94B has, accordingly, been inserted in the Income-tax Act, 1961, in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest expenses claimed by an entity to its associated enterprises shall not be deductible in computation of income under the "Profits and gains of business or profession" to the extent that it arises from excess interest.

Excess interest shall mean an amount of

- total interest paid or payable* in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or
- interest paid or payable to associated enterprise for that previous year

whichever is less.

**Total interest paid or payable may be interpreted as interest paid or payable to non-resident associated enterprise as per the intent expressed in section 94B(1) and also the Explanatory Memorandum to the Finance Bill, 2017.*

(5) **Applicability**: The provision shall be applicable to an Indian company, or a permanent establishment of a foreign company in India, being the borrower who incurs expenditure by way of interest or similar nature in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower.

However, the provision of this section would be applicable only where the expenditure by way of interest or of similar nature exceeds **₹ 1 crore,** in respect of any form of debt issued by a non-resident, being an 'associated enterprise' of such borrower.

(6) **Meaning of debt**: Any loan, financial instrument, finance lease, financial derivative, or any arrangement that gives rise to interest, discounts or other finance charges that are deductible in the computation of income chargeable under the head "Profits and gains of business or profession".

(7) **Provision of guarantee and deposit of matching amount deemed to be debt issued**: Where the debt is issued by a lender which is not associated but an associated enterprise either

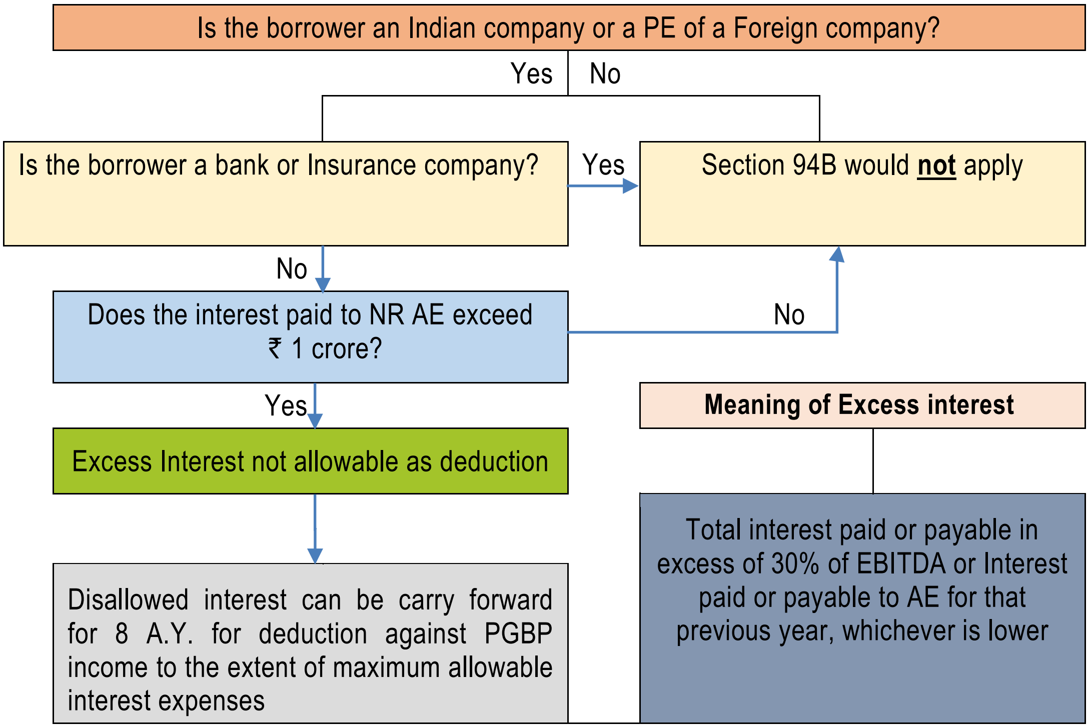
- provides an implicit or explicit guarantee to such lender or
- deposits a corresponding and matching amount of funds with the lender,

such debt shall be deemed to have been issued by an associated enterprise.

(8) **Carry forward of excess interest**: The disallowed interest expense can be carried forward upto eight assessment years immediately succeeding the assessment year for which the disallowance was first made and claimed as deduction against the income computed under the head "Profits and gains of business or profession” to the extent of maximum allowable interest expenditure.

(9) **Businesses excluded from applicability of the provisions of section 94B**: Taking into consideration the special nature of business of Banks and Insurance business, an Indian company or permanent establishment of a foreign company which is engaged in these business have been excluded from the applicability of the provisions of this section.

Limitation of interest deduction (Section 94B): A Summary



Is the borrower an Indian company or a PE of a Foreign company?

Is the borrower a bank or Insurance company?

Section 94B would **not** apply

Does the interest paid to NR AE exceed ₹ 1 crore?

Excess Interest not allowable as deduction

Disallowed interest can be carry forward for 8 A.Y. for deduction against PGBP income to the extent of maximum allowable interest expenses

Meaning of Excess interest

Total interest paid or payable in excess of 30% of EBITDA or Interest paid or payable to AE for that previous year, whichever is lower

EXERCISE

Question 1

Examine the consequences that would follow if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment?

Answer

In case the Assessing Officer makes adjustment to arm's length price in an international transaction which results in increase in taxable income of the assessee, the following consequences shall follow:-

(1) No deduction under section 10AA or Chapter VI-A shall be allowed from the income so increased.

(2) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:-

(1) In case the assessee is an eligible assessee under section 144C, he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Assessing Officer in pursuance of the directions of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.

(2) In any other case, he can file an appeal under section 246A to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.

(3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within one year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

Question 2

I. Limited, an Indian Company supplied billets to its holding company, U. Limited, UK during the previous year 2019-20. I. Limited also supplied the same product to another UK based company, V. Limited, an unrelated entity. The transactions with U. Limited are priced at Euro 500 per MT (FOB), whereas the transactions with V. Limited are priced at Euro 700 per MT (CIF). Insurance *and Freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with U. Limited.*

Answer

In this case, I. Limited, the Indian company, supplied billets to its foreign holding company, U. Limited. Since the foreign company, U. Limited, is the holding company of I. Limited, I. Limited and U. Limited are the associated enterprises within the meaning of section 92A.

As I. Limited supplies similar product to an unrelated entity, V. Limited, UK, the transactions between I. Limited and V. Limited can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between I. Limited and U. Limited Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

Transactions with U. Limited are on FOB basis, whereas transactions with V. Limited are on CIF basis. This difference has to be adjusted before comparing the prices.

	Amount (in Euro)
Price per MT of billets to V. Limited	700
Less: Cost of insurance and freight per M.T.	200
Adjusted Price per M.T.	500

Since the adjusted price for V. Limited, UK and the price fixed for U. Limited are the same, the arm's length price is Euro 500 per MT. Since the sale price to related party (i.e., U. Limited) and unrelated party (i.e., V. Limited) is the same, the transaction with related party U. Limited has also been carried out at arm's length price.

Question 3

X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% shares of X Ltd. and out of 7 directors of the company, 4 were appointed by them. The Assessing Officer, after verification of international transactions of ₹ 300 lacs of X Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accountants report, adjusted its income by making an addition of ₹ 30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd seeks your expert opinion.

Answer

The facts of the case indicate that X Ltd. and Yen Ltd. of Japan are associated enterprises since Yen Ltd. holds 55% shares of X Ltd. and has appointed more than half of the board of directors of X Ltd. Since Yen Ltd. is a non-resident, any transaction between X Ltd. and Yen Ltd. would fall within the meaning of "international transaction" under section 92B. Therefore, the income arising from such transactions have to be computed having regard to the arm's length price.

The action of the Assessing Officer in making addition to the declared income and issuing show cause notice for levy of various penalties is correct since X Ltd. had committed defaults, as listed hereunder, in respect of which penalty, as briefed hereunder, is imposable -

(i) Failure to report any international transaction or any transaction, deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X applies, would attract penalty @ 200% of the amount of tax payable since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).

(ii) Failure to maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which will be 2% of the value of each international transaction.

(iii) Failure to furnish report from an accountant as required under section 92E makes it liable for penalty under section 271BA i.e., a fixed penalty of ₹ 1 Lac.

The Assessing Officer shall give an opportunity of hearing to the assessee with a notice as to why the arm's length price should not be determined on the basis of material or information or document in the possession of the Assessing Officer.

Note: *It is assumed that X Ltd. has not entered into an APA and has also not opted to be subject to Safe Harbour Rules.*

Question 4

Anush Motors Ltd., an Indian company declared income of ₹ 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2020:

(i) 10,000 cars sold to Rida Ltd., US company, which holds 30% shares in Anush Motors Ltd. at a price which is less by $ 200 each car than the price charged from Shingto Ltd.

(ii) Royalty of $ 1,20,00,000 was paid to Kyoto Ltd., a US company, for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for $ 90,00,000.

(iii) Loan of Euro 1000 crores carrying interest @10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2020. The total book value of assets of Anush Motors Ltd. on the date was ₹ 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y.2020-21 keeping in mind that the value of 1$ and of 1 EURO was ₹ 63 and ₹ 84, respectively, throughout the year.

Answer

Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.

Section 92A defines an "associated enterprise" and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that "Anush Motors Ltd." is associated with :-

(i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;

(ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

(iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Anush Motors Ltd.

The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2020-21.

	Particulars	₹ (in crores)
Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X		300.00
Add:	Difference on account of adjustment in the value of international transactions:	
(i)	Difference in price of car @ $ 200 each for 10,000 cars ($ 200 x 10,000 x ₹ 63)	12.60
(ii)	Difference for excess payment of royalty of $ 30,00,000 ($ 30,00,000 x ₹ 63) [See Note below]	18.90
(iii)	Difference for excess interest paid on loan of EURO 1000 crores (₹ 84*1000*1/100)	840.00
Total Income		**1,171.50**

The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Anush Motors Ltd is wholly dependent on the use of know-how owned by Kyoto Ltd.

***Note**: It is presumed that Anush Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.*

Question 5

What is the legislative objective of bringing into existence the provisions relating to transfer pricing in relation to international transactions? Examine.

Answer

The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing.

There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue. Therefore, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

Question 6

R, an individual resident in India, bought 1,000 equity shares of ₹ 10 each of A Ltd. at ₹ 50 per share on 30.5.2019. He sold 700 equity shares at ₹ 35 per share on 30.9.2019 and the remaining 300 shares at ₹ 25 per share on 20.12.2019. A Ltd. declared a dividend of 50%, the record date being 10.8.2019. R sold on 1.2.2020, a house from which he derived a long-term capital gain of ₹ 75,000.

Compute the amount of capital gain arising to R for the assessment year 2020-21.

Answer

The amount of capital gains arising to R has to be computed applying the provisions of section 94(7), which provides that where:

(a) any person buys or acquires any securities or unit within a period of three months prior to the record date; and

(b) such person sells or transfers -

  (i) such securities within a period of three months after such date; or

  (ii) such unit within a period of nine months after such date; and

(c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then the loss, if any, arising to him on account of such purchase and sale of securities or unit, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or unit, shall be ignored for the purpose of computing his income chargeable to tax".

For this purpose, "record date" means such date as may be fixed by a company for the purpose of entitlement of the holder of the securities to receive dividend; "securities" includes stocks and shares.

Computation of capital gains of Mr. R for the assessment year 2020-21

Particulars	₹	₹
Long-term capital gain on sale of building		75,000
Less: Short-term capital loss on sale of shares		
700 shares	7,000	
300 shares	7,500	14,500
Taxable long-term capital gains		**60,500**

Computation of capital gain on sale of shares of A Ltd. by Mr. R

Date of purchase of shares		30.5.2019
Record date		10.8.2019
Date of sale of shares	30.9.2019	20.12.2019
Number of shares sold	700	300
Sale price per share	₹ 35	₹ 25

Particulars	₹	₹
Sale consideration	24,500	7,500
Less: Cost of acquisition	35,000	15,000
	10,500	7,500
Less: Dividend income as per section 94(7)[700×₹10×50%] [See Note below]	3,500	-
Short-term capital loss on sale of shares	**7,000**	**7,500**

Note:

(1) 700 shares are sold within 3 months after the record date. Hence, as per section 94(7), the related dividend income should be deducted from the loss.

(2) 300 shares having been sold after 3 months of record date, section 94(7) is not attracted. Therefore, the dividend income of ₹ 1,500 [300×₹10×50%] should not be deducted. Such dividend is exempt under section 10(34).

(3) Short-term capital loss can be set-off against long-term capital gains as per the provisions of section 74(1)(a). Therefore, short-term capital loss on sale of shares can be set-off against long-term capital gains on sale of building.

Question 7

XE Ltd. is an Indian Company in which Zilla Inc., a US company, has 28% shareholding and voting power. Following transactions were effected between these two companies during the financial year 2019-20.

(i) XE Ltd. sold 1,00,000 pieces of T-shirts at $ 2 per T-Shirt to Zilla Inc. The identical T-Shirts were sold to unrelated party namely Kennedy Inc., at $ 3 per T-Shirt.

(ii) XE Ltd. borrowed $ 2,00,000 from a foreign lender based on the guarantee of Zilla Inc. For this, XE Ltd. paid $ 10,000 as guarantee fee to Zilla Inc. To an unrelated party for the same amount of loan, Zilla Inc. collected $ 7000 as guarantee fee.

(iii) XE Ltd. paid $15,000 to Zilla Inc. for getting various potential customers details to improve its business. Zilla Inc. provided the same service to unrelated parties for $ 10,000.

Assume the rate of exchange as 1 $ = ₹ 64

XE Ltd. is located in a Special Economic (SEZ) and its income before transfer pricing adjustments for the year ended 31st March, 2020 was ₹ 1,200 lakhs.

Compute the adjustments to be made to the total income of XE Ltd. Assuming that such adjustments are made by the Assessing Officer, state whether it can claim deduction under section 10AA for the income enhanced by applying transfer pricing provisions.

Answer

XE Ltd, the Indian company and Zilla Inc., the US company are deemed to be associated enterprises as per section 92A(2)(a), since Zilla Inc. holds shares carrying not less than 26% of the voting power in XE Ltd.

As per *Explanation* to section 92B, the transactions entered into between these two companies for sale of product, lending or guarantee and provision of services relating to market research are included within the meaning of “international transaction”.

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm’s length price. In this case, from the information given, the arm’s length price has to be determined taking the comparable uncontrolled price method to be the most appropriate method.

Particulars		₹ in lakhs
Amount by which total income of XE Ltd. is enhanced on account of adjustment in the value of international transactions:		
(i)	Difference in price of T-Shirt @ $ 1 each for 1,00,000 pieces sold to Zilla	64.00

	Inc. ($ 1 x 1,00,000 x ₹ 64)	
(ii)	Difference for excess payment of guarantee fee to Zilla Inc. for loan borrowed from foreign lender ($ 3,000 x ₹ 64)	1.92
(iii)	Difference for excess payment for services to Zilla Inc. ($ 5,000 x ₹ 64)	3.20
		69.12
XE Ltd. cannot claim deduction under section 10AA in respect of ₹ 69.12 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4)		

Question 8

Examine the correctness or otherwise of the following with reference to the provisions of the Income-tax Act, 1961

(i) *Transfer pricing rules shall have no implication where income is computed on the basis of book profits.*

(ii) *Assessing Officer can complete the assessment of income from international transaction in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of assessee.*

Answer

(i) The statement is correct.

For the purpose of computing book profit for levy of minimum alternate tax, the net profit shown in the statement of profit and loss prepared in accordance with the Companies Act can be increased/ decreased only by the additions and deductions specified in *Explanation 1* below section 115JB(2).

No other adjustments can be made to arrive at the book profit for levy of MAT, except where:

(a) it is discovered that the statement of profit and loss is not drawn up in accordance with the relevant Schedule of the Companies Act

(b) incorrect accounting policies and/or accounting standards have been adopted for preparing such accounts; and

(c) the method and rate of depreciation adopted is not correct.

Therefore, transfer pricing adjustments cannot be made while computing book profit for levy of MAT.

(ii) The statement is not correct.

Section 92CA(4) provides that on receipt of the order of the Transfer Pricing Officer determining the arm's length price of an international transaction, the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer.

The order of the Transfer Pricing Officer is binding on the Assessing Officer. Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer by accepting the contention raised by the assessee.

CHAPTER 2

NON RESIDENT TAXATION

LEARNING OUTCOMES

After studying this Chapter, you will be able to –

- **determine** the residential status of foreign companies applying the Place of Effective Management (POEM) Guidelines;
- **examine** the scope of income taxable in the hands of non-residents;
- **examine** when income arising in the hands of non-resident from a transaction is deemed to accrue or arise in India;
- **appreciate** the circumstances when the presence of eligible fund manager in India would not constitute business connection in India for an eligible investment fund;
- **identify** whether a particular income is exempt in the hands of a non-resident based on the provisions of the Income-tax Act, 1961;
- **compute** the profits and gains from shipping business, business of operation of aircraft, business of civil construction etc. in certain turnkey power projects in the case of non-corporate non-residents and foreign company applying the presumptive tax provisions under the Income-tax Act, 1961;
- **determine** the quantum of head office expenditure allowable as deduction, in the case of non-residents;
- **determine** the tax payable by the non-residents on dividend, royalty and fees for technical service applying the special provisions of Chapter XII;
- **determine** the tax payable by non-residents applying the special provisions relating to certain incomes of non-residents prescribed under Chapter XII-A;
- **examine** the withholding tax provisions to determine the tax, if any, required to be deducted at source on certain payments made to non-residents;
- **compute** the total income of non-residents and tax payable thereon, applying the general provisions and special provisions applicable to non-residents under the Income-tax Act, 1961.

2.1 INTRODUCTION

Taxation of cross-border transactions are generally based on the two concepts:

1. Residence based taxation

2. Source based taxation

Residence based taxation: The concept of residence-based taxation asserts that natural persons or individuals are taxable in the country or tax jurisdiction in which they establish their residence or domicile, regardless of the source of income. In case of companies, the place of incorporation or the place of effective management is generally considered as its place of residence.

Source based taxation: According to this concept, a country considers certain income as taxable income, if such income arises within its jurisdiction. Such income is taxed in the country of source regardless of the residence of the taxpayer.

The overview of residence and source rules in India may largely be gathered from sections 5, 6 & 9 of the Income-tax Act, 1961. While residents are taxable on global income, non-residents are taxed on their India-source income or income that is received in India or has accrued or deemed to accrue in India.

The term "Non-resident" is defined under section 2(30) of the Income-tax Act, 1961 as a person who is not a "resident", and for the purposes of sections 92 ,93 and 168 includes a person who is not ordinarily resident within the meaning of clause (6) of section 6.

2.2 RESIDENTIAL STATUS AND SCOPE OF TOTAL INCOME

Section 6 contains the provisions for determining the residential status of a person, section 5 deals with scope of total income of resident, resident but not ordinarily resident and non-resident. The provisions of these sections except determination of residential status of foreign companies applying the Place of Effective Management (POEM) Guidelines are discussed in detail in Chapter 2: Residential Status and Scope of Total Income in Module 1 of Part I – Direct Tax Laws.

(1) Residential status of a Company

With effect from assessment year 2017-18, a company would be resident in India in any previous year, if-

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India.

> ***"Place of effective management"*** *means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made [Explanation to section 6(3)].*

Guiding Principles for determination of Place of Effective management ('POEM') of a Company, other than an Indian company – [Circular No. 6/2017, dated 24.01.2017 & Circular No. 8/2017, dated 23-02-2017]:

Place of effective management' (POEM) is an internationally recognised test for determination of residence of a company incorporated in a foreign jurisdiction. Most of the tax treaties entered into by India recognises the concept of 'place of effective management' for determination of residence of a company as a tie-breaker rule for avoidance of double taxation.

The CBDT has laid down the following guiding principles to be followed for determination of POEM.

Concept of Substance over form

Any determination of the POEM will depend upon the facts and circumstances of a given case. The POEM concept is one of substance over form. It may be noted that an entity may have more than one place of management, but it can have only one place of effective management at any point of time. Since "residence" is to be determined for each year, POEM will also be required to be determined on year to year basis.

Whether the company is engaged in active business outside India? - An important criterion for determination of POEM

The process of determination of POEM would be primarily based on the fact as to **whether or not the company is engaged in active business outside India.**

A company shall be said to be engaged in 'active business outside India'

- if passive income is not more than 50% of its total income, and
- less than 50% of its total asset are situated in India; and
- less than 50% of total number of employees are situated in India or are resident in India; and
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Meaning of certain terms:

Term	Meaning
Income	(a) As computed for tax purpose in accordance with the laws of the country of incorporation; or (b) As per books of account, where the laws of the country of incorporation does not require such a computation.

<table>
<tr><td rowspan="3">Value of assets</td><td>(a) In case of an individually depreciable asset</td><td>The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the previous year; and</td></tr>
<tr><td>(b) In case of pool of fixed asset, being treated as a block for depreciation</td><td>The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year;</td></tr>
<tr><td>(c) In case of any other asset</td><td>Value as per books of account</td></tr>
<tr><td>Number of employees</td><td colspan="2">The average of the number of employees as at the beginning and at the end of the year and shall include persons, who though not employed directly by the company, perform tasks similar to those performed by the employees.</td></tr>
<tr><td>Pay roll</td><td colspan="2">This term includes the cost of salaries, wages, bonus and all other employee compensation including related pension and social costs borne by the employer.</td></tr>
<tr><td>Passive income</td><td colspan="2">It is the aggregate of, -
(i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and
(ii) income by way of royalty, dividend, capital gains, interest or rental income;
However, any income by way of interest shall not be considered to be passive income in case of a company which is engaged in the business of banking or is a public financial institution, and its activities are regulated as such under the applicable laws of the country of incorporation.</td></tr>
</table>

Place of Effective Management:

(i) In case of Companies engaged in Active Business outside India

POEM of a company engaged in active business shall be presumed to be outside India if the majority of the board meeting are held outside India.

However, in case the Board is not exercising its powers of management and such powers are being exercised by either the holding company or any other person, resident in India, then POEM shall be considered to be in India.

For this purpose, merely because the Board of Directors (BOD) follows general and objective principles of global policy of the group laid down by the parent entity which may be in the field of Pay roll functions, Accounting, Human resource (HR) functions, IT infrastructure and network platforms, Supply chain functions, Routine banking operational procedures, and not being specific to any entity or group of entities per se; would not constitute a case of BoD of companies standing aside.

CBDT Circular No. 25/2017, dated 23.10.2017 clarifies that so long as the Regional Headquarter operates for subsidiaries/ group companies in a region within the general and objective principles of global policy of the group laid down by the parent entity in the field of Pay roll functions, Accounting, HR functions, IT infrastructure and network platforms, Supply chain functions, Routine banking operational procedures, and not being specific to any entity or group of entities per se; it would, in itself, not constitute a case of BoD of companies standing aside and such activities of Regional Headquarter in India alone will not be a basis for establishment of PoEM for such subsidiaries/ group companies.

It is further mentioned in the said Circular that the provisions of General Anti-Avoidance Rule contained in Chapter X-A of the Income-tax Act, 1961 may get triggered in such cases where the above clarification is found to be used for abusive/ aggressive tax planning.

For the purpose of determining whether the company is engaged in active business outside India, the average of the data of the previous year and two years prior to that shall be taken into account. In case the company has been in existence for a shorter period, then data of such period shall be considered. Where the accounting year for tax purposes, in accordance with laws of country of incorporation of the company, is different from the previous year, then, data of the accounting year that ends during the relevant previous year and two accounting years preceding it shall be considered.

The final guidelines have clarified that mere following of global policies laid down by the Indian holding company would not constitute that Board is standing aside.

(ii) In case Companies not engaged in active business outside India

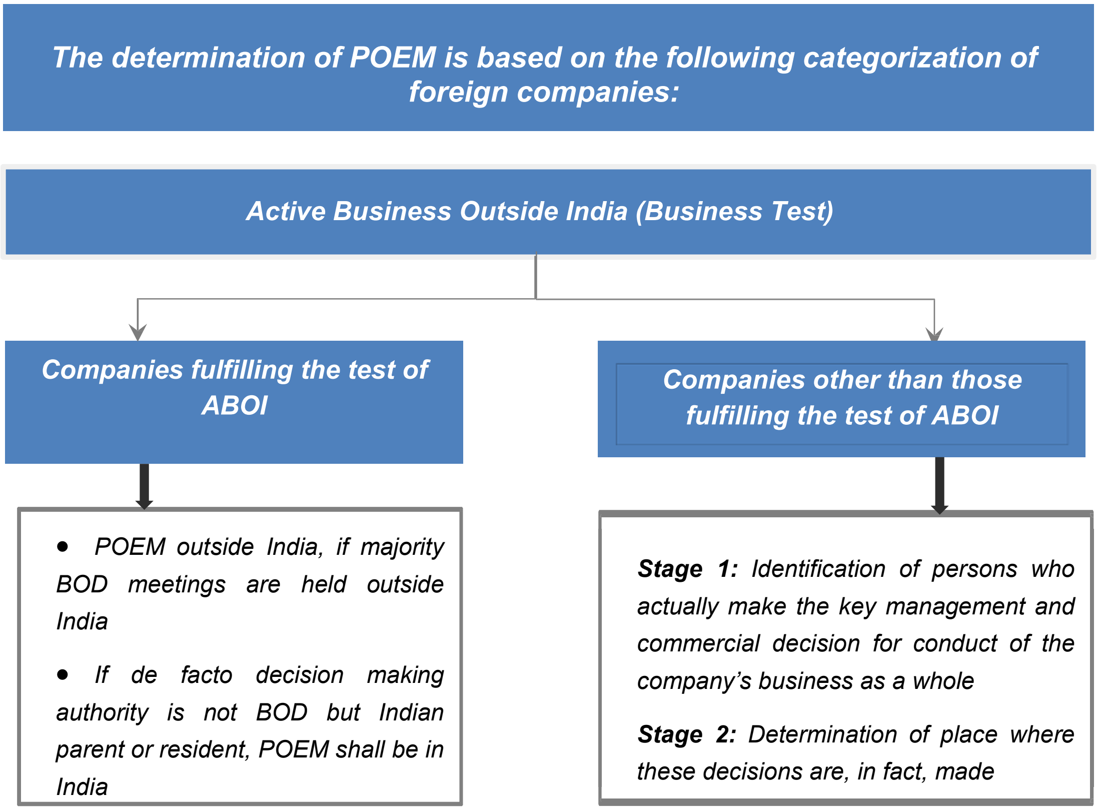
The guidelines provide a two stage process for determination of POEM in case of companies not engaged in active business.

(a) **First stage**: Identifying the person(s) who actually make the key management and commercial decisions for the conduct of the company as a whole.

(b) **Second stage**: Determine the place where these decisions are, in fact, being made.

The place where these management decisions are taken would be more important than the place where such decisions are implemented. For the purpose of determination of POEM, it is the substance which would be conclusive rather than the form.

The conditions specified in the circular are depicted in the flow charts below:



The determination of POEM is based on the following categorization of foreign companies:

Active Business Outside India (Business Test)

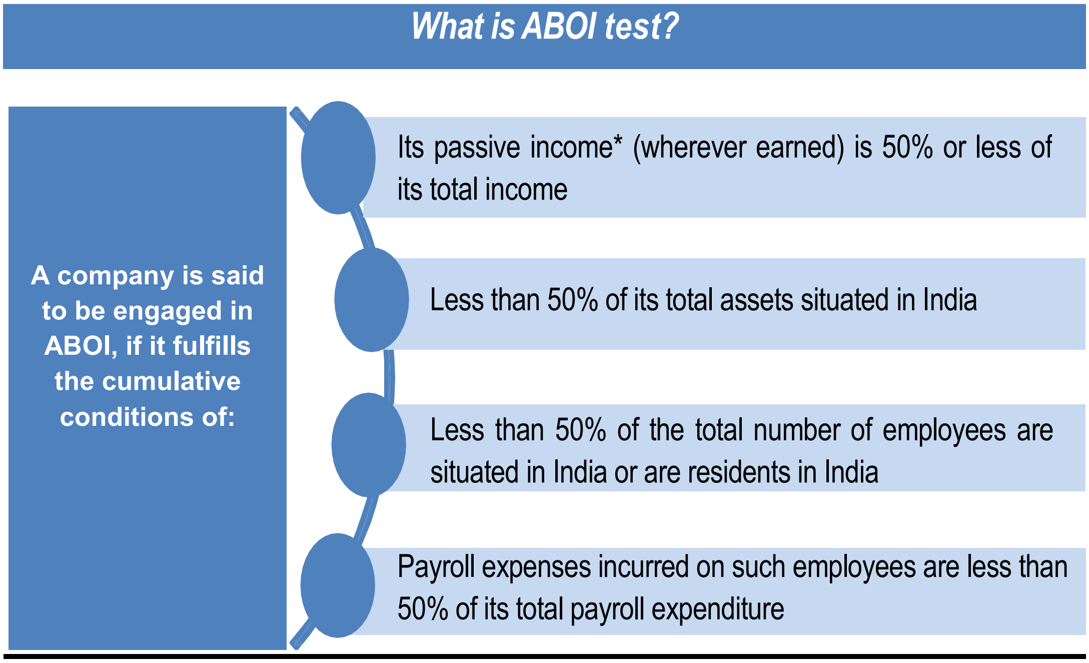
Companies fulfilling the test of ABOI

- *POEM outside India, if majority BOD meetings are held outside India*
- *If de facto decision making authority is not BOD but Indian parent or resident, POEM shall be in India*

Companies other than those fulfilling the test of ABOI

Stage 1: *Identification of persons who actually make the key management and commercial decision for conduct of the company's business as a whole*

Stage 2: *Determination of place where these decisions are, in fact, made*



What is ABOI test?

A company is said to be engaged in ABOI, if it fulfills the cumulative conditions of:

Its passive income* (wherever earned) is 50% or less of its total income

Less than 50% of its total assets situated in India

Less than 50% of the total number of employees are situated in India or are residents in India

Payroll expenses incurred on such employees are less than 50% of its total payroll expenditure

** Passive income of a company shall be aggregate of:*

(i) Income from the transactions where both the purchase and sale of goods is from/ to its associated enterprises; and

(ii) income by way of royalty, dividend, capital gains, interest (except for banking companies and public financial institutions) or rental income whether or not involving associated enterprises

Some of the guiding principles which may be taken into account for determining the POEM are as follows:

(a) Location where the Board of Directors meet and makes decisions: This location may be the place of effective management of a company provided, the Board –

(i) retains and exercises its authority to govern the company; and

(ii) does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.

It may be mentioned that mere formal holding of board meetings at a place would by itself not be conclusive for determination of POEM being located at that place. If the key decisions by the directors are in fact being taken in a place other than the place where the formal meetings are held then such other place would be relevant for POEM.

As an example this may be the case where the board meetings are held in a location distinct from the place where head office of the company is located or such location is unconnected with the place where the predominant activity of the company is being carried out.

If a Board has *de facto* delegated the authority to make the key management and commercial decisions for the company to the senior management or any other person including a shareholder, promoter, strategic or legal or financial advisor etc. and does nothing more than routinely ratifying the decisions that have been made, the company's place of effective management will ordinarily be the place where these senior managers or the other person make those decisions.

"Senior Management" in respect of a company means the person or persons who are generally responsible for developing and formulating key strategies and policies for the company and for ensuring or overseeing the execution and implementation of those strategies on a regular and on-going basis. While designation may vary, these persons may include:

(i) Managing Director or Chief Executive Officer;

(ii) Financial Director or Chief Financial Officer;

(iii) Chief Operating Officer; and

(iv) The heads of various divisions or departments (for example, Chief Information or Technology Officer, Director for Sales or Marketing).

(b) **Location of Executive Committee, in case powers are delegated by the Board:** A company's board may delegate some or all of its authority to one or more committees such as an executive committee consisting of key members of senior management. In these situations, the location where the members of the executive committee are based and where that committee develops and formulates the key strategies and policies for mere formal approval by the full board will often be considered to be the company's place of effective management.

The delegation of authority may be either *de jure* (by means of a formal resolution or Shareholder Agreement) or *de facto* (based upon the actual conduct of the board and the executive committee).

(c) **Location of Head Office**: The location of a company's head office will be a very important factor in the determination of the company's place of effective management because it often represents the place where key company decisions are made. The following points need to be considered for determining the location of the head office of the company:-

If the company's senior management and their support staff are based in a single location and that location is held out to the public as the company's principal place of business or headquarters then that location is the place where head office is located.

If the company is more decentralized (for example where various members of senior management may operate, from time to time, at offices located in the various countries) then the company's head office would be the location where these senior managers,-

(i) are primarily or predominantly based; or

(ii) normally return to following travel to other locations; or

(iii) meet when formulating or deciding key strategies and policies for the company as a whole.

Members of the senior management may operate from different locations on a more or less permanent basis and the members may participate in various meetings via telephone or video conferencing rather than by being physically present at meetings in a particular location. In such situation the head office would normally be the location, if any, where the highest level of management (for example, the Managing Director and Financial Director) and their direct support staff are located.

In situations where the senior management is so decentralised that it is not possible to determine the company's head office with a reasonable degree of certainty, the location of a company's head office would not be of much relevance in determining that company's place of effective management.

> **"Head Office"** of a company would be the place where the company's senior management and their direct support staff are located or, if they are located at more than one location, the place where they are primarily or predominantly located. A company's head office is not necessarily the same as the place where the majority of its employees work or where its board typically meets.

(d) **Use of modern technology:** The use of modern technology impacts the place of effective management in many ways. It is no longer necessary for the persons taking decision to be physically present at a particular location. Therefore physical location of board meeting or executive committee meeting or meeting of senior management may not be where the key decisions are in substance being made. In such cases the place where the directors or the persons taking the decisions or majority of them usually reside may also be a relevant factor.

(e) **Decision *via* circular resolution or round robin voting:** In case of circular resolution or round robin voting the factors like, the frequency with which it is used, the type of decisions made in that manner and where the parties involved in those decisions are located etc. are to be considered. It cannot be said that proposer of decision alone would be relevant but based on past practices and general conduct; it would be required to determine the person who has the authority and who exercises the authority to take decisions. The place of location of such person would be more important.

(f) **Decisions made by Shareholders are not relevant factor in determination of POEM:** The decisions made by shareholder on matters which are reserved for shareholder decision under the company laws are not relevant for determination of a company's place of effective management. Such decisions may include sale of all or substantially all of the company's assets, the dissolution, liquidation or deregistration of the company, the modification of the rights attaching to various classes of shares or the issue of a new class of shares etc. These decisions typically affect the existence of the company itself or the rights of the shareholders as such, rather than the conduct of the company's business from a management or commercial perspective and are therefore, generally not relevant for the determination of a company's place of effective management.

However, the shareholder's involvement can, in certain situations, turn into that of effective management. This may happen through a formal arrangement by way of shareholder agreement etc. or may also happen by way of actual conduct. As an example if the shareholders limit the authority of board and senior managers of a company and thereby remove the company's real authority to make decision then the shareholder guidance transforms into usurpation and such undue influence may result in effective management being exercised by the shareholder.

Therefore, whether the shareholder involvement is crossing the line into that of effective management is one of fact and has to be determined on case-to-case basis only.

(g) **Day to day routine operational decisions are not relevant for determination of POEM:** It may be clarified that day to day routine operational decisions undertaken by junior and middle management shall not be relevant for the purpose of determination of POEM. The operational decisions relate to the oversight of the day-to-day business operations and activities of a company whereas the key management and commercial decision are concerned with broader strategic and policy decision. For example, a decision to open a major new manufacturing facility or to discontinue a major product line would be examples of key commercial decisions affecting the company's business as a whole. By contrast, decisions by the plant manager appointed by senior management to run that facility, concerning repairs and maintenance, the implementation of company-wide quality controls and human resources policies, would be examples of routine operational decisions. In certain situations it may happen that person responsible for operational decision is the same person who is responsible for the key management and commercial decision. In such cases it will be necessary to distinguish the two type of decisions and thereafter assess the location where the key management and commercial decisions are taken.

If the above factors do not lead to clear identification of POEM then the final guidelines provide that following secondary factors may be considered:

- Place where main and substantial activity of the company is carried out; or
- Place where the accounting records of the company are kept.

It needs to be emphasized that the determination of POEM is to be based on all relevant facts related to the management and control of the company, and is not to be determined on the basis of isolated facts that by itself do not establish effective management, as illustrated by the following examples:

(i) The fact that a foreign company is completely owned by an Indian company will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(ii) The fact that there exists a Permanent Establishment of a foreign entity in India would itself not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(iii) The fact that one or some of the Directors of a foreign company reside in India will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(iv) The fact of, local management being situated in India in respect of activities carried out by a foreign company in India will not, by itself, be conclusive evidence that the conditions for establishing POEM have been satisfied.

(v) The existence in India of support functions that are preparatory and auxiliary in character will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

It is reiterated that the above principles for determining the POEM are for guidance only. No single principle will be decisive in itself. The above principles are not to be seen with reference to any particular moment in time rather activities performed over a period of time, during the previous year, need to be considered.

In other words, a "snapshot" approach is not to be adopted. Further, based on the facts and circumstances if it is determined that during the previous year the POEM is in India and also outside India then POEM shall be presumed to be in India if it has been mainly /predominantly in India

The CBDT also clarified that the Assessing Officer (AO) shall, before initiating any proceedings for holding a company incorporated outside India, on the basis of its POEM, as being resident in India, seek prior approval of the Principal Commissioner or the Commissioner, as the case may be.

Further, in case the AO proposes to hold a company incorporated outside India, on the basis of its POEM, as being resident in India then any such finding shall be given by the AO after seeking prior approval of the collegium of three members consisting of the Principal Commissioners or the Commissioners, as the case may be, to be constituted by the Principal Chief Commissioner of the region concerned, in this regard. The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter.

Example 1: *Company A Co. is a sourcing entity, for an Indian multinational group, incorporated in country X and is 100% subsidiary of Indian company (B Co.). The warehouses and stock in them are the only assets of the company and are located in country X. All the employees of the company are also in country X. The average income wise breakup of the company's total income for three years is, -*

(i) 30% of income is from transaction where purchases are made from parties which are non-associated enterprises and sold to associated enterprises;

(ii) 30% of income is from transaction where purchases are made from associated enterprises and sold to associated enterprises;

(iii) 30% of income is from transaction where purchases are made from associated enterprises and sold to non-associated enterprises; and

(iv) 10% of the income is by way of interest.

Interpretation: In this case, passive income is 40% of the total income of the company. The passive income consists of, -

(i) 30% income from the transaction where both purchase and sale is from/to associated enterprises; and

(ii) 10% income from interest.

The A Co. satisfies the first requirement of the test of active business outside India. Since no assets or employees of A Co. are in India the other requirements of the test is also satisfied. Therefore, company is engaged in active business outside India.

Example 2: *The other facts remain same as that in Example 1 with the variation that A Co. has a total of 50 employees. 47 employees, managing the warehouse, storekeeping and accounts of the company, are located in country X. The Managing Director (MD), Chief Executive Officer (CEO) and sales head are resident in India. The total annual payroll expenditure on these 50 employees is of ₹ 5 crore. The annual payroll expenditure in respect of MD, CEO and sales head is of ₹ 3 crore.*

Interpretation: Although the first limb of active business test is satisfied by A Co. as only 40% of its total income is passive in nature. Further, more than 50% of the employees are also situated outside India. All the assets are situated outside India. However, the payroll expenditure in respect of the MD, the CEO and the sales head being employees resident in India exceeds 50% of the total payroll expenditure. Therefore, A Co. is not engaged in active business outside India.

Example 3: *The basic facts are same as in Example 1. Further facts are that all the directors of the A Co. are Indian residents. During the relevant previous year 5 meetings of the Board of Directors is held of which two were held in India and 3 outside India with two in country X and one in country Y.*

Interpretation: The A Co. is engaged in active business outside India as the facts indicated in Example 1 establish. The majority of board meetings have been held outside India. Therefore, the POEM of A Co. shall be presumed to be outside India.

Example 4: *The facts are same as in Example 3 but it is established by the Assessing Officer that although A Co.'s senior management team signs all the contracts, for all the contracts above ₹ 10 lakh the A Co. must submit its recommendation to B Co. and B Co. makes the decision whether or not the contract may be accepted. It is also seen that during the previous year more than 99% of the contracts are above ₹ 10 lakh and over past years also the same trend in respect of value contribution of contracts above ₹ 10 lakh is seen.*

Interpretation: These facts suggest that the effective management of the A Co. may have been usurped by the parent company B Co. Therefore, POEM of A Co. may in such cases be not presumed to be outside India even though A Co. is engaged in active business outside India and majority of board meeting are held outside India.

Example 5: *An Indian multinational group has a local holding company A Co. in country X. The A Co. also has 100% downstream subsidiaries B Co. and C Co. in country X and D Co. in country Y. The A Co. has income only by way of dividend and interest from investments made in its subsidiaries. The Place of Effective Management of A Co. is in India and is exercised by ultimate parent company of the group. The subsidiaries B, C and D are engaged in active business outside*

India. The meetings of Board of Director of B Co., C Co. and D Co. are held in country X and Y respectively.

Interpretation: Merely because the POEM of an intermediate holding company is in India, the POEM of its subsidiaries shall not be taken to be in India. Each subsidiary has to be examined separately. As indicated in the facts since B Co., C Co., and D Co. are independently engaged in active business outside India and majority of Board meetings of these companies are also held outside India. The POEM of B Co., C Co., and D Co. shall be presumed to be outside India.

> ***Further, the CBDT vide Circular no. 8/2017 dated 23.02.2017 also clarified that POEM guidelines shall not apply to a company having turnover or gross receipts of ₹ 50 crores or less in a financial year.***

ILLUSTRATION 1

ABC Inc., a Swedish company headquartered at Stockholm, not having a permanent establishment in India, has set up a liaison office in Mumbai in April, 2019 in compliance with RBI guidelines to look after its day to day business operations in India, spread awareness about the company's products and explore further opportunities. The liaison office takes decisions relating to day to day routine operations and performs support functions that are preparatory and auxiliary in nature. The significant management and commercial decisions are, however, in substance made by the Board of Directors at Sweden. Determine the residential status of ABC Inc. for A.Y. 2020-21.

SOLUTION

Section 6(3) provide that a company would be resident in India in any previous year, if-

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India .

In this case, ABC Inc. is a foreign company. Therefore, it would be resident in India for P.Y.2019-20 only if its place of effective management, in that year, is in India.

Explanation to section 6(3) defines "place of effective management" to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made. In the case of ABC Inc., its place of effective management for P.Y.2019-20 is not in India, since the significant management and commercial decisions are, in substance, made by the Board of Directors outside India in Sweden.

ABC Inc. has only a liaison office in India through which it looks after its routine day to day business operations in India. The place where decisions relating to day to day routine operations are taken and support functions that are preparatory or auxiliary in nature are performed are not relevant in determining the place of effective management.

Hence, ABC Inc., being a foreign company is a non-resident for A.Y.2020-21, since its place of effective management is outside India in the P.Y.2019-20.

Transition Mechanism for a company incorporated outside India and has not been assessed to tax earlier [Chapter XII-BC – Section 115JH]

A transition mechanism for a company which is incorporated outside India, which has not been assessed to tax in India earlier and has become resident in India for the first time due to application of POEM, has been provided in Chapter XII-BC comprising of section 115JH.

(a) Accordingly, the Central Government is empowered to notify exception, modification and adaptation subject to which, the provisions of the Act relating to computation of income, treatment of unabsorbed depreciation, set-off or carry forward and set off of losses, special provision relating to avoidance of tax and the collection and recovery of taxes shall apply in a case where a foreign company is said to be resident in India due to its POEM being in India for the first time and the said company has never been resident in India before.

(b) In a case where the determination regarding foreign company to be resident in India has been made in the assessment proceedings relevant to any previous year, then, these transition provisions would also cover any subsequent previous year, if the foreign company is resident in India in that previous year and the previous year ends on or before the date on which such assessment proceeding is completed. In effect, the transition provisions would also cover any subsequent amendment upto the date of determination of POEM in an assessment proceeding. However, once the transition is complete, then, normal provisions of the Act would apply.

(c) In the notification issued by the Central Government, certain conditions including procedural conditions subject to which these adaptations shall apply can be provided for and in case of failure to comply with the conditions, the benefit of such notification would not be available to the foreign company.

Accordingly, where in a previous year, any benefit, exemption or relief has been claimed and granted to the foreign company in accordance with the notification, and subsequently, there is failure to comply with any of the conditions specified therein, then –

(i) the benefit, exemption or relief shall be deemed to have been wrongly allowed;

(ii) the Assessing Officer may re-compute the total income of the assessee for the said previous year and make the necessary amendment as if the exceptions, modifications and adaptations as per the notification does not apply; and

(iii) the provisions of section 154 shall, so far as may be, apply thereto and the period of four years for rectification of mistake apparent from the record has to be reckoned from the end of the previous year in which the failure to comply with the condition stipulated in the notification takes place.

(d) Every notification issued in exercise of this power by the Central Government shall be laid before each house of the Parliament.

(e) Accordingly, in exercise of the power under section 115JH(1) of the Income-tax Act, 1961,the Central Government has, vide notification No. 29/2018, dated 22nd June, 2018, specified the exceptions, modifications and adaptions subject to which, the provisions of the Act relating to computation of income, treatment of unabsorbed depreciation, set-off or carry forward and set off of losses, special provision relating to avoidance of tax and the collection and recovery of taxes shall apply in a case where a foreign company is said to be resident in India in any previous year on account of its POEM being in India and the such foreign company has not been resident in India before the said previous year.

Particulars	Provisions
Determination of opening WDV	**If the foreign company is assessed to tax in the foreign jurisdiction** **Where depreciation is required to be taken into account for the purpose of computation of its taxable income**, the WDV of the depreciable asset as per the tax record in the foreign country on the 1st day of the previous year shall be adopted as the opening WDV for the said previous year. **Where WDV is not available as per tax records,** the WDV shall be calculated assuming that the asset was installed, utilised and the depreciation was actually allowed as per the provisions of the laws of that foreign jurisdiction. The WDV so arrived at as on the 1st day of the previous year shall be adopted to be the opening WDV for the said previous year. **If the foreign company is not assessed to tax in the foreign jurisdiction** WDV of the depreciable asset as appearing in the books of account as on the 1st day of the previous year maintained in accordance with the laws of that foreign jurisdiction shall be adopted as the opening WDV for the said previous year.
Brought forward loss and unabsorbed depreciation	**If the foreign company is assessed to tax in the foreign jurisdiction** Brought forward loss and unabsorbed depreciation as per the tax record shall be determined year wise on the 1st day of the said previous year. **If the foreign company is not assessed to tax in the foreign jurisdiction** Brought forward loss and unabsorbed depreciation as per the books

	of account prepared in accordance with the laws of that country shall be determined year wise on the 1st day of the said previous year. **Other provisions** Such brought forward loss and unabsorbed depreciation shall be deemed as loss and unabsorbed depreciation brought forward as on the 1st day of the said previous year and shall be allowed to be set off and carried forward in accordance with the provisions of the Act for the remaining period calculated from the year in which they occurred for the first time taking that year as the first year. However, the losses and unabsorbed depreciation of the foreign company shall be allowed to be set off only against such income of the foreign company which has become chargeable to tax in India on account of it becoming resident in India due to application of POEM. In cases where the brought forward loss and unabsorbed depreciation originally adopted in India are revised or modified in the foreign jurisdiction due to any action of the tax or legal authority, the amount of the loss and unabsorbed depreciation shall be revised or modified for the purposes of set off and carry forward in India.
Period of profit and loss account and balance sheet in cases where accounting year of foreign company does not end on 31st March	The foreign company is required to prepare profit and loss account and balance sheet for the period starting from the date on which the accounting year immediately following said accounting year begins, upto 31st March of the year immediately preceding the period beginning with 1st April and ending on 31st March during which the foreign company has become resident. The foreign company is also required to prepare profit and loss account and balance sheet for succeeding periods of twelve months, beginning from 1st April and ending on 31st March, till the year the foreign company remains resident in India on account of its POEM. **Examples:** **Example 1:** If the accounting year of the foreign company is a calendar year and the company becomes resident in India during P.Y. 2019-20 for the first time due to its POEM being in India, then, the company is required to prepare profit and loss account and balance sheet for the period 1st January, 2019 to 31st March, 2019. It is also required to prepare profit and loss account and balance sheet for the period 1st April, 2019 to 31st March, 2020. For the purpose of carry forward of loss and unabsorbed depreciation in this case, since the period 1st January, 2019 to 31st March, 2019 is less than 6 months, it is to be included in the accounting year immediately preceding the accounting year in which the foreign company is held to be resident in India for the first time. Accordingly, the profit and loss and balance sheet of the 15 month period from 1 January, 2018 to 31st March, 2019 is to be prepared.

	Example 2: If the accounting year of the foreign company is from 1st July to 30th June and the company becomes resident in India during P.Y. 2019-20 for the first time due to its POEM being in India, then, the company is required to prepare profit and loss account and balance sheet for the period 1st July, 2018 to 31st March, 2019. It is also required to prepare profit and loss account and balance sheet for the period 1st April, 2019 to 31st March, 2020. For the purpose of carry forward of loss and unabsorbed depreciation in this case, since the period is more than 6 months, it is to be treated as a separate accounting year. The loss and unabsorbed depreciation as per tax record or books of account, as the case may be, of the foreign company shall, be allocated on proportionate basis.
Applicability of provisions of Chapter XVII-B (TDS provisions)	Where more than one provision of Chapter XVII-B of the Act applies to the foreign company as resident as well as foreign company, the provision applicable to the foreign company alone shall apply. Compliance to those provisions of Chapter XVII-B of the Act as are applicable to the foreign company prior to its becoming Indian resident shall be considered sufficient compliance to the provisions of said Chapter. The provisions of section 195(2) relating to application to Assessing Officer to determine the appropriate proportion of sum chargeable to tax shall apply in such manner so as to include payment to the foreign company.
Availability of deduction under section 90 or 91 (Foreign tax credit)	The foreign company shall be entitled to relief or deduction of taxes paid in accordance with the provisions of section 90 or section 91 of the Act. Where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India in respect of the income to which it relates and shall be in accordance with the provisions of rule 128 of the Income-tax Rules, 1962 [Given as Annexure 1 at the end of this material].
Non applicability of the notification	The above exceptions, modifications and adaptations shall not apply in respect of such income of the foreign company which otherwise would have been chargeable to tax in India, even if the foreign company had not become Indian resident.
Applicability of the notification where foreign company becomes resident in the subsequent	In a case where the foreign company is said to be resident in India during a previous year, immediately succeeding a previous year during which it is said to be resident in India; the exceptions, modifications and adaptations shall apply to the said previous year subject to the condition that the WDV, the brought forward loss and the unabsorbed depreciation to be adopted on the 1st day of the previous year shall be those which

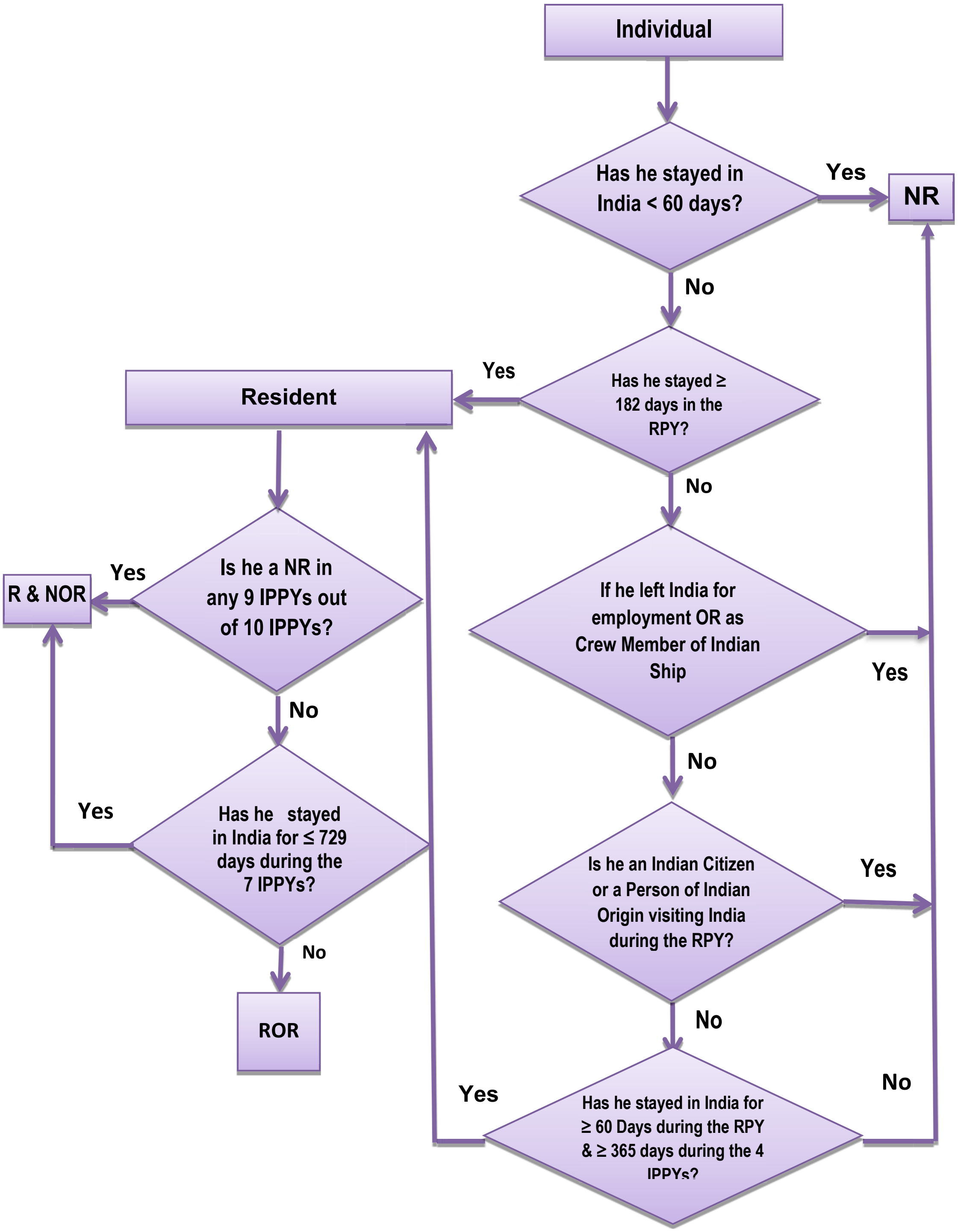
previous year also	have been arrived at on the last day of the preceding previous year in accordance with the provisions of this notification.
No effect on other transactions	Any transaction of the foreign company with any other person or entity under the Act shall not be altered only on the ground that the foreign company has become Indian resident.
Applicability of other provisions relating to foreign company	Subject to the above exceptions, modifications and adaptions specifically provided vide this notification, the foreign company shall continue to be treated as a foreign company even if it is said to be resident in India and all the provisions of the Act shall apply accordingly. Consequently, the provisions specifically applicable to,— (i) a foreign company, shall continue to apply to it; (ii) non-resident persons, shall not apply to it; and (iii) the provisions specifically applicable to resident, shall apply to it.
Applicability of tax rate on foreign company	In case of conflict between the provision applicable to the foreign company as resident and the provision applicable to it as foreign company, the later shall generally prevail. Therefore, the rate of tax in case of foreign company i.e., 40% shall remain the same, i.e., rate of income-tax applicable to the foreign company even though residency status of the foreign company changes from non-resident to resident on the basis of POEM.
Applicability of notification	This notification shall be deemed to have come into force from 1st April, 2017.
Meaning of foreign jurisdiction	The place of incorporation of the foreign company.
Applicability of rule 115 of the Income-tax Rules, 1962.	The rate of exchange for conversion into rupees of value expressed in foreign currency, wherever applicable, shall be in accordance with provision of rule 115 of the Income-tax Rules, 1962. [Given as Annexure 2 at the end of this material]

Determination of Residential Status: A summary

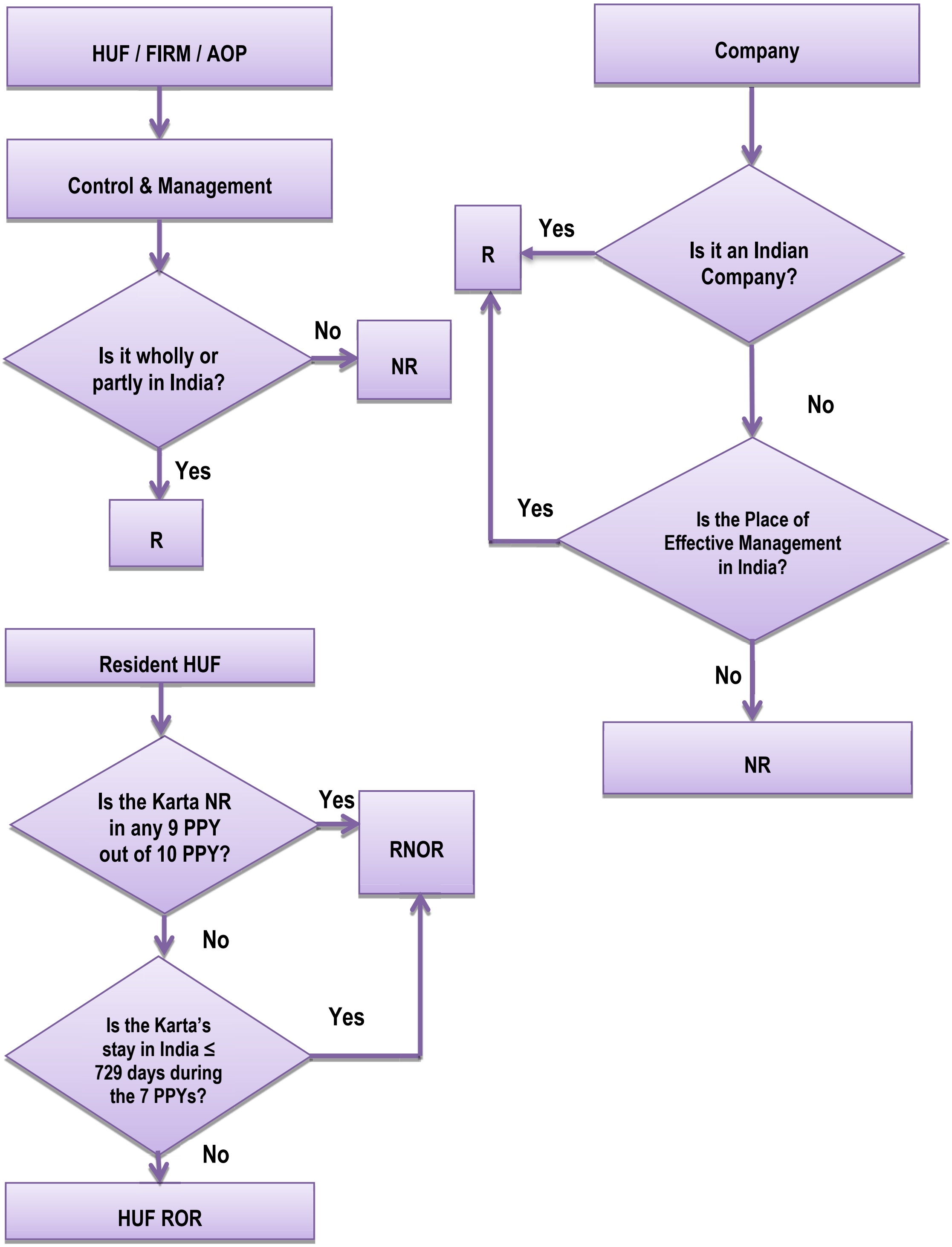
Abbreviations used in the Flow Charts in pages 2.19 & 2.20

IC	**=**	**Indian Citizen**	**RPY**	**=**	**Relevant Previous Year**
R	**=**	**Resident**	**NR**	**=**	**Non-resident**
IPPYs	**=**	**Immediately Preceding Previous Years**	**AOP**	**=**	**Association of Persons**
N & OR	**=**	**Resident but Not Ordinarily Resident**	**HUF**	**=**	**Hindu Undivided Family**
ROR	**=**	**Resident and Ordinarily Resident**			

Determination of Residential Status of Individual


Individual
Has he stayed in India < 60 days?
Yes
NR
No
Has he stayed ≥ 182 days in the RPY?
Yes
Resident
No
Is he a NR in any 9 IPPYs out of 10 IPPYs?
Yes
R & NOR
No
If he left India for employment OR as Crew Member of Indian Ship
Yes
No
Has he stayed in India for ≤ 729 days during the 7 IPPYs?
Yes
No
ROR
Is he an Indian Citizen or a Person of Indian Origin visiting India during the RPY?
Yes
No
Has he stayed in India for ≥ 60 Days during the RPY & ≥ 365 days during the 4 IPPYs?
Yes
No

Determination of Residential Status of HUF/ Firm/ AOP/ Company


HUF / FIRM / AOP
Control & Management
Is it wholly or partly in India?
No
NR
Yes
R
Company
Is it an Indian Company?
Yes
R
No
Is the Place of Effective Management in India?
Yes
No
NR
Resident HUF
Is the Karta NR in any 9 PPY out of 10 PPY?
Yes
RNOR
No
Is the Karta's stay in India ≤ 729 days during the 7 PPYs?
Yes
No
HUF ROR

(2) Scope of Total Income [Section 5]

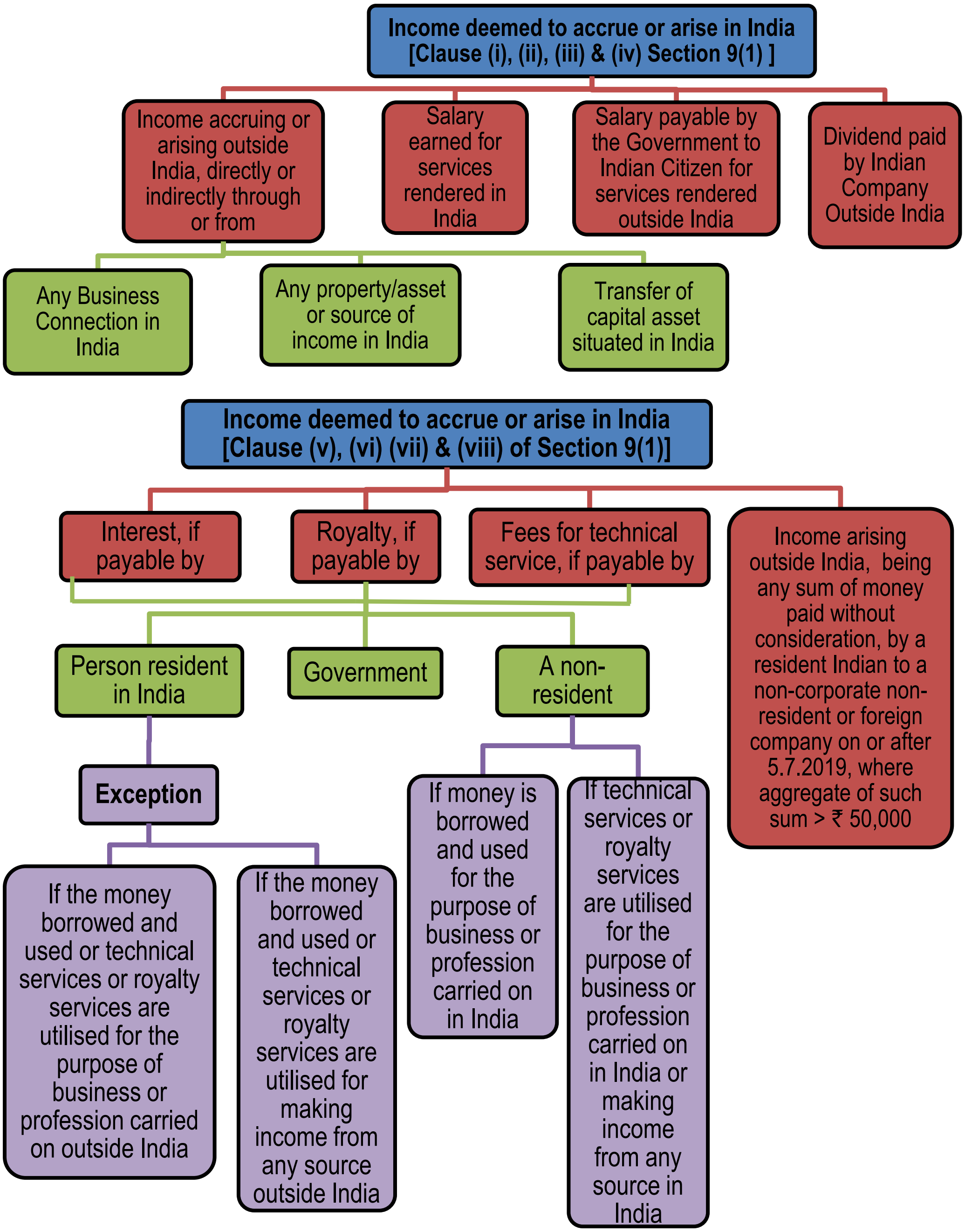
Section 5 provides the scope of total income in terms of the residential status of the assessee because the incidence of tax on any person depends upon his residential status.

Summary of scope of Total Income

Particulars	Resident and Ordinary Resident	Not ordinary Resident	Non-Resident
Income received or deemed to be received in India whether earned in India or elsewhere	Yes	Yes	Yes
Income which accrue or arise or deemed to accrue or arise in India during the previous year whether received in India or elsewhere	Yes	Yes	Yes
Income which accrue or arise outside India and received outside India from a business controlled from India	Yes	Yes	No
Income which accrue or arise outside India and received outside India in the previous year from any other source	Yes	No	No
Income which accrues or arises outside India and received outside India during the year preceding the year and remitted to India during the previous year	No	No	No

(i) Income deemed to accrue or arise in India [Section 9]

Under section 9, certain types of income are deemed to accrue or arise in India even though they may actually accrue or arise outside India.


Income deemed to accrue or arise in India [Clause (i), (ii), (iii) & (iv) Section 9(1)]
Income accruing or arising outside India, directly or indirectly through or from
Salary earned for services rendered in India
Salary payable by the Government to Indian Citizen for services rendered outside India
Dividend paid by Indian Company Outside India
Any Business Connection in India
Any property/asset or source of income in India
Transfer of capital asset situated in India
Income deemed to accrue or arise in India [Clause (v), (vi) (vii) & (viii) of Section 9(1)]
Interest, if payable by
Royalty, if payable by
Fees for technical service, if payable by
Income arising outside India, being any sum of money paid without consideration, by a resident Indian to a non-corporate non-resident or foreign company on or after 5.7.2019, where aggregate of such sum > ₹ 50,000
Person resident in India
Government
A non-resident
Exception
If the money borrowed and used or technical services or royalty services are utilised for the purpose of business or profession carried on outside India
If the money borrowed and used or technical services or royalty services are utilised for making income from any source outside India
If money is borrowed and used for the purpose of business or profession carried on in India
If technical services or royalty services are utilised for the purpose of business or profession carried on in India or making income from any source in India

The categories of income which are deemed to accrue or arise in India are:

(1) Any income accruing or arising to an assessee in any place outside India whether directly or indirectly

(i) through or from any business connection in India,

(ii) through or from any property in India,

(iii) through or from any asset or source of income in India or

(iv) through the transfer of a capital asset situated in India

would be deemed to accrue or arise in India. **[Section 9(1)(i)]**

(i) What is Business Connection?

'Business connection' shall include any business activity carried out through a person acting on behalf of the non-resident [*Explanation 2* to section 9(1)(i)]

For a business connection to be established, the person acting on behalf of the non-resident –

(a) must have an authority, which is habitually exercised in India, to conclude contracts on behalf of the non-resident or

habitually concludes contracts or plays the principal role leading to conclusion of contracts by that non-resident and such contracts are

- in the name of the non-resident; or
- for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or
- for the provision of services by that non-resident.

Note - This amendment in the definition of "business connection" is for the purpose of alignment with the provisions of the Double Taxation Avoidance Agreement (DTAA) as modified by Multilateral Instrument (MLI) so as to make the provisions in the treaty effective.

(b) in a case, where he has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, or

(c) habitually secures orders in India, mainly or wholly for the non-resident.

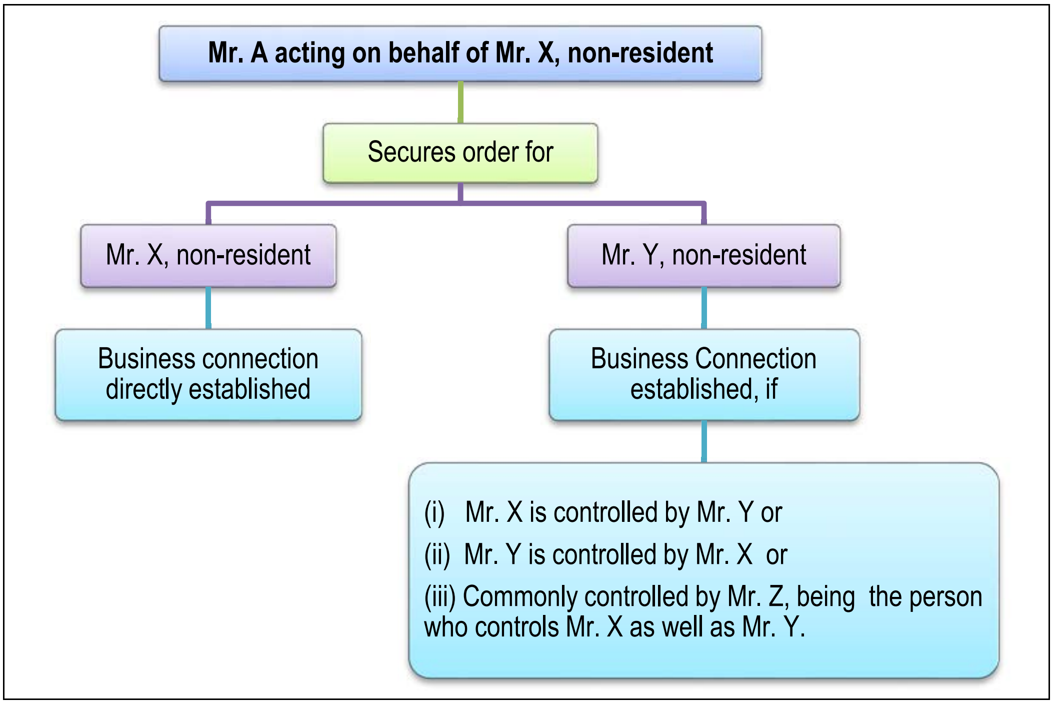
Further, there may be situations when the person acting on behalf of the non-resident secure order for other non-residents. In such situation, business connection for other non-residents is established if,

i. such other non-resident controls the non-resident or

ii. such other non-resident is controlled by the non-resident or

iii. such other non-resident is subject to same control as that of non-resident.

In all the three situations, business connection is established, where a person habitually secures orders in India, mainly or wholly for such non-residents.


Mr. A acting on behalf of Mr. X, non-resident
Secures order for
Mr. X, non-resident
Mr. Y, non-resident
Business connection directly established
Business Connection established, if
(i) Mr. X is controlled by Mr. Y or
(ii) Mr. Y is controlled by Mr. X or
(iii) Commonly controlled by Mr. Z, being the person who controls Mr. X as well as Mr. Y.

Agents having independent status are not included in Business Connection: Business connection, however, shall not be established, where the non-resident carries on business through a broker, general commission agent or any other agent having an independent status, if such a person is acting in the ordinary course of his business.

A broker, general commission agent or any other agent shall be deemed to have an independent status where he does not work mainly or wholly for the non-resident.

He will, however, not be considered to have an independent status in the three situations explained above, where he is employed by such a non-resident.

Where a business is carried on in India through a person referred to in (a), (b) or (c) of (i) above, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India *[Explanation 3* to section 9(1)(i)].

Significant economic presence [*Explanation 2A* to section 9(1)(i)]

Significant economic presence of a non-resident in India shall also constitute business connection in India.

Significant economic presence means-

	Nature of transaction	Condition
(a)	transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India,	Aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed
(b)	systematic and continuous soliciting of business activities or engaging in interaction with users in India through digital means	The users should be of such number as may be prescribed

The threshold of "aggregate of payments" in (a) and "users" in India in (b) would be prescribed by Rules. Further, the above transactions or activities shall constitute significant economic presence in India, whether or not,—

(i) the agreement for such transactions or activities is entered in India;

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

However, where a business connection is established by reason of significant economic presence in India, only so much of income as is attributable to the transactions or activities referred to in (a) or (b) above shall be deemed to accrue or arise in India.

In the case of a non-resident the following shall not, however, be treated as business connection in India *[Explanation 1* to section 9(1)(i)*]:*

(a) **In the case of a business, in respect of which all the operations are not carried out in India [*Explanation 1(a)* to section 9(1)(i)]:** In the case of a business of which all the operations are not carried out in India, the income of the business deemed to accrue or arise in India shall be only such part of income as is reasonably attributable to the operations carried out in India. Therefore, it follows that such part of income which cannot be reasonably attributed to the operations in India, is not deemed to accrue or arise in India.

(b) **Purchase of goods in India for export [*Explanation 1(b)* to section 9(1)(i)]:** In the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export.

(c) **Collection of news and views in India for transmission out of India [*Explanation 1(c)* to section 9(1)(i)]:** In the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India.

(d) **Shooting of cinematograph films in India [*Explanation 1(d)* to section 9(1)(i)]:** In the case of a non-resident, no income shall be deemed to accrue or arise in India through or from operations which are confined to the shooting of any cinematograph film in India, if such non-resident is :

- an individual, who is not a citizen of India or
- a firm which does not have any partner who is a citizen of India or who is resident in India; or
- a company which does not have any shareholder who is a citizen of India or who is resident in India.

(e) **Activities confined to display of rough diamonds in SNZs [*Explanation 1(e)* to section 9(1)(i)]**: In case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to display of uncut and unassorted diamonds in any special zone notified by the Central Government in the Official Gazette in this behalf.

(ii) & (iii) Income from property, asset or source of income in India

Any income which arises from any property in India (movable, immovable, tangible and intangible property) would be deemed to accrue or arise in India.

Examples:

- *Hire charges or rent paid outside India for the use of the machinery or buildings situated in India,*
- *deposits with an Indian company for which interest is received outside India etc.*

(iv) Income through transfer of a capital asset situated in India

Capital gains arising through or from the transfer of a capital asset situated in India would be deemed to accrue or arise in India in all cases irrespective of the fact whether

- The capital asset is movable or immovable, tangible or intangible;
- The place of registration of the document of transfer etc., is in India or outside; and
- The place of payment of the consideration for the transfer is within India or outside.

Accordingly, the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of". ***[Explanation 4* to section 9(1)(i)*]***

Further, an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India. ***[Explanation 5* to section 9(1)(i)*]***

However, an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I or Category-II foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, made under the Securities and Exchange Board of India Act, 1992, shall not deemed to be or deemed to have been situated in India [Proviso to *Explanation 5* to section 9(1)(i)]

The CBDT has, vide Circular No. 28/2017, dated 07.11.2017, clarified that the provisions of section 9(1)(i) read with Explanation 5, shall not apply in respect of income accruing or arising to a non-resident on account of redemption or buyback of its share or interest held indirectly (i.e. through upstream entities registered or incorporated outside India) in the specified funds (namely, investment funds, venture capital company and venture capital funds) if such income accrues or arises from or in consequence of transfer of shares or securities held in India by the specified funds and such income is chargeable to tax in India.

However, the above benefit shall be applicable only in those cases where the proceeds of redemption or buyback arising to the non-resident do not exceed the pro-rata share of the non-resident in the total consideration realized by the specified funds from the said transfer of shares or securities in India. It is further clarified that a non-resident investing directly in the specified funds shall continue to be taxed as per the extant provisions of the Act.

Declaration of dividend by a foreign company outside India does not have the effect of transfer of any underlying assets located in India. *Circular No. 4/2015, dated 26-03-2015*, therefore, clarifies that the dividends declared and paid by a foreign company outside India in respect of shares which derive their value substantially from assets situated in India would **NOT** be deemed to be income accruing or arising in India by virtue of the provisions of section 9(1)(i).

***Explanation 6* to section 9(1)(i)** provides that the share or interest in a company or entity registered or incorporated outside India, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if on the specified date, the value of Indian assets, -

- exceeds the amount of ₹ 10 crore; and
- represents at least 50% of the value of all the assets owned by the company or entity, as the case may be;

Meaning of certain terms:

Term	Meaning
Value of an asset	The **fair market value as on the specified date**, of such asset **without reduction of liabilities**, if any, in respect of the asset, determined in prescribed manner**.**

Specified date	The date on which the **accounting period** of the company or, as the case may be, the entity **ends** preceding the date of transfer of a share or an interest. However, the date of transfer shall be the specified date of valuation, in a case where the book value of the assets of the company or entity on the date of transfer exceeds by at least 15%, the book value of the assets as on the last balance sheet date preceding the date of transfer.
Accounting period	Each period of 12 months ending with 31st March. However, where a company or an entity, referred to in *Explanation* 5, regularly adopts a period of 12 months ending on a day other than 31st March for the purpose of— (a) complying with the provisions of the tax laws of the territory, of which it is a resident, for tax purposes; or (b) reporting to persons holding the share or interest, then, the period of twelve months ending with the other day shall be the accounting period of the company or, as the case may be, the entity:
First Accounting Period	First accounting period of the company or, as the case may be, the entity shall **begin from the date of its registration or incorporation** and **end with the 31st March** or such other day, as the case may be, following the date of such registration or incorporation.
Later accounting period	Later accounting period shall be the **successive periods of twelve months**
Accounting period of an entity which ceases to exist	If the company or the entity ceases to exist before the end of accounting period, as aforesaid, then, the accounting period shall end immediately before the company or, as the case may be, the entity, ceases to exist.

Note - The manner of determination of fair market value of the assets of the foreign company is given in Rule 11UB. Determination of income attributable to assets in India is given in Rule 11UC[1].

***Explanation 7* to section 9(1)(i)** provides that **no income shall be deemed** to accrue or arise to a non-resident from transfer, outside India, of any share of, or interest in, a company or an entity, registered or incorporated outside India, in the following cases;

(1)	Foreign company or entity **directly** owns the assets situated in India	**AND**	**the transferor** (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, **does not hold** • the right of management or control in relation to foreign company or entity; or • the voting power or share capital or interest

[1] For detailed reading of Rule 11UB and 11UC of the Income-tax Rules, 1962, students may visit https://www.incometaxindia.gov.in/Pages/default.aspx

			exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the foreign company or entity; or
(2)	Foreign company or entity **indirectly** owns the assets situated in India	**AND**	**the transferor** (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, **does not hold** • the right of management or control in relation to foreign company or entity; or • any right in, or in relation to, such foreign company or entity which would entitle him to the right of management or control in the company or entity that directly owns the assets situated in India; or • such percentage of voting power or share capital or interest in foreign company or entity which results in holding of (either individually or along with associated enterprises) a voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the company or entity that directly owns the assets situated in India;

In effect, the exemption shall be available to the transferor of a share of, or interest in, a foreign entity if he along with its associated enterprises, -

- neither holds the right of control or management,
- nor holds voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest,

in the foreign company or entity directly holding the Indian assets (direct holding company).

In case the transfer is of shares or interest in a foreign entity which does not hold the Indian assets directly then the exemption shall be available to the transferor if he along with its associated enterprises,-

- neither holds the right of management or control in relation to such company or the entity,
- nor holds any rights in such company which would entitle it to either exercise control or management of the direct holding company or entity or entitle it to voting power or share capital or total interest exceeding 5% in the direct holding company or entity.

Further, where all the assets owned, directly or indirectly, by a company or, as the case may be, an entity registered or incorporated outside India, are not located in India, the income of the non-resident transferor, from transfer outside India of a share of, or interest in the foreign company or entity, deemed to accrue or arise in India under this clause, shall be only such part of the income as is reasonably attributable to assets located in India and determined in the prescribed manner.

"Associated enterprise", in relation to another enterprise, means an enterprise—

- which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

(2) Income from salaries earned in India [Section 9(1)(ii)]

Income, which falls under the head "Salaries", deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India would be treated as earned in India.

Further, any income under the head "Salaries" payable for rest period or leave period which is preceded and succeeded by services rendered in India, and forms part of the service contract of employment, shall be regarded as income earned in India.

(3) Income from salaries payable by the Government for services rendered outside India [Section 9(1)(iii)].

Income from 'Salaries' which is payable by the Government to a citizen of India for services rendered outside India would be deemed to accrue or arise in India.

However, allowances and perquisites paid or allowed outside India by the Government to an Indian citizen for services rendered outside India is exempt, by virtue of section 10(7).

ILLUSTRATION 2

J, a citizen of India, employed in the Indian Embassy at Tokyo, Japan. He received salary and allowances at Tokyo from the Government of India for the year ended 31.3.2020 for services rendered by him in Tokyo. Besides, he was allowed perquisites by the Government. He is a non-resident for the assessment year 2020-21. Examine the taxability of salary, allowances and perquisites in the hands of J for the assessment year 2020-21.

SOLUTION

As per section 9(1)(iii), salaries payable by the Government to a citizen of India for services rendered outside India shall be deemed to accrue or arise in India. As such, salary received by J is chargeable to tax, even though he was a non-resident for A.Y. 2020-21.

As per section 10(7), all allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering services outside India is exempt from tax. Therefore, the allowances and perquisites received by J are exempt as per section 10(7).

(4) *Dividend paid by a Indian company outside India [Section 9(1)(iv)]*

All dividends paid by an Indian company would be deemed to accrue or arise in India. Under section 10(34), income from dividends referred to in section 115-O i.e., dividend distributed by a domestic company on which DDT is leviable in the hands of the company, is exempt from tax in the hands of the shareholder. However, it will not be exempt if such dividend is chargeable to tax under section 115BBDA. Section 115BBDA, which brings to tax dividend in excess of ₹ 10 lakh in the hands of the shareholder @10%, does not apply to the non-residents.

(5) *Interest [Section 9(1)(v)]*

Under section 9(1)(v), an interest is deemed to accrue or arise in India if it is payable by -

(i) the Government;

(ii) a person resident in India;

Exception: Where it is payable in respect of any debt incurred or money borrowed and used, for the purposes of a business or profession carried on by him outside India or for the purposes of making or earning any income from any source outside India, it will not be deemed to accrue or arise in India.

(iii) a non-resident, when it is payable in respect of any debt incurred or moneys borrowed and used, for the purpose of a business or profession carried on in India by him.

Exception: Interest on money borrowed by the non-resident for any purpose other than a business or profession, will not be deemed to accrue or arise in India.

> ***Example:*** *If a non-resident 'A' borrows money from a non-resident 'B' and invests the same in shares of an Indian company, interest payable by 'A' to 'B' will not be deemed to accrue or arise in India.*

Meaning of interest: Interest means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized.

Taxability of interest payable by the Permanent Establishment of a non-resident engaged in banking business to the head office

In order to provide clarity and certainty, on the issue of taxability of interest payable by the PE of a non-resident engaged in banking business to the head office, an Explanation has been inserted in section 9(1)(v). Accordingly, in the case of a **non-resident, being a person engaged in the business of banking,** any interest payable by the **PE in India of such non-resident to the head office** or any PE or any other part of such non-resident outside India, shall be deemed to accrue or arise in India.

Such interest shall be chargeable to tax in addition to any income attributable to the PE in India.

Further, the PE in India shall be deemed to be a person separate and independent of the non-resident person of which it is a PE and the provisions of the Act relating to computation of total income, determination of tax and collection and recovery would apply accordingly.

Also, the PE in India has to deduct tax at source on any interest payable to either the head office or any other branch or PE, etc. of the non-resident outside India. Non-deduction would result in disallowance of interest claimed as expenditure by the PE and may also attract levy of interest and penalty in accordance with relevant provisions of the Act.

Permanent establishment includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

(6) Royalty [Section 9(1)(vi)]

Royalty will be deemed to accrue or arise in India when it is payable by -

(i) the Government;

(ii) a person who is a resident in India

Exception: Where it is payable for the transfer of any right or the use of any property or information or for the utilization of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India, or

(iii) a non-resident only when the royalty is payable in respect of any right, property or information used or services utilised for purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.

Important points:

1. **Lumpsum royalty not deemed to accrue arise in India:** Lumpsum royalty payments made by a resident for the transfer of all or any rights (including the granting of a licence) in respect of **computer software** supplied by a non-resident manufacturer along with computer hardware under any scheme approved by the government under the policy on computer software export, software development and training, 1986 shall not be deemed to accrue or arise in India.

2. **Meaning of Computer software:** "Computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customised electronic data.

3. **Meaning of Royalty:** The term 'royalty' means consideration (including any lumpsum consideration but excluding any consideration which would be the income of the recipient chargeable under the head 'capital gains') for:

   (i) the transfer of all or any rights (including the granting of licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property;

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

(v) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

(vi) the transfer of all or any rights (including the granting of licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films;

(vii) the rendering of any service in connection with the activities listed above.

The definition of 'royalty' for this purpose is wide enough to cover both industrial royalties as well as copyright royalties. The deduction specially excludes income which should be chargeable to tax under the head 'capital gains'.

4. Consideration for use or right to use of computer software is royalty within the meaning of section 9(1)(vi)

The consideration for use or right to use of computer software is royalty by clarifying that, transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred *[Explanation 4]*

Consequently, the provisions of tax deduction at source under section 194J and section 195 would be attracted in respect of consideration for use or right to use computer software since the same falls within the definition of royalty.

Note - The Central Government has, vide *Notification No. 21/2012 dated 13.6.2012* to be effective from 1st July, 2012, exempted certain software payments from the applicability of tax deduction under section 194J. Accordingly, where payment is made by the transferee for acquisition of software from a resident-transferor, the provisions of section 194J would not be attracted if –

(1) the software is acquired in a subsequent transfer without any modification by the transferor;

(2) tax has been deducted either under section 194J or under section 195 on payment for any previous transfer of such software; and

(3) the transferee obtains a declaration from the transferor that tax has been so deducted along with the PAN of the transferor.

5. Consideration in respect of any right, property or information – Is it royalty?

Explanation 5 provides that Royalty includes and has always included consideration in respect of any right, property or information, whether or not,

(a) the possession or control of such right, property or information is with the payer;

(b) such right, property or information is used directly by the payer;

(c) the location of such right, property or information is in India *[Explanation 5]*

6. Meaning of Process

Explanation 6 provides that the term "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret *[Explanation 6]*

ILLUSTRATION 3

Mr. Soham, an Indian Citizen, left India on 20-04-2017 for the first time to setup a software firm in Singapore. On 10-04-2019, he entered into an agreement with LK Limited, an Indian Company, for the transfer of technical documents and designs to setup an automobile factory in Faridabad. He reached India along with his team to render the requisite services on 15-05-2019 and was able to complete his assignment on 20-08-2019. He left for Singapore on 21-08-2019. He charged ₹ 50 lakhs for his services from LK Limited.

Determine the residential status of Mr. Soham for the Assessment Year 2020-21 and examine whether the fees charged from LK Limited would be chargeable to tax as per the Income-tax Act, 1961.

SOLUTION

Determination of residential status of Mr. Soham

As per section 6(1), an individual is said to be resident in India in any previous year if he satisfies the conditions:-

(i) He has been in India during the previous year for a total period of 182 days or more, or

(ii) He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the previous year.

In the case of an Indian citizen leaving India for the purposes of employment outside India during the previous year or an Indian citizen, who being outside India, comes on a visit to India in any previous year, the period of stay during the previous year in condition (ii) above, to qualify as a resident, would be 182 days instead of 60 days.

In this case, Mr. Soham is an Indian citizen who left India to set up a software firm in Singapore on 20.04.2017. Therefore, he is an Indian citizen living in Singapore, who comes on a visit to India during the P.Y.2019-20. His stay in India during the period of his visit is only 99 days (i.e., 17+30+31+21 days). Since his stay in India during the previous year 2019-20 is only 99 days, he does not satisfy the minimum criterion of 182 days stay in India for being a resident. Hence, his residential status for A.Y.2020-21 is Non-Resident.

Taxability of income

As per section 5(2), in case of a non-resident, only income which accrues or arises or which is deemed to accrue or arise to him in India or which is received or deemed to be received in India in the relevant previous year is taxable in India.

In this case, Mr. Soham, a non-resident, charges fees from LK Ltd., an Indian company, for transfer of technical documents and designs to set up an automobile factory in Faridabad. He renders the requisite services in India for which he stays in India for 99 days during the P.Y.2019-20.

Section 9(1)(vi) defines "royalty" to mean consideration for transfer of all or any rights in respect of, *inter alia*, a design and also for the rendering of services in connection with such activity. Transfer of rights in the above definition includes transfer of right for use or right to use a computer software also. Therefore, the fees received by Mr. Soham for transfer of technical documents and designs and rendering of requisite services in relation thereto would fall within the meaning of "royalty".

As per section 9(1)(vi), income by way of royalty payable by a person who is a resident (in this case, LK Limited, an Indian company) would be deemed to accrue or arise in India in the hands of the non-resident (Mr. Soham, in this case), except where such royalty is payable in respect of any right or property or information used or for services utilized for the purpose of a business carried on by such person outside India or for the purposes of making or earning income from any source outside India.

In this case, since the royalty is payable by LK Limited*,* an Indian company, to Mr. Soham, a non-resident, in respect of services utilized for a business in India (namely, for setting up an automobile factory in Faridabad), the same is deemed to accrue or arise in India and is hence, taxable in India in the hands of Mr. Soham, a non-resident for the A.Y. 2020-21.

(7) Fees for technical services [Section 9(1)(vii)]

Any fees for technical services will be deemed to accrue or arise in India if they are payable by -

(i) the Government.

(ii) a person who is resident in India

Exception: Where the fees is payable in respect of technical services utilised in a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India.

(iii) a person who is a non-resident, only where the fees are payable in respect of services utilised in a business or profession carried on by the non-resident in India or where such services are utilised for the purpose of making or earning any income from any source in India.

Fees for technical services mean any consideration (including any lumpsum consideration) for the rendering of any managerial, technical or consultancy services (including providing the services of technical or other personnel). However, it does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'.

Income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fee for technical services to be taxed irrespective of territorial nexus [*Explanation* to section 9]

Income by way of interest, royalty or fee for technical services which is deemed to accrue or arise in India by virtue of clauses (v), (vi) and (vii) of section 9(1), shall be included in the total income of the non-resident, whether or not –

(i) the non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India.

In effect, the income by way of fee for technical services, interest or royalty, from services utilized in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

ILLUSTRATION 4

Miss Vivitha paid a sum of 5000 USD to Mr. Kulasekhara, a management consultant practising in Colombo, specializing in project financing. The payment was made in Colombo. Mr. Kulasekhara is a non-resident. The consultancy is related to a project in India with possible Ceylonese collaboration. Is this payment chargeable to tax in India in the hands of Mr. Kulasekhara?

SOLUTION

A non-resident is chargeable to tax in respect of income received outside India only if such income accrues or arises or is deemed to accrue or arise to him in India.

The income deemed to accrue or arise in India under section 9 comprises, *inter alia*, income by way of fees for technical services, which includes any consideration for rendering of any managerial, technical or consultancy services. Therefore, payment to a management consultant relating to project financing is covered within the scope of "fees for technical services".

The *Explanation* below section 9(2) clarifies that income by way of, *inter alia*, fees for technical services, from services utilized in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India or whether or not the non-resident has a residence or place of business or business connection in India.

In the instant case, since the services were utilized in India, the payment received by Mr. Kulasekhara, a non-resident, in Colombo is chargeable to tax in his hands in India, as it is deemed to accrue or arise in India.

(8) Any sum of money paid by a resident Indian to a non-corporate non-resident or foreign company [Section 9(1)(viii)]

Income arising outside India, being any sum of money paid without consideration, by a Indian resident person to a non-corporate non-resident or foreign company on or after 5.7.2019 would be deemed to accrue or arise in India if the same is chargeable to tax under section 56(2)(x) i.e., if the aggregate of such sum received by a non-corporate non-resident or foreign company exceeds ₹ 50,000.

ILLUSTRATION 5

Compute the total income in the hands of an individual, aged 55 years, being a resident and ordinarily resident, resident but not ordinarily resident, and non-resident for the A.Y. 2020-21:

Particulars	*Amount (₹)*
Interest on UK Development Bonds, 50% of interest received in India	*10,000*
Income from a business in Chennai (50% is received in India)	*20,000*
Short term capital gains on sale of shares of an Indian company received in London	*20,000*
Dividend from British company received in London	*5,000*
Long term capital gains on sale of plant at Germany, 50% of profits are received in India	*40,000*
Income earned from business in Germany which is controlled from Delhi (₹ 40,000 is received in India)	*70,000*
Profits from a business in Delhi but managed entirely from London	*15,000*
Income from house property in London deposited in an Indian Bank at London, brought to India (Computed)	*50,000*
Interest on debentures in an Indian company received in London	*12,000*

Fees for technical services rendered in India but received in London	*8,000*
Profits from a business in Bombay managed from London	*26,000*
Pension for services rendered in India but received in Burma	*4,000*
Income from property situated in Pakistan, received there	*16,000*
Past foreign untaxed income brought to India during the previous year	*5,000*
Income from agricultural land in Nepal received there and then brought to India	*18,000*
Income from profession in Kenya which was set up in India, received there but spent in India	*5,000*
Gift received on the occasion of his wedding	*20,000*
Interest on savings bank deposit in State Bank of India	*12,000*
Income from a business in Russia, controlled from Russia	*20,000*
Dividend from Reliance Petroleum Limited, an Indian Company	*5,000*
Agricultural income from a land in Rajasthan	*15,000*

SOLUTION

Computation of total income for the A.Y. 2020-21

Particulars	Resident and ordinarily resident ₹	Resident but not ordinarily resident ₹	Non-resident ₹
Interest on UK Development Bonds, 50% of interest received in India	10,000	5,000	5,000
Income from a business in Chennai (50% is received in India)	20,000	20,000	20,000
Short term capital gains on sale of shares of an Indian company received in London	20,000	20,000	20,000
Dividend from British company received in London	5,000	-	-
Long term capital gain on sale of plant at Germany, 50% of profits are received in India	40,000	20,000	20,000
Income earned from business in Germany which is controlled from Delhi, out of which ₹ 40,000 is received in India	70,000	70,000	40,000
Profits from a business in Delhi but managed entirely from London	15,000	15,000	15,000
Income from property in London deposited in a Bank at London, later on remitted to India	50,000	-	-

Interest on debentures in an Indian company received in London	12,000	12,000	12,000
Fees for technical services rendered in India but received in London	8,000	8,000	8,000
Profits from a business in Bombay managed from London	26,000	26,000	26,000
Pension for services rendered in India but received in Burma	4,000	4,000	4,000
Income from property situated in Pakistan, received there	16,000	-	-
Past foreign untaxed income brought to India during the previous year	-	-	-
Income from agricultural land in Nepal received there and then brought to India	18,000	-	-
Income from profession in Kenya which was set up in India, received there but spent in India	5,000	5,000	-
Gift received on the occasion of his wedding **[not taxable]**	-	-	-
Interest on savings bank deposit in State Bank of India	12,000	12,000	12,000
Income from a business in Russia, controlled from Russia	20,000	-	-
Dividend from Reliance Petroleum Limited, an Indian Company **[Exempt under section 10(34)]**	-	-	-
Agricultural income from a land in Rajasthan **[Exempt under section 10(1)]**	-	-	-
Gross Total Income	**3,51,000**	**2,17,000**	**1,82,000**
Less: Deduction under section 80TTA			
[Interest on savings bank account subject to a maximum of ₹10,000]	10,000	10,000	10,000
Total Income	**3,41,000**	**2,07,000**	**1,72,000**

(3) Presence of Eligible Fund Manager in India not to constitute Business Connection in India of such Eligible Investment Fund on behalf of which he undertakes Fund Management Activity [Section 9A]

(i) **Fund Management Activity through an eligible fund manager not to constitute business connection:** In the case of an eligible investment fund, the fund management activity carried out through an eligible fund manager acting on behalf of such fund shall not constitute business connection in India of the said fund, subject to fulfillment of certain conditions.

(ii) **Location of Fund Manager in India not to affect residential status of an eligible investment fund:** An eligible investment fund shall not be said to be resident in India merely because the eligible fund manager undertaking fund management activities on its behalf, is located in India.

(iii) **Conditions to be fulfilled by an Eligible Investment Fund:** The eligible investment fund means a fund established or incorporated or registered outside India, which collects funds from its members for investing it for their benefit. Further, it should fulfill the following conditions:

(a) the fund should not be a person resident in India;

(b) the fund should be a resident of a country or a specified territory with which an agreement referred to in section 90(1) or section 90A(1) has been entered into or should be established or incorporated or registered outside India in a country or a specified territory notified by the Central Government in this behalf;

(c) the aggregate participation or investment in the fund, directly or indirectly, by persons being resident in India should not exceed 5% of the corpus of the fund;

(d) the fund and its activities should be subject to applicable investor protection regulations in the country or specified territory where it is established or incorporated or is a resident;

(e) the fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;

(f) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;

(g) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%;

(h) the investment by the fund in any entity shall not exceed 20% of the corpus of the fund;

(i) no investment shall be made by the fund in its associate entity;

(j) the monthly average of the corpus of the fund shall not be less than ₹ 100 crore. If the fund has been established or incorporated in the previous year, the corpus of fund should not be less than ₹ 100 crore rupees ***at the end of a period of six months from the last day of the month of its establishment or incorporation, or the end of such previous year, whichever is later***;

However, this condition shall not be applicable to a fund which has been wound up in the previous year.

(k) the fund shall not carry on or control and manage, directly or indirectly, any business in India;

(l) the fund should neither be engaged in any activity which constitutes a business connection in India nor should have any person acting on its behalf whose activities constitute a business connection in India other than the activities undertaken by the eligible fund manager on its behalf.

(m) the remuneration paid by the fund to an eligible fund manager in respect of fund management activity undertaken on its behalf should not be less than ***the amount calculated in the prescribed manner***.

(iv) **Certain conditions not to apply to investment fund set up by the Government or the Central Bank of a foreign State or a Sovereign Fund or other notified fund [Proviso to Section 9A(3)]:** The following conditions would, however, not be applicable in case of an investment fund set up by the Government or the Central Bank of a foreign State or a sovereign fund or such other fund notified by the Central Government (i.e., an investment fund set up by a Category-I or Category-II Foreign Portfolio Investor registered under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, made under the Securities and Exchange Board of India Act, 1992:

(e) the fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;

(f) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;

(g) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%.

(v) **Eligible Fund Manager [Section 9A(4)]:** The eligible fund manager, in respect of an eligible investment fund, means any person who is engaged in the activity of fund management and fulfills the following conditions:

(a) the person should not be an employee of the eligible investment fund or a connected person of the fund;

(b) the person should be registered as a fund manager or investment advisor in accordance with the specified regulations;

The CBDT has, vide ***Circular No.8/2019 dated 10.5.2019****, clarified that a fund manager includes an Asset Management Company (AMC) approved by SEBI under the SEBI (Mutual Funds) Regulations, 1996. This is because AMCs are engaged in* *the activity of fund management of Mutual Funds and hence are, in substance, Fund Managers.*

(c) the person should be acting in the ordinary course of his business as a fund manager;

(d) the person along with his connected persons shall not be entitled, directly or indirectly, to more than 20% of the profits accruing or arising to the eligible investment fund from the transactions carried out by the fund through such fund manager.

(vi) **Furnishing of Statement in prescribed form [Section 9A(5)]:** Every eligible investment fund shall, in respect of its activities in a financial year, furnish within 90 days from the end of the financial year, a statement in the prescribed form to the prescribed income-tax authority. The statement should contain information relating to –

(a) the fulfillment of the above conditions; and

(b) such other relevant information or document which may be prescribed.

If any eligible investment fund fails to furnish such statement or information or document within 90 days from the end of the financial year, the income-tax authority prescribed under the said sub-section may direct that such fund shall pay, by way of penalty, a sum of ₹ 5,00,000. [Section 271FAB]

(vii) **Non-applicability of special taxation regime under section 9A [Section 9A(6)]:** This special taxation regime would not have any impact on taxability of any income of the eligible investment fund which would have been chargeable to tax irrespective of whether the activity of the eligible fund manager constituted business connection in India of such fund or not.

Further, the said regime shall not have any effect on the scope of total income or determination of total income in the case of the eligible fund manager.

(viii) CBDT to prescribe guidelines for the manner of application of the provisions of this section.

(ix) **Meaning of certain terms:**

Term	Meaning
Associate	An entity in which a director or a trustee or a partner or a member or a fund manager of the investment fund or a director or a trustee or a partner or a member of the fund manager of such fund, holds, either individually or collectively, share or interest, being more than 15% of its share capital or interest, as the case may be.
Corpus	The total amount of funds raised for the purpose of investment by the eligible investment fund as on a particular date.
Connected	Any person who is connected directly or indirectly to another person and

person	includes,— (a) any relative of the person, if such person is an individual; (b) any director of the company or any relative of such director, if the person is a company; (c) any partner or member of a firm or association of persons or body of individuals or any relative of such partner or member, if the person is a firm or association of persons or body of individuals; (d) any member of the Hindu undivided family or any relative of such member, if the person is a Hindu undivided family; (e) any individual who has a substantial interest in the business of the person or any relative of such individual; (f) a company, firm or an association of persons or a body of individuals, whether incorporated or not, or a Hindu undivided family having a substantial interest in the business of the person or any director, partner, or member of the company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member; (g) a company, firm or association of persons or body of individuals, whether incorporated or not, or a Hindu undivided family, whose director, partner, or member has a substantial interest in the business of the person, or family or any relative of such director, partner or member; (h) any other person who carries on a business, if - (i) the person being an individual, or any relative of such person, has a substantial interest in the business of that other person; or (ii) the person being a company, firm, association of persons, body of individuals, whether incorporated or not, or a Hindu undivided family, or any director, partner or member of such company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member, has a substantial interest in the business of that other person;

2.3 EXEMPT INCOME OF NON RESIDENTS

Section 10 of the Income-tax Act, 1961 exempts from tax various incomes including the following in the hands of a non-resident:

(1) Interest on moneys standing to the credit of individual in his NRE A/c [Section 10(4)(ii)]

As per section 10(4)(ii), in the case of an individual, any income by way of interest on moneys standing to his credit in a **Non-resident (External) Account (NRE A/c)** in any bank in India in accordance with the Foreign Exchange Management Act, 1999 (FEMA, 1999), and the rules made thereunder, would be exempt, provided such individual;

- is a person resident outside India, as defined in FEMA, 1999, or
- is a person who has been permitted by the Reserve Bank of India to maintain such account.

In this context, it may be noted that the joint holders of the NRE Accounts do not constitute an AOP by merely having these accounts in joint names. The benefit of exemption under section 10(4)(ii) will be available to such joint account holders, subject to fulfillment of other conditions contained in that section by each of the individual joint account holders.

Example: *Mrs. Neena Kansal, is resident of Singapore since year 2000. She holds an NRE account with Bank of Baroda, New Delhi Branch. Interest of ₹ 10,000 was credited to such account during financial year 2019-20. Such interest income earned by her shall be exempt from income-tax while she files her tax return for A.Y 2020-21.*

(2) Interest income of a non-corporate non-resident or foreign company on specified off-shore Rupee Denominated Bonds issued by an Indian company or business trust [Section 10(4C)]

Interest payable by an Indian company or business trust to a non-corporate non-resident or a foreign company in respect of money borrowed from a source outside India by way of issue of rupee denominated bond during the period from 17.9.2018 to 31.3.2019 would be exempt.

(3) Income of a specified fund on transfer of certain specified asset on recognized stock exchange, to the extent such income accrues or arises to, or is received in respect of units held by a non-resident [Section 10(4D)]

Income accrued or arising to or received by specified fund on transfer of a capital asset, being a bond of an Indian Company or a public sector company (sold by the Government and purchased by the specified fund in foreign currency), GDR or rupee denominated bond or derivative or any other notified security, on a recognized stock exchange located in any IFSC would be exempt –

(i) where the consideration is paid or payable in convertible foreign exchange,

(j) to the extent such income accrues or arises to, or is received in respect of units held by a non-resident.

Meaning of certain terms:

S. No.	Term	Meaning
1	*Specified fund*	*A fund established or incorporated in India in the form of a trust or a company or a LLP or a body corporate, –* *(i) which has been granted a certificate of registration as a Category III Alternative Investment Fund and is regulated under the SEBI*

		(Alternative Investment Fund) Regulation, 2012, made under the SEBI Act, 1992 *(ii) which is located in any IFSC* *(iii) of which all the units are held by non-residents other than units held by a sponsor or manager*
2	*Trust*	*A trust established under the Indian Trust Act, 1882 or under any other law for the time being in force.*
3	*Unit*	*Unit means beneficial interest of an investor in the fund and shall include shares or partnership interests.*
4	*Manager*	*Any person or entity who is appointed by the Alternative Investment Fund to manage its investment by whatever name called. Manager may also be same as the sponsor of the Fund.*
5	*Sponsor*	*Any person or persons who set up the Alternative Investment Fund and includes promoter in case of a company and designated partner in case of LLP.*

(4) Remuneration received by individuals, who are not citizens of India [Section 10(6)]

(i) Remuneration received by officials of Embassies etc. of Foreign States [Section 10(6)(ii)]: The remuneration received by an individual, who is not a citizen of India, for services as an official by whatever name called of an embassy, high commission, legation, commission, consulate or trade representation of foreign state, or a member of staff of any of these official is exempt.

Conditions

(a) The remuneration received by our corresponding Government officials resident in such foreign countries should be exempt.

(b) The above-mentioned member of the staff of such officials should be the subjects of the respective countries and should not be engaged in any other business or profession or employment in India.

Examples:

1. *Mr. A, a citizen of India but resident of USA since year 2012, was appointed as a senior official of the US embassy in India. He earned a remuneration of ₹ 10 lakhs during F.Y. 2019-20.* ***Being an Individual who is a citizen of India, though fulfilling other conditions of the section, such remuneration shall not be exempt in his hands for A.Y. 2020-21.***

2. *Mr. Vikram Kohli, an Indian born person but currently the resident and Citizen of USA, was appointed as a senior official of the US embassy in India. He earned a remuneration of ₹ 10 lakhs during F.Y. 2019-20.* ***Being an Individual who is not***

a citizen of India and also fulfilling other conditions of the section, such remuneration shall be exempt in his hands for A.Y. 2020-21.

3. *Mr. Frank D'Souza, an Irish Citizen but currently the resident of USA, was appointed as a senior official of the US embassy in India. He earned a remuneration of ₹ 10 lakhs during F.Y. 2019-20.* ***Being an Individual who is not a citizen of India, such remuneration shall be exempt in his hands for A.Y. 2020-21, subject to fulfilment of the conditions.***

(ii) **Remuneration received for services rendered in India by a Foreign National employed by foreign enterprise [Section 10(6)(vi)]**: The remuneration received by a foreign national as an employee of a foreign enterprises, for services rendered by him during his stay in India is exempt from tax.

Conditions

(a) The foreign enterprise is not engaged in any business or trade in India:

(b) The employee's stay in India does not exceed in the aggregate a period of 90 days in such previous year and

(c) The remuneration is not liable to be deducted from the income of the employer chargeable under the Income-tax Act, 1961.

Examples:

1. *Mr. A, citizen of India but resident of USA since year 2012, was appointed in India in October, 2018 as an employee of a US enterprise. Such US enterprise is not engaged in any business in India. A's job requires him to visit his US office every twenty five (25) days for reporting purposes.*

   During F.Y. 2019-20, Mr. A earned a remuneration of ₹ 10 lakhs for his India related assignment and his stay in India in aggregate was 85 days. Further, such US enterprise has not claimed any deduction of such remuneration under the Income-tax Act, 1961.

   Being an Individual who is a citizen of India, such remuneration shall not be exempt in his hands for A.Y. 2020-21 under this section i.e., section 10(6)(vi), though he may get exemption under any other provision of the Income-tax Act, 1961, subject to fulfilment of conditions stipulated thereunder.

2. *In the above case, let's consider that Mr. A is a citizen of USA. All other facts remaining same, his* ***remuneration shall be exempt from tax in his hands for A.Y. 2020-21 under this section.***

3. *Let's take another variation, Mr. A is a citizen of USA but the remuneration paid to him is borne by the permanent establishment of such US enterprise in India. ₹ 10*

lakhs paid to A is cross charged by the US enterprise to its Indian permanent establishment (PE).

In this case, the remuneration shall not be exempt from taxation in the hands of Mr. A as the same is getting deducted from the income of the Indian PE of such foreign enterprise.

(iii) **Salary received by a non-citizen for services rendered in connection with employment on foreign ship [Section 10(6)(viii)]:** Any income chargeable under the head "Salaries" received by or due to, non-citizen of India who is also a non-resident as remuneration for services rendered in connection with his employment on a foreign ship is exempt provided his total stay in India does not exceed 90 days during the previous year.

(iv) **Remuneration received by Foreign Government employees during their stay in India for specified training [Section 10(6)(xi)]:** Any remuneration received by employee of the Government of a foreign state from their respective Government during his stay in India, is exempt from tax, if remuneration is received in connection with training in any establishment or office of or in any undertaking owned by,-

(a) the Government, or

(b) any company owned by the Central Government or any State Government or partly by the Central Government and partly by one or more State Government

(c) any company which is subsidiary of a company referred to in (b) above, or

(d) any statutory corporation; or

(e) any society registered under Societies Registration Act, 1860 or under any law and wholly financed by the Central Government or any State Government(s) or partly by the Central Government and partly by one or more State Governments.

It may be carefully noted that exemption is available under section 10(6) only to an individual who is not a citizen of India.

Exempt Income of Non-Residents

Section	Income	Available to
10(4)(ii)	Interest on money standing to the credit in a Non-resident (External) account of an Individual in any bank in India as per the FEMA Act, 1999.	Individual resident outside India (under FEMA Act) or an individual who has been permitted to maintain said account by RBI
10(4C)	***Interest payable by an Indian company or business trust in respect of moneys borrowed from a source outside India by way of issue of***	***A non-corporate non-resident or foreign company***

	rupee denominated bond during the period from 17.9.2018 to 31.3.2019	
10(4D)	***Income on transfer of a capital asset, being a bond of an Indian Company or a public sector company (sold by the Government and purchased by the specified fund in foreign currency), GDR or rupee denominated bond or derivative or any other notified security, on a recognized stock exchange located in any IFSC is exempt –*** ***(i) where the consideration is paid or payable in convertible foreign exchange;*** ***(ii) to the extent such income accrues or arises to, or is received in respect of units held by a non-resident***	***A specified fund***
10(6)(ii)	Remuneration received by Foreign Diplomats/ Consulate and their staff (Subject to conditions)	Individual (not being a citizen of India)
10(6)(vi)	Remuneration received as an employee of a foreign enterprise for services rendered by him during his stay in India, if: a) Foreign enterprise is not engaged in any trade or business in India; b) His stay in India does not exceed the aggregate a period of 90 days in such previous year; and c) Such remuneration is not liable to deducted from the income of employer chargeable under this Act	Individual - Salaried Employee (not being a citizen of India) of a foreign enterprise
10(6)(viii)	Salary received by or due for services rendered in connection with his employment on a foreign ship if his total stay in India does not exceed 90 days in the previous year.	Individual Salaried Employee (Non-resident who is not a citizen of India) of a foreign enterprise
10(6)(xi)	Remuneration received as an employee of the Government of a foreign state during his stay in India in connection with his training in any Government Office/ Statutory Undertaking/ corporation/ registered society etc.	Individual - Salaried Employee (not being a citizen of India) of Government of foreign state
10(6A)	Tax paid by Government or Indian concern (under terms of agreement entered into after 31-3-1976 but before 1-6-2002 by the Government or Indian concern with the foreign company) on income	Foreign Company

	derived by way of royalty or fees for technical services by the foreign company from Government or Indian concern.	
10(6B)	Tax paid by Government or Indian concern under terms of agreement entered into before 1-6-2002 by Central Government with Government of foreign State or international organization on income derived by a non-corporate non-resident or foreign company from the Government or Indian concern, other than income by way of salary, royalty or fees for technical services	Non-corporate non-resident or foreign company
10(6BB)	Tax paid by Indian company, engaged in the business of operation of aircraft, which has acquired an aircraft or an aircraft engine on lease, under an approved (by Central Government) agreement entered into between 1-4-1997 and 31-3-1999, or after 31-3-2007, on lease rental/income derived (other than payment for providing spares or services in connection with the operation of leased aircraft) by the Government of a Foreign State or foreign enterprise.	Government of foreign State or foreign enterprise (i.e., a person who is a non-resident)
10(6C)	Royalty income or fees for technical services under an agreement with the Central Government for providing services in or outside India in projects connected with security of India	Foreign company (notified by the Central Government)
10(6D)	Royalty income from or fees from technical services rendered in or outside India to, the National Technical Research Organisation (NTRO)	Non-corporate non-resident or foreign company
10(8)	Foreign income; and Remuneration received by an individual from the Government of a foreign State, in connection with any co-operative technical assistance programme and project under agreement between Central Government and the Government of a foreign State.	Individual who is assigned to duties in India
10(8A)	Foreign income; and Any remuneration or fee received by such person (agreement relating to his engagement must be approved) out of funds made available to an international organization (agency like World Bank or any other multi-lateral agency) under a technical assistance grant agreement between that agency and the Government of a foreign State (such	Consultant, being (i) An individual: a) not being an Indian citizen; or b) being an Indian citizen who is not ordinarily resident in India, or

	technical assistant should be in accordance with an agreement between the Central Government and the agency).	(ii) any other person, being a non- resident engaged by the agency for rendering technical services in India in connection with any technical assistance programme or project in accordance with the approved agreement.
10(8B)	Foreign income; and Remuneration received, directly or indirectly, by an individual who is assigned to duties in India in connection with any technical assistance programme and project in accordance with an agreement entered into by the Central Government and the agency from a consultant referred to in section 10(8A)	Employee of a consultant, being an individual: a) not being an Indian citizen; or b) being an Indian citizen who is not ordinarily resident in India Contract of service must be approved by the prescribed authority before commencement of service.
10(9)	Foreign income	Any family member of individual as referred to in section 10(8)/(8A)/(8B), accompanying him to India.
Foreign income referred in section 10(8)/(8A)/(8B)/(9) above refers to the other income accruing or arising outside India. Such income would be exempt provided: (i) it is not deemed to accrue or arise in India; and (ii) the individual is required to pay any income tax or social security tax of such income to the Government of that Foreign State or Country of origin of such member.		
10(15)(iiia)	Interest on deposits made by a foreign bank with scheduled bank with approval of RBI.	Bank incorporated outside India and authorised to perform Central Banking functions in that country.
10(15)(iv)(fa)	Interest payable by scheduled bank on deposits in foreign currency where acceptance of such deposits is duly approved by RBI. [Scheduled bank does not include co-operative bank]	a) Non-resident b) Individual or HUF being a resident but not ordinary resident
10(15)(viii)	Interest on deposit on or after 01.04.2005 in an Offshore Banking Unit	

10(15)(ix)	***Interest payable by a unit located in an IFSC in respect of monies borrowed by it on or after 1.9.2019***	***Non-resident***
10(15A)	Lease rental paid by Indian company, engaged in the business of operation of aircraft, to acquire an aircraft or an aircraft engine on lease (other than payment for providing spares or services in connection with the operation of leased aircraft) under an approved (by Central Government) agreement not entered into between 1-4-1997 and 31-3-1999, or after 31-3-2007.	Government of foreign State or foreign enterprise (i.e., a person who is a non-resident)
10(23BBB)	Income of European Economic Community derived in India from interest, dividends or capital gains from investment out of its funds under notified scheme of Central Government.	European Economic Community
10(23BBC)	Income of SAARC Fund for Regional Projects set up by Colombo Declaration.	SAARC Fund for Regional Projects.
10(48)	Income received in India in Indian currency on account of sale of Crude oil or any other goods or rendering of services as may be notified by the Central Government in this behalf. Foreign company and agreement should be notified by the Central Government in national interest.	Foreign company on account of sale of crude oil, any other goods or rendering of services. It should not be engaged in any other activity in India.
10(48A)	Income accruing or arsing on account of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India. Foreign company and agreement should be notified by the Central Government in national interest.	Foreign company on account of storage of crude oil in a facility in India and sale of crude oil therefrom.
10(48B)	Income from sale of leftover stock of crude oil from facility in India after the expiry of agreement or arrangement referred to in section 10(48A) or on termination of the said agreement or arrangement, in accordance with the terms mentioned therein, as the case may be, subject to such conditions, as may be notified by the Central Government.	Foreign company from sale of leftover stock of crude oil from the facility in India.

2.4 PRESUMPTIVE TAXATION FOR NON RESIDENTS

Section 28 details the income chargeable to tax under the head “Profits and Gains of Business or Profession”. Certain provisions have been incorporated in the Income-tax Act, 1961, whereby the

"Profits and gains of business or profession" of certain non-resident assessee is computed on the basis of certain percentage of the amount accrued or arisen and received in India.

(1) Special provision for computing the profits and gains of shipping business in the case of non-residents [Section 44B]

Section 44B is a non-obstante clause. Accordingly, sections 28 to 43A are not applicable in the case of a non-resident engaged in the business of operation of ships.

Section 44B provides that profits and gains of a non-resident engaged in the business of operation of ships are to be taken @ 7.5% of the aggregate of the following amounts:

(i) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of carriage of passengers, livestock, mail or goods shipped at any port in India; and

(ii) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock mail or goods shipped at any port outside India.

The amounts referred to in (i) and (ii) shall include demurrage charges or handling charges or any other amount of similar nature.

The amounts paid or payable or the amounts received or deemed to be received will also include the amount paid or payable or received or deemed to be received by way of demurrage charges or handling charges or any other amount of similar nature [*CIT v. Japan Lines Ltd. 260 ITR 656 (Mad)*]**.** Thus 7.5% of the gross amounts mentioned above would be liable to tax and no deduction would be allowed for any expenditure, (i.e. the provisions of section 28 to 43A are not to be taken into account) however carried forward losses would be allowed to be set off from such income.

Analysis of section 44B and section 172:

Section 44B	Section 172
Presumptive tax provisions for non-residents engaged in shipping business. It does not, however, contain any procedure for assessment and collection of tax.	Complete code for taxation of occasional shipping business of non-residents, including assessment and collection of tax.
Manner of computation of presumptive Income:	
Notwithstanding anything to the contrary contained in sections 28 to 43A, in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7.5% of the aggregate of the - - amount paid or payable (whether in or outside	Where a ship carries passengers, livestock, mail or goods shipped at a port in India, a sum equal to **7.5%** of - the amount paid or payable on account of such carriage to the owner or the charterer or to any person on his behalf,

India) to the non-resident or to any other person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any Indian port and - the amount received or deemed to be received in India on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India. **shall be deemed to be the profits and gains of such business** chargeable to tax under the head "Profits and gains of business or profession".	whether that amount is paid or payable in or out of India, **shall be deemed to be income accruing in India** to the owner or charterer on account of such carriage.

Other provisions of section 172

(i) Furnish a return of the amount paid to the owner: Section 172(3) imposes an obligation on the master of the ship to prepare and furnish to the Assessing Officer a return of the full amount paid or payable to the owner or charterer or any person on this behalf, on account of the carriage of all passengers, livestock, mail or goods shipped at any port in India since the last arrival of the ship thereat. Such return is, ordinarily, to be furnished by the master of the ship before the departure, from that port in India, of the ship.

A return may, however, be filed by the person authorized by the master of the ship within 30 days of the departure of the ship from the port, if:

(a) the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return required by section 172(3) before the departure of the ship from the port and

(b) the master of the ship has made satisfactory arrangement for the filing of the return and payment of tax by any other person on this behalf.

(ii) Assessment [Section 172(4)]: This section provides for a summary procedure of assessment. On receipt of the return filed by the master of the ship or by any person on this behalf, the Assessing Officer has to determine the tax payable on the taxable income. By virtue of the provisions of section 172(2), the taxable income is a sum equal to 7.5% of the amount paid or payable on account of carriage of passengers etc. to the owner or charterer or to any person on his behalf, whether that amount is paid or payable in or out of India. The tax payable on such taxable income is to be calculated at the **rate or rates in force applicable to the total income of a foreign company**. The master of the ship is liable for payment of such tax.

(iii) **Time limit for passing the assessment order [Section 172(4A)/(5)]:** It is incumbent on the Assessing Officer to pass the order of assessment within 9 months from the end of the financial year in which the return of income under section 172(3) is filed.

For the purpose of determining the tax payable, Assessing Officer is empowered to call for such accounts and documents as he may require.

(iv) **Grant of port of clearance to the ship [Section 172(6)]:** A port clearance shall not be granted to the ship until the Collector of customs or other authorized officer, is satisfied that the tax assessable under section 172 has been duly paid or that satisfactory arrangements have been made for the payment thereof.

(v) **Option to pay tax as per normal provisions of the Income-tax Act, 1961 on the income chargeable to tax under section 172 [Section 172(7)]:** The owner or charterer has the option to claim before the expiry of the assessment year relevant to the previous year in which the date of departure of the ship from the Indian port falls, that an assessment in respect of his total income for the previous year and the tax payable on the basis thereof be determined in accordance with the other provisions of this Act. In such a case, any payment made under section 172 is to be treated as a payment in advance of the tax leviable for that assessment year and the difference between the sum so paid and the amount of tax found payable by him on such assessment is to be paid by him or refunded to him, as the case may be.

> The sum chargeable to tax under this section shall include amounts payable by way of **demurrage charge or handling charge** or any other amount of similar nature [Section 172(8)].

Section 172 *vis-à-vis* section 44B

In case the assessee is covered under section 172, 7.5 per cent of the amount paid or payable on account of the carriage of the passengers, livestock, mail or goods to the owner or the chartered or to any person on his behalf is deemed as his income and tax is levied on such income at a rate applicable to a foreign company i.e., 40% *plus* surcharge, if any, and *plus* health and education cess @4%.

Under the provisions of section 172(7), the non-resident owner or charterer is allowed an option to be assessed on his total income of the previous year in accordance with other provisions of the Act i.e., as per section 44B.

When such option is exercised, a regular assessment is made. In such a case, the tax already paid under the provisions of section 172(4) by the non-resident owner or charterer would be treated as tax paid in advance for that assessment year before determining the amount of tax finally due**.** The difference between the sum so paid and the amount of tax payable by him on such assessment shall be paid by the assessee or refunded to him (See Note below).

In that case, the non-resident assessee is liable to pay interest under sections 234B and 234C and also entitled to receive interest under section 244A of the Income-tax Act, 1961 as the case may be. [**Circular No. 9/2001, dated 9-7-2001]**

Note *–Refund may arise in case of non-corporate non-residents, since they are liable to pay tax at a rate lower than the rate of 40% (plus surcharge, if any, and cess@4%) applicable to a foreign company.*

The Supreme Court, in *A.S. Glittre v CIT (1997) 225 ITR 739 (SC)*, held that the assessment made under section 172(4) shall be an 'adhoc' assessment and it will be superceded if a regular assessment is opted as per the provisions of the Act.

ILLUSTRATION 6

Sea Port Shipping Line, a non-resident foreign company ships is engaged in the business of carriage of goods shipped at Mumbai port. During the previous year ended on 31.3.2020, it had collected freight of 100 lakhs, demurrages of ₹ 20 lakhs and handling charges of ₹ 10 lakhs. The expenses of operating its fleet during the year for the Indian Ports were ₹ 110 lakhs. Compute its income applying the presumptive provisions under section 44B.

SOLUTION

Section 44B provides that in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7.5% of the aggregate of the following amounts would be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

(i) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and

(ii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The above amounts will include demurrage charges and handling charges.

These provisions for computation of income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act, 1961.

Therefore, in this case, M/s. Sea Port Shipping Line is required to pay tax in India on the basis of presumptive scheme as per the provisions of section 44B. The assessee shall not be entitled to set off any of the expenses incurred for earning of such income. Therefore, the Shipping Line is required to pay tax on deemed profit of ₹ 9.75 lacs (7.50% on the total receipts of ₹ 130 lacs). The tax payable would be reduced by the amount of tax paid under section 172(4).

(2) Special provision for computing profits and gains in connection with the business of exploration etc. of mineral oils [Section 44BB]

Section 44BB is a non-obstante clause. Accordingly, sections 28 to 41 and section 43 and 43A are not applicable in the case of a non-resident engaged in the business of providing services of facilities in connection with, or supplying plant and machinery on hire used, or to be used in the prospecting for, or extraction or production of, mineral oils.

(i) **Eligible assessee:** Section 44BB provides for determination of income of taxpayer being a non-resident engaged in the business of providing services and facilities in connection with, or supplying plant and machinery on hire used or to be used in the prospecting for, or extraction or production of mineral oils.

(ii) **Presumptive rate:** In such case, the profits and gains shall be deemed to be equal to 10% of the following amounts:

- paid or payable to the taxpayer or to any person on his behalf whether in or out of India, on account of the provision of such services or facilities or supply of plant & machinery for the aforesaid purposes in India; and
- received or deemed to be received in India by or on behalf of the assesse on account of such service or facilities or supply of plant and machinery used or to be used in prospecting for, or extraction or production of mineral oils outside India.

(iii) **Non-applicability of presumptive taxation under section 44BB:** The provisions of section 44BB shall not apply to any income to which the provisions of section 42 or section 44DA, 115A or 293A apply for the purpose of computing profit or gains or any other income referred to in these sections.

Section	Provision
42	Special provision for deductions in the case of business for prospecting, etc., for mineral oil
44DA	Special provisions for computing income by way of royalties, etc., in case of non-residents.
115A	Tax on dividends, royalty and fees for technical services in the case of foreign companies
293A	Power to make exemption, etc., in relation to participation in the business of prospecting for, extraction, etc., of mineral oils.

(iv) **Option to claim lower profits:** An assessee may claim lower income than the presumptive rate of 10%, if he keeps and maintains books of account under section 44AA(2) and get them audited and furnish a report of such audit under section 44AB. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

(v) Meaning of certain terms: For the purposes of this section,-

(a) "Plant" includes ships, aircraft, vehicles, drilling units, scientific apparatus and equipment, used for the purposes of the said business;

(b) "Mineral oil" includes petroleum and natural gas.

Note *- If the income of a non-resident is in the nature of fees for technical services, it shall be taxable under the provisions of either section 44DA or section 115A irrespective of the business to which it relates. Section 44BB would apply only in a case where consideration is for services and other facilities relating to exploration activity which are not in the nature of technical services.*

(3) Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents [Section 44BBA]

Section 44BBA is a non-obstante clause. Accordingly, sections 28 to 43A are not applicable in the case of a non-resident engaged in the business of operation of aircraft.

(i) Eligible assessee: Section 44BBA provides presumptive rate in case of a non-resident engaged in the business of operation of aircraft.

(ii) Presumptive rate: Income from such business is calculated at a flat rate of **5%** of the following:

(a) amount paid or payable, in or out of India, to the tax payer or to any person on his behalf on account or carriage of passenger, livestock, mail or goods from any place in India and

(b) amount received or deemed to be received in India by or on behalf of the taxpayer on account of carriage of passenger, livestock, mail or goods from any place outside India.

ILLUSTRATION 7

Mr. Q, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts while carrying on the business of operation of aircrafts for the year ended 31.3.2020:

(i) ₹ 2 crores in India on account of carriage of passengers from Chennai.

(ii) ₹ 1 crore in India on account of carriage of goods from Chennai.

(iii) ₹ 3 crores in India on account of carriage of passengers from Singapore.

(iv) ₹ 1 crore in Singapore on account of carriage of passengers from Chennai.

The total expenditure incurred by Mr. Q for the purposes of the business during the year ending 31.3.2020 was ₹ 6.75 crores.

Compute the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the assessment year 2020-21.

What would be your answer in case the business was carried on by a foreign company, Q Airlines (P) Ltd?

SOLUTION

Section 44BBA says for computing profits and gains of the business of operation of aircraft in the case of non-residents a sum equal to 5% of the aggregate of the following amounts -

(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

Keeping in view the provisions of section 44BBA, the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder-

Particulars	₹
Amount received in India on account of carriage of passengers from Chennai	2,00,00,000
Amount received in India on account of carriage of goods from Chennai	1,00,00,000
Amount received in India on account of carriage of passengers from Singapore	3,00,00,000
Amount received in Singapore on account of carriage of passengers from Chennai	1,00,00,000
	7,00,00,000

Income from business under section 44BBA at 5% of ₹ 7,00,00,000 is ₹ 35,00,000, which is the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y. 2020-21.

In case the assessee is a foreign company, say, Q Airlines (P) Ltd, the answer would be the same since section 44BBA does not distinguish corporate and non-corporate taxpayers who operate aircraft provided their residential status is that of non-resident.

(4) Special provision for computing profits and gains of foreign companies engaged in the business of civil construction etc. in certain turnkey power projects [Section 44BBB]

(i) **Eligible assessee:** A foreign company engaged in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof in connection with a turnkey power project approved by the Central Government in this behalf.

(ii) **Presumptive rate:** A sum equal to 10% of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account of such civil construction, erection, testing or commissioning shall be deemed to be the profits and gains of such business chargeable to tax under the head 'profits and gains of business or profession'.

(iii) **Option to claim lower profits:** An assessee may claim lower income than the presumptive rate of 10%, if he keeps and maintains books of account under section 44AA(2) and get them audited and furnish a report of such audit under section 44AB. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

SUMMARY OF PRESUMPTIVE PROVISIONS APPLICABLE TO NON RESIDENTS

Particulars	44B	44BBA	44BB	44BBB
Nature of business	Shipping business	Operation of aircraft	Business of providing services or facilities in connection with, or supplying P & M on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils	Business of civil construction or the business of erection of P&M or testing or commissioning thereof, in connection with turnkey power projects approved by the Central Government.
Eligible assessee	Non-resident	Non-resident	Non-resident	Only Foreign Co.
Presumptive income	7.5% of specified sum	5% of specified sum	10% of specified sum	10% of specified sum
Specified sum	(i) Amount paid or payable on account of carriage of passengers, livestock, mail or goods shipped at/ from any port/place in India; and (ii) Amount received or deemed to be received in India on account of the carriage of passengers, livestock mail or goods shipped at/ from any port/place outside India		(i) Amount paid or payable on account of the provision of such services or facilities for the aforesaid purposes in India; and (ii) Amount received or deemed to be received in India on account of the provisions of services or facilities for the aforesaid purpose outside India.	Amount paid or payable on a/c of such civil construction, erection, testing or commissioning
Option to declare lower profits	Not available		Lower profits may be claimed u/s 44BB and u/s 44BBB provided the assessee maintains Books of account u/s 44AA and gets them audited u/s 44AB.	

(5) Deduction in respect of head office expenses in case of non-residents [Section 44C]

In case of a non-resident, head office expenditure is allowed in accordance with the provision of section 44C. This section is a non-obstante provision and anything contrary contained in sections 28 to 43A is not applicable.

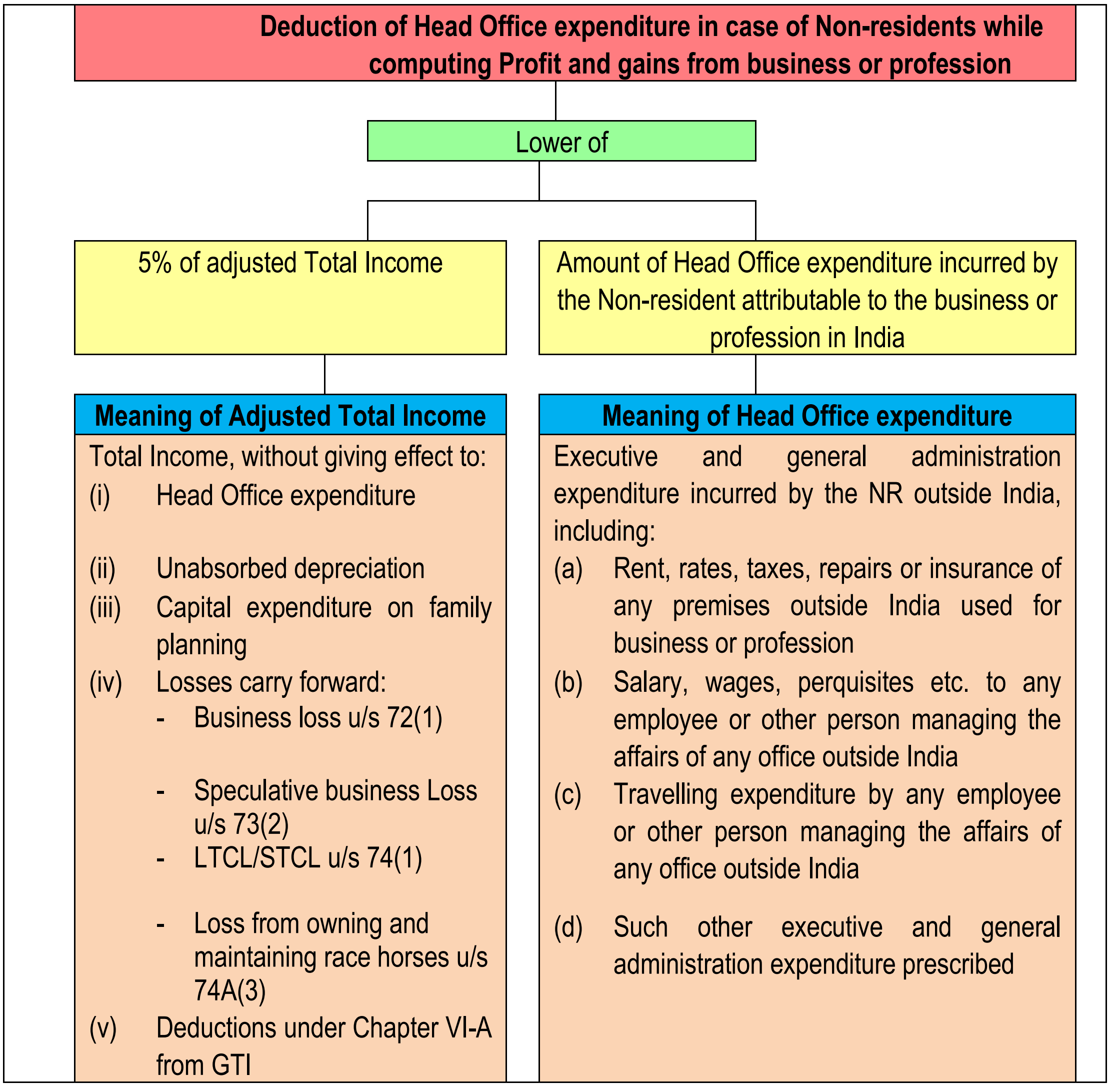
Deduction in respect of head office expenditure is restricted to the least of the following:

(a) an amount equal to 5% of **"adjusted total income"** or in the case of loss, 5% of the **"average" adjusted total income**; or

(b) the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India.

Meaning of certain terms:

Term	Meaning
Adjusted total income	Total income computed in accordance with the provisions of the Act without giving effect to the following :- ▪ Allowance under this section ▪ Unabsorbed depreciation allowance under section 32(2). ▪ Expenditure incurred by a company for the purpose of promoting family planning amongst its employees under first proviso to section 36(1)(ix). ▪ Business loss brought forward under section 72(1). ▪ Speculation loss brought forward under section 73(2). ▪ Loss under the head Capital Gain under section 74(1). ▪ Loss from certain specified source brought forward under Section 74A(3). ▪ Deduction under Chapter VI-A.
Average adjusted total income	(a) The total income of the assessee, assessable for each of the **three assessment years** immediately preceding the relevant assessment year, one third of the aggregate amount of the adjusted total income in respect of previous years relevant to the aforesaid three assessment years is average adjusted total income. (b) When the total income of the assessee is assessable only for **two of the aforesaid three assessment years**, one half of the aggregate amount of the adjusted total income in respect of the previous year's relevant to the aforesaid two assessment years is taken on average adjusted total income. (c) Where the total income of the assessee is assessable only for **one of the aforesaid three assessment years,** the amount of the adjusted total income in respect of the previous year relevant to that assessment year is average adjusted total income.
Head office expenditure	Executive and general administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of: a. rent, rates, taxes, repairs or insurance of any premises outside India used for the purpose of the business or profession. b. salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profit in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India; c. traveling by any employee or other person employed in, or managing the affairs, of any office outside India; and d. such other matters connected with executive and general administrative as may be prescribed.



Deduction of Head Office expenditure in case of Non-residents while computing Profit and gains from business or profession

Lower of

5% of adjusted Total Income

Amount of Head Office expenditure incurred by the Non-resident attributable to the business or profession in India

Meaning of Adjusted Total Income

Total Income, without giving effect to:

(i) Head Office expenditure

(ii) Unabsorbed depreciation

(iii) Capital expenditure on family planning

(iv) Losses carry forward:

- Business loss u/s 72(1)
- Speculative business Loss u/s 73(2)
- LTCL/STCL u/s 74(1)
- Loss from owning and maintaining race horses u/s 74A(3)

(v) Deductions under Chapter VI-A from GTI

Meaning of Head Office expenditure

Executive and general administration expenditure incurred by the NR outside India, including:

(a) Rent, rates, taxes, repairs or insurance of any premises outside India used for business or profession

(b) Salary, wages, perquisites etc. to any employee or other person managing the affairs of any office outside India

(c) Travelling expenditure by any employee or other person managing the affairs of any office outside India

(d) Such other executive and general administration expenditure prescribed

ILLUSTRATION 8

The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2020 was a loss of ₹ 100 lakhs after charge of head office expenses of ₹ 200 lakhs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 2020-21.

SOLUTION

Section 44C restricts the allowability of the head office expenses to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India.

For the purpose of computing the adjusted total income, the head office expenses of ₹ 200 Lakhs charged to the profit and loss account have to be added back.

The amount of income to be declared by the assessee for A.Y. 2020-21 will be as under:

Particulars	₹
Net loss for the year ended on 31.03.2020	(100 lakhs)
Add: Amount of head office expenses to be considered separately as per section 44C	200 lakhs
Adjusted total income	100 lakhs
Less: Head Office expenses allowable under section 44C is the lower of -	
(i) ₹ 5 lakhs, being 5% of ₹ 100 lakhs, or	
(ii) ₹ 200 lakhs.	5 lakhs
Income to be declared in return	**95 lakhs**

(6) Special provision for computing income by way of royalties etc. in case of non-residents [Section 44DA]

(i) **Eligible assessee:** Section 44DA provides the method of computation of income by way of royalty or fees for technical services arising from the agreement made by the non-resident with the Indian company or Government of India after 31.03.2003 where:

(a) such non-resident carries business/ profession in India through permanent establishment or fixed place of profession; and

(b) the right, property or contract in respect of which the royalty or fees for technical services are paid is effectively connected with such permanent establishment or fixed place of service.

(ii) **Expenses not allowed as deduction**: While computing the income chargeable to tax under this section, the following expenses are not allowed as deduction:

- expenditure or allowance incurred which is not wholly and exclusively for such permanent establishment or fixed place of service in India

- amount paid (otherwise than Reimbursement of actual expenses) by the permanent establishment to head office or to any of its other offices.

(iii) **Non-applicability of section 44BB:** The provisions of section 44BB do not apply in respect of income covered by this section.

(iv) **Mandatory requirement to maintain books of account and get them audited:** Under this section, the non-resident is mandatorily required to keep and maintain the books of account under section 44AA and get them audited and furnish a report of such audit.

2.5 CAPITAL GAINS TAXATION FOR NON RESIDENTS

Any person including a foreign company or non-corporate non-resident is liable to capital gains tax in India, if there is a transfer of a property (capital asset) in India which results in profit or gain. The provisions relating non-residents in respect of capital gains taxation are discussed in detail in Chapter 7: Capital Gains at Module 1 of Part I: Direct Tax Laws.

First Proviso to Section 48 read with Rule 115A:-

In order to give protection to non-residents who invest foreign exchange to acquire capital assets, the first proviso to section 48 provides that capital gains arising from the transfer of shares or debentures of an Indian company is to be computed as follows:

- The cost of acquisition, the expenditure incurred wholly and exclusively in connection with the transfer and the full value of the consideration are to be converted into the same foreign currency with which such shares or debentures were acquired.
- The resulting capital gains shall be reconverted into Indian currency.

The aforesaid manner of computation of capital gains shall be applied for every purchase and sale of shares or debentures in an Indian company.

Benefit of indexation will not be applied in this case.

Rule 115A of the Income-tax Rules, 1962 provides that the average of the telegraphic transfer buying rate and telegraphic transfer selling rate of the foreign currency initially utilized in purchase of the capital asset as on the date specified in column (3) in the table below, shall be used to convert rupees into foreign currency for the purpose of computation of capital gains.

(1)	(2)	(3)
S. No.	**Item**	**Date**
(a)	Cost of acquisition of capital asset	Date of acquisition of capital asset
(b)	Expenditure incurred wholly and exclusively in connection with transfer of capital asset	Date of transfer of capital asset
(c)	Full value of consideration received or accruing as a result of transfer of a capital asset	Date of transfer of capital asset

For reconverting capital gains computed in the foreign currency initially utilized in the purchase of the capital asset into rupees, the telegraphic transfer buying rate of such currency, as on the date of transfer of the capital asset, is to be considered.

Meaning of certain terms

Term	Meaning
Telegraphic transfer buying rate	The rate or rates of exchange adopted by the State Bank of India for buying foreign currency having regard to the guidelines specified from time to time by the RBI for buying foreign currency where such currency, made available to that bank through a telegraphic transfer.

Telegraphic transfer selling rate	The rate of exchange adopted by the State Bank of India for selling foreign currency where such currency is made available by that bank through telegraphic transfer.

However, the benefit of indexation and currency fluctuation would not be available in respect of capital gains arising from the transfer of the following long term capital assets referred to in section 112A –

(i) equity share in a company on which STT is paid both at the time of acquisition and transfer

(ii) unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer.

Other Important Points:

a. It is also provided that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every re-investment thereafter in and sale of shares in or debentures of an Indian company.

b. If the total income of an assessee includes any income chargeable under the head 'Capital Gains' arising from transfer of a capital asset being an equity share in a company or unit of an equity oriented fund or unit of a business trust, then, tax on short term capital gains shall be payable at the rates specified in section 111A if transaction of sale of such security has been entered on or after October 1, 2004 on which STT is chargeable; and tax on long-term capital gains shall be payable on such securities as per section 112A, if STT has been paid both at the time of acquisition and transfer of equity share or at the time of transfer of unit of equity oriented fund or unit of business trust.

c. Section 50CA provides that where the consideration received or accruing as a result of transfer of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share determined in such manner as may be prescribed, such fair market value shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

   This provision would, however, not be applicable to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.

d. Section 50D provides that, in case where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

e. The shares and debentures (whether listed or non-listed) of Indian companies only are covered under this proviso. Indian company shall include Government company. However, bonds of Central Government/State Government and RBI are not covered for this purpose.

ILLUSTRATION 9

Mr. A, a non-resident Indian remits US $ 40,000 to India on 16.09.2005. The amount is partly utilised on 3.10.2005 for purchasing 10,000 equity shares in A Ltd, an Indian Company, at the rate of ₹ 12 per share. These shares are sold for ₹ 48 per share on 30.03.2020. Fair Market value of these shares on 31.01.2018 was ₹ 35 per share.

The telegraphic transfer buying and selling rate of US dollars adopted by the State Bank of India is as follows :-

Date	*Buying Rate (1 US$)*	*Selling Rate (1 US $)*
16.09.2005	*18*	*20*
3.10.2005	*19*	*21*
30.3.2020	*59*	*61*

Compute Capital gain chargeable to tax for the A.Y. 2020-21 on the assumption that –

(a) These shares have not been sold through a recognised stock exchange

(b) These shares have been purchased and sold through a recognised stock exchange.

SOLUTION

(a) Where the shares are not sold through recognised stock exchange

Particulars	US $
Sale consideration (₹ 4,80,000/60)	8000
Less: Cost of Acquisition (1,20,000/20)	6000
Long term capital gain	**2000**

Long-term capital gain converted into $ 2000 x ₹ 59 = ₹ 1,18,000

(b) **Where the shares are purchased and sold through a recognised stock exchange**

Particulars		₹
Sale consideration		4,80,000
Less: Cost of Acquisition		
Higher of the following		
Cost of acquisition	1,20,000	
Lower of Fair market value as on 31.1.2018 and Full value of consideration (i.e., lower of ₹ 3,50,000 and ₹ 4,80,000)	3,50,000	3,50,000
Long term capital gain		**1,30,000**

Long term capital gains upto ₹ 1,00,000 would be exempt. Long term capital gains exceeding ₹ 1,00,000, i.e., ₹ 30,000 is taxable @10% under section 112A.

Fourth Proviso to Section 48

As a measure to enable Indian companies to raise funds from outside India, the RBI has permitted them to issue rupee denominated bonds outside India. Accordingly, in case of non-resident assessees, any gains arising on account of appreciation of rupee between the date of purchase and the date of redemption of rupee denominated bond of an Indian company held by him against foreign currency in which investment is made shall not be included in computation of full value of consideration. This would provide relief to the non-resident investor who bears the risk of currency fluctuation.

Note *- Non-corporate non-residents and foreign companies to be subject to tax at a concessional rate of 10% (without indexation benefit or currency fluctuation) on long-term capital gains arising from transfer of unlisted securities or shares of a company in which public are not substantially interested [Section 112]*

2.6 SPECIAL PROVISIONS PRESCRIBED UNDER CHAPTER XII-A

Chapter XII-A, introduced in the Income-tax Act 1961 with effect from June 01, 1983, contains seven sections viz. 115C, 115D, 115E ,115F,115G,115H and115-I. The provisions of this Chapter are applicable to a non-resident Indian who derives investment income from a foreign exchange asset and/ or long term capital gains in respect thereof.

(1) Definitions [Section 115C]

	Terms	Meaning
(a)	Convertible foreign exchange	Foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the Foreign Exchange Management Act, 1999, and any rules made thereunder.
(b)	Foreign exchange asset	Any specified asset which the assessee has acquired or purchased with, or subscribed to in, convertible foreign exchange
(c)	Investment income	Any income derived (other than dividends referred to in section 115-O) from a foreign exchange asset.
(d)	Long-term capital gains	Income chargeable under the head “Capital gains” relating to a capital asset, being a foreign exchange asset which is not a short-term capital asset.
(e)	Non-resident Indian	An individual, being a citizen of India or a person of Indian origin who is not a “resident. A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grand-parents, was born in undivided India
(f)	Specified asset	Any of the following assets, namely: (i) Shares in an Indian company;

		(ii) Debentures issued by an Indian company which is not a private company (iii) Deposits in an Indian Company which is not a private company (iv) Any security of the Central Government (v) Any other asset which the Central Government may notify

(2) Special provisions relating to taxation of investment income and on long term capital gains of a non-resident [Sections 115D to 115F]

(i) **On gross basis [Section 115D(1)]:** Section 115D deals with the computation of total income of non-residents. In computing the investment income of non-resident Indian, no deduction is to be allowed under any provision of the Act in respect of any expenditure or allowance thereabout.

(ii) **No deduction allowed [Section 115D(2)]:** No deduction under Chapter VI-A shall be allowed and indexation benefit will **not** be available, where the gross total income of a non-resident Indian consists only of investment income or/and long term capital gain.

However, where the gross total income includes investment incomes or/and long term capital gain, the deduction under Chapter VI-A shall be allowed only on that portion of gross total income which does not include the investment income and long term capital gain.

(iii) **Tax rate on investment income and long term capital gains [Section 115E]:** Under section 115E, the investment income and long-term capital gains of non-resident Indians are to be treated as a separate block and charged to tax at flat rates.

Tax payable by shall be aggregate of –

(a) income-tax on Investment income at 20%;

(b) income-tax on long term capital gains from transfer of specified assets (i.e., purchased in foreign currency) at 10%; and

(c) income-tax on his other total income

Investment Income

↓

20% + Surcharge (if applicable) + Health and Education Cess@4%

Long-term Capital Gain on Foreign Exchange Assets

↓

10% + Surcharge (if applicable) + Health and Education Cess@4%

(iv) Exemption for long-term capital gains [Section 115F]

Where a non-resident Indian has transferred a long-term foreign exchange asset and has within a period of six months after the date of such transfer, invested the whole or part of the net consideration in any specified asset then

(a) If the cost of the new asset is not less than the net consideration in respect of the original asset , the whole of the capital gains shall not be charged to tax under section 45

(b) If the cost of the new asset is less than the net consideration in respect of the original asset, the amount as calculated below shall not be charged to tax under section 45

$$\text{Capital Gains x}\,\frac{\text{Cost of acquisition of new asset}}{\text{Net Consideration}}$$

Important points:

1. Net consideration means the full value of consideration from transfer less expenditure incurred wholly and exclusively in connection with transfer.

2. Where the new asset is transferred or converted into money within a period of 3 years from the date of its acquisition, the amount of capital gains arising from the transfer of original asset not charged to tax earlier shall be deemed to be the income under the head “Capital Gains ‘’ relating to long term capital assets. The same shall be charged to tax in the previous year in which new asset is transferred or converted into money.

ILLUSTRATION 10

A non-resident Indian acquired shares in an Indian company, A Ltd., on 1.1.2009 for ₹ 1,00,000 in foreign currency. These shares are sold by him on 1.1.2019 for ₹ 3,00,000. He invests ₹ 3,00,000 in shares on 31.03.2019 and these shares are sold by him on 30.06.2019 for ₹ 3,50,000. Discuss the tax implications. Ignore the effect of first proviso to section 48.

SOLUTION

Computation of Long term Capital Gain for Assessment Year 2019-20

Particulars	Amount (₹)
Sale consideration	3,00,000
Less: Cost of Acquisition	1,00,000
Long term capital gain	2,00,000
Less: Exemption under section 115F	2,00,000
Exempt long-term capital gain	**NIL**

Capital Gain for Assessment year 2020-21:

1. LTCG of ₹ 2,00,000 which was exempt in A.Y.2019-20 becomes taxable this year.
2. STCG of ₹ 50,000 is also taxable this year.

ILLUSTRATION 11

Mr. John, a non-resident Indian, purchased unlisted shares of an Indian Company at a cost of ₹ 70,000 on 01.07.20010 in foreign currency. Mr. John sold the said shares for a consideration of ₹ 2,50,000 on 01.08.2019 and the expenditure incurred wholly or exclusively in connection with the transfer is ₹ 10,000. Compute the taxable capital gain if he deposited in specified assets ₹ 1,50,000 out of sale consideration. Ignore the effect of first proviso to section 48.

SOLUTION

Particulars	Amount (₹)
Sale Consideration	2,50,000
Less: Transfer Expenses	10,000
Net Consideration	2,40,000
Less: Cost of Acquisition	70,000
Long-term capital gain	1,70,000
Less: Exemption u/s 115F	1,06,250*
Taxable long-term capital gain	**63,750**

$$\frac{*\ 1{,}70{,}000 \times 1{,}50{,}000}{2{,}40{,}000} = ₹\ 1{,}06{,}250$$

(v) **Option not to file income-tax return [Section 115G]**

A non-resident Indian need not furnish a return of income under section 139(1) if he satisfies the following two conditions:-

(a) His total income consists only of investment income or income by way of long-term capital gains or both; and

(b) Tax deductible at source has been deducted from such income.

(vi) **Continuance of benefits after the non-resident becomes a resident [Section 115H]**

(a) Where a person who is NRI in any previous year becomes assessable as a resident in any subsequent year, then he may furnish a declaration in writing along with the return of income under section 139 for the year in which he is so assessable.

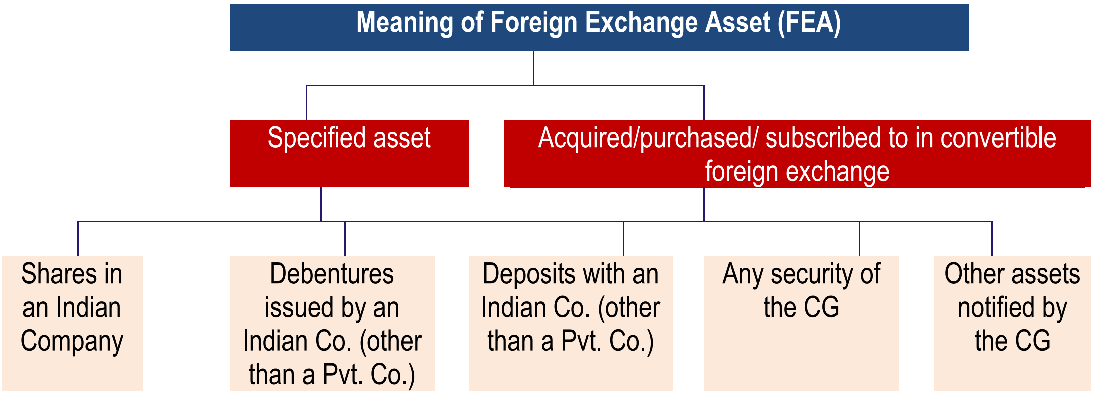
(b) The declaration shall be to the effect that the provisions of this chapter shall continue to apply to him in respect of the investment income derived from foreign exchange assets being debentures, deposits, securities of Central Government and such other notified assets as specified under section 115C.

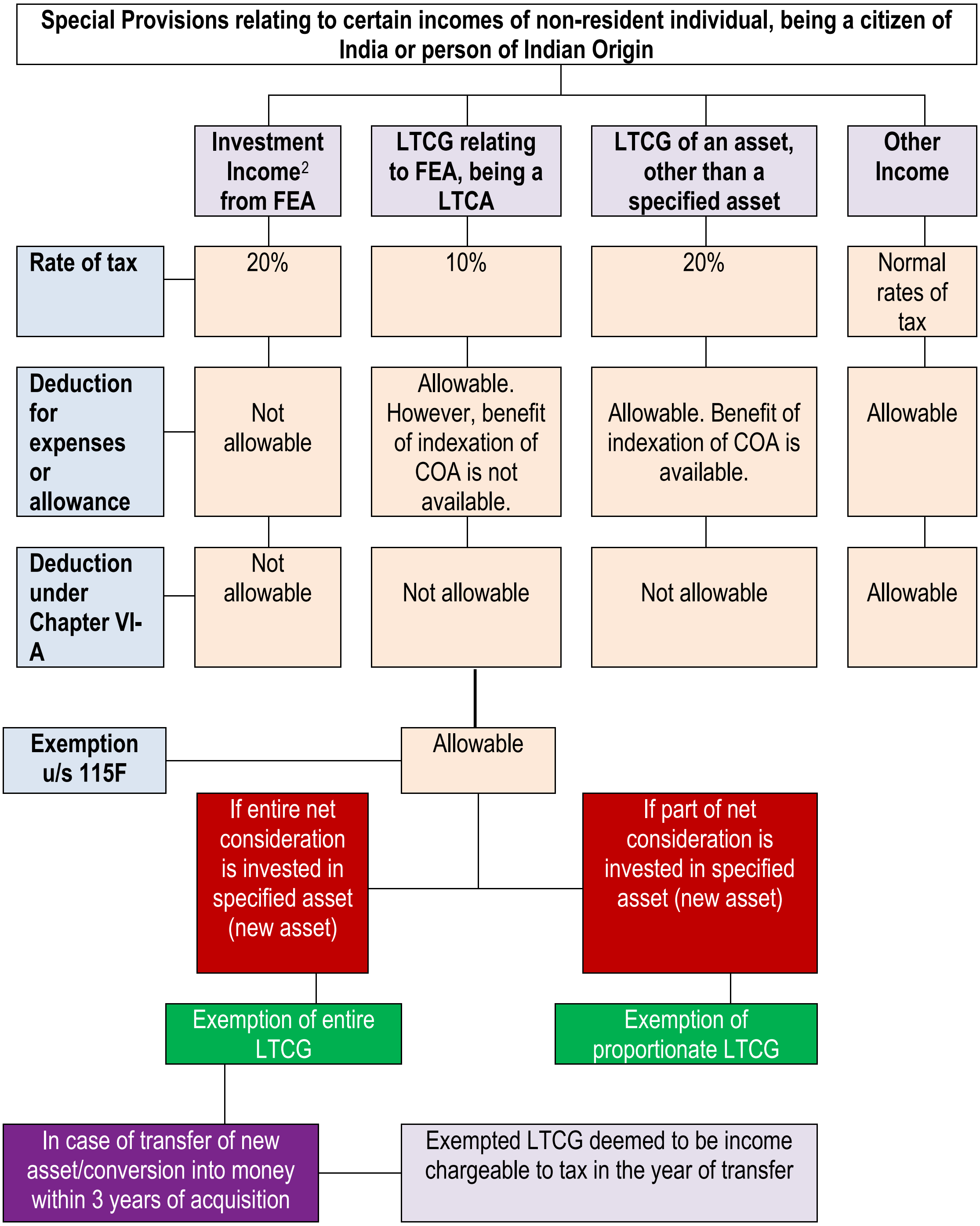
(c) If he does so, the provisions of this chapter shall continue to apply to him in relation to such income for that assessment year and every subsequent year until the transfer or conversion into money of such assets.

(vii) Option to opt out of Chapter XII-A [Section 115-I]

This section gives an option to a non-resident Indian to elect that he should not be governed by the special provisions of Chapter XII-A for any particular assessment year by furnishing his return of income for that assessment year under section 139 declaring therein that the provisions of Chapter XII-A shall not apply to him for that assessment year. In case where such an option is exercised by a non-resident Indian, his total income for that assessment year would be charged to tax under the general provisions of the Act.

Summary


Meaning of Foreign Exchange Asset (FEA)
Specified asset
Acquired/purchased/ subscribed to in convertible foreign exchange
Shares in an Indian Company
Debentures issued by an Indian Co. (other than a Pvt. Co.)
Deposits with an Indian Co. (other than a Pvt. Co.)
Any security of the CG
Other assets notified by the CG



Special Provisions relating to certain incomes of non-resident individual, being a citizen of India or person of Indian Origin

	Investment Income[2] from FEA	LTCG relating to FEA, being a LTCA	LTCG of an asset, other than a specified asset	Other Income
Rate of tax	20%	10%	20%	Normal rates of tax
Deduction for expenses or allowance	Not allowable	Allowable. However, benefit of indexation of COA is not available.	Allowable. Benefit of indexation of COA is available.	Allowable
Deduction under Chapter VI-A	Not allowable	Not allowable	Not allowable	Allowable

Exemption u/s 115F

Allowable

If entire net consideration is invested in specified asset (new asset)

Exemption of entire LTCG

In case of transfer of new asset/conversion into money within 3 years of acquisition

Exempted LTCG deemed to be income chargeable to tax in the year of transfer

If part of net consideration is invested in specified asset (new asset)

Exemption of proportionate LTCG

[2] Other than dividend referred to in section 115-O

2.7 DETERMINATION OF TAX IN CERTAIN SPECIAL CASES [CHAPTER XII]

Sections 111A, 112 and 112A have already been discussed Module 1 of Part I – Direct Tax Laws. The special provisions contained in other sections under Chapter XII are discussed hereunder -

(1) Special provisions for computing tax on income by way of royalty, fees for technical service, interest etc. [Section 115A]

(i) **Tax on dividend and interest in case of non-corporate non-residents and foreign companies:**

Where the total income of a foreign company or a non-corporate non- resident includes any income by way of	Rate of Tax
(1) Dividends [other than dividend referred to in section 115-O]	20%
(2) Interest received from the Government or an Indian concern on moneys borrowed or debt incurred by the Government /Indian concern in foreign currency, other than 3 and 4 mentioned below	20%
(3) Interest received from an infrastructure debt fund referred to in section 10(47)	5%
(4) Interest referred to in section 194LC received from an Indian company or business trust – - in respect of monies borrowed by an Indian company or business trust in foreign currency from sources outside India • Under a loan agreement between 1.7.2012 and 30.6.2020 or • by way of issue of long-term infrastructure bonds between 1.7.2012 and 30.9.2014 or • by way of issue of long-term bonds including long term infrastructure bond between 1.10.2014 and 30.6.2020 as approved by the Central Government - in respect of monies borrowed from sources outside India by way of rupee denominated bond before 1.7.2020	5%
(5) Interest referred to in section 194LD payable between 1.6.2013 and 30.6.2020 to a Foreign Institutional Investor or Qualified Foreign Investor on investment made in – - Rupee denominated bond of an Indian company - Government security	5%
(6) Interest referred to in section 194LBA(2), being interest income of a business trust from a SPV, distributed by business trust to non-resident unit holders of a business trust	5%

(7) Income received in respect of units purchased in foreign currency of a mutual fund specified under section 10(23D) or of the Unit Trust of India	20%

(ii) **Tax on royalty or fees for technical services in case of non-residents**

Where the total income of a foreign company or a non-corporate non-resident includes any income by way of royalty or fees for technical services (FTS) other than the income referred to in section 44DA	**Applicable Rate of Tax**
(1) Received from the Government in pursuance of an agreement made by the non-resident/ foreign company with the Government	10% of such royalty or FTS. However, if DTAA provides for a rate lower than 10%, then, the provisions of DTAA would apply.
(2) Received from the Indian concern in pursuance of an agreement made by the non-resident/ foreign company with the Indian concern and the agreement is approved by the Central Government or where it relates to industrial policy of Government of India, the agreement in accordance with that policy.	

Important Points:

1. Special rate of tax is applicable on the above mentioned incomes. The remaining income of the assessee will be chargeable to tax at normal rates applicable to assessee.

2. No deduction in respect of any expenditure or allowance shall be allowed to the assessee under sections 28 to 44C and section 57 in computing the above income.

3. Deduction under Chapter VI-A is not available in respect of dividend and interest referred to in (i) above. ***However, this condition would not be applicable to deduction allowed to a unit of an International Financial Services Centre (IFSC) under section 80LA i.e., a unit of an IFSC can claim deduction under section 80LA against dividend and interest referred to in (i) above.***

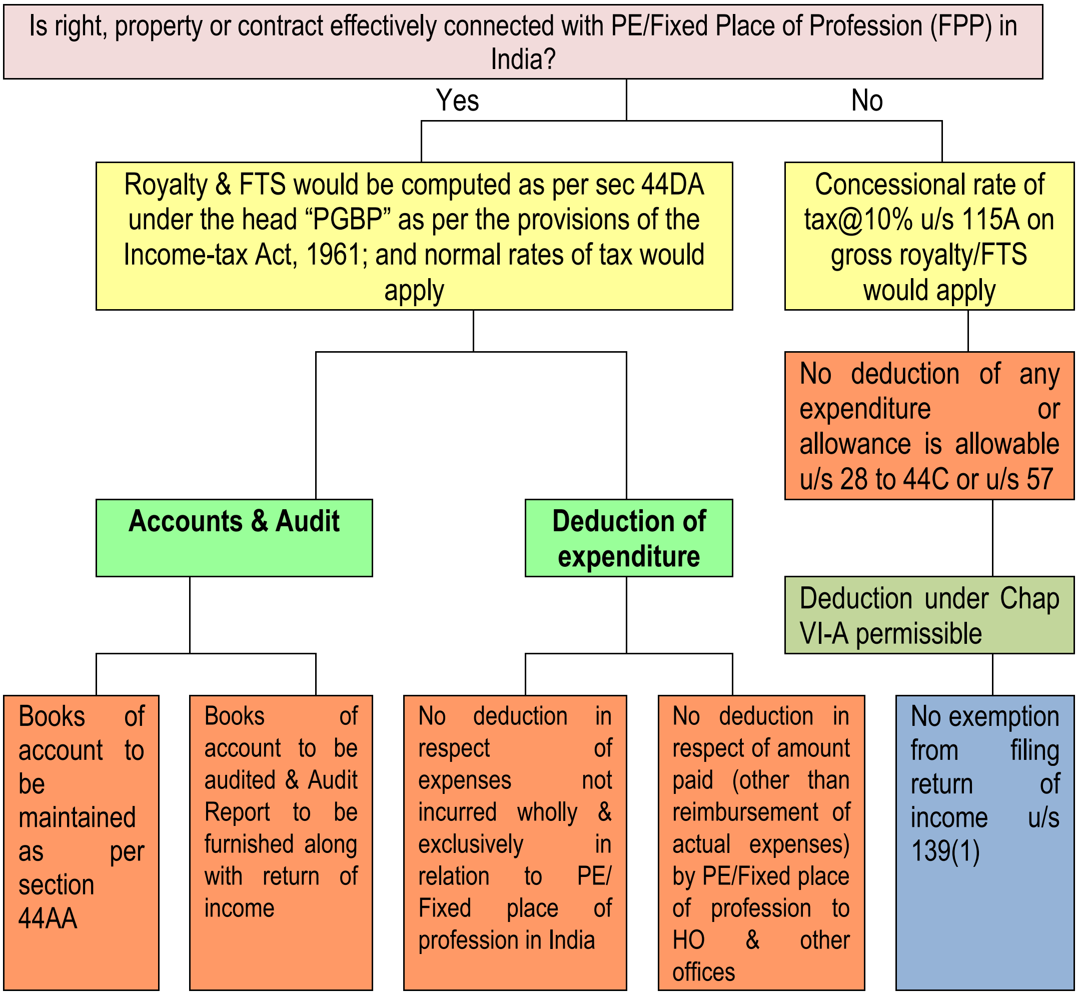
4. It shall not be necessary for the assessee to furnish a return of income if the following conditions are satisfied :

   (a) The total income consists of only the interest or dividend income referred to in (i) above

   (b) Tax deductible at source has been deducted from such income.

Summary

Tax treatment of Royalty & Fees for technical service received from Government / Indian concern in pursuance of approved agreement



Is right, property or contract effectively connected with PE/Fixed Place of Profession (FPP) in India?

Yes

Royalty & FTS would be computed as per sec 44DA under the head "PGBP" as per the provisions of the Income-tax Act, 1961; and normal rates of tax would apply

Accounts & Audit

Books of account to be maintained as per section 44AA

Books of account to be audited & Audit Report to be furnished along with return of income

Deduction of expenditure

No deduction in respect of expenses not incurred wholly & exclusively in relation to PE/ Fixed place of profession in India

No deduction in respect of amount paid (other than reimbursement of actual expenses) by PE/Fixed place of profession to HO & other offices

No

Concessional rate of tax@10% u/s 115A on gross royalty/FTS would apply

No deduction of any expenditure or allowance is allowable u/s 28 to 44C or u/s 57

Deduction under Chap VI-A permissible

No exemption from filing return of income u/s 139(1)

(2) Special provision for computing tax on income from units purchased in foreign currency or capital gains arising from their transfer in case of offshore fund [Section 115AB]

Where the total income of an overseas financial organisation (Offshore Fund) includes the following incomes namely-

(i) Income received in respect of units purchased in foreign currency or

(ii) by way of long term capital gains arising from the **transfer of units** of a mutual fund specified under section 10(23D) or units of UTI purchased in **foreign currency**,

Then, the income tax payable shall be the aggregate of the following:

(a) **10%** on income referred to above

(b) the amount of income-tax with which the Offshore Fund would have been chargeable had its total income been reduced by the amount of Long term Capital Gains and income received referred to above.

Important Points:

(i) The benefit of indexation shall **not** be available in the computation of long term capital gains.

(ii) No deduction shall be allowed to the assessee under sections 28 to 44C or section 57(i)/(iii) or under Chapter VI-A in computing the above income.

(iii) Where the gross total income of the Overseas Financial Organisation consists of other incomes, then, the deduction under Chapter VI- A will be available in respect of other incomes. The normal provisions of the Income-tax Act,1961 will apply for computation of other income.

(iv) **"Overseas Financial Organisation''** means any fund, institution, association or body, whether incorporated or not, established under the laws of a country outside India, which has entered into an arrangement for investment in India with any public sector bank or public financial institution or a mutual fund specified under section 10(23D). Such arrangement should be approved by the Securities and Exchange Board of India.

(v) It may be noted that long term capital gains upto ₹ 1,00,000 on units of equity oriented fund would be exempt and long term capital gains exceeding ₹ 1,00,000 shall be taxable @10% under section 112A provided securities transaction tax has been paid on the sale of such units.

(vi) It may be noted that short term capital gains on units of equity oriented fund are taxable @15% under section 111A provided securities transaction tax has been paid on the sale of such units.

(3) Special provision for computing tax on income from bonds or Global Depository Receipts purchased in foreign currency or capital gains arising from their transfer [Section 115AC]

(i) **Eligible assessee and special rate of tax:** According to section 115AC(1), where the total income of an assessee, being a non-resident includes:

(a) income by way of interest on bonds of an Indian company issued in accordance with such scheme as the Central Government may notify or on bonds of a public sector company sold by the Government, and purchased by him in foreign currency; or

(b) income by way of dividends, other than dividends referred to in section 115-O, on Global Depository Receipts-

(1) issued in accordance with such scheme as the Central Government may specify against the initial issue of shares of an Indian company and purchased by him in foreign currency through an approved intermediary; or

(2) issued against the shares of a public sector company sold by the Government and purchased by him in foreign currency through an approved intermediary; or

(3) issued or re-issued in accordance with such scheme as the Central Government may specify against the existing shares of an Indian company purchased by him in foreign currency through an approved intermediary; or

(c) income by way of long-term capital gains arising from the transfer of above bonds or GDRs,

then, income-tax will be charged at the rate of 10% on the above income.

(ii) Deductions not allowable [Section 115AC(2)]: Where the gross total income of the non-resident consists only the aforesaid interest or dividend income referred to in (a) and (b) of (i) above, no deduction shall be allowed to him under section 28 to 44C or section 57(i) or 57(iii) or under Chapter VIA.

Deduction under Chapter VI-A is also **not** allowable against long term capital gains arising from transfer of bonds or GD₹

Where the gross total income of the non-resident consists of incomes other than interest, dividend and long term capital gains referred to in (a), (b) and (c) of (i) above, then, the deduction under Chapter VI-A will be available in respect of other incomes

(iii) Non-availability of indexation benefit and computation of capital gains in foreign currency [Section 115AC(3)]: The indexation benefit and benefit of computation of capital gains in foreign currency, shall not be available for the computation of long-term capital gains arising out of the transfer of long term asset, being bonds or GD₹

(iv) Filing of Return of Income not required [Section 115AC(4)]: It shall not be necessary for a non-resident to furnish under section 139(1), a return of income if his total income in respect of which he is assessable under the Act during the previous year consisted only of aforesaid interest or dividend income, and the tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.

(v) Concessional tax treatment for GDR/Bonds acquired in course of Amalgamation [Section 115AC(5)]: Where the assessee acquired GDR or bonds in an amalgamated or resulting company by virtue of his holding GDR or bonds in the amalgamating or demerged company, in accordance with the provisions of 115AC(1) the concessional tax treatment would apply to such GDR or bonds.

(vi) Meaning of Global Depository Receipts: "Global Depository Receipts" means any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India and issued to investors against the issue of —

(a) ordinary shares of issuing company, being a company listed on a recognised stock exchange in India; or

(b) foreign currency convertible bonds of issuing company;

(4) Special provisions for computing tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer [Section 115AD]

(i) Special rate of tax: Where the total income of a Foreign Institutional Investor includes the income referred to in column (2), the same would be subject to tax at the rate mentioned in column (3):

(1)	(2)	(3)
S. No.	**Income**	**Rate of Tax**
(a)	Income received in respect of securities **other than** • income by way of dividends ref u/s 115-O • income on units ref u/s 115AB i.e., units of Mutual Fund specified u/s 10(23D) or UTI • Interest referred u/s 194LD	20%
(b)	Interest referred u/s 194LD	5%
(c)	Income by way of Short term capital gains arising from the transfer of securities (other than Short term capital gains u/s 111A)	30%
(d)	Income by way of Short term capital gains u/s 111A	15%
(e)	Income by way of Long term capital gains arising from the transfer of securities (other than Long term capital gains u/s 112A)	10%
(f)	Income by way of Long term capital gains u/s 112A exceeding ₹ 1 lakh	10%
(g)	Other income of FII	At normal rates of tax

> ***Note*** *- The Finance (No. 2) Act, 2019 has levied an enhanced surcharge of 25% and 37%, where the total income of an individual/HUF/AOP/BOI exceeds ₹ 2 crores and ₹ 5 crores, respectively. However, the enhanced surcharge of 25% and 37% has been withdrawn on tax payable at special rate under section 115AD by the FPI on the capital gains arising from the transfer of derivatives (Future & Options).*
>
> *In case of assessee other than FPI, derivatives are not treated as capital asset and the income arising from the transfer of the derivatives is treated as business income. Further, it has been clarified that the business income arising from the transfer of derivatives to a person other than FPI would be liable to enhanced surcharge* ***[Press Release dated 24-8-2019]***

(ii) **No deduction is allowed [Section 115AD(2)]:** Where the gross total income of the Foreign Institutional Investor comprises only of the aforesaid interest or dividend income from securities, no deduction shall be allowed to it under sections 28 to 44C or section 57(i) or 57(iii) or under Chapter VI-A.

Deduction under Chapter VI-A is also not allowable in case of short term capital gain or long term capital gain arising from transfer of securities.

Where the gross total income of the Foreign Institutional Investor consists of incomes other than income referred to in (a), (b) and (c) of table in (i) above, then, the deduction under Chapter VI-A will be available in respect of other incomes.

(iii) **First and second provisos to section 48 shall not apply [Section 115AD(3)]:** The benefit of computation of capital gains in foreign currency and the benefit of indexation would not be available for the computation of capital gains arising on transfer of securities.

(5) Special provision for computing tax on non-resident sportsmen or sports associations [Section 115BBA]

(i) **Eligible assessee and special rate of tax:** Where the total income of an assessee, referred to in column (2) includes income referred to in column (3) of the table below, such income would be chargeable to tax@20%.

	Assessee	Income
(1)	(2)	(3)
(a)	A sportsman (including an athlete), who is not a citizen of India and is a non-resident	Any income received or receivable by way of— (i) participation in India in any game (other than a game the winnings wherefrom are taxable under section 115BB, being winning from crossword puzzles, races including horse races, card games and other games of any sort of gambling or betting) or sport; or (ii) advertisement; or

		(iii) contribution of articles relating to any game or sport in India in newspapers, magazines or journals;
(b)	A non-resident sports association or institution	Any amount guaranteed to be paid or payable to such association or institution in relation to any game (other than a game the winnings wherefrom are taxable under section 115BB) or sport played in India
(c)	An entertainer who is not a citizen of India and is a non-resident	Any income received or receivable from his performance in India

(ii) **Deduction of expenditure not permissible:** No deduction in respect of any expenditure or allowance shall be allowed under any provision of this Act in computing the income referred to in (*a*) or (b) or (c) in the table given above.

(iii) **Filing of return of income not required:** The assessee is **not** required to furnish under section 139(1) a return of his income if—

(a) his total income in respect of which he is assessable under this Act during the previous year consisted **only** of income referred to in (a) or (b) or (c) above; and

(b) the tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.

Note: The issue as to whether the non-resident match referees and umpires in the games played in India fall within the meaning of "sportsmen" to attract taxability under the provisions of section 115BBA, and consequently attract the TDS provisions under section 194E in the hands of the payer was taken up by the Calcutta High Court in Indcom v. CIT (TDS) (2011) 335 ITR 485.

In order to attract the provisions of the section 194E, the person should be a non-resident sportsperson or non-resident sports association or institution whose income is taxable as per the provisions of section 115BBA.

Umpires and match referees can be described as professionals or technical persons who render professional or technical services, but they cannot be said to be either non-resident sportsmen (including an athlete) or non-resident sports association or institution so as to attract the provisions of section 115BBA and consequently, the provisions of tax deduction at source under section 194E are can not be attracted.

The Calcutta High Court held that although the payments made to non-resident umpires and the match referees are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA and thus, the assessee is not liable to deduct tax under section 194E.

It may be noted that since income has accrued and arisen in India to the non-resident umpires and match referees, the TDS provisions under section 195 would be attracted and tax would be deductible at the rates in force.

ILLUSTRATION 12

During the financial year 2019-20, Nadal, a tennis professional and a non-Indian citizen participated in India in a Tennis Tournament and won prize money of ₹ 15 lakhs. He contributed articles on the tournament in a local newspaper for which he was paid ₹ 1 lakh. He was also paid ₹ 5 lakhs by a Soft Drink company for appearance in a T.V. advertisement. Although his expenses in India were met by the sponsors, he had to incur ₹ 3 lakhs towards his travel costs to India. He was a non-resident for tax purposes in India.

What would be his tax liability in India for A.Y. 2020-21? Is he required to file his return of income?

SOLUTION

Under section 115BBA, all the three items of receipts in India viz. prize money of ₹ 15 lakhs, amount received from newspaper of ₹ 1 lakh and amount received towards TV advertisement of ₹ 5 lakhs - are chargeable to tax. No expenditure is allowable as deduction against such receipts. The rate of tax chargeable under section 115BBA is 20%, *plus* health and education cess @4%. The total tax liability works out to ₹ 4,36,800 being 20.8% of ₹ 21 lakhs. Thus, Nadal will be liable to tax on the income earned in India

He is not required to file his return of income if -

(a) his total income during the previous year consists only of income arising under section 115BBA; **and**

(b) the tax deductible at source under the provisions of Chapter XVII-B have been deducted from such incomes.

ILLUSTRATION 13

Smith, a foreign national and a cricketer came to India as a member of Australian cricket team in the year ended 31st March, 2020. He received ₹ 5 lakhs for participation in matches in India. He also received ₹ 1 lakh for an advertisement of a product on TV. He contributed articles in a newspaper for which he received ₹ 10,000. When he stayed in India, he also won a prize of ₹ 20,000 from horse racing in Mumbai. He has no other income in India during the year.

(i) Compute tax liability of Smith for Assessment Year 2020-21.

(ii) Are the income specified above subject to deduction of tax at source?

(iii) Is he liable to file his return of income for Assessment Year 2020-21?

(iv) What would have been his tax liability, had he been a match referee instead of a cricketer?

SOLUTION

(i) Computation of tax liability of Smith for the A.Y.2020-21

Particulars	₹	₹
Income taxable under section 115BBA		
Income from participation in matches in India	5,00,000	
Advertisement of product on TV	1,00,000	
Contribution of articles in newspaper	10,000	
Income taxable under section 115BB		
Income from horse races	20,000	
Total income	**6,30,000**	
Tax@ 20% under section 115BBA on ₹ 6,10,000		1,22,000
Tax@ 30% under section 115BB on income of ₹ 20,000 from horse races		6,000
		1,28,000
Add: Health and Education cess@4%		5,120
Total tax liability of Smith for the A.Y.2020-21		**1,33,120**

(ii) Yes, the above income is subject to tax deduction at source.

Income referred to in section 115BBA (i.e., ₹ 6,10,000, in this case) is subject to tax deduction at source@ 20% under section 194E.

Income referred to in section 115BB (i.e., ₹ 20,000, in this case) is subject to tax deduction at source@30% under section 194BB.

Since Smith is a non-resident, the amount of tax to be deducted calculated at the prescribed rates mentioned above, would be increased by health and education cess@4%.

(iii) Section 115BBA provides that if the total income of the non-resident sportsman comprises of only income referred to in that section and tax deductible at source has been fully deducted, it shall not be necessary for him to file his return of income. However, in this case, Mr. Smith has income from horse races as well. Therefore, he cannot avail the benefit of exemption from filing of return of income as contained in section 115BBA. Hence, he would be liable to file his return of income for A.Y.2020-21.

(iv) The Calcutta High Court in *Indcom v. CIT (TDS)(2011) 335 ITR 485* has held that 'match referee' would not fall within the meaning of "sportsmen" to attract the provisions of section 115BBA. Therefore, although the payments made to non-resident 'match referee' are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA. They are subject to the normal rates of tax.

Particulars		₹
Tax@30% under section 115BB on winnings of ₹ 20,000 from horse races		6,000
Tax on ₹ 6,10,000 at the rates in force		
Upto ₹ 2,50,000	Nil	
2,50,000 – 5,00,000 @5%	12,500	
5,00,000 – 6,10,000 @ 20%	22,000	34,500
		40,500
Add: Health and Education cess@4%		1,620
Total tax liability		**42,120**

2.8 SPECIAL PROVISIONS RELATING TO CONVERSION OF INDIAN BRANCH OF A FOREIGN BANK INTO A SUBSIDIARY COMPANY [CHAPTER XII-BB]

(1) Conversion of an Indian branch of foreign company into subsidiary Indian company [Section 115JG(1)]

(i) The provisions of this section apply to a foreign company engaged in banking business in India through its branch situated in India, which is converted into an Indian subsidiary company in accordance with the scheme framed by RBI.

(ii) If the conditions notified by the Central Government in this behalf are satisfied, then capital gains arising from such conversion would not be chargeable to tax in the assessment year relevant to the previous year in which such conversion takes place.

(iii) Also, the provisions of the Act relating to computation of income of foreign company and Indian subsidiary company would apply with such exceptions, modifications and adaptations as specified in the notification.

(iv) Further, the benefit of set-off of unabsorbed depreciation, set-off or carry forward and set-off of losses, tax credit in respect of tax paid on deemed income relating to certain companies available under the Act shall apply with such exceptions, modifications and adaptations as specified in the notification.

Accordingly, the Central Government has, vide notification no. 85/2018, specified the conditions to be fulfilled –

(1) For Capital Gains exemption:

Where a foreign company is engaged in the business of banking through its Indian branch and converts such Indian branch into its Indian subsidiary company in accordance with the scheme framed by RBI, the capital gains arising from such conversion would not be chargeable to tax, if -

(a) the Indian branch amalgamates with the Indian subsidiary company in accordance with the scheme of amalgamation approved by the shareholders of the foreign company and the Indian subsidiary company and sanctioned by the RBI[3]

(b) all the assets and liabilities of the Indian branch immediately before conversion would become the assets and liabilities of the Indian subsidiary company;

(c) the asset and liabilities of the Indian branch are transferred to the Indian subsidiary company at values appearing in the books of account of the Indian branch immediately before its conversion.

Note *- Any change in the value of assets consequent to their revaluation would not be considered while determining the value of the assets.*

(d) the foreign bank or its nominee shall hold the whole of the share capital of the Indian subsidiary company during the period beginning from the date of conversion and ending on the last day of the previous year in which the conversion took place and continue to hold the shares of Indian subsidiary company carrying not less than 51% of the voting power for a period of five years immediately succeeding the said previous year;

(e) the foreign company does not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the Indian subsidiary company.

(2) Application of the provisions of the Income-tax Act, 1961 with modifications/exceptions

The provisions of the Income-tax Act, 1961 relating to unabsorbed depreciation, set off or carry forward and set off of losses, tax credit in respect of tax paid on deemed income relating to certain companies and the computation of income in case of foreign company and Indian subsidiary company shall apply with following modifications, exceptions and adaptation –

	Purpose	***Modification/exception/adaptation***
(a)	*Allowance of depreciation under*	*The aggregate deduction, in respect of depreciation on buildings, machinery, plant or furniture, being tangible assets, or know-how,*

[3] under paragraph 20(h) of the Framework for setting up of wholly owned subsidiaries by foreign banks in India issued by the Reserve Bank of India *vide* Press release number 2013-2014/936 dated 6th day of November, 2013

	section 32	*patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets, allowable to the Indian branch and the Indian subsidiary company shall not exceed in any previous year the deduction calculated at the prescribed rates as if the conversion had not taken place.* *Such deduction would be apportioned between the Indian branch and the Indian subsidiary company in the ratio of the number of days for which the assets were used by them;*
(b)	*Set-off and c/f of loss and depreciation*	*The **accumulated loss** and the **unabsorbed depreciation** of the Indian branch would be deemed to be the loss or allowance for depreciation of the Indian subsidiary company for the previous year in which conversion was effected; and provisions of the Income-tax Act, 1961, relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.*
(c)	*Determination of actual cost u/s 43(1)*	*The actual cost of the block of assets in the case of the Indian subsidiary company shall be the written down value of the block of assets as in the case of the Indian branch on the **date of its conversion** into the Indian subsidiary company* *The actual cost of any capital asset on which deduction has been allowed or is allowable under section 35AD, shall be treated as 'nil' in the case of the Indian subsidiary company if the capital asset became the property of the Indian subsidiary company as a result of conversion of the Indian branch*
(d)	*Cost of acquisition of other capital assets*	*Where the capital asset other than those referred to in (c) above became the property of the Indian subsidiary company as a result of conversion of the Indian branch, the cost of acquisition of the asset for the purposes of computation of capital gains shall be deemed to be the cost for which the Indian branch acquired it or, as the case may be, the cost for which **previous owner** has acquired it.*
(e)	*Tax credit*	*The **tax credit** of the Indian branch shall be deemed to be the tax credit of the Indian subsidiary company for the purpose of the previous year in which conversion was effected; and the provisions of section 115JAA of the Income-tax Act, 1961 shall apply accordingly.*
(f)	*Amortisation of VRS Expenditure*	*The provisions of 35DDA of the Act shall be, as far as may be, apply to the Indian subsidiary company, as they would have applied to the Indian branch, if the conversion had not taken place*
(g)	*Deemed credit balance in provision for bad and doubtful debts*	*The credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia) of the Indian branch on the date of conversion shall be deemed to be the credit balance of the Indian subsidiary company and the provisions of section 36 of the Income-tax Act, 1961, shall apply accordingly*

(h)	*Non-applicability of section 56(2)(x)*	*The provisions of section 56(2)(x) shall not apply to the transaction of receipt of shares in the Indian subsidiary company by the foreign company or its nominee in consequence of the conversion of the Indian branch into the Indian subsidiary company.*

Meaning of certain terms (given in bold in the above table):

Term	***Meaning***
Accumulated loss	*So much of the loss of the Indian branch before its conversion into Indian subsidiary company under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such Indian branch would have been entitled to carry forward and set off under the provisions of section 72, if the conversion had not taken place.*
Unabsorbed depreciation	*So much of the allowance for depreciation of the Indian branch before its conversion into Indian subsidiary company, which remains to be allowed and which would have been allowed to the Indian branch under the provisions of the Act, if the conversion had not taken place.*
Previous owner	*In relation to any capital asset owned by the Indian subsidiary company means the last previous owner of the capital asset who acquired it by a mode of acquisition other than those referred in section 49(1)(i)/(ii)/(iii)/(iv) or section 115JG(1).*
Tax credit	*So much of the tax credit of the Indian branch before conversion into Indian subsidiary company which such Indian branch would have been entitled to carry forward and set off under the provisions of section 115JAA of the Act, if the conversion had not taken place.*
Date of conversion	*The date, which the Reserve Bank of India appoints for the vesting of undertaking of the Indian branch in Indian subsidiary company*[4]

(2) Consequences of failure to comply with the specified conditions [Section 115JG(2)]

If the conditions specified in the scheme of RBI or notification issued by the Central Government are not complied with, then, all the provisions of the Act would apply to the foreign company and Indian subsidiary company without any benefit, exemption or relief under this section.

(3) Consequences of subsequent failure to comply with the conditions [Section 115JG(3)]

(i) If the benefit, exemption or relief has been granted to the foreign company or Indian subsidiary company in any previous year and thereafter, there is a failure to comply with any of the conditions specified in the scheme or notification, then, such benefit, exemption or relief shall be deemed to have been wrongly allowed.

[4] under paragraph 20(i) of the Framework for setting up of wholly owned subsidiaries by foreign banks in India issued by the Reserve Bank of India vide press release number 2013-2014/936 dated 6th day of November, 2013.

(ii) In such a case, the Assessing Officer is empowered to re-compute the total income of the assessee for the said previous year and make the necessary amendment. This power is notwithstanding anything contained in the Income-tax Act, 1961.

(iii) The provisions of rectification under section 154, would, accordingly, apply and the four year period within which such rectification should be made has to be reckoned from the end of the previous year in which the failure to comply with such conditions has taken place.

(iv) Every notification under issued under this section shall be laid before each House of Parliament.

2.9 WITHHOLDING TAX PROVISIONS FOR NON-RESIDENTS

(1) Salary payable in foreign currency [Section 192]

By virtue of section 9(1)(ii), salary is deemed to accrue or arise in India, if services are rendered in India. Therefore, if a non-resident renders services in India, the salary income would be chargeable to tax in India and the person responsible for paying the salary income i.e., the employer, has to deduct withholding tax in accordance with the provisions of Section 192.

Such income-tax has to be calculated at the average rate of income-tax computed on the basis of the rates in force for the relevant financial year in which the payment is made, on the estimated total income of the assesse.

Average rate of income-tax means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.

Section 192(6) deals with the provisions of withholding tax in case of salary payable in foreign currency. In case, where salary is payable in foreign currency, the amount of tax deducted is to be calculated after converting the salary payable into Indian currency at the telegraphic transfer buying rate as adopted by State Bank of India on the last day of the month immediately preceding the month in which the salary is due, or is paid in advance or in arrears [Rule 26 read with Rule 115].

Students may note that the Rule 26 and Rule 115 have been given as Annexure – 2 at the end of this material.

(2) Income from units [Section 196B]

The person responsible for making the following payment to an Offshore Fund shall deduct tax @ 10% plus surcharge, wherever applicable, *plus* health and education cess@4% at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

- income in respect of units referred to in section 115AB or
- income by way of long-term capital gains arising from the transfer of such units

(3) Income from foreign currency bonds or shares of Indian company [Section 196C]

The person responsible for making the following payment to a non-resident has to deduct tax @ 10% plus surcharge, wherever applicable, *plus* health and education cess@4% at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

- income by way of interest or dividends in respect of bonds or Global Depository Receipts referred to in section 115AC or
- income by way of long-term capital gains arising from the transfer of such bonds or Global Depository Receipts.

However, no deduction shall be made in respect of any dividends referred to in section 115-O.

(4) Income of foreign institutional investors from securities [Section 196D]

(i) The person responsible for making the payment in respect of securities referred to in section 115AD(1)(a) to a Foreign Institutional Investor has to deduct tax @20% *plus* surcharge, wherever applicable, *plus* health and education cess@4% at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

(ii) However, no deduction shall be made in respect of the following

- any dividends referred to in section115-O
- income, by way of capital gains arising from the transfer of securities referred to in section 115AD, payable to a Foreign Institutional Investor.

The summary of withholding tax provisions relating to non-residents is given below. These provisions are discussed in detail in the following chapters mentioned in Column (4):

Section	Nature of payment	Rate of TDS	Chapter
(1)	(2)	(3)	(4)
192	Salary	Normal Slab rates	15: Deduction, Collection and Recovery of Tax (Module 3: Part I- Direct Tax Laws)
192A	Premature withdrawal from EPF, aggregating to ₹ 50,000 or more	10%	
194B	Income by way of winnings from lotteries, crossword puzzles, card games and other games of any sort, where payment to a person > ₹ 10,000	30%	
194BB	Income by way of winnings from horse races, where payment to a person > ₹ 10,000	30%	
194E	Specified payments referred under section 115BBA to non-resident sportsmen/sports	20%	

	association or an entertainer		
194G	Commission etc. on the sale of lottery tickets, where payment to a person > ₹ 15,000	5%	
194LB	Payment of interest on infrastructure debt fund	5%	
194LBA(2)	Distribution any interest income, received or receivable by a business trust from a SPV, to its unit holders.	5%	12: Assessment of Various Entities (Module 2 Part I- Direct Tax Laws)
194LBA(3)	Distribution of any income received from renting or leasing or letting out any real estate asset directly owned by the business trust, to its unit holders.	At the rates in force	
194LBB	Investment fund paying income to a unit holder [other than income which is exempt under section 10(23FBB)].		
194LBC(2)	Income in respect of investment made in a securitisation trust (specified in *Explanation* to section 115TCA)		
194LC	Payment of interest by an Indian Company or a business trust to a non-corporate non-resident or foreign company - in respect of money borrowed in foreign currency from a source outside India • under a loan agreement between 1.7.2012 and 30.6.2020 or • by way of issue of long term bonds (including long term infrastructure bond) between 1.10.2004 and 30.6.2020 as approved by Central Government or - in respect of money borrowed from source outside India by way of rupee denominated bond before 1.7.2020	5%	15: Deduction, Collection and Recovery of Tax (Module 3: Part I- Direct Tax Laws)
	Interest payable by an Indian company or a business trust to a non-resident, including a foreign company, in respect of rupee denominated bond issued outside India during the period from 17.9.2018 to 31.3.2019	Nil (Since such interest is exempt u/s 10(4C), no tax is deductible u/s 194LC)	
194LD	Payment of interest between 1.6.2013 and 30.6.2020 on rupee denominated bond of an Indian Company or Government securities to a	5%	

	Foreign Institutional Investor or a Qualified Foreign Investor		
194N	On withdrawal of cash in excess of ₹ 1 crore	2% on amount exceeding ₹ 1 crore	
195	Payment of any other sum to a non-resident	At the rates in force	
196B	Income from units of a mutual fund or UTI purchased in foreign currency (including long term capital gain on transfer of such units) payable to an Offshore Fund	10%	1: Non Resident Taxation (Module 4: Part II- International Taxation)
196C	Income by way of interest on bonds of an Indian company or public sector company sold by the Government and purchased by a non-resident in foreign currency or GDRs referred to in section 115AC (including long term capital gain on transfer of such bonds or GDRs payable to a non-resident	10%	
196D	Income of foreign Institutional Investors from securities (not being income by way of interest referred to in section 194LD, dividend referred under section 115-O or capital gain arising from such securities)	20%	

Note: *In all the above cases, the rate of tax would be increased by surcharge, wherever applicable, and health and education cess @4%.*

2.10 MISCELLANEOUS PROVISIONS

(1) Recovery of tax in respect of non- resident from his assets [Section 173]

In a case where the person entitled to the income arising from any business connection in India or from any property in India or through or from any asset or source of income in India or through the transfer of a capital asset situated in India is a non-resident, the tax chargeable thereon, whether in his name or in the name of his agent who is liable as a representative assessee, may be recovered by deduction under any of the provisions of Chapter XVII-B. Further, any arrears of tax may be recovered also in accordance with the provisions of this Act from any assets of the non-resident which are, or may at any time come, within India. These provisions are without prejudice to the provisions of section 161(1) or of section 167.

(2) Recovery against the assessee's property in foreign countries [Section 228A]

Where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may, if the assessee ***is a resident of a country*** (being a country with which the Central Government has entered into an agreement for the recovery of income tax under this Act and the corresponding law in force in that country) ***or has any property in that country***, forward to the CBDT a certificate drawn up by him under section 222. Thereafter, the CBDT may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

Similarly, the Government of the other country or any authority under that Government may send to the CBDT a certificate of recovery of any tax due under such corresponding law from a person having property in India and the CBDT may forward such certificate to Tax Recovery Officer ***having jurisdiction over the resident or*** within whose jurisdiction such property is situated, for recovery of such tax. Tax Recovery Officer can proceed to recover the amount specified in the Certificate by –

(a) attachment and sale of assessee's movable or immovable property

(b) arrest of the assessee and his detention in prison.

(c) appointing a receiver for the management of assessee's movable and immovable property.

He shall thereafter remit the sum so recovered to the CBDT.

(3) Submission of statement by a non-resident having liaison office [Section 285]

(i) A non-resident can operate in India through a branch or a liaison office set up after getting the approval of the Reserve Bank of India. Since the branch constitutes a permanent establishment of the non-resident, it has to file its return of income. However, prior to 1.6.2011, there was no such requirement as regards a liaison office since no business activity is allowed to be carried out in India *via* a liaison office of a non-resident.

(ii) With effect from 1.6.2011, such a non-resident is required to file a statement in the prescribed form [Form No.49C] to the Assessing Officer having jurisdiction, within 60 days from the end of the financial year, providing the details in respect of activities carried out by the liaison office in India during the financial year.

(iii) This requirement has to be complied with by every person, being a non-resident having a liaison office in India set up in accordance with the guidelines issued by the RBI under the Foreign Exchange Management Act, 1999.

(iv) The statement of a particular financial year should be filed on or before 30th May, of the succeeding financial year in electronic form along with digital signature. For example, the statement for F.Y. 2019-20 should be filed on or before 30th May, 2020. Further, the statement is to be verified by a Chartered Accountant or by the Authorized Signatory i.e., the person authorized by the non-resident in this behalf.

(4) Furnishing of information or documents by an Indian Concern [Section 285A]

(i) There shall be a reporting obligation on the Indian concern through or in which the Indian assets are held by a foreign company or entity.

(ii) For the purposes of determination of any income accruing or arising in India under section 9(1)(i), an Indian concern has to furnish, within the prescribed period to the prescribed income-tax authority, the information or documents, in prescribed manner, if -

- 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 section 9(1)(i), and
- such company or, entity, holds, directly or indirectly, such assets in India through, or in, the Indian concern.

(iii) The information has to be furnished in Form No.49D electronically within a period of 90 days from the end of the financial year in which the transfer of such share or interest referred to above takes place.

(iv) If any Indian concern fails to furnish the information or documents, the income-tax authority, as may be prescribed under the said section, may direct that such Indian concern shall pay, by way of penalty under section 271GA,—

(a) @2% 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;

(b) ₹ 5,00,000 in any other case.

Note – *Rule 114DB prescribes the time limit and Information or documents to be furnished under section 285A*[5]*.*

The other miscellaneous provisions relating to non-residents are discussed in detail in the following chapters:

Section	Provision	Chapter
160	Who may be regarded as Representative Assessee?	22: Liability in Special Cases (Module 3 of Part I - Direct Tax Laws)
161	Liability of Representative Assessee	
162	Rights of representative assessee to recover tax paid	
163	Who may be regarded as agent?	

[5] For detailed reading of Rule 114DB of the Income-tax Rules, 1962, students may visit https://www.incometaxindia.gov.in/Pages/default.aspx

EXERCISE

Question 1

Peeyush, returned to India on 12th June, 2019 for permanently residing in India after a stay of about 20 years in U.K., provides the sources of his various incomes and seeks your opinion to know about his liability to income tax thereon in India in assessment year 2020-21:

(i) Income of rent of the flat in London which was deposited in a bank there. The flat was given on rent by him after his return to India since July, 2019.

(ii) Dividends on the shares of three German Companies which are being collected in a bank account in London. He proposes to keep the dividend on shares in London with the permission of the Reserve Bank of India.

(iii) He has got two sons, one of whom is of 12 years and other 19 years. Both his sons are staying in London and not returning to India with him. Each of his sons is having income of ₹ 75,000 in U.K. in foreign currency (not received in India) and of ₹ 20,000 in India.

(iv) During the preceding accounting year when he was a non-resident, he had sold 1000 shares which were acquired by him in British Pound Sterling and the sale proceeds were repatriated. The profit in terms of British Pound Sterling on sale of these 1000 shares was 175% of the cost at ₹ 37,500 while in terms of Indian Rupee it was ₹ 50,000.

Answer

Peeyush returned to India on 12th June 2019 for permanently residing in India after staying in UK for 20 years. During the P.Y.2019-20, he stays in India for 294 days. Since he has stayed in India for a period of 182 days or more during the previous year 2019-20, he would be a resident in India for the A.Y.2020-21. However, he would be a resident but not ordinarily resident, assuming that he was a non-resident in nine out of ten previous years preceding P.Y.2019-20 and his stay in India during the seven previous years is less than 730 days. The residential status of Peeyush for A.Y.2020-21 is, therefore, **Resident but Not Ordinarily Resident.**

As per section 5(1), only income which is received/ deemed to be received/ accrued or arisen/ deemed to accrue or arise in India is taxable in case of a Resident but not Ordinarily Resident. Income which accrues or arises outside India shall not be included in his total income, unless it is derived from a business controlled in, or a profession set up in, India.

(i) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.

(ii) Dividends from shares of three German Companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.

(iii) As per section 64(1A), all income accruing or arising to a minor child is includible in the hands of the parent, after providing for deduction of ₹ 1,500 per child under section 10(32).

Accordingly, income of ₹ 20,000 accruing to his minor son, aged 12 years, in India is includible in the income of Peeyush, after providing deduction of ₹ 1,500. Therefore, ₹18,500 is includible in the income of Peeyush. Income accruing to the minor child outside India (which is also received outside India) is not includible in the income of Peeyush.

Since the other son is major, his income is not includible in the income of Peeyush.

(iv) Repatriation of sale proceeds of 1000 shares sold in the preceding accounting year, when Peeyush was a non-resident, is not taxable in the A.Y.2020-21 since it is not the income of the P.Y.2019-20.

Consequently, only the income includible under section 64(1A) would form part of the total income of Mr. Peeyush for A.Y.2020-21. Since his total income (i.e., ₹ 18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y.2020-21.

Question 2

Mr. David, a citizen of India, serving in the Ministry of External Affairs in India, was transferred to Indian Embassy in Canada on 31.03.2019. He did not visit India any time during the previous year 2019-20. He has received the following income for the Financial Year 2019-20:

S.No.	*Particulars*	*₹*
(i)	*Salary (Computed)*	*5,00,000*
(ii)	*Foreign Allowance*	*4,00,000*
(iii)	*Interest on fixed deposit from bank in India*	*1,00,000*
(iv)	*Income from agriculture in Pakistan*	*2,00,000*
(v)	*Income from house property in Pakistan*	*2,50,000*

Compute his gross total income for Assessment Year 2020-21.

Answer

As per section 6(1), Mr. David is a non-resident for the A.Y. 2020-21, since he was not present in India at any time during the previous year 2019-20.

As per section 5(2), a non-resident is chargeable to tax in India only in respect of following incomes:

(i) Income received or deemed to be received in India; and

(ii) Income accruing or arising or deemed to accrue or arise in India.

In view of the above provisions, income from agriculture in Pakistan and income from house property in Pakistan would not be chargeable to tax in the hands of David, assuming that the same were received in Pakistan.

Income from 'Salaries' payable by the Government to a citizen of India for services rendered outside India is deemed to accrue or arise in India as per section 9(1)(iii). Hence, such income is taxable in the hands of Mr. David, even though he is a non-resident.

However, allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering service outside India is exempt under section 10(7). Hence, foreign allowance of ₹ 4,00,000 is exempt under section 10(7).

Gross Total Income of Mr. David for A.Y. 2020-21

Particulars	₹
Salaries	5,00,000
Income from other sources (Interest on fixed deposit in India)	1,00,000
Gross Total Income	**6,00,000**

Question 3

Mr. A, a citizen of India, left for USA for the purposes of employment on 1.5.2019. He has not visited India thereafter. Mr. A borrows money from his friend Mr. B, who also left India for employment purpose one week before Mr. A's departure, to the extent of ₹ 10 lakhs and buys shares in X Ltd., an Indian company. Discuss the taxability of the interest charged @10% in B's hands where the same has been received in New York.

Answer

An individual is said to be resident in India in any previous year, if he -

(i) has been in India during that year for a total period of 182 days or more, or

(ii) has been in India during the four years immediately preceding that year for a total period of 365 days or more and has been in India for at least 60 days in that year.

In the case of an Indian citizen leaving India for the purposes of employment outside India during the previous year, the period of stay during the previous year in condition (ii) above, to qualify as a resident, would be 182 days instead of 60 days.

In this case, Mr. A is an Indian citizen who left India for employment outside India on 01.05.2019. Mr. A has been in India only from 1.4.2019 to 01.05.2019 i.e. for 31 days. Since his stay in India during the previous year 2019-20 is only 31 days, he does not satisfy the minimum criterion of 182 days stay in India for being a resident. Hence, his residential status for A.Y. 2020-21 is Non-Resident. Mr. B, who left India one week before A's departure, is also a non-resident for the same reasons.

Section 9(1)(v) provides that income by way of interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India shall be deemed to accrue or arise in India.

Therefore, interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purpose of making or earning any income from any source other than a business or profession carried on by him in India, shall not be deemed to accrue or arise in India. Therefore, interest payable by Mr. A on money borrowed from Mr. B to invest in shares of an Indian company shall not be deemed to accrue or arise in India and hence, is not taxable in India in the hands of Mr. B.

Question 4

JJ Limited, a company incorporated in Australia has entered into an agreement with KK Limited, an Indian company for rendering technical services to the latter for setting up a fertilizer plant in Orissa. As per the agreement, JJ Limited rendered both off-shore services and on-shore services to KK Limited at fee of ₹ 1 crore and ₹ 1.5 crore, respectively. JJ Limited is of the view that it is not liable to tax in India in respect of fee of ₹ 1 crore as it is for rendering services outside India. Discuss the correctness of the view of JJ Limited.

Answer

The *Explanation* below section 9(2) clarifies that income by way of, *inter alia*, fees for technical services from services utilized in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

In this case, the technical services rendered by the foreign company, JJ Ltd., were for setting up a fertilizer plant in Orissa. Therefore, the services were utilized in India. Consequently, as per the *Explanation* below section 9(2), the fee of ₹ 2.5 crore for technical services rendered by JJ Ltd. (both off-shore and on-shore services) to KK Ltd. is deemed to accrue or arise in India and includible in the total income of JJ Ltd.

Therefore, the view of JJ Ltd. that it is not liable to tax in India in respect of fee of ₹ 1 crore (as it is for rendering services outside India) is not correct.

Question 5

Examine with reasons whether the following transactions attract income-tax in India, in the hands of recipients under section 9 of Income-tax Act, 1961:

(i) A non-resident German company, which did not have a permanent establishment in India, entered into an agreement for execution of electrical work in India. Separate payments were made towards drawings & designs, which were described as "Engineering Fee". The assessee contended that such business profits should be taxable in Germany as there is no business connection within the meaning of section 9(1)(i) of the Income-tax Act, 1961.

(ii) A firm of solicitors in Mumbai engaged a barrister in UK for arguing a case before Supreme Court of India. A payment of 5000 pounds was made as per terms of professional engagement.

(iii) Amount paid by Government of India for use of a patent developed by Mr. A, who is a non-resident.

(iv) Sai Engineering, a non-resident foreign company entered into a collaboration agreement on 25/6/2019, with an Indian Company and was in receipt of interest on 8% debentures for ₹ 20 lakhs, issued by Indian Company, in consideration of providing technical know-how utilised in its business in Mumbai during previous year 2019-20.

Answer

(i) Fees for technical services is taxable under section 9(1)(vii). In this case, the separate payments made towards drawings and designs (described as "engineering fee") are in the nature of fee for technical services and, therefore, it is taxable in India by virtue of section 9(1)(vii), since the services are utilized for execution of electrical work in India *[Aeg Aktiengesllschaft v. CIT (2004) 267 ITR 209 (Kar.)].*

As per *Explanation* to section 9, where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of the non-resident German company, regardless of whether it has a residence or place of business or business connection in India.

(ii) As per section 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India.

In this case, there was a professional connection between the firm of solicitors in Mumbai and the barrister in UK. The expression "business" includes not only trade and manufacture; it includes, within its scope, "profession" as well. Therefore, the existence of professional connection amounts to existence of "business connection" under section 9(1)(i). It was so held by the Supreme Court in *Barendra Prasad Roy v. ITO (1981) 129 ITR 295.*

Hence, the amount of 5,000 pounds paid to the barrister in UK as per the terms of the professional engagement constitutes income which is deemed to accrue or arise in India under section 9(1)(i). Hence, it is taxable in India.

(iii) As per section 9(1)(vi), income by way of royalty payable by the Government of India is deemed to accrue or arise in India. "Royalty" means consideration for, *inter alia*, use of patent. Therefore, the amount paid by Government of India for use of patent developed by Mr. A, a non-resident, is deemed to accrue or arise in India. Hence, it is taxable in India in the hands of Mr. A.

(iv) ₹ 20 lakhs, being the value of debentures issued by an Indian company in consideration of providing technical know-how for use in its business in India, is in the nature of fee for technical services, deemed to accrue or arise in India to Sai Engineering, a non-resident foreign company, under section 9(1)(vii). Hence, it is taxable in India.

Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident of India is deemed to accrue or arise in India. Therefore, interest income from debentures of an Indian company is deemed to accrue or arise in India in the hands of Sai Engineering by virtue of section 9(1)(v). Hence, it is taxable in India.

Note – *Since the question specifically requires the candidates to examine the taxability of the above transactions under section 9, the provisions of double taxation avoidance agreement, if any, applicable in the above cases, have not been taken into consideration.*

Question 6

Z, an American tourist, comes to India for the first time on June 17, 2019. He leaves India on September 29, 2019. Determine his residential status for the assessment year 2020-21. Does it make any difference if he comes to India on a business trip or if he is an Indian citizen?

Answer

Previous year 2019-20:	105 [14+31+31+29]
Previous year 2018-19:	Nil
Previous year 2017-18:	Nil

and so on ……

He is non-resident for the assessment year 2020-21 as he does not satisfy any of the basic conditions. It does not make any difference if he comes on a business trip to India.

Further, in this case, it does not make any difference if he is an Indian citizen as far as the answer of non-resident is concerned. However, there is a difference in application of basic conditions as an Indian citizen who comes on a visit to India during the previous has the option of only one basic condition of 182 days to become a resident.

Question 7

M/s. Global Airlines incorporated as a company in USA operated its flights to India and vice versa during the year 2019-20 (April, 2019 to March, 2020) and collected charges of ₹ 125 lakhs for carriage of passengers and cargo out of which ₹ 65 lakhs were received in New York in U.S Dollars for the passenger fare booked from New York to Mumbai. The total expenses for the year on operation of such flights were ₹ 195 lakhs. Compute the income chargeable to tax of the foreign airlines.

Answer

As per section 44BBA, in case of a non-resident engaged in the business of operation of aircraft, 5% of the following amounts would be deemed to be the profits and gains from such business:

(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

In the present case, the income chargeable to tax of M/s Global Airlines applying the provisions of section 44BBA are as follows:

Particulars	Fare booked from India to outside India whether received in India or not (₹)	Fare booked from New York to Mumbai (₹)
Fare	60,00,000 (1,25,00,000 – 65,00,000)	65,00,000
Deemed income @5% u/s 44BBA	3,00,000 (60,00,000 × 5%)	Nil (since the amount not received in India)

Question 8

Atlant Italy, a company incorporated in France, was engaged in manufacture, trade and supply equipment and services for GSM Cellular Radio Telephones Systems. It supplied hardware and software to various entities in India. Software licensed by assessee embodied the process which is required to control and manage the specific set of activities involved in the business use of its customers, and also made available to its customers, who used it to carry out their business activities. The Assessing Officer contented that the consideration for supply of software embedded in hardware is 'royalty' under section 9(1)(vi)

Examine the correctness of the action of the Assessing Officer assuming that the software that was loaded on the hardware and embedded in the system does not have any independent existence.

Answer

The issue under consideration in this case is whether consideration for supply of software embedded in hardware would tantamount to 'royalty' for attracting deemed accrual of income under section 9(1)(vi).

As per section 9(1)(vi), income by way of royalty payable by a person who is a resident in India would be deemed to accrue or arise in India. However, where it is payable for the transfer of any right or the use of any property or information or for the utilization of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India, the amount payable by way royalty would not be deemed to accrue or arise in India, in the hands of non-resident.

For this purpose, 'royalty' includes transfer of all or any right for use or right to use a computer software irrespective of the medium through which such right is transferred.

The facts of the case are similar to the facts in *CIT v. Alcatel Lucent Canada (2015) 372 ITR 476*, wherein the above issue came up before the Delhi High Court. The Court observed that the software supply is an integral part of GSM mobile telephone system and is used by the cellular operators for providing cellular services to its customers. Where payment is made for hardware in which the software is embedded and the software does not have independent functional existence, no amount could be attributed as 'royalty' for software in terms of section 9(1)(vi).

In this case, since the software that was loaded on the hardware and embedded in the system does not have any independent existence, there could not be any independent use of such software. Therefore, the rationale of the Delhi High Court ruling can be applied to the case on hand. Accordingly, the action of the Assessing Officer in treating the consideration for supply of software embedded in hardware as royalty under section 9(1)(vi) is **not** correct.

CHAPTER 3

DOUBLE TAXATION RELIEF

LEARNING OUTCOMES

After studying this chapter, you would be able to -

❑ **appreciate** the need for double taxation relief;

❑ **appreciate** the types of double taxation relief available;

❑ **comprehend and apply** the provisions relating to double taxation relief contained in the Income-tax Act, 1961 and Income-tax Rules, 1962 in problem solving and addressing related issues;

❑ **comprehend** the procedure for claiming deduction where there is no double taxation avoidance agreement between India and the other country where the income has been taxed and **compute** the amount of deduction;

❑ **appreciate** the concept of Permanent Establishment under double taxation avoidance agreements and its relevance.

3.1 CONCEPT OF DOUBLE TAXATION RELIEF

In the present era of cross-border transactions across the globe, the effect of taxation is one of the important considerations for any trade and investment decision in other countries. One of the most significant results of globalisation is the visible impact of one country's domestic tax policies on the economy of another country. This has led to the need for continuously assessing the tax regimes of various countries and bringing about necessary reforms.

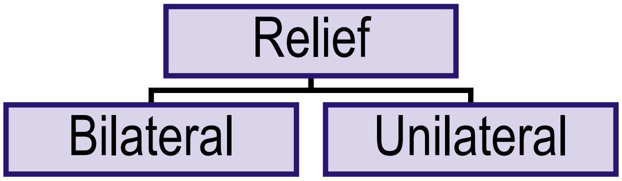
Where a taxpayer is resident in one country but has a source of income situated in another country it gives rise to possible double taxation. This arises from the two basic rules that enables the country of residence as well as the country where the source of income exists to impose tax namely, (i) the source rule and (ii) the residence rule. The source rule holds that income is to be taxed in the country in which it originates irrespective of whether the income accrues to a resident or a non-resident whereas the residence rule stipulates that the power to tax should rest with the country in which the taxpayer resides. If both rules apply simultaneously to a business entity and it were to suffer tax at both ends, the cost of operating on an international scale would become prohibitive and would deter the process of globalisation. It is from this point of view that Double Taxation Avoidance Agreements (DTAA) become very significant.

DTAAs lay down the rules for taxation of the income by the source country and the residence country. Such rules are laid for various categories of income, for example, interest, dividend, royalties, capital gains, business income etc. Each such category is dealt with by separate article in the DTAA.

Double taxation means taxing the same income twice in the hands of an assessee. In India, a person is taxed on the basis of his residential status. Likewise, it may so happen that he is taxed on this basis or some other basis in another country on the same income. However, it is a universally accepted principle that the same income should not be subjected to tax twice. In order to take care of such situations, the Income-tax Act, 1961 has provided for double taxation relief.

3.2 TYPES OF RELIEF

Relief from double taxation can be provided in mainly two ways:



(1) **Bilateral Relief**: Under this method, the Governments of two countries can enter into an agreement to provide relief against double taxation by mutually working out the basis on which the relief is to be granted. India has entered into agreements for relief against or avoidance of double taxation with more than 100 countries which include Sri Lanka, Switzerland, Sweden, Denmark, Japan, Federal Republic of Germany, Greece, etc.

Bilateral Relief may be granted in either one of the following methods:

Exemption Method

- A particular income is taxed in only one of the two countries.

Tax Credit Method

- Income is taxable in both countries in accordance with their respective tax laws read with double taxation avoidance agreement.
- The country of resident of the tax payer, however, allows him credit for the tax charged thereon in the country of source.

In India, double taxation relief is provided by a combination of the two methods.

(2) Unilateral Relief: This method provides for relief of some kind by the home country even where no mutual agreement has been entered into by the two countries.

3.3 DOUBLE TAXATION RELIEF PROVISIONS UNDER THE INCOME TAX ACT, 1961

Sections 90 and 91 of the Income-tax Act, 1961 provide for double taxation relief in India.

(1) Agreement with foreign countries or specified territories - Bilateral relief [Section 90]

(i) Section 90(1) provides that the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—

(a) for the granting of relief in respect of—

(i) income on which income-tax has been paid both in India and in that country or specified territory; or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory to promote mutual economic relations, trade and investment; or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory; or

Accordingly, the Central Government has notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement *[Notification No. 91/2008, dated 28.8.2008].*

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory or investigation of cases of such evasion or avoidance; or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory.

The Central Government may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(ii) Where the Central Government has entered into such an agreement with the Government of any country outside India or specified territory outside India for granting relief of tax, or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

(iii) However, the provisions of Chapter X-A, General Anti-Avoidance Rule, shall apply to the assessee even if such provisions are not beneficial to him.

(iv) **Meaning of terms used in any DTAA with a foreign country or specified territory**

	Particulars	Meaning of the term
(1)	Term used in any DTAA with a foreign country or specified territory, and not defined in the agreement or the Act but assigned a meaning in the notification issued by the Central Government in the Official Gazette, which is still in force.	The term shall have the meaning assigned in the said notification and the meaning shall be deemed to have effect from the date on which the DTAA came into force.
(2)	Term used in any DTAA with a foreign country or specified territory, which is defined in the DTAA itself.	The term shall have the same meaning assigned to it in the DTAA.
(3)	Term used in any DTAA with a foreign country or specified territory, which is not defined in the said DTAA, but defined in the Income-tax Act, 1961.	The term shall have the meaning assigned to it in the Income-tax Act, 1961 and explanation, if any, given to it by the Central Government.

(v) The DTAAs under section 90 are intended to provide relief to the taxpayer, who is resident of one of the contracting country to the agreement. Such tax payer can claim relief by applying the beneficial provisions of either the treaty or the domestic law. However, in many cases, taxpayers who were not residents of a contracting country also resorted to claiming the benefits under the agreement entered into by the Indian Government with the Government of the other country. In effect, third party residents claimed the unintended treaty benefits.

Therefore, section 90(4) provides that the non-resident to whom the agreement referred to in section 90(1) applies, shall be allowed to claim the relief under such agreement if a Tax Residence Certificate (TRC) obtained by him from the Government of that country or specified territory, is furnished declaring his residence of the country outside India or the specified territory outside India, as the case may be.

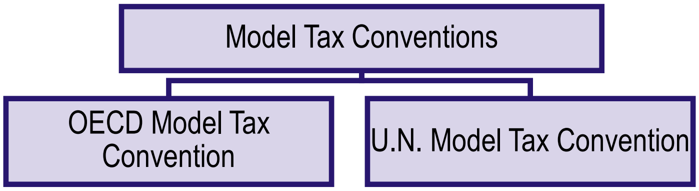
(vi) Therefore, a certificate issued by the Government of a foreign country would constitute proof of tax residency, without any further conditions regarding furnishing of "prescribed particulars" therein. In addition to such certificate issued by the foreign Government, the assessee would be required to provide such other documents and information, as may be prescribed, for claiming the treaty benefits.

(vii) The charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

(viii) *Circular No. 333 dated 2.4.1982*, issued by CBDT provides that a specific provision of the DTAA will prevail over the general provisions of the Income-tax Act, 1961. Therefore, where a DTAA provides for a particular mode of computation of income, this mode will take precedence over the Income-tax Act, 1961. However, where there is no specific provision in the treaty, then the Income-tax Act will apply.

(ix) *Notification No. 91/2008 dated 28.8.2008* issued by CBDT states that any income of a resident of India which "may be taxed" in the other country (Source Country) as per the DTAA shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961. Thereafter, relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

Tax treaties are generally based on certain models. The most common ones are:



These model tax conventions will be discussed in detail in Chapter 9 "Overview of Model Tax Conventions".

ILLUSTRATION 1

Examine the correctness or otherwise of the following statement with reference to the provisions of Income-tax Act, 1961.

The double taxation avoidance treaties entered into by the Government of India override the domestic law.

SOLUTION

The statement is correct.

Section 90(2) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee.

In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 1961, the provisions of the DTAA would prevail over the Act in view of the provisions of section 90(2), to the extent they are more beneficial to the assessee [*CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC)].*

(2) Double taxation relief to be extended to agreements between specified associations adopted by the Central Government [Section 90A]

(i) Section 90A provides that any specified association in India may enter into an agreement with any specified association in the specified territory outside India and the Central Government may, by notification in the Official Gazette, make the necessary provisions for adopting and implementing such agreement for -

(a) grant of double taxation relief,

(b) avoidance of double taxation of income,

(c) exchange of information for the prevention of evasion or avoidance of income- tax, or

(d) recovery of income-tax.

Section 90A(1) provides that an agreement may be entered into by any specified association in India with any specified association in the specified territory outside India which may be adopted by the Central Government by way of notification in the Official Gazette, for granting relief of tax or, as the case may be, for avoidance of double taxation.

The Central Government has, vide *Notification No.90/2008 dated 28.8.2008*, notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

(ii) In relation to any assessee to whom the said agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

(iii) However, the provisions of Chapter X-A, General Anti-avoidance rule, shall apply to the assesse even if such provisions are not beneficial to him.

(iv) **Meaning of terms used in any agreement which any specified association in India may enter into with any specified association in the specified territory outside India for double taxation relief**

	Particulars	Meaning of the term
(1)	Term used in any such agreement, and not defined in the agreement or the Act but assigned a meaning in the notification issued by the Central Government in the Official Gazette, which is still in force	The term shall have the meaning assigned in the said notification and the meaning shall be deemed to have effect from the date on which the agreement came into force.
(2)	Term used in any such agreement, which is defined in the agreement itself	The term shall have the same meaning assigned to it in the said agreement
(3)	Term used in any such agreement, which is not defined in the said agreement, but defined in the Income-tax Act, 1961	The term shall have the meaning assigned to it in the Income-tax Act, 1961 and explanation, if any, given to it by the Central Government

(v) The DTAAs under section 90A are intended to provide relief to the taxpayer, who is resident of one of the contracting country to the agreement. Such tax payer can claim relief by applying the beneficial provisions of either the treaty or the domestic law. However, in many cases, taxpayers who were not residents of a contracting country also resorted to claiming the benefits under the agreement entered into by the Indian Government with the Government of the other country. In effect, third party residents claimed the unintended treaty benefits.

Therefore, section 90A(4) provides that the non-resident to whom the agreement referred to in section 90A(1) applies, shall be allowed to claim the relief under such agreement if a Tax Residence Certificate (TRC) obtained by him from the Government of that country or specified territory is furnished, declaring his residence of the country outside India or the specified territory outside India, as the case may be.

(vi) Therefore, a certificate issued by the Government of a foreign country would constitute proof of tax residency, without any further conditions regarding furnishing of "prescribed particulars" therein. In addition to such certificate issued by the foreign Government, section 90A(5) requires the assessee to provide such other documents and information, as may be prescribed, for claiming the treaty benefits.

Documents and information, to be furnished by the assessee for claiming treaty benefits, prescribed by CBDT vide *Notification No. 57/2013 dated 01.08.2013*:

(i) Status (individual, company, firm etc.) of the assessee;

(ii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);

(iii) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident;

(iv) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and

(v) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (iv) above, is applicable.

However, the assessee may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in section 90(4) or section 90A(4).

The assessee shall keep and maintain such documents as are necessary to substantiate the information provided. An income-tax authority may require the assessee to provide the said documents in relation to a claim by the said assessee of any relief under an agreement referred to in section 90(1) or section 90A(1), as the case may be.

(vii) The charge of tax at a higher rate for a company incorporated in the specified territory outside India as compared to a domestic company would not be considered as less favourable charge or levy of tax in respect of such company.

(viii) For the purpose of this section, the 'specified association' means any institution, association or body, whether incorporated or not, functioning under any law for the time being in force in India or the laws of the specified territory outside India and which may be notified as such by the Central Government and 'specified territory' means any area outside India which may be notified by the Central Government.

(3) Countries with which no agreement exists – Unilateral Agreements [Section 91] In the case of income arising to an assessee in countries with which India does not have any double taxation agreement, relief would be granted under Section 91 provided all the following conditions are fulfilled:

(a) The assessee is a resident in India during the previous year in respect of which the income is taxable.

(b) The income accrues or arises to him outside India.

(c) The income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.

(e) The assessee has paid tax on the income in the foreign country.

(f) There is no agreement for relief from double taxation between India and the other country where the income has accrued or arisen.

In such a case, the assessee shall be entitled to a deduction from the Indian income-tax payable by him. The deduction would be a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax in the said country, whichever is lower, or at the Indian rate of tax if both the rates are equal.

Meaning of important terms:

(i) "Indian rate of tax" means the rate determined by dividing the amount of Indian income-tax after deduction of any relief due under the provisions of the Act but before deduction of any double taxation relief due to the assessee.

(ii) "Rate of tax of the said country" means income-tax and super-tax actually paid in that country in accordance with the corresponding laws in force in the said country after deduction of all relief due, but before deduction on account of double taxation relief due in the said country, divided by the whole amount of income assessed in the said country.

(iii) The expression "income-tax" in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

ILLUSTRATION 2

Nandita, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well-known dramatist deriving income of ₹ 1,10,000 from theatrical works played abroad. Tax of ₹ 11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to ₹ 6,10,000. In view of tax planning, she has deposited ₹ 1,50,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC ₹ 32,000. She also contributed ₹ 28,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of ₹ 26,000 to insure the health of her father, a non-resident aged 84 years, who is not dependent on her. Compute the tax liability of Nandita for the Assessment year 2020-21.

SOLUTION

Computation of tax liability of Nandita for the A.Y. 2020-21

Particulars	₹	₹
Indian Income		6,10,000
Foreign Income		1,10,000
Gross Total Income		**7,20,000**

Less: Deduction under section 80C		
Deposit in PPF	1,50,000	
Under section 80CCC		
Contribution to approved Pension Fund of LIC	32,000	
	1,82,000	
Under section 80CCE		
The aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to ₹ 1,50,000	1,50,000	
Under section 80D		
Contribution to Central Government Health Scheme ₹ 28,000 is also allowable as deduction under section 80D. Since she is a resident senior citizen, the deduction is allowable to a maximum of ₹ 50,000 **(See Note 1)**	28,000	
Medical insurance premium of ₹ 26,000 paid for father aged 84 years. Since the father is a non-resident in India, he will not be entitled for the higher deduction of ₹ 50,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of ₹ 25,000.	25,000	2,03,000
Total Income		**5,17,000**
Tax on Total Income		
Income-tax (See Note below)		13,400
Add: Health and Education Cess @4%		536
		13,936
Average rate of tax in India (i.e. ₹ 13,936/ ₹ 5,17,000 × 100)	2.696%	
Average rate of tax in foreign country (i.e. ₹ 11,000/ ₹ 1,10,000 ×100)	10%	
Deduction under section 91 on ₹ 1,10,000 @ 2.696% (lower of average Indian-tax rate or average foreign tax rate)		2,966
Tax payable in India (₹ 13,936 – ₹ 2,966)		**10,970**

Notes:

1. Section 80D allows a higher deduction of up to ₹ 50,000 in respect of the medical premium paid to insure the heath of a senior citizen. Therefore, Nandita will be allowed deduction of ₹ 28,000 under section 80D, since she is a resident Indian of the age of 60 years.

2. The basic exemption limit for senior citizens is ₹ 3,00,000 and the age criterion for qualifying as a "senior citizen" for availing the higher basic exemption limit is 60 years. Accordingly, Nandita is eligible for the higher basic exemption limit of ₹ 3,00,000, since she is 60 years old.

3. An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-

(a) The assessee is a resident in India during the relevant previous year.

(b) The income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, since all the above conditions are satisfied, Nandita is eligible for deduction u/s 91.

(4) Foreign Tax Credit [Rule 128 of Income-tax Rules, 1962]

(i) Year of availability of credit for foreign tax paid

An assessee, being a resident shall be allowed a credit for the amount of any foreign tax paid by him in a country or specified territory outside India, by way of deduction or otherwise, in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India, in the manner and to the extent as specified in this rule.

However, in a case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.

(ii) Meaning of "Foreign tax":

	Country/Specified Territory	Foreign Tax
(i)	in respect of a country or specified territory outside India with which India has entered into an agreement for the relief or avoidance of double taxation of income in terms of section 90 or section 90A	the tax covered under the said agreement
(ii)	in respect of any other country or specified territory outside India	the tax payable under the law in force in that country or specified territory in the nature of income-tax referred to in section 91. For this purpose, income-tax in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

(iii) Components of income-tax in respect of which FTC is available

Foreign Tax Credit (FTC) is available against the amount of tax, surcharge and cess payable under the Income-tax Act, 1961. However, it is not available in respect of any sum payable by way of interest, fee or penalty.

(iv) Manner of computing FTC

The credit of foreign tax would be the aggregate of the amounts of credit computed separately for each source of income arising from a particular country or specified territory outside India and shall be given effect to in the following manner:-

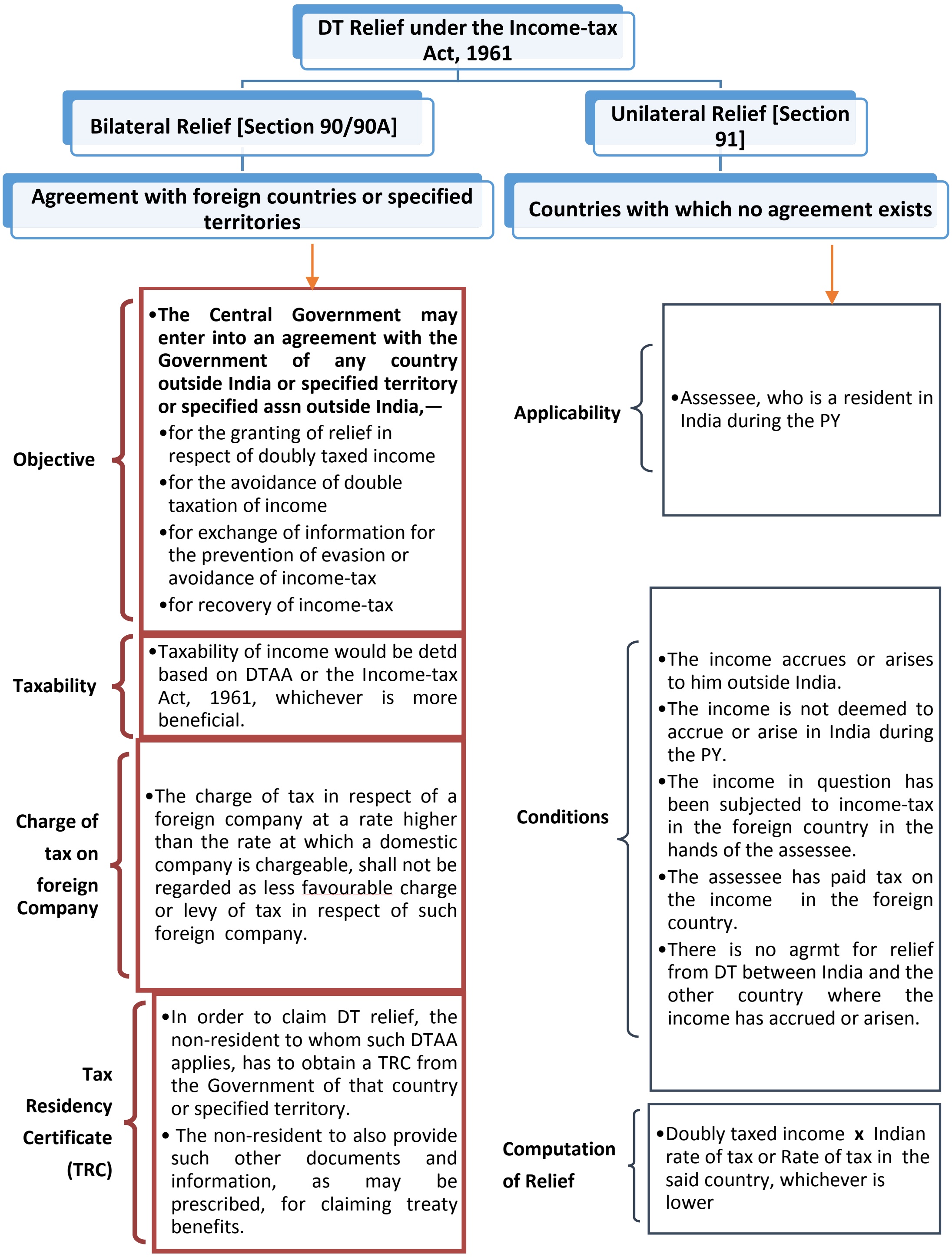
(a) the credit would be the lower of the tax payable under the Income-tax Act, 1961 on such income and the foreign tax paid on such income.

However, where the foreign tax paid exceeds the amount of tax payable in accordance with the provisions of the agreement for relief or avoidance of double taxation, such excess has to be ignored.

(b) the credit would be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.

Note *– Students are advised to refer to Rule 128 of Income-tax Rules, 1961 given as Annexure 1 at the end of the Study Material.*

Summary



DT Relief under the Income-tax Act, 1961

Bilateral Relief [Section 90/90A]

Agreement with foreign countries or specified territories

Objective

- **The Central Government may enter into an agreement with the Government of any country outside India or specified territory or specified assn outside India,—**
  - for the granting of relief in respect of doubly taxed income
  - for the avoidance of double taxation of income
  - for exchange of information for the prevention of evasion or avoidance of income-tax
  - for recovery of income-tax

Taxability

- Taxability of income would be detd based on DTAA or the Income-tax Act, 1961, whichever is more beneficial.

Charge of tax on foreign Company

- The charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

Tax Residency Certificate (TRC)

- In order to claim DT relief, the non-resident to whom such DTAA applies, has to obtain a TRC from the Government of that country or specified territory.
- The non-resident to also provide such other documents and information, as may be prescribed, for claiming treaty benefits.

Unilateral Relief [Section 91]

Countries with which no agreement exists

Applicability

- Assessee, who is a resident in India during the PY

Conditions

- The income accrues or arises to him outside India.
- The income is not deemed to accrue or arise in India during the PY.
- The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.
- The assessee has paid tax on the income in the foreign country.
- There is no agrmt for relief from DT between India and the other country where the income has accrued or arisen.

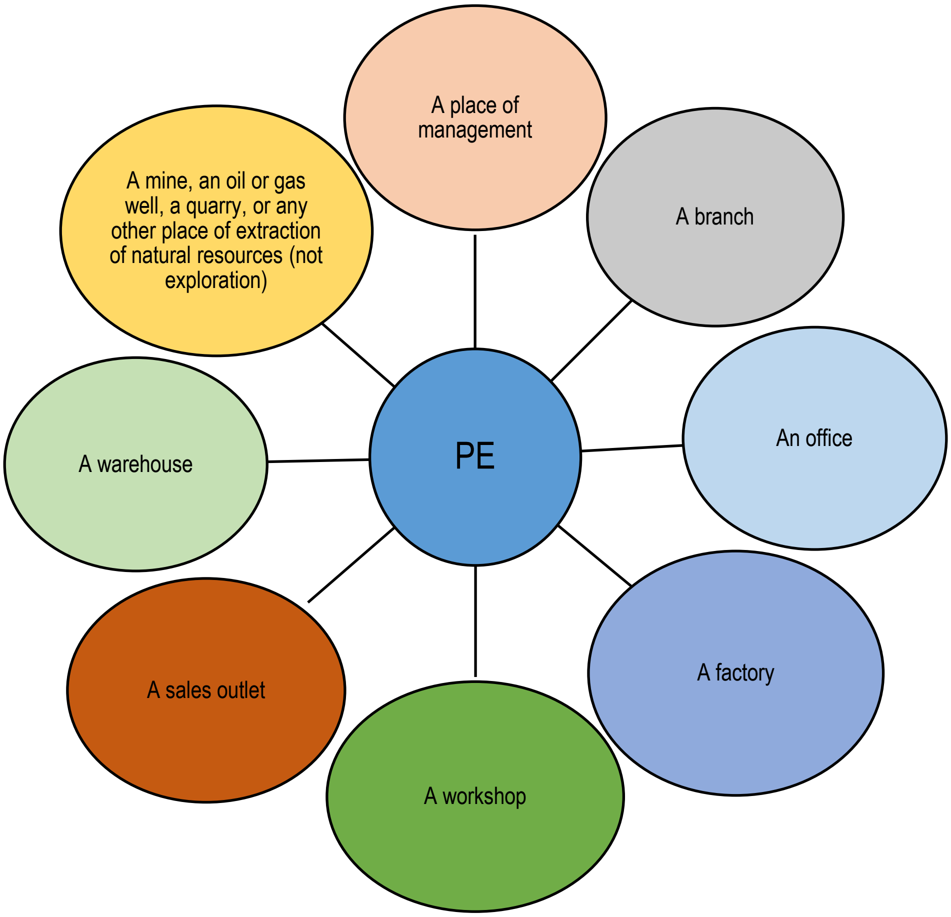
Computation of Relief

- Doubly taxed income **x** Indian rate of tax or Rate of tax in the said country, whichever is lower

3.4 CONCEPT OF PERMANENT ESTABLISHMENT

In order to determine the taxability of business income of foreign enterprises operating in India, it is important to determine the existence of a Permanent Establishment ('PE'). Article 5(1) of the DTAA provides that for the purpose of this convention the term 'Permanent Establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term 'Enterprise' has been defined in section 92F(iii) [See discussion under section 92A in Chapter 1].

According to Article 5(2), the term PE includes

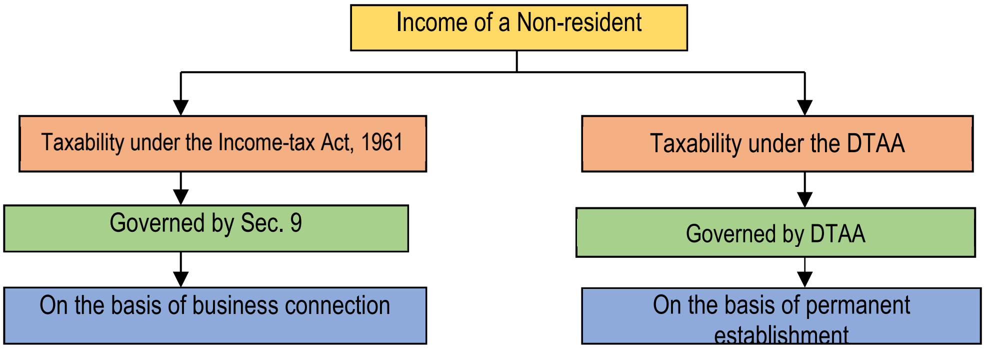

A place of management
A branch
A mine, an oil or gas well, a quarry, or any other place of extraction of natural resources (not exploration)
A warehouse
PE
An office
A sales outlet
A factory
A workshop

(1) Permanent establishment means a fixed place of business through which the business of an enterprises is wholly or partly carried on.

(2) Every DTAA has a specific clause, which will deal with an explanation of permanent establishment for the purpose of such DTAA.

(3) Business Income of a non-resident will not be taxed in India, unless such non-resident has a permanent establishment in India.

(4) Taxability of income under business connection and permanent establishment is explained here below:


Income of a Non-resident
Taxability under the Income-tax Act, 1961
Taxability under the DTAA
Governed by Sec. 9
Governed by DTAA
On the basis of business connection
On the basis of permanent establishment

3.5 TAXATION OF BUSINESS PROCESS OUTSOURCING UNITS IN INDIA

The provisions containing taxation of IT-enabled business process outsourcing units are not contained in the Income-tax Act, 1961 but are given in *Circular No.5/2004 dated 28.9.2004* issued by CBDT. The provisions are briefed hereunder -

(a) A non-resident entity may outsource certain services to a resident Indian entity. If there is no business connection between the two, the resident entity may not be a Permanent Establishment of the non-resident entity, and the resident entity would have to be assessed to income-tax as a separate entity. In such a case, the non-resident entity will not be liable under the Income-tax Act, 1961.

(b) However, it is possible that the non-resident entity may have a business connection with the resident Indian entity. In such a case, the resident Indian entity could be treated as the Permanent Establishment of the non-resident entity.

(c) The non-resident entity or the foreign company will be liable to tax in India only if the IT enabled BPO unit in India constitutes its Permanent Establishment.

(d) A non-resident or a foreign company is treated as having a Permanent Establishment in India if the said non-resident or foreign company carries on business in India through a branch, sales office etc. or through an agent (other than an independent agent) who habitually exercises an authority to conclude contracts or regularly delivers goods or merchandise or habitually secures orders on behalf of the non-resident principal. In such a case, the profits of the non-resident or foreign company attributable to the business activities carried out in India by the Permanent Establishment becomes taxable in India.

(e) If a foreign enterprise carries on business in another country through a Permanent Establishment situated therein, the profits of the enterprise may be taxed in the other country but only so much of them as is attributable to the Permanent Establishment.

(f) Profits are to be attributed to the Permanent Establishment as if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a Permanent Establishment.

(g) In determining the profits of a Permanent Establishment there shall be allowed as deduction, expenses which are incurred for the purposes of the Permanent Establishment including executive and general administrative expenses so incurred, whether in the State in which the Permanent Establishment is situated or elsewhere.

(h) The expenses that are deductible would have to be determined in accordance with the accepted principles of accountancy and the provisions of the Income-tax Act, 1961.

(i) The profits to be attributed to a Permanent Establishment are those which that Permanent Establishment would have made if, instead of dealing with its Head Office, it had been dealing with an entirely separate enterprise under conditions and at prices prevailing in the ordinary market. This corresponds to the "arm's length principle".

(j) Hence, in determining the profits attributable to an IT-enabled BPO unit constituting a Permanent Establishment, it will be necessary to determine the price of the services rendered by the Permanent Establishment to the Head office or by the Head office to the Permanent Establishment on the basis of "arm's length principle".

EXERCISE

Question 1

Cosmos Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2019. The Indian branch has filed return of income for assessment year 2020-21 disclosing income of ₹ 50 lacs. It paid tax at the rate applicable to domestic company i.e. 30% plus higher education cess@4% on the basis of paragraph 2 of Article 24 (Non-Discrimination) of the Double Taxation Avoidance Agreement between India and Mauritius, which reads as follows:

"The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances."

However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a foreign company i.e. 40% plus higher education cess@4%.

Is the action of the Assessing Officer in accordance with law?

Answer

Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to the assessee. Thus, in view of paragraph 2 of Article 24 (Non-discrimination of the DTAA, it appears that the Indian branch of Cosmos Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).

However, *Explanation 1* to section 90 clarifies that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this *Explanation*, the action of the Assessing Officer in levying tax@40% on the Indian branch of Cosmos Ltd. is in accordance with law.

Question 2

Kalpesh Kumar, a resident individual, is a musician deriving income of ₹ 7,50,000 from concerts performed outside India. Tax of ₹ 1,00,000 was deducted at source in the country where the concerts were performed. India does not have any double tax avoidance agreement with that country. His income in India amounted to ₹ 30,00,000. Compute tax liability of Kalpesh Kumar for the assessment year 2020-21 assuming he has deposited ₹ 1,50,000 in Public Provident Fund and *paid medical insurance premium in respect of his father, resident in India, aged 65 years, ₹ 52,000.*

Answer

Computation of tax liability of Mr. Kalpesh for A.Y.2020-21

Particulars	₹	₹
Indian Income		30,00,000
Foreign Income		7,50,000
Gross Total Income		**37,50,000**
Less: **Deduction under section 80C**		
PPF Contribution	1,50,000	
Deduction under section 80D		
Medical insurance premium of father, being a resident senior citizen, restricted to	50,000	2,00,000
Total Income		**35,50,000**
Tax on total income		8,77,500
Add: Health and Education cess @4%		35,100
		9,12,600
Average rate of tax in India [i.e., ₹ 9,12,600 /₹ 35,50,000 x 100]	25.71%	
Average rate of tax in foreign country [i.e. ₹ 1,00,000/ ₹ 7,50,000 x 100]	13.333%	
Doubly taxed income	7,50,000	
Deduction under section 91 on ₹ 7,50,000 @13.33% (lower of average Indian tax rate and foreign tax rate]		1,00,000
Tax payable in India [₹ 9,12,600 – ₹ 1,00,000]		**8,12,600**

Note: An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-

(a) The assessee is a resident in India during the relevant previous year.

(b) The income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, Kalpesh Kumar is eligible for deduction under section 91 since all the above conditions are fulfilled.

Question 3

The following are the particulars of income earned by Miss Vivitha, a resident Indian aged 25, for the assessment year 2020-21:

	(₹ In lacs)
Income from playing snooker matches in country L	*12.00*
Tax paid in country L	*1.80*
Income from playing snooker tournaments in India	*19.20*
Life Insurance Premium paid	*1.10*
Medical Insurance Premium paid for her father aged 62 years (paid through credit card)	*0.54*

Compute her total income and tax liability for the assessment year 2020-21. There is no Double Taxation Avoidance Agreement between India and country L.

Answer

Computation of total income and tax liability of Miss Vivitha for the A.Y. 2020-21

Particulars	₹	₹
Indian Income [Income from playing snooker tournaments in India]		19,20,000
Foreign Income [Income from playing snooker matches in country L]		12,00,000
Gross Total Income		**31,20,000**
Less: Deduction under Chapter VIA		
Deduction under section 80C		
Life insurance premium of ₹ 1,10,000 paid during the previous year deduction, is within the overall limit of ₹ 1.5 lakh. Hence, fully allowable as deduction	1,10,000	
Deduction under section 80D		
Medical insurance premium of ₹ 54,000 paid for her father aged 62 years. Since her father is a senior citizen, the deduction is allowable to a maximum of ₹ 50,000 (assuming that her father is also a resident in India). Further, deduction is allowable where payment is made by any mode other than cash. Here payment is made by credit card hence, eligible for deduction.	50,000	1,60,000
Total Income		**29,60,000**
Tax on Total Income		
Income-tax		7,00,500
Add: Health and education cess @4%		28,020
		7,28,520

Average rate of tax in India (i.e. ₹ 7,28,520/₹ 29,60,000 × 100)	24.61%	
Average rate of tax in foreign country (i.e. ₹ 1,80,000/ ₹12,00,000 ×100)	15.00%	
Deduction under section 91 on ₹ 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)		1,80,000
Tax payable in India (₹ 7,28,520 – ₹ 1,80,000)		**5,48,520**

Note: Miss Vivitha shall be allowed deduction under section 91, since the following conditions are fulfilled:-

(a) She is a resident in India during the relevant previous year.

(b) The income accrues or arises to her outside India during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign country L in her hands and she has paid tax on such income in the foreign country L.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and country L where the income has accrued or arisen.

Question 4

The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Examine the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreements (DTAA).

Answer

Double Taxation Avoidance Agreements (DTAAs) generally contain an Article providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment in the country of source, and such income can be attributed to the permanent establishment.

As per section 92F(iiia), the term “Permanent Establishment” includes a fixed place of business through which the business of an enterprise is wholly or partly carried on.

As per this definition, to constitute a permanent establishment, there must be a place of business which is fixed and the business of the enterprise must be carried out wholly or partly through this place.

Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs however provide that business income is taxable only if there is a permanent establishment in India.

Therefore, in cases covered by DTAAs, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i).

However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

Question 5

An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists, asks you to examine whether the credit for the tax paid on the foreign income will be allowed against his income-tax liability in India.

Answer

The assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, section 91 specifies that if a person resident in India has paid tax in any country with which no agreement under section 90 exists, then, for the purpose of relief or avoidance of double taxation, **a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such foreign country, whichever is lower, or at the Indian rate of tax, if both the rates are equal.** Accordingly, the assessee shall not be given any credit of the tax paid on the income in other country, but shall be allowed a deduction from the Indian income-tax payable by him as per the scheme of section 91 read with Rule 128 on Foreign Tax Credit.

Question 6

The Income-tax Act, 1961 provides for taxation of a certain income earned in India by Mr. X, a non-resident. The Double Taxation Avoidance Agreement, which applies to Mr. X provides for taxation of such income in the country of residence. Is Mr. X liable to pay tax on such income earned by him in India? Examine.

Answer

Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement with a country outside India, then **in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee.** This means that where tax liability is imposed by the Act, the Double Taxation Avoidance Agreement may be resorted to for reducing or avoiding the tax liability.

However, as per section 90(4), the assessee, in order to claim relief under the agreement, has to obtain a certificate [Tax Residence Certificate (TRC)] from the Government of that country, declaring the residence of the country outside India. Further, he also has to provide the following information in Form No. 10F:

(i) Status (individual, company, firm etc.) of the assessee;

(ii) PAN of the assessee, if allotted;

(iii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);

(iv) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident;

(v) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and

(vi) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (v) above, is applicable.

However, the assessee may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in section 90(4) or section 90A(4).

The Supreme Court has held, in *CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654,* that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act, 1961. Mr. X is, therefore, not liable to pay tax on the income earned by him in India provided he submits the Tax Residence Certificate obtained from the government of the other country, and provides such other documents and information as may be prescribed.

Question 7

Arif is a resident of both India and another foreign country in the previous year 2019-20. He owns immovable properties (including residential house) in both the countries. He earned income of ₹ 50 lacs from rubber estates in the foreign country during the financial year 2019-20. He also sold some house property situated in foreign country resulting in short-term capital gain of ₹ 10 lacs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of ₹ 6 lacs from property let out in India and he has a house in Lucknow where he stays during his visit to India.

Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Arif is a resident, provides that "where an individual is a resident of both the Contracting States, then, he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)".

You are required to examine with reasons whether the business income of Arif arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India.

Answer

Section 90(1) of the Income-tax Act, 1961 empowers the Central Government to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

Arif has residential houses both in India and foreign country. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with foreign country provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

Arif owns rubber estates in a foreign country from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore his personal and economic relations with foreign country are closer, since foreign country is the place where –

(a) the property is located and

(b) the permanent establishment (PE) has been set-up

Therefore, he shall be deemed to be resident of the foreign country for A.Y. 2020-21.

The fact of the case and issues arising therefrom are similar to that of *CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654*, where the Supreme Court held that if an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

However, as per section 90(4), in order to claim relief under the agreement, Arif has to obtain a certificate [Tax Residency Certificate (TRC)] declaring his residence of the country outside India from the Government of that country. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, Arif is not liable to income tax in India for assessment year 2020-21 in respect of business income and capital gains arising in the foreign country provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

Question 8

Mr. Kamesh, an individual resident in India aged 52 years, furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year 2019-20. India has not entered into double taxation avoidance agreement with these two countries.

Particulars	*₹*
Income from profession carried on in India	*7,50,000*
Agricultural income in Country "X" (gross)	*50,000*
Dividend received from a company incorporated in Country "Y" (gross)	*1,50,000*
Royalty income from a literary book from Country "X" (gross)	*6,00,000*
Expenses incurred for earning royalty	*50,000*
Business loss in Country "Y" (Proprietary business)	*65,000*
Rent from a house situated in Country "Y" (gross)	*2,40,000*
Municipal tax paid in respect of the above house in Country "Y" (not allowed as deduction in country "Y")	*10,000*

***Note:** Business loss in Country "Y" not eligible for set off against other incomes as per law of that country.*

The rates of tax in Country "X" and Country "Y" are 10% and 20%, respectively.

Compute total income and tax payable by Mr. Kamesh in India for Assessment Year 2020-21.

Answer

Computation of total income of Mr. Kamesh for A.Y.2020-21

Particulars	₹	₹
Income from House Property [House situated in country Y]		
Gross Annual Value[1]	2,40,000	
Less: Municipal taxes	10,000	
Net Annual Value	2,30,000	
Less: Deduction under section 24 – 30% of NAV	69,000	
		1,61,000
Profits and Gains of Business or Profession		
Income from profession carried on in India	7,50,000	
Royalty income from a literary book from Country X (after deducting expenses of ₹ 50,000)	5,50,000	
Less: Business loss in country Y set-off[2]	65,000	
		12,35,000

[1] Rental Income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.

[2] As per section 70(1), inter-source set-off of income is permitted.

Income from Other Sources		
Agricultural income in country X	50,000	
Dividend received from a company in country Y	1,50,000	2,00,000
Gross Total Income		**15,96,000**
***Less:* Deduction under Chapter VIA**		
Under section 80QQB – Royalty income of a resident from literary work[3]		3,00,000
Total Income		**12,96,000**

Computation of tax liability of Mr. Kamesh for A.Y.2020-21

Particulars	₹
Tax on total income [30% of ₹ 2,96,000 + ₹ 1,12,500]	2,01,300
Add: Health and Education cess@4%	8,052
	2,09,352
Less: Deduction under section 91 **(See Working Note below)**	69,739
Tax Payable	**1,39,613**
Tax payable (rounded off)	1,39,610

Working Note: Calculation of Rebate under section 91

	₹	₹
Average rate of tax in India [i.e., ₹ 2,09,352 / ₹ 12,96,000 x 100]	**16.154%**	
Average rate of tax in country X	**10%**	
Doubly taxed income pertaining to country X		
Agricultural Income	50,000	
Royalty Income [₹ 6,00,000 – ₹ 50,000 (Expenses) – ₹ 3,00,000 (deduction under section 80QQB)][4]	2,50,000	
	3,00,000	
Deduction under section 91 on ₹ 3,00,000 @10% [being the lower of average Indian tax rate (16.154%) and foreign tax rate (10%)]		30,000
Average rate of tax in country Y	**20%**	

[3] It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.

[4] Doubly taxed income includes only that part of income which is included in the assessee's total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount – *CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).*

Doubly taxed income pertaining to country Y		
Income from house property	1,61,000	
Dividend	1,50,000	
	3,11,000	
Less: Business loss set-off	65,000	
	2,46,000	
Deduction u/s 91 on ₹ 2,46,000 @16.154% (being the lower of average Indian tax rate (16.154%) and foreign tax rate (20%)]		39,739
Total rebate under section 91 (Country X + Country Y)		**69,739**

Note: Mr. Kamesh shall be allowed deduction u/s 91, since the following conditions are fulfilled:-

(a) He is a resident in India during the relevant previous year (i.e., P.Y.2019-20).

(b) The income in question accrues or arises to him outside India in foreign countries X and Y during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign countries X and Y in his hands and it is presumed that he has paid tax on such income in those countries.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Countries X and Y where the income has accrued or arisen.

CHAPTER **4**

ADVANCE RULINGS

LEARNING OUTCOMES

After studying this Chapter, you will be able to–

❑ **comprehend** the meaning and scope of the term “advance ruling” and the need for obtaining advance ruling;

❑ **appreciate** the constitution of Authority for Advance Rulings;

❑ **appreciate** the procedure for making an application to the Authority for Advance Rulings and the procedure to be followed by the Authority on receipt of application;

❑ **appreciate** the restricted binding nature of an Advance Ruling;

❑ **know** the circumstances when an advance ruling can be declared void.

4.1 INTRODUCTION

Chapter XIX-B, consisting of sections 245N to 245V provides a scheme for giving advance rulings in respect of transactions involving non-residents and specified residents with a view to avoiding needless litigation and promoting better tax-payer relations.

4.2 DEFINITIONS

(1) Advance Ruling [Section 245N(a)]: The meaning of Advance Ruling is detailed hereunder:

Section	Determination by the Authority
245N(a)(i)	in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant.
245N(a)(ii)	in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident and such determination shall include the determination of any question of law or of fact specified in the application.
245N(a)(iia)	in relation to the tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant and such determination shall include the determination of any question of law or of fact specified in the application.
245N(a)(iii)	in respect of an issue relating to computation of total income which is pending before any Income-tax Authority or the Appellate Tribunal and such determination or decision shall include the determination or decision of any question of law or fact in relation to such computation of total income specified in the application.
245N(a)(iv)	or decision whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

(2) Applicant [Section 245N(b)(A)]: 'Applicant' means any person who –

(i) is a non-resident referred to in section 245N(a)(i) above; or

(ii) is a resident referred to in section 245N(a)(ii) above; or

(iii) is a resident referred to in section 245N(a)(iia) above falling within any such class or category of persons as the Central Government may, by notification in the Official Gazette, specify.

[A resident in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or is proposed to be undertaken would be an applicant – Notification No.73/2014 dated 28.11.2014]; or

(iv) is a resident falling within such class or category of persons as the Central Government may, by notification in the Official Gazette, specify in this behalf *[Public sector company as defined under section 2(36A) of the Income-tax Act, 1961 – Notification No. 725(E) dated 3.8.2000]*; or

(v) is referred to in section 245N(a)(iv) above; and

who makes an application for advance ruling under section 245Q(1).

On account of the merger of Authority for Advance Rulings for income-tax, central excise, customs duty and service tax, the definition of applicant would now also include an applicant defined under the Central Excise Act, 1944, Customs Act, 1962 and the Finance Act, 1994[1].

Who can be an applicant in relation to different clauses of section 245N(a) defining advance ruling?

S. No.	Applicant u/s 245N(b)	Advance Ruling u/s 245N(a) means determination by the AAR in relation to
(i)	Non-resident (NR)	A transaction which has been undertaken or is proposed to be undertaken by him.
(ii)	Resident	The tax liability of a NR arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such NR and such determination shall include the determination of any question of law or of fact specified in the application.
(iii)	Resident of class or category of persons notified by Central Government	The tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant and such determination shall include the determination of any question of law or of fact specified in the application.
	Note: *The Central Government notified a resident, in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total.*	
(iv)	Resident of class or category of persons notified by Central Government	an issue relating to computation of total income which is pending before any Income-tax Authority or the Appellate Tribunal and such determination or decision shall include the determination or decision of any question of law or fact in relation to such computation of total income specified in the application.
	Note: *A public sector undertaking has been notified by the Central Government.*	
(v)	Resident or NR	whether an arrangement, which is proposed to be undertaken by any person being a resident or a NR, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

[1] No amendment has been made in pursuance of GST being effective from 01.07.2017

Restrictions on Appellate Authority: Section 245RR provides that where a resident applicant has made an application to AAR in respect of an issue for decision of AAR, then, any Income-tax Authority or Tribunal shall not take any decision in respect of such issues. In other words, a resident assessee cannot pursue both the remedies, i.e. an appeal or revision before Income-tax Authority/Appellate Authority as well as an application for Advance Ruling to AAR, in respect of an issue.

4.3 AUTHORITY FOR ADVANCE RULINGS [SECTION 245-O]

The Authority for Advance Rulings shall be constituted by the Central Government.

Particulars	Provisions
Composition of AAR	AAR to consist of a Chairman and such number of Vice Chairmen, revenue Members and law Members as the Central Government may, by notification, appoint. **Qualifications for appointment**: (a) **Chairman –** a person who has been a judge of the Supreme Court or the Chief Justice of a High Court or for at least seven years a judge of a High Court; (b) **Vice Chairman** – a person who has been a Judge of a High Court; (c) **A Revenue Member from the Indian Revenue Service** – a person who is, or is qualified to be, a Member of the Board on the date of occurrence of vacancy; (d) **A Revenue Member from the Indian Customs and Central Excise Service** – a person who is, or is qualified to be a Member of the Central Board of Excise and Customs on the date of occurrence of vacancy. (e) **A law Member from the Indian legal service** – a person who is, or is qualified to be, an Additional Secretary to the Government of India ('GOI') on the date of occurrence of vacancy. ***Note** – The above qualifications are relevant for appointments made before 26.5.2017. Appointments made on or after 26.5.2017 shall be governed by section 184 of the Finance Act, 2017 **[Refer para 4.4 below]***
Terms & Conditions	The terms and conditions of service and the salaries and allowances payable to the Members shall be such as may be prescribed. ***Note** – The terms and conditions in respect of appointments made on or after 26.5.2017 shall be governed by section 184 of the Finance Act, 2017 **[Refer para 4.4 below]***

Officers & Employees	The Central Government shall provide to the Authority with such officers and employees, as may be necessary, for the efficient discharge of the functions of the Authority under the Act.
Location of AAR and benches	The Authority shall be located in the National Capital Territory of Delhi and its benches shall be located at places as notified by the Central Government.
Constitution of Benches	The powers and functions of the AAR may be discharged by its Benches as may be constituted by the Chairman from amongst its Members thereof.
Composition of Benches	A Bench shall consist of the Chairman or the Vice-Chairman and one revenue and one law Member. However, where the **Authority is dealing** with an application seeking advance ruling in **any matter relating to the Income-tax Act**, the **revenue member** of the Bench shall be such **Member from the Indian Revenue Service**, who is, or is qualified to be, a member of the Board.
Any vacancy in the office of the Chairman by reason of his death, resignation or otherwise	The senior-most Vice Chairman shall act as the Chairman until the date on which a new Chairman, appointed in accordance with the provisions of the Act to fill such vacancy, enters upon his office
In case the Chairman is unable to discharge his functions owing to absence, illness or other cause	The senior-most Vice Chairman shall discharge the functions of the Chairman until the date on which the Chairman resumes his duties.

4.4 QUALIFICATIONS, TERMS AND CONDITIONS OF SERVICE OF CHAIRMAN, VICE CHAIRMAN AND MEMBERS [SECTION 245-OA]

The qualifications, appointment, term of office, salaries and allowances, resignation, removal and the other terms and conditions of service of the Chairman, Vice-Chairman and other Members of the Authority appointed on or after 26.05.2017, being the date on which the provisions of Part XIV of Chapter VI of the Finance Act, 2017 came into force, shall be governed by the provisions of section 184 of Finance Act 2017.

However, the Chairman, Vice-Chairman and Member appointed before 26.05.2017 shall continue to be governed by the provisions of the Act and the rules made thereunder as if the provisions of section 184 of the Finance Act, 2017 had not come into force.

Section 184 of Finance Act, 2017

(1) **Power to Central Government to make rules:** The Central Government may, by notification, make rules to provide for qualifications, appointment, term of office, salaries and allowances, resignation, removal and the other terms and conditions of service of the Chairman, Vice-Chairman or Member of the Authority.

(2) **Term of Chairman, Vice-Chairman or Member of the Authority:** The Chairman, Vice-Chairman or Member of the Authority shall hold office for such term as specified in the rules made by the Central Government but not exceeding 5 years from the date on which he enters upon his office and shall be eligible for reappointment.

(3) **Age Criteria of Chairman, Vice-Chairman or Member of the Authority:** No Chairman, Vice-Chairman or Member of the Authority shall hold office as such after he has attained such age as specified in the rules made by the Central Government which shall not exceed -

In case of	*Age*
Chairman	*seventy years*
Vice-Chairman or any other Member	*sixty-seven years*

Accordingly, the Central Government had notified "Tribunal, Appellate Tribunal and other Authorities (Qualifications, Experience and other Conditions of Service of Members) Rules, 2017", to specify the qualifications, appointment, term of office, salaries and allowances, resignation, removal and the other terms and conditions of service of the Chairman, Vice-Chairman and other Members of the Authority. Qualifications and term of office of the Chairman, Vice-Chairman and other Members of the Authority is as follows:

Particulars	*Provisions*
Qualifications for appointment	(a) ***Chairman*** *– a person who* - *is or has been or is qualified to be a judge of the Supreme Court or* - *is or has been a Chief Justice of a High Court or* - *has, for at least 7 years, been a Judge of a High Court or* - *has, for at least 3 years, been a Vice-Chairman, Revenue Member or Law Member of the Authority for Advance Ruling or* - *is a person of ability, integrity and standing, and having special knowledge of, and professional experience of not less than 25 years in economics, business, commerce, law, finance, accountancy, management, industry, public affairs, administration,*

	taxation or any other matter which in the opinion of the Central Government is useful to the Authority. (b) ***Vice Chairman** – a person who is, or has been, or is qualified to be, a Judge of a High Court;* (c) ***Revenue Member*** - *from the Indian Revenue Service is qualified to be a Member of the Central Board of Direct Taxes Board and* - *an officer of the Indian Customs and Central Excise Service, who is qualified to be a Member of the Central Board of Excise and Customs.* (d) ***A law Member from the Indian legal service** – a person who is an Additional Secretary to the Government of India ('GOI').*
Term of Chairman, Vice-Chairman or Member of the Authority	*The Chairman, Vice-Chairman or Member of the Authority shall hold office for a term of three years.*
Age Criteria of Chairman, Vice-Chairman or Member of the Authority	***In case of*** — ***Age*** *Chairman* — *70 years* *Vice-Chairman* — *65 years* *Member* — *62 years*

4.5 VACANCIES, ETC., NOT TO INVALIDATE PROCEEDINGS [SECTION 245P]

No proceeding before, or pronouncement of advance ruling by, the Authority shall be questioned or shall be invalid on the ground merely of the existence of any vacancy or defect in the constitution of the Authority.

4.6 APPLICATION FOR ADVANCE RULING [SECTION 245Q]

Section 245Q(1) provides that an applicant desirous of obtaining an advance ruling may make an application stating the question on which the advance ruling is sought in the prescribed form and in the prescribed manner.

As per section 245Q(2), the application shall be made in quadruplicate and be accompanied by a fee of ₹ 10,000 or such fee as may be prescribed, whichever is higher.

Rule 44E prescribes the fees mentioned in column (3) to be paid by the applicant mentioned in column (1) in the cases of column (2).

Category of applicant	Category of case	Fee
(1)	(2)	(3)
An applicant referred to in sub-clauses (i) or (ii) or (iia) of clause (b) of section 245N	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought does not exceed ₹ 100 crore.	₹ 2 lacs
	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought exceeds ₹ 100 crore but does not exceed ₹ 300 crore.	₹ 5 lacs
	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought exceeds ₹ 300 crore.	₹ 10 lacs
Any other applicant	In all cases	₹ 10000

Rule 44E prescribes the form of application for obtaining an advance ruling. Every application under Rule 44E shall be accompanied by the proof of payment of fees.

Section 245Q(3) provides that an applicant may withdraw an application within 30 days from the date of the application.

4.7 PROCEDURE ON RECEIPT OF APPLICATION [SECTION 245R]

The Authority on receipt of an application will send a copy to the Principal Commissioner or Commissioner concerned and wherever considered necessary, also call upon the Principal Commissioner or Commissioner to furnish relevant records. Such records will be returned to the Principal Commissioner or Commissioner as soon as possible.

The Authority may either allow or reject an application. However, the Authority **shall not allow** an application where the question raised in the application is:

Pending with income-tax authorities/ tribunal/court	is already pending before any income-tax authority, or Appellate Tribunal or any court. However, a resident falling within any class or category of persons as notified by the Central Government i.e., a public sector undertaking can seek for advance ruling even if question raised is pending before any income-tax authority or Appellate.

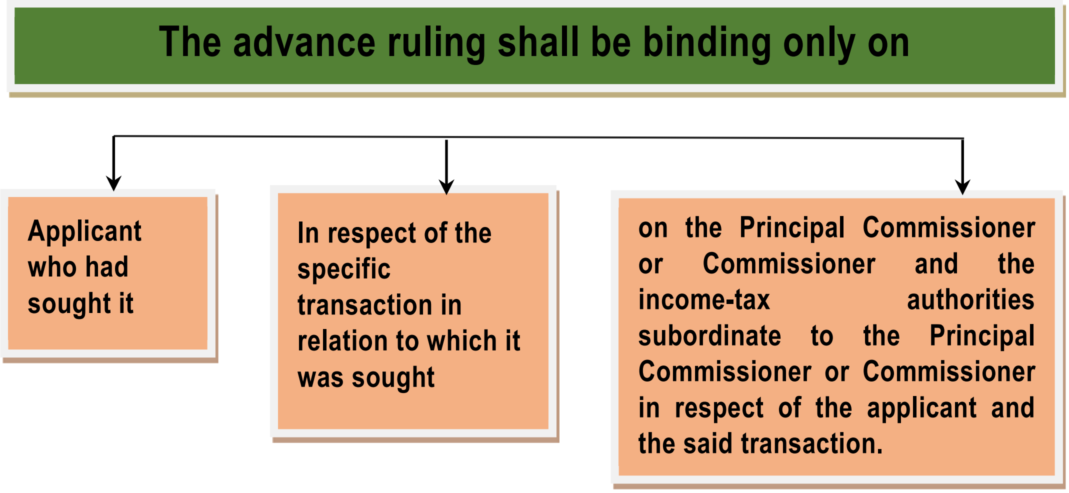
Determination of Fair Market Value	involves the determination of the fair market value of any property;
Transaction designed for avoidance of income-tax	relates to a transaction or issue which is designed *prima facie* for avoidance of income-tax (except in case of a resident applicant falling within any class or category of persons as notified by the Central Government i.e., a public sector undertaking or in the case of resident or a non-resident for determination of whether an arrangement, which is proposed to be undertaken is an impermissible avoidance arrangement).

However, no application shall be rejected unless an opportunity has been given to the applicant of being heard. Further, where an application is rejected, the reason for rejection shall be given in the order. A copy of every order shall be sent to the applicant and to the PCIT/CIT.

Where an application is allowed, the Authority would pronounce its advance ruling on that question specified in the application, after examining such further material as may be placed before it by the applicant or obtained by the Authority.

An applicant on request can appear either in person or can be represented through a duly authorised representative. The authority will pronounce the advance ruling **within 6 months** from the receipt of application by the authority and the copy of advance ruling pronounced, duly signed by the Members and certified, shall be sent to the applicant and to the PCIT/CIT.

4.8 APPLICABILITY OF ADVANCE RULING [SECTION 245S]



The advance ruling shall be binding only on

Applicant who had sought it

In respect of the specific transaction in relation to which it was sought

on the Principal Commissioner or Commissioner and the income-tax authorities subordinate to the Principal Commissioner or Commissioner in respect of the applicant and the said transaction.

The advance ruling will continue to remain in force unless there is a change either in law or in fact on the basis of which the advance ruling was pronounced.

4.9 ADVANCE RULING TO BE VOID IN CERTAIN CIRCUMSTANCES [SECTION 245T]

Where the Authority finds, on a representation made to it by the PCIT/CIT or otherwise, that an advance ruling has been obtained by the applicant by fraud or misrepresentation of facts, the Authority may, by order, declare such ruling to be *void ab initio.* The provisions of the Act shall apply (excluding the period beginning with the date of such advance ruling and ending with the date of order under this section) to the applicant as if such advance ruling had never been made. A copy of this order shall be sent to the applicant and the Principal Commissioner or Commissioner.

4.10 POWERS OF THE AUTHORITY [SECTION 245U]

The Authority shall have all the powers of the Civil Court in respect of discovery and inspection, enforcing the attendance of any person, including any officer of a banking company and examining on oath, issuing commissions and compelling the production of books of accounts and other documents. The Authority shall be deemed to be a Civil Court for the purposes of section 195 of the Code of Criminal Procedure, 1973 which provides for prosecution for contempt of lawful authority of public servants, for offences against public justice. Every proceeding before the Authority shall be deemed to be a judicial proceeding under the Indian Penal Code.

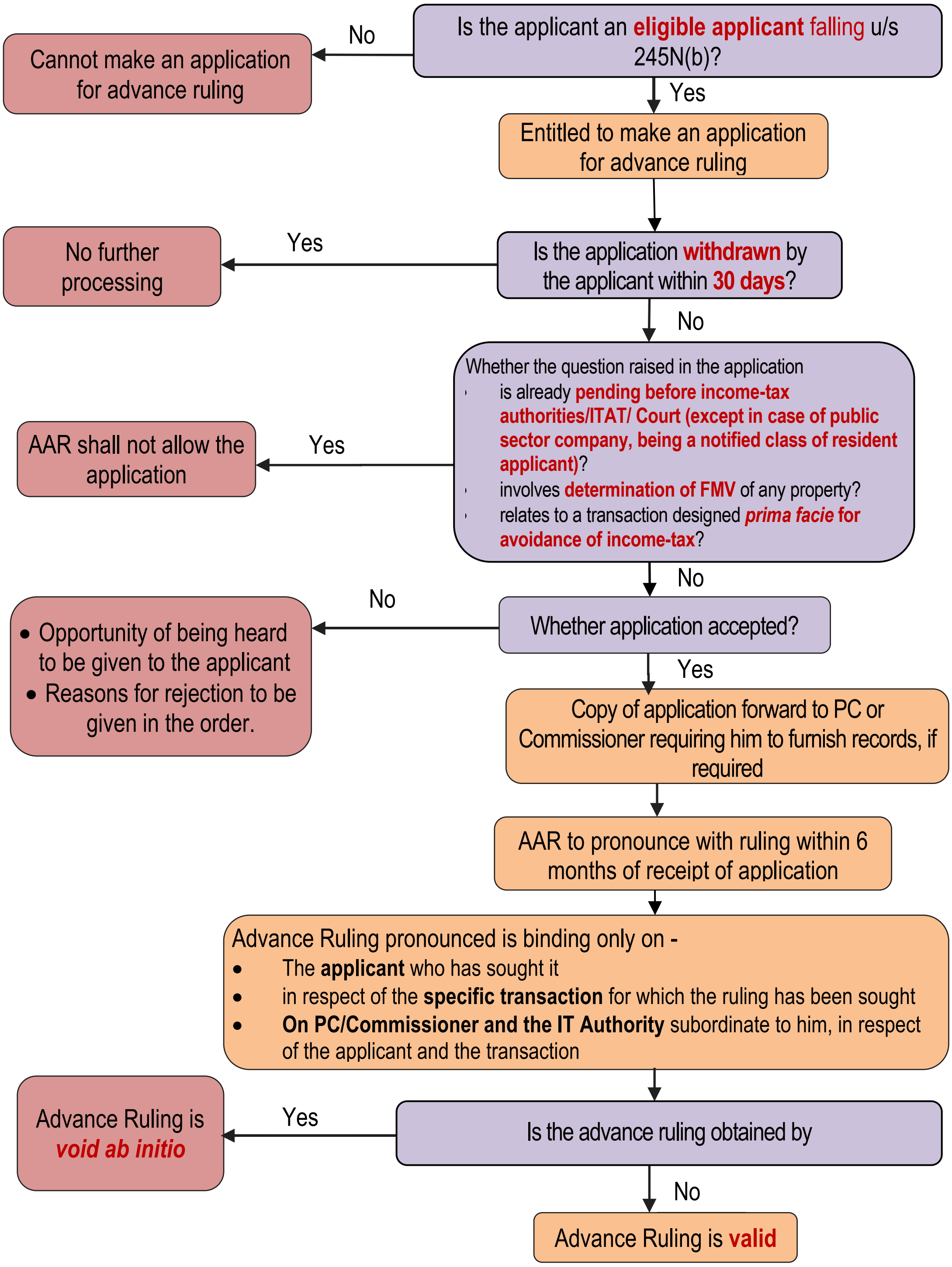
However, the Authority shall not be deemed to a Civil Court for the purpose of Chapter XXVI of the Code of Criminal Procedure, 1973 containing the provisions as to offences affecting the administration of justice.

4.11 PROCEDURE OF AUTHORITY [SECTION 245V]

The Authority shall, subject to the provisions of this Chapter, have power to regulate its own procedure in all matters arising out of the exercise of its powers under the Act.

For ease of reference, the process of application for Advance Ruling is explained below in a summarized form:

Overview of Advance Ruling Procedure



Is the applicant an **eligible applicant** falling u/s 245N(b)?

No → Cannot make an application for advance ruling

Yes → Entitled to make an application for advance ruling

Is the application **withdrawn** by the applicant within **30 days**?

Yes → No further processing

No → Whether the question raised in the application

- is already **pending before income-tax authorities/ITAT/ Court (except in case of public sector company, being a notified class of resident applicant)**?
- involves **determination of FMV** of any property?
- relates to a transaction designed ***prima facie* for avoidance of income-tax**?

Yes → AAR shall not allow the application

No → Whether application accepted?

No →

- Opportunity of being heard to be given to the applicant
- Reasons for rejection to be given in the order.

Yes → Copy of application forward to PC or Commissioner requiring him to furnish records, if required

AAR to pronounce with ruling within 6 months of receipt of application

Advance Ruling pronounced is binding only on -

- The **applicant** who has sought it
- in respect of the **specific transaction** for which the ruling has been sought
- **On PC/Commissioner and the IT Authority** subordinate to him, in respect of the applicant and the transaction

Is the advance ruling obtained by

Yes → Advance Ruling is ***void ab initio***

No → Advance Ruling is **valid**

EXERCISE

Question 1

Examine whether a person resident in India can seek advance ruling from the Authority for Advance Ruling.

Answer

A resident can make an application to the Authority for Advance Ruling to seek an advance ruling in the following cases:

(i) Section 245N(b)(A)(III) enables a resident referred in section 245N(a)(iia) falling within any such class or category of persons as may be notified by the Central Government to make an application to Authority for Advance Rulings. Such notified resident applicant can seek ruling in relation to his tax liability arising out of a transaction which has been undertaken or is proposed to be undertaken by **such applicant**, and such determination shall include the determination of any question of law or of fact specified in the application.

A resident in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(ii) Section 245N(b)(A)(IV) enables a resident falling within any such class or category of persons as may be notified by the Central Government to make an application for Advance Ruling. Such notified resident applicant can seek ruling in respect of issues relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal. Such a resident applicant can make an application to seek determination or decision by the AAR on a question of law or a question of fact relating to such computation of total income specified in the application.

"Public sector companies" as defined in section 2(36A) of the Income-tax Act, 1961 have been notified as applicant for this purpose.

(iii) A resident can also make an application seeking advance ruling in relation to the tax liability of a non-resident arising out of a transaction undertaken or proposed to be undertaken by him with such non-resident.

(iv) A resident can make an application seeking advance ruling on whether an arrangement proposed to be undertaken by him is an impermissible avoidance arrangement under Chapter X-A.

Question 2

Q, a non-resident, made an application to the Authority for Advance Rulings on 2.7.2019 in relation to a transaction proposed to be undertaken by him. On 31.8.2019, he decides to withdraw the said application. Can he withdraw the application on 31.8.2019?

Answer

Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since more than 30 days have elapsed since the date of application by Q to the Authority for Advance Rulings, he cannot withdraw the application.

However, the Authority for Advance Rulings (AAR*),* in *M.K.Jain AAR No.644 of 2004*, has observed that though section 245Q(3) provides that an application may be withdrawn by the applicant within 30 days from the date of the application, this, however, does not preclude the AAR from permitting withdrawal of the application after the said period, if the circumstances of the case so justify.

Question 3

Examine when can an advance ruling pronounced by the Authority for Advance Rulings be declared void. What is the consequence?

Answer

As per section 245T, an advance ruling can be declared to be *void ab initio* by the Authority for Advance Rulings if, on a representation made to it by the Principal Commissioner or Commissioner or otherwise, it finds that the ruling has been obtained by fraud or misrepresentation of facts. Thereafter, all the provisions of the Act will apply as if no such advance ruling has been made. A copy of such order shall be sent to the applicant and the Principal Commissioner or Commissioner.

Question 4

Mr. Balram is a non-resident. The appeal pertaining to the assessment year 2018-19 is pending before the Income-tax Appellate Tribunal, the issue involved being computation of export profit and tax thereon. The same issue persists for the assessment year 2019-20 as well. Mr. Balram's brother Mr. Krishna has obtained an advance ruling under Chapter XIX - B of Income-tax Act, 1961 from the Authority for Advance Rulings on an identical issue. Mr. Balram proposes to use the said ruling for his assessment pertaining to the assessment year 2019-20. Can he do so?

Answer

As per section 245S(1), the advance ruling pronounced under section 245R by the Authority for Advance Rulings shall be binding only on the applicant who had sought it and in respect of the specific transaction in relation to which advance ruling was sought. It shall also be binding on the Principal Commissioner/Commissioner and the income-tax authorities subordinate to him, in respect of the concerned applicant and the specific transaction.

In view of the above provision, Mr. Balram cannot use the advance ruling, obtained on an identical issue by his brother, for his assessment pertaining to the assessment year 2019-20.

Note – *Though the ruling of the Authority for Advance Rulings is not binding on others but there* *is no bar on the Tribunal taking a view or forming an opinion in consonance with the reasoning of the Authority for Advance Rulings dehors the binding nature [CIT v. P. Sekar Trust (2010) 321 ITR 305 (Mad.)].*

Question 5

The Authority for Advance Rulings has the powers of compelling the production of books of account – Examine the correctness or otherwise of this statement.

Answer

The statement is correct.

Under section 245U, the Authority for Advance Rulings shall have all the powers vested in the Civil Court under the Code of Civil Procedure, 1908 as are referred to in section 131.

Accordingly, the Authority for Advance Rulings shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely -

(1) discovery and inspection;

(2) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;

(3) compelling the production of books of account and other documents; and

(4) issuing commissions.

Therefore, the Authority for Advance Ruling has the powers of compelling the production of books of account.

Question 6

The term 'Advance Ruling' includes within its scope, a determination by the Authority for Advance Rulings only in relation to a transaction undertaken by a non-resident applicant. Examine the correctness of this statement, with reference to the provisions of the Income-tax Act 1961.

Answer

The statement is not correct.

The term ‘Advance Ruling’ has been defined in section 245N(a) to mean:-

(a) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a **non-resident applicant**; or

(b) a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken **by a resident applicant with such non-resident**; and such determination shall include the determination of any question of law or of fact specified in the application or

(c) a determination by the Authority in relation to the tax liability of a **resident applicant**, arising out of a transaction which has been undertaken or is proposed to be undertaken by **such applicant**, and such determination shall include the determination of any question of law or of fact specified in the application

A resident in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(d) a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision on any question of law or of fact relating to such computation of total income specified in the application.

(e) a determination or decision by the Authority whether an arrangement, which is proposed to be undertaken by **any person being a resident** or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

Question 7

An Irish company, Phi plc., entered into a contract with an Indian company, Beta Ltd., for provision of technical know-how and made an application to the Authority for Advance Rulings for advance ruling on the rate of withholding tax on receipts from Beta Ltd. Beta Ltd. had also made an application to the Assessing Officer for determination of the rate at which tax is deductible on the said payment to Phi plc. The Authority for Advance Rulings rejected the application of Phi plc. on the ground that the question raised in the application is already pending before an income tax authority. Is the rejection of the application of Phi plc. justified in law?

Answer

This issue came up before the AAR in, *Nuclear Power Corporation of India Ltd. In Re, [2012] 343 ITR 220*, wherein it was held that an advance ruling is not only applicant specific, but is also transaction specific. The advance ruling is on a transaction entered into or undertaken by the applicant. That is why section 245S specifies that a ruling is binding on the applicant, **the transaction** and the Principal Commissioner or Commissioner of Income-tax and those subordinate to him, and not only on the applicant.

What is barred by the first proviso to section 245R(2) of the Act in the context of clause (i) thereof is the allowing of an application under section 245R(2) of the Act where “the question raised in the application is already pending before any Income-tax authority, or Appellate Tribunal or any court”. The significance of the dropping of the words, “in the applicant’s case” with effect from June 1, 2000, cannot be wholly ignored.

On the basis of this view expressed by the AAR in the above case, explaining the impact of the dropping of the words “in the applicant’s case” with effect from 1.6.2000, a view can be taken that the AAR can reject the application made by Phi plc. before the AAR on the ground that similar issue is pending before the Assessing Officer in respect of the same transaction i.e., provision of technical know to Beta Ltd.

Note – *The issue relates to the admission or rejection of the application filed before the Advance Rulings Authority on the grounds specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.*

The first proviso to section 245R(2) has been substituted by the Finance Act, 2000 with effect from 1.6.2000. Clause (i) of the first proviso, prior to and post amendment, reads as follows:

Prior to 1.6.2000	***On or After 1.6.2000***
Provided that the Authority shall not allow the application ***except in the case of a resident applicant*** *where the question raised in the application is already pending* ***in the applicant's case*** *before any income-tax authority, the Appellate Tribunal or any court;*	*Provided that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court.*

The words "except in the case of a resident applicant" and "in the applicant's case" has been removed in clause (i) of the first proviso with effect from 1.6.2000. However, the Explanatory Memorandum to the Finance Act, 2000, explaining the impact of the substitution, reads as follows "It is proposed to substitute the proviso to provide that the Authority shall not allow the application when the question raised is already pending in the applicant's case before any income-tax authority, Appellate Tribunal or any court in regard to a non-resident applicant and resident applicant in relation to a transaction with a non-resident". Therefore, according to the intent expressed in the Explanatory Memorandum, the AAR shall not allow the application both in the case of resident and non-resident applicant if the question raised is already ***pending in the applicant's case*** *before any income-tax authority. Thus, as per the Explanatory Memorandum, it is possible to take a view that even post-amendment, the Authority shall not allow the application only where a question is* ***pending in the applicant's case*** *before any income-tax authority. Thus, an alternative view is possible on the basis of the AAR ruling in Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203, which continues to hold good even after the amendment, if we consider the intent expressed in the Explanatory Memorandum.* ***Accordingly, based on this view, the AAR can allow the application made by Phi plc., even if the question raised in the application is pending before the Assessing Officer in Beta Ltd.'s case****.*

CHAPTER 5

EQUALISATION LEVY

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- ❑ **appreciate** the issues in taxing e-commerce transactions;
- ❑ **comprehend** the OECD recommendations for taxing e-commerce transactions under Action Plan 1 of Base Erosion and Profit Shifting (BEPS) project;
- ❑ **appreciate** the need for equalization levy;
- ❑ **appreciate** the meaning of "specified services" which are subject to equalisation levy;
- ❑ **comprehend and apply** the provisions of equalisation levy contained in Chapter VIII of the Finance Act, 2016 and the relevant Rules in problem solving and addressing related issues.

5.1 GROWTH OF E-COMMERCE AND CONCERNS EMERGING THEREFROM

(1) The rapid growth of information and communication technology has resulted in substantial expansion of the supply and procurement of digital goods and services globally, including India. The digital economy is growing at approximately 10% per annum, significantly faster than the global economy as a whole.

(2) At present, in the digital domain, business may be conducted without regard to national boundaries and may dissolve the link between an income-producing activity and a specific location. Hence, business in digital domain doesn't actually occur in any physical location but instead takes place in "cyberspace." Persons carrying business in digital domain could be located anywhere in the world. Entrepreneurs across the world have been quick to evolve their business to take advantage of these changes. It has also made it possible for the businesses to conduct themselves in ways that did not exist earlier, and given rise to new business models that rely more on digital and telecommunication network, do not require physical presence, and derives substantial value from data collected and transmitted from such networks.

5.2 TAXATION ISSUES RELATING TO E-COMMERCE

These new business models have created new tax challenges. The typical taxation issues relating to e-commerce are:

(1) the difficulty in characterizing the nature of payment and establishing a nexus or link between taxable transaction, activity and a taxing jurisdiction,

(2) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

The digital business, thus, challenges physical presence-based permanent establishment rules. If permanent establishment principles are to remain effective in the new economy, the fundamental PE components developed for the old economy i.e. place of business, location, and permanency must be reconciled with the new digital reality.

5.3 OECD RECOMMENDATIONS UNDER ACTION PLAN 1 OF THE BEPS PROJECT

The OECD has recommended several options to tackle the direct tax challenges which include:

(1) Modifying the existing definition of permanent establishment to provide for whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.

(2) Introducing the concept of a virtual fixed place of business in the concept of permanent establishments i.e., creation of a permanent establishments when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.

(3) Imposition of a final withholding tax on gross basis in case of certain payments made for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having permanent establishment in other contracting state.

Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.

5.4 EQUALISATION LEVY - CHAPTER VIII IN THE FINANCE ACT, 2016

In order to address these challenges, Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having PE in India, from a resident in India who carries out business or profession, or from a non-resident having PE in India.

The CBDT issued a notification dated 27 May, 2016, stating that the provisions of Chapter VIII relating to the equalisation levy would come into effect from 1st June 2016. This Chapter extends to the whole of India except Jammu and Kashmir. It applies in respect of consideration received or receivable for specified services provided on or after 1.6.2016.

The key aspects related to Equalisation Levy have been discussed below.

(1) Meaning of "Equalisation Levy" [Section 164(d) of the Finance Act, 2016]:

Equalisation levy means the tax leviable on consideration received or receivable for any specified service

(2) Meaning of "Specified Service" [Section 164(i) of the Finance Act, 2016]:

(i) Online advertisement;

(ii) Any provision for digital advertising space or any other facility or service for the purpose of online advertisement;

(iii) Any other service as may be notified by the Central Government.

Note – 'Online' means a facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network.

(3) Charge of Equalisation Levy [Section 165 of Finance Act, 2016]:

(i) Equalisation levy @6% is leviable on the amount of consideration for specified service received or receivable by a person, being a non-resident from -

(a) a person resident in India and carrying on business or profession; or

(b) a non-resident having a PE in India.

(ii) Equalisation levy is not chargeable, where –

(a) the non-resident providing the specified service has a PE in India and the specified service is effectively connected with such PE;

(b) the aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident from a person resident in India and carrying on business or profession, or from a non-resident having a PE in India, does not exceed ₹ 1 lakh; or

(c) where the payment for the specified service by the person resident in India, or the PE in India is not for the purposes of carrying out business or profession.

(4) Relief to small players in the digital domain:

In order to reduce burden of small players in the digital domain, it is also provided that no such levy shall be made if the aggregate amount of consideration for specified services received or receivable by a non-resident from a person resident in India and carrying on business or profession or from a non-resident having a permanent establishment in India does not exceed ₹ 1 lakh in any previous year.

Further, equalisation levy shall not be charged where the payment for the specified service by the person resident in India or the permanent establishment in India, is not for the purposes of carrying out business or profession.

(5) Provisions of Chapter on Equalisation Levy:

Section	Subject	Provisions
166	**Collection and recovery of equalisation levy**	
	Person responsible for deduction of equalisation levy	Every person, being a resident and carrying on business or profession or a non-resident having a permanent establishment in India shall deduct equalisation levy from the amount paid or payable to a non-resident in respect of the specified service.
	Rate of equalisation levy	6% of the amount of consideration for specified service paid or payable to a non-resident in respect of specified

		service by a person resident in India and carrying on business or profession or a non-resident having a PE in India. The amount of consideration of specified services, equalisation levy, interest and penalty payable and refund shall be **rounded off to the nearest multiple of ten rupees**. [Rule 3 of Equalisation Levy Rules, 2016]
	Threshold limit	Equalisation levy is deductible if the aggregate amount of consideration for specified service in a previous year exceeds **one lakh rupees**.
	Time period for remittance of equalisation levy	The equalisation levy so deducted during any calendar month shall be paid by every assessee to the credit of the Central Government **by the 7th of the month immediately following the said calendar month**. Equalisation levy deducted during any calendar month is to be paid to the credit of the Central Government by remitting it to the Reserve Bank of India or the State Bank of India or any other authorised bank, accompanied by an equalisation levy challan. [Rule 4 of Equalisation Levy Rules, 2016]
	Consequence of failure to deduct equalisation levy	Any assessee who fails to deduct equalisation levy shall, notwithstanding such failure, be liable to pay the levy to the credit of the Central Government by the 7th of the month immediately following the said calendar month. Thus, if the assessee responsible for deducting equalisation levy, fails to so deduct, he has, in any case, to pay such levy to the credit of the Central Government by the 7th of the month immediately following the said calendar month.
167	**Furnishing of statement**	
	Statement in prescribed form within time	Every assessee shall, within the prescribed time after the end of each financial year, prepare and deliver or cause to be delivered to the Assessing Officer or to any other authority or agency authorised by the Board in this behalf, a statement in the prescribed form, verified in the prescribed manner and setting forth the prescribed particulars in respect of all specified services during such financial year. The statement in respect of all specified services chargeable to equalisation levy during any financial year is required to be furnished electronically in **Form No. 1** (verified through either

		a digital signature or an electronic verification code) **on or before 30th June** immediately following that financial year [Rule 5 of Equalisation Levy Rules, 2016]
	Time limit for filing a revised statement	An assessee who has not furnished the statement on or before 30th June immediately following the financial year or having furnished a statement within that time, notices any omission or wrong particulars therein, may furnish a statement or a revised statement, as the case may be. Such statement or revised statement has to be filed at any time **before the expiry of two years from the end of the financial year** in which the specified service was provided.
	Time limit for filing a statement in response to notice issued by the Assessing Officer	Where any assessee fails to furnish the statement within the prescribed time, the Assessing Officer may serve a notice upon such assessee requiring him to furnish the statement in the prescribed form, verified in the prescribed manner and setting forth the prescribed particulars, within such time, as may be prescribed. The Assessing Officer has been empowered to issue notice for furnishing such statement, which then has to be furnished, **within 30 days from date of serving of such notice** [Rule 6 of Equalisation Levy Rules, 2016]
168	**Processing of statement.**	
	Manner of processing of statement	Where a statement has been made under section 167 by the assessee, such statement shall be processed in the following manner, namely:— (a) the equalisation levy shall be computed after making the adjustment for any arithmetical error in the statement; (b) the interest, if any shall be computed on the basis of sum deductible as computed in the statement; (c) the sum payable by, or the amount of refund due to, the assessee shall be determined after adjustment of interest computed against the equalisation levy paid under section 166(2) or interest paid section 170 and any amount paid otherwise by way of tax or interest; (d) an intimation shall be prepared or generated and sent to the assessee specifying the sum determined to be payable by, or the amount of refund due to him; and (e) the amount of refund due to the assessee in pursuance of such determination shall be granted to

		him. However, no such intimation shall be sent after the expiry of **one year from the end of the financial year** in which the statement is furnished.
	Prescribed form for service of notice of demand on the taxpayer	Where any levy, interest or penalty is payable under the equalisation levy provisions, a notice of demand in Form No. 2 specifying the sum so payable shall be served upon the taxpayer. Further, intimation issued upon processing of the statement of specified services shall also be deemed to be a notice of demand. [Rule 7 of Equalisation Levy Rules, 2016]
	Scheme for centralised processing of statements	For the purposes of processing of statements, the CBDT may make a scheme for centralised processing of such statements to expeditiously determine the tax payable by, or the refund due to, the assessee as required thereunder.
169	**Rectification of mistake**	
	Time limit for amending an intimation	With a view to rectifying any mistake apparent from the record, the Assessing Officer may amend any intimation issued under section 168. Such intimation can be amended within **one year from the end of the financial year** in which the intimation sought to be amended was issued.
	Amendment can be made *suo motu* or brought to notice by the assessee	The Assessing Officer may make an amendment to any intimation, either *suo motu* or on any mistake brought to his notice by the assessee.
	Opportunity of being heard to be given by the Assessing Officer before amending an intimation	An amendment to any intimation, which has the effect of increasing the liability of the assessee or reducing a refund, shall not be made unless the Assessing Officer has given notice to the assessee of his intention so to do and has given the assessee a reasonable opportunity of being heard.
		Where any such amendment to any intimation has the effect of enhancing the sum payable or reducing the refund already made, the Assessing Officer shall make an order specifying the sum payable by the assessee and the provisions of this Chapter shall apply accordingly.
170	**Interest on delayed payment of equalisation**	An assessee who fails to credit the equalisation levy or any part thereof within 7th of the month following the calendar month in which it is deducted, to the account of

<table>
<tr><td></td><td>levy</td><td>the Central Government, has to pay simple interest at the rate of 1% of such levy for every month or part of a month by which such crediting of the tax or any part thereof is delayed.</td></tr>
<tr><td>171</td><td>Penalty for failure to deduct or pay equalisation levy.</td><td>
<table>
<tr><th>Nature of default</th><th>Penalty</th></tr>
<tr><td>Failure to deduct whole or part of equalisation levy</td><td>In addition to payment of equalisation levy under section 166(3) and interest under section 170, penalty equal to the amount of equalisation levy that he failed to deduct would be leviable</td></tr>
<tr><td>Failure to remit equalisation levy to the Central Government on or before 7th of the following month, after deduction</td><td>In addition to paying the equalisation levy under section 166(2) and interest under section 170, a penalty of ₹ 1,000 for every day during which the failure continues is leviable.
However, such penalty shall not exceed the amount of equalisation levy that he failed to pay.</td></tr>
</table>
</td></tr>
<tr><td>172</td><td>Penalty for failure to furnish statement</td><td>For failure to furnish the statement within 30th June of the immediately following year or within 30 days from the date of service of notice by the Assessing Officer, penalty of ₹100 for each day during which the failure continues is leviable.</td></tr>
<tr><td>173</td><td>Circumstances when penalty cannot be imposed under section 171 and 172</td><td>No penalty for failure to deduct or pay equalisation levy or failure to furnish statement shall be imposable, if the assessee proves to the satisfaction of the Assessing Officer that there was reasonable cause for the said failure.
Further, no order imposing a penalty under this Chapter shall be made unless the assessee has been given a reasonable opportunity of being heard.</td></tr>
<tr><td>174</td><td>Appeal to Commissioner of Income-tax (Appeals).</td><td></td></tr>
<tr><td></td><td>Time limit for filing of appeal against</td><td>An assessee aggrieved by an order imposing penalty under this Chapter, may appeal to the Commissioner of</td></tr>
</table>

	an order imposing penalty	Income-tax (Appeals) within a period of **30 days from the date of receipt of the order** of the Assessing Officer
	Fee for filing appeal	An appeal shall be in the prescribed form [Form 3] and verified in the prescribed manner. It shall be accompanied by a **fee of ₹1,000**. It may be filed electronically under digital signature or electronically through EVC. Any document accompanying Form No.3 has to be furnished in the manner in which Form No.3 is furnished.[Rule 8 of Equalisation Levy Rules, 2016]
	Provisions of the Income-tax Act, 1961 applicable in case of such appeals	Where an appeal has been filed, the provisions of sections 249 to 251 of the Income-tax Act, 1961 would, as far as may be, apply to such appeal. Section 250 specifies the procedure in appeal and section 251 enlists the powers of the Commissioner (Appeals).
175	**Appeal to Appellate Tribunal**	
	Assessee/CIT may file appeal to Appellate Tribunal against an order passed by Commissioner (Appeals) under section 174	An assessee aggrieved by an order made by the Commissioner of Income-tax (Appeals) under section 174 may appeal to the Appellate Tribunal against such order. The Commissioner of Income-tax may, if he objects to any order passed by the Commissioner of Income-tax (Appeals) under section 174, direct the Assessing Officer to appeal to the Appellate Tribunal against such order.
	Time limit for filing appeal	An appeal shall be filed within **60 days** from the date on which the order sought to be appealed against is received by the assessee or by the Commissioner of Income-tax, as the case may be.
	Fee for filing appeal	The appeal shall be in the prescribed form [Form No.4] and verified in the prescribed manner. In the case of an appeal filed by an assessee, it shall be accompanied by a **fee of ₹1,000**. Also, the form of appeal, the grounds of appeal and the form of verification appended thereto shall be signed by the person specified in Form No.4 [Rule 9 of Equalisation Levy Rules, 2016]
	Provisions of the Income-tax Act, 1961 applicable in case of such appeals	Where an appeal has been filed before the Appellate Tribunal under sub-section (1) or sub-section (2), the provisions of sections 253 to 255 of the Income-tax Act, 1961 would, as far as may be, apply to such appeal.

<table>
<tr><td rowspan="2">176</td><td rowspan="2">Punishment for false statement</td><td>If a person -
(a) <i>makes a false statement in any verification</i> under this Chapter or any rule made thereunder; or
(b) <i>delivers an account or statement, which is false</i>, and which he either knows or believes to be false, or does not believe to be true,
he shall be punishable with imprisonment for a term which may extend to three years and with fine.</td></tr>
<tr><td>An offence so punishable shall be deemed to be non-cognizable within the meaning of the Code of Criminal Procedure. This is irrespective of anything contained in the Code of Criminal Procedure, 1973.</td></tr>
<tr><td>177.</td><td>Institution of prosecution</td><td>Prior sanction of the Chief Commissioner of Income-tax is required for instituting prosecution against any person for any offence under section 176.</td></tr>
<tr><td>178.</td><td>Application of certain provisions of Income-tax Act, 1961</td><td>The following provisions of the Income-tax Act, 1961 shall so far as may be, apply in relation to equalisation levy, as they apply in relation to income-tax.
<table>
<tr><th>Section</th><th>Content</th></tr>
<tr><td>120</td><td>Jurisdiction of income-tax authorities</td></tr>
<tr><td>131</td><td>Power regarding discovery, production of evidence, etc.</td></tr>
<tr><td>133A</td><td>Power of survey</td></tr>
<tr><td>138</td><td>Disclosure of information respecting assessees</td></tr>
<tr><td>156</td><td>Notice of demand</td></tr>
<tr><td>Chapter XV</td><td>Liability in special cases</td></tr>
<tr><td>220-227</td><td>- When tax payable and when assessee deemed in default,
- Penalty payable when tax in default,
- Certificate to Tax Recovery Officer,
- Tax Recovery Officer by whom recovery is to be effected,
- Validity of certificate and cancellation or amendment thereof,
- Stay of proceedings in pursuance of certificate and amendment or cancellation thereof,</td></tr>
</table>
</td></tr>
</table>

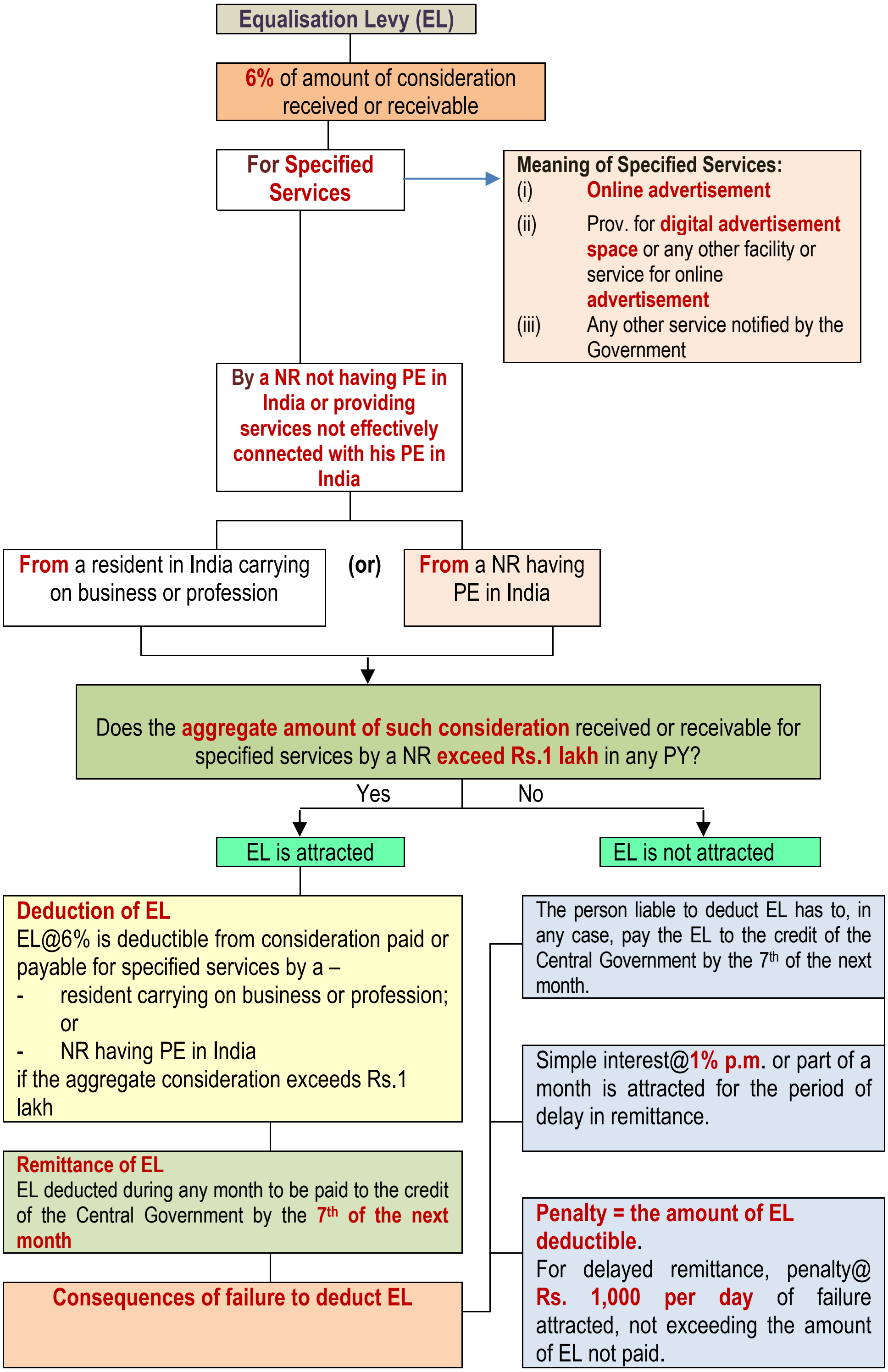
			- Other modes of recovery, - Recovery through State Government.
		229	Recovery of penalties, fine, interest and other sums
		232	Recovery by suit or under other law not affected.
		260A	Appeal to High Court
		261	Appeal to Supreme Court
		262	Hearing before Supreme Court
		265 to 269	- Tax to be paid notwithstanding reference etc., - Execution for costs awarded by Supreme Court, - Amendment of assessment on appeal - Exclusion of time taken for copy, - Filing of appeal or application for reference by income-tax authority, - Definition of "High Court"
		278B	Offences by companies
		280A	Special Courts
		280B	Offences triable by Special Court
		280C	Trial of offences as summons case
		280D	Application of Code of Criminal Procedure, 1973 to proceedings before Special Court
		282	Service of notice generally
		288 to 293	- Appearance by authroised representative, - Rounding off of income, - Rounding off of amount payable and refund due, - Receipt to be given, - Indemnity, - Power to tender immunity from prosecution, - Cognizance of offences, - Section 360 of the Code of Criminal Procedure, 1973 and the Probation of Offenders Act, 1958, not to apply,

		- Return of income, etc., not to be invalid on certain grounds, - Notice deemed to be valid in certain circumstances, - Presumption as to assets, books of account etc., - Authorisation and assessment in case of search or requisition, - Bar of suits in civil courts
179	**Power to make rules**	The Central Government is empowered to make rules for the purposes of carrying out the provisions of this Chapter. Also, every Rule made under this Chapter shall be laid before each House of Parliament.
		In particular, such rules may also provide for all or any of the following matters, namely:— (a) the time within which and the form and the manner in which the statement shall be delivered or caused to be delivered or furnished under section 167; (b) the form in which an appeal may be filed and the manner in which it may be verified under sections 174 and 175; (c) any other matter which is to be, or may be, prescribed.
		Every rule made under this Chapter shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of **30 days**. This period of 30 days may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree: (i) in making any modification in the rule, then, the rule shall thereafter have effect only in such modified form; (ii) that the rule should not be made, then, the rule would be of no effect. However, any such modification or annulment would be without prejudice to the validity of anything previously done under that rule.

180	**Power to remove difficulties**	The Central Government is empowered to remove any difficulty which arises in giving effect to the provisions of this Chapter. It may, by order published in the Official Gazette, not inconsistent with the provisions of this Chapter, remove the difficulty. However, no such order shall be made after the expiry of a period of **two years from the date on which the provisions of this Chapter come into force**. Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

(6) Consequential provisions in the Income-tax Act, 1961:

	Section	Provision
(i)	10(50)	In order to avoid double taxation, section 10(50) provides to exempt any income arising from providing any specified service on or after the date on which the provisions of Chapter VIII of the Finance Act, 2016 comes into force, and chargeable to equalisation levy under that Chapter.
(ii)	40(a)(ib)	In order to ensure compliance with the provisions this Chapter, section 40(a)(ib) provides that if any consideration is paid or payable to a non-resident for a specified service on which equalisation levy is deductible, and such levy has not been deducted or after deduction, has not been paid on or before the due date under section 139(1), then, such expenses incurred by the assessee towards consideration for specified service shall not be allowed as deduction. However, where in respect of such consideration, if the equalisation levy has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified under section 139(1), such sum shall be allowed as deduction in computing the income of the previous year in which such levy has been paid.



Equalisation Levy (EL)

6% of amount of consideration received or receivable

For Specified Services

Meaning of Specified Services:

(i) **Online advertisement**

(ii) Prov. for **digital advertisement space** or any other facility or service for online **advertisement**

(iii) Any other service notified by the Government

By a NR not having PE in India or providing services not effectively connected with his PE in India

From a resident in India carrying on business or profession

(or)

From a NR having PE in India

Does the **aggregate amount of such consideration** received or receivable for specified services by a NR **exceed Rs.1 lakh** in any PY?

Yes

No

EL is attracted

EL is not attracted

Deduction of EL

EL@6% is deductible from consideration paid or payable for specified services by a –

- resident carrying on business or profession; or
- NR having PE in India

if the aggregate consideration exceeds Rs.1 lakh

Remittance of EL

EL deducted during any month to be paid to the credit of the Central Government by the **7th of the next month**

Consequences of failure to deduct EL

The person liable to deduct EL has to, in any case, pay the EL to the credit of the Central Government by the 7th of the next month.

Simple interest@**1% p.m.** or part of a month is attracted for the period of delay in remittance.

Penalty = the amount of EL deductible.

For delayed remittance, penalty@ **Rs. 1,000 per day** of failure attracted, not exceeding the amount of EL not paid.

EXERCISE

Question 1

Explain the core reasons for difference between the e-commerce transactions and the traditional business transactions causing difficulty to tax the income of e-commerce transactions.

Answer

The core reasons for difference between e-commerce transactions and traditional business transactions causing difficulty to tax the income from e-commerce transactions under the Income-tax Act, 1961 are absence of national boundaries, no requirement of physical presence of goods and no requirement of physical delivery (in certain cases). Since e-commerce transactions are completed in cyberspace, it is often not clear as to the place where the transaction is effected, thereby causing difficulty in implementing source rule taxation.

Question 2

E-commerce transactions have replaced concepts generally associated with international transactions traditionally. Discuss briefly the issues involving such transactions.

Answer

The typical taxation issues relating to e-commerce are:

(1) the difficulty in characterizing the nature of payment and establishing a nexus or link between taxable transaction, activity and a taxing jurisdiction,

(2) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

Question 3

ABC ltd., an Indian company, is carrying on the business of manufacture and sale of teakwood furniture under the brand name "PUREWOOD". In order to expand its overseas sales/exports, it launched a massive advertisement campaign of its products. For the purpose of online advertisement, it utilized the services of PQR Inc., a London based company. During the previous year 2019-20, ABC Ltd. Paid ₹ 5 lakhs to PQR Inc. for such services. Discuss the tax implications/TDS implications of such payment and receipt in the hands of ABC Ltd. and PQR Inc., respectively, if –

(i) PQR Inc. has no permanent establishment in India

(ii) PQR Inc. has a permanent establishment in India, and the service is effectively connected to the permanent establishment in India

Answer

Chapter VIII of the Finance Act, 2016, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

“Specified Service” means

(1) online advertisement;

(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and

(3) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-

- where the non-resident providing the specified services has a permanent establishment in India and the specified service is effectively connected with such permanent establishment.
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed ₹ 1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession

(i) Where PQR Inc. has no permanent establishment in India

In the present case, equalisation levy @6% is chargeable on the amount of ₹ 5,00,000 received by PQR Inc., a non-resident not having a PE in India from ABC Ltd., an Indian company. Accordingly, ABC Ltd. is required to deduct equalisation levy of ₹ 30,000 i.e., @6% of ₹ 5 lakhs, being the amount paid towards online advertisement services provided by PQR Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.

(ii) Where PQR Inc. has permanent establishment in India and the service is effectively connected to the permanent establishment in India

Equalisation levy would not be attracted where the non-resident service provider (PQR Inc., in this case) has a permanent establishment in India and the service is effectively connected to the permanent establishment in India. Therefore, the ABC Ltd. is not required to deduct equalisation levy on ₹ 5 lakhs, being the amount paid towards online advertisement services to PQR Inc, in this case.

However, tax has to be deducted by ABC Ltd. at the rates in force under section 195 in respect of such payment to PQR Inc. Non-deduction of tax at source under section 195 would attract disallowance under section 40(a)(i) of 100% of the amount paid while computing business income.

CHAPTER 6

APPLICATION AND INTERPRETATION OF TAX TREATIES

LEARNING OUTCOMES

After studying this chapter, you would be able to

- **identify** the connecting factors of double taxation;
- **appreciate** the meaning of, and need for, tax treaties;
- **appreciate** the basic principles of interpretation of tax treaties;
- **identify** the extrinsic aids to interpretation of a tax treaty;
- **appreciate** the importance of commentaries in interpretation of tax treaties;
- **appreciate** the role of Vienna Convention in application and interpretation of tax treaties.

6.1 INTRODUCTION

Article 38(1) of the International Court of Justice[1] provides that the court shall apply the following in deciding on a particular matter –

International Convention(s) [general or particular]

- establishing rules expressly recognised by the contesting states

International Customs

- serving as evidence of general practice accepted as law

General principles

- recognised by civilised nations

Judicial decisions and teachings of highly qualified publicists of various nations

- serving as subsidiary means for determination of rules of law

Success of any law depends upon the manner in which it is interpreted and administered. In order to interpret any law or agreement, one needs to understand the philosophy of law which has been kept in mind at the time of passing such law in a country or at the time of forming an agreement between the two countries on a particular aspect. This gives rise to the principles of public international law (example – U.N principles on business and human rights).

Tax has been a consequence of business for several hundreds of years; some of the principles would definitely have their bearing on the manner in which law is passed. International tax law has evolved so that conflict of national interests can be resolved (double taxation being the primary issue).

Source(s) of International Tax Law

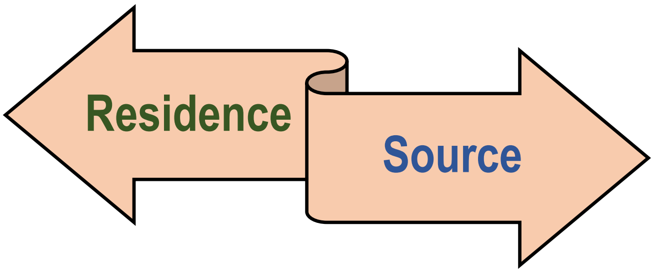
S. No.	Source	Particulars relating to the source/origin
(i)	Multilateral international agreements	For example, the Vienna Convention on Law of Treaties (VCLT)
(ii)	Double Taxation Avoidance	DTAAs may be comprehensive or otherwise. It is to be noted that along with the DTAA, it is the protocols, memorandum of

[1] https://www.icj-cij.org/en/statute#CHAPTER_II

	Agreement (DTAA)	understanding, and exchange of information, etc. forming part of the DTAA which enables interpretation of a DTAA.
(iii)	Customary international law and general principles of law	For example, principles of law recognised by civilized nations in their national legal systems, customary law and judicial decisions and the practices of international organizations. Customary international law is the aspect of international law that derives from customs and convention. Along with general principles of law and treaties, custom is also considered by the International Court of Justice, jurists, the United Nations, and its member states to be among the primary sources of international law. The vast majority of the world's governments accept, in principle, the existence of customary international law, although there are many differing opinions as to what rules are contained therein.

6.2 DOUBLE TAXATION AND CONNECTING FACTORS

The taxability of a foreign entity in any country depends upon two distinct factors, namely, whether it is doing business **with that country** or **in that country**. Internationally, the term used to determine the jurisdiction for taxation is "connecting factors". There are two types of connecting factors, namely, "Residence" and "Source". It means a company can be subject to tax either on its residence link or its source link with a country. Broadly, if a company is doing business **with** another country (i.e. host/source country), then it would be subject to tax in its home country alone, based on its residence link. However, if a company is doing business **in a** host/source country, then, besides being taxed in the home country on the basis of its residence link, it will also be taxed in the host country on the basis of its source link.



- **Juridical double taxation**

  When source rules overlap, double taxation may arise i.e. tax is imposed by two or more countries as per their domestic laws in respect of the same transaction, income arises or is deemed to arise in their respective jurisdictions. This is known as "juridical double taxation".

In order to avoid such double taxation, a company can invoke provisions of Double Taxation Avoidance Agreements (DTAAs) (also known as **Tax Treaty** or Double Taxation Convention–DTC) with the host/source country, or in the absence of such an agreement, an Indian company can invoke provisions of section 91, providing unilateral relief in the event of double taxation.

Example

Company ICO is a resident of India. It has set up a branch in UK. Here, India would be the country of residence for ICO, whereas UK would be the country of source. UK would tax the profits earned by the branch of ICO located in UK, whereas ICO would be taxed on worldwide basis in India, including profits of its UK branch. However, ICO can claim relief in respect of taxes paid in UK while filing its tax return in India under the Indo-UK Double Taxation Avoidance Agreement.

If, instead of UK, ICO has a branch in a state with which India does not have tax treaty, then it can claim unilateral relief under section 91 of the Income-tax Act, 1961 in respect of taxes paid by its branch in that state.

- **Economic double taxation**

  'Economic double taxation' happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different persons (because of lack of subject identity)

Example

When one state attributes an income/capital to its legal owner whereas the tax law of other state attributes it in the hands of the person in possession or having economic control over the income, it leads to economic double taxation.

Yet another classic example is tax on distributed surplus by a company which is taxed in the hands of the company distributing such surplus, while the other jurisdiction taxes the said income from distribution in the hands of the shareholder, thus leading to double taxation of the same income albeit in the hands of different persons.

6.3 TAX TREATIES: AN OVERVIEW

(1) Definition of "Treaty"

Treaty is a generic term embracing all instruments binding under international law, regardless of their formal designation, concluded between two or more international juridical persons.

The application of the term treaty signifies that the parties intend to create rights and obligations enforceable under international law.

Article 2 of Vienna Convention on Law of Treaties, 1969 defines a “treaty” as an international **agreement** concluded between States **in written form** and **governed by international law**, whether embodied in a **single instrument or in two or more related instruments** and whatever its particular designation.

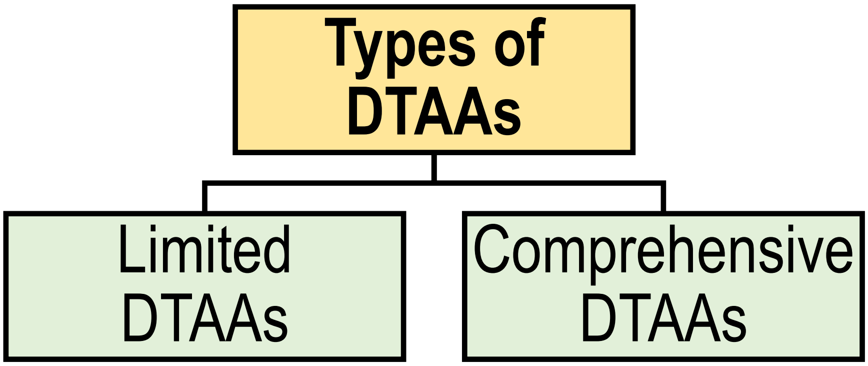
(2) Role of Tax Treaties

“Treaty” represents various compromises agreed upon by the respective Contracting States depending upon the economic expediency of a particular country.

Tax, in the country of source is considered as a cost, whereas the same is an obligation in the country of residence. Therefore, there is need to achieve tax efficiency. Double Tax Avoidance Agreements come into play to mitigate hardship caused by subjecting the same income to double taxation.

Tax Treaties attempt to eliminate double taxation and try to achieve balance and equity. They aim at sharing of tax revenues by the concerned states on a rational basis. Tax treaties do not always succeed in eliminating Double Taxation, but contain the incidence to a tolerable level.

(3) Types of DTAAs



Limited DTAAs are those which are limited to certain types of incomes only. e.g., DTAA between India and Pakistan is limited to income from international air transport only.

Comprehensive DTAAs are those which cover almost all types of incomes covered by any model convention. Many a time, a treaty also covers wealth tax, gift tax, surtax, etc.

(4) Directive Principles set out in the Indian Constitution

In the Indian context, Article 51 of the Indian Constitution has, *inter alia*, set out some directive principles which must be followed by the State in the context of International agreements and relationships. It has been provided that-

"The State shall endeavor to -

(a) Promote international peace and security;

(b) Maintain just and honourable relations amongst nations;

(c) Foster respect for international law and treaty obligations in the dealings of organised people with one another; and

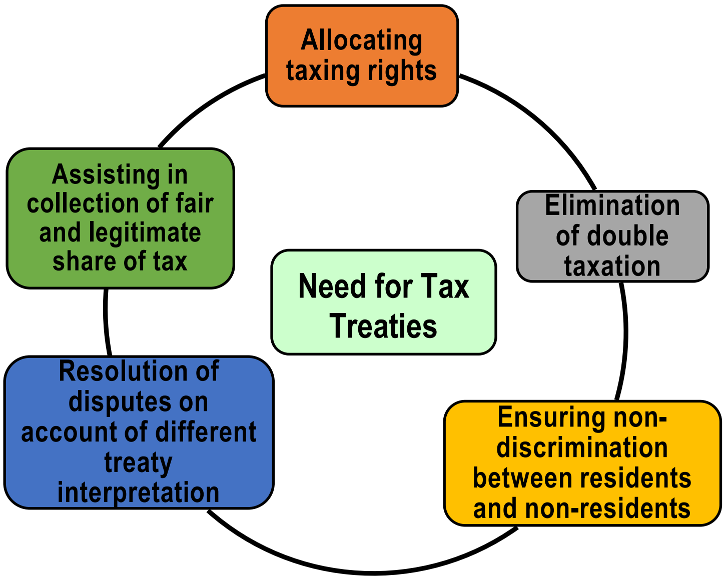
(d) Encourage settlement of international disputes by arbitration.

It is pertinent to note that entries 10 and 14 of List I of the Seventh Schedule to the Constitution of India confer the power on Parliament to legislate treaties with foreign countries. Further, this power of Parliament has been delegated to the Central Government vide sections 90 and 90A of the Income-tax Act, 1961.

(5) Need for tax treaties

The concept of source and residence prevailing in a majority of the countries is the root cause of double taxation. Hence, there is a need to have tax treaties in force. In addition to allocating the taxing rights and eliminating double taxation, there are various other important considerations as mentioned below:

- Ensuring non-discrimination between residents and non-residents
- Resolution of disputes arising on account of different interpretation of tax treaty by the treaty partner.
- Providing assistance in the collection of the fair and legitimate share of tax.


Allocating taxing rights
Elimination of double taxation
Ensuring non-discrimination between residents and non-residents
Resolution of disputes on account of different treaty interpretation
Assisting in collection of fair and legitimate share of tax
Need for Tax Treaties

Further, in addition to above, there are some other principles which must be considered by countries in their tax system –

(i) **Equity and fairness:** Same income earned by different taxpayers must be taxed at the same rate regardless of the source of income.

(ii) **Neutrality and efficiency:** Neutrality factor provides that economic processes should not be affected by external factors such as taxation. Neutrality is two-fold.

(a) Capital export neutrality and

(b) Capital import neutrality (CIN).

Capital export neutrality (CEN) provides that business decision must not be affected by tax factors between the country of residence and the target country; whereas CIN provides that the level of tax imposed on non-residents as well as the residents must be similar.

(iii) **Promotion of mutual economic relation, trade and investment:** In some cases, it is observed that avoidance of double taxation is not the only objective. The other objective may be to give impetus to a country's overall economic growth and development.'

6.4 APPLICATION AND INTERPRETATION OF TAX TREATIES

Application of Tax Treaties

In various countries, unless the context otherwise requires, the provisions of the DTAA shall prevail over the domestic tax provisions. No two treaties between the countries are alike. DTAA signed by India with USA is different in comparison to the DTAA signed with other countries like Netherlands. These differences include taxpayers to resort to tax arbitrage strategies. This frustrates Government's objective and results in unintended tax benefits. Therefore, in specified circumstances, treaty benefits are denied. Some of the circumstances in the Indian context induce (i) General Anti-Avoidance Rules (GAAR)[2] (ii) Targeted anti avoidance rules (transfer pricing), etc. (iii) Beneficial Ownership Conditions (iv) Entitlement to Benefits/Limitation on Benefits Clause/ Articles, etc.

In recent past, India has re-negotiated DTAAs with countries like Mauritius, Singapore, etc. to prevent fiscal evasion with respect to taxes on income and capital gains of the investor[3].

(1) Article 4 of DTAA – Gateway to avail tax benefits

It is a well-accepted proposition in a tax treaty scenario that a person shall be entitled to a tax treaty only if he is a resident of one or both of the Contracting States.

[2] GAAR provisions in India are applicable from Assessment Year 2018-19

[3] Effective from 01 April 2017

This provision aims at curbing the 'treaty shopping' practices. It must be noted that though 'Article 4' of the tax treaty deals with residential status of a person, it does not provide rules for determination of residence. Instead, it refers to the determination in accordance with the provisions of domestic tax law of the respective Contracting State. This is clear from the language which provides that "*the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature.............*". Therefore, the primary requirement is for a person to qualify as a resident under the law of the concerned Contracting State.

Determination of residential status of a person is crucial since it is ultimately the country of residence that may have full right to tax the worldwide income of its resident. Further, in addition to taxing the global income, the country of residence would grant relief in respect of tax paid in the country of source.

Place of effective management is an important criterion for availing treaty benefits by a corporate. India-U.A.E DTAA (as revised) further limits the application of treaty by providing that the treaty would be applicable to U.A.E company only if it is incorporated in U.A.E and is controlled wholly in U.A.E. Only such company would be regarded as resident of U.A.E. Further, the India–U.A.E DTAA provides that if a person other than an individual is resident of both the States, then it should be deemed to be resident of the State in which its Place of effective management is situated.

(2) Computation of income liable for the purpose of taxation

The provisions of tax treaty *inter alia* allocates taxing rights between the treaty partners, provides relief or reduces or eliminates the harmful effects of double taxation. However, it is to be noted that except for the provisions under *'Article 7 i.e. Business Profits taxation',* generally the treaty does not provide rules for computation of income. It would depend upon the domestic tax law provisions. Treaties, at best, distribute the taxing rights between two states. It may limit the rate of tax (generally, in the state of source) or provide the upper limit up to which taxes can be levied. Certain treaties do reduce the incidence of tax by providing or restricting the scope of the subject matter of taxation.

(3) Distributive Rule

Tax treaties only distribute or assign taxing jurisdiction. It does not impose tax. Having assigned the jurisdiction of tax between the State of Residence and State of Source, the domestic tax laws of the respective State determine taxing rules. Taxing experts in early 1920 appointed by the League of Nations describe the method of classification as Contracting States dividing tax sources and tax objects amongst themselves by mutually binding themselves not to levy taxes or to tax only to a limited extent.

English lawyers called it "Classification and Assignment Rule", whereas German jurists called it the **"Distributive Rule".** According to this principle, "to the extent that an exemption is agreed to, its effect is, in principle, independent of whether the Contracting States imposes a tax, in the situation to which the exemption applies, and irrespective of whether the State actually levies the tax". The point here is that having agreed to give the right of tax to the other state, that state may or may not levy tax and if the state in whose favour right to tax is devolved, chooses not to tax such income, then, it may result in double non-taxation. The argument in favour of double non-taxation is that income would be subject to tax in the exempt state as and when the exemption is withdrawn or tax is levied. Thus, this rule ensures that double taxation does not arise in future also, if the source state decides to levy tax.

(A) Treaties are entered into for "Mutual Benefits"

Apart from the allocation of tax between the treaty partners, tax treaties can also help to resolve problems and can obtain benefits which cannot be achieved unilaterally.

Treaties are negotiated and entered into at a political level and have several considerations as their basis. Thus, treaties should be seen in the context of aiding commercial relations between treaty partners.

(B) A tax treaty provision may have an unequal effect4

State A imposes tax but state B does not impose a tax, yet wordings of the treaty are reciprocal – so that if and when State 'B' does introduce such a tax, the treaty rates would be operative in State 'B'. Until such time there would be an unequal effect. Moreover, State 'A' may make a distributive rule operative upon fulfilment of certain condition or comparable feature.

Interpretation of Tax Treaties

Tax treaties are signed between two sovereign nations by competent authorities under delegated powers from the respective Governments. Thus, an international agreement has to be respected and interpreted in accordance with the rules of international law as laid down in the Vienna Convention on Law of Treaties (VCLT). These rules of interpretation are not restricted to tax treaties but also apply to any treaty between two countries. Therefore, any dispute between two nations in respect of Article 25 relating to Mutual Agreement Procedure of the OECD/UN Model Conventions has to be solved in the light of the VCLT.

However, when it comes to application of a tax treaty in the domestic forum, the appellate authorities and the courts are primarily governed by the laws of the respective countries for interpretation.

In India, even before insertion of Section 90(2) by the Finance (No.2) Act, 1991, with retrospective effect from 1-4-1972, CBDT had clarified *vide Circular No. 333 dated 2-4-1982* that where a specific provision is made in the DTAA, the provisions of the DTAA will prevail over the general provisions contained in the Act and where there is no specific provision in the DTAA, it is the basic law i.e. the provisions of the Act, that will govern the taxation of such income.

The Income-tax Act, 1961 provides that where the Indian Government has entered into DTAAs which are applicable to the taxpayers, then, the provisions of the Act shall apply to the extent they are more beneficial to the taxpayer.

[4] Tax Treaty Interpretation – The International Tax Treaties Service"

Interpretation of any statute, more so international tax treaties, requires that we follow some rules of interpretation. In subsequent paragraphs, we shall deal with rules of interpretation of tax treaties.

(1) Basic Principles of Interpretation of a Treaty

Principles or rules of interpretation of a tax treaty would be relevant only where terms or words used in treaties are ambiguous, vague or are such that different meanings are possible. If words are clear or unambiguous, then there is no need to resort to different rules for interpretation.

Prior to the Vienna Convention, treaties were interpreted according to the customary international law. Just as each country's legal system has its own canons of statutory construction and interpretation, likewise, several principles exist for the interpretation of treaties in customary international law. We would be discussing some of the rules of interpretation of Vienna Convention on law of Treaties in the later part of this chapter.

Some of the important principles of Customary International law in interpretation of tax treaties are as follows:

(i) **Golden Rule – Objective Interpretation:** Ideally, any term or word should be interpreted keeping its objective or ordinary or literal meaning in mind. The term has to be interpreted contextually.

Words and phrases are in the first instance to be construed according to their plain and natural meaning. However, if the grammatical interpretation would result in an absurdity, or in marked inconsistency with other portions of the treaty, or would clearly go beyond the intention of the parties, it should not be adopted[5].

(ii) **Subjective Interpretation:** Under this approach, the terms of a treaty are to be interpreted according to the common intention of the contracting parties at the time the treaty was concluded. The intention must be ascertained from the words used in the treaty and the context thereof.

In *Abdul Razak A. Meman's case [2005] 276 ITR 306,* the Authority for Advance Rulings [the AAR] relied on the speeches delivered by the Finance Ministers of India as well as UAE to arrive at the intention of parties in signing the India-UAE Tax Treaty.

(iii) **Purposive Interpretation:** In this approach the treaty is to be interpreted so as to facilitate the attainment of the aims and objectives of the treaty. This approach is also known as the 'objects and purpose' method.

In case of *Union of India v. Azadi Bachao Andolan 263 ITR 706,* the Supreme Court of India observed that "the principles adopted for interpretation of treaties are not the same as those in interpretation of statutory legislation. The interpretation of provisions of an international treaty, including one for double taxation relief, is that the treaties are entered into at a political level and have several considerations as their bases."

[5] Prof. J. G. Starke in Introduction to International Law 10th Edition

The Apex Court also agreed with the contention of the Appellant that "the preamble to the Indo-Mauritius DTAA recites that it is for 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty".

(iv) **The Principle of Effectiveness:** According to this principle, a treaty should be interpreted in a manner to have effect rather than make it void.

This principle, particularly stressed by the Permanent Court of International Justice, requires that the treaty should be given an interpretation which 'on the whole' will render the treaty 'most effective and useful', in other words, enabling the provisions of the treaty to work and to have their appropriate effects[6].

(v) **Principle of *Contemporanea Expositio:*** A treaty's terms are normally to be interpreted on the basis of their meaning at the time the treaty was concluded. However, this is not a universal principle.

In *Abdul Razak A. Meman's* case *[2005] 276 ITR 306*, the AAR observed that "there can be little doubt that while interpreting treaties, regard should be had to material *contemporanea exposition,* which means that a statute is best explained by following the construction put upon it by judges at the time it was made, or soon after. This proposition is embodied in Article 32 of the Vienna Convention, referred to above, and is also referred to in the decision of the Hon'ble Supreme Court in *K. P. Varghese v. ITO [1981] 131 ITR 597*."

(vi) **Liberal Construction:** It is a general principle of construction with respect to treaties that they shall be liberally construed so as to carry out the apparent intention of the parties.

In *John N. Gladden v. Her Majesty the Queen* [7], the principle of liberal interpretation of tax treaties was reiterated by the Federal Court, which observed that "contrary to an ordinary taxing statute a tax treaty or convention must be given a liberal interpretation with a view to implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated in so far as the particular item under consideration is concerned."

The Court further recognised that "we cannot expect to find the same nicety or strict definition as in modern documents, such as deeds, or Acts of Parliament, it has never been the habit of those engaged in diplomacy to use legal accuracy but rather to adopt more liberal terms."

(vii) **Treaty as a Whole – Integrated Approach:** A treaty should be construed as a whole and effect should be given to each word which would be construed in the same manner wherever it occurs. Any provision should not be interpreted in isolation; rather the entire treaty should be read as a whole to arrive at its object and purpose.

[6] Prof. J. G. Starke in Introduction to International Law 10th Edition

[7] 85 D.T.C. 5188 at 5190, Source: UOI v. Azadi Bachao Andolan 263 ITR 706 (SC)

(viii) **Reasonableness and consistency[8] :** Treaties should be given an interpretation in which the reasonable meaning of words and phrases is preferred, and in which a consistent meaning is given to different portions of the instrument. In accordance with the principles of consistency, treaties should be interpreted in the light of existing international law.

An important aspect to be noted regarding the rules of interpretation is that they are not rules of law and are not to be applied like the rules enacted by the legislature in an Interpretation Act.

(2) Extrinsic Aids to Interpretation of a Tax Treaty

A wide range of extrinsic material is permitted to be used in interpretation of tax treaties. According to Article 32 of the Vienna Convention, the supplementary means of interpretation include the preparatory work of the treaty and the circumstances of its conclusion.

According to Prof. Starke, one may resort to following extrinsic aids to interpret a tax treaty provided that clear words are not thereby contradicted:

(i) Interpretative Protocols, Resolutions and Committee Reports, setting out agreed interpretations;

(ii) A subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions [Art. 31(3) of the VCLT];

(iii) Subsequent conduct of the state parties, as evidence of the intention of the parties and their conception of the treaty;

(iv) Other treaties, in *pari materia* (i.e., relating to the same subject matter), in case of doubt.

(i) Provisions in Parallel Tax Treaties

If the language used in two tax treaties (say treaties: X and Y) are same and one treaty is more elaborative or clear in its meaning (say treaty X) can one rely on the interpretation/explanations provided in a treaty X while applying provisions of a treaty Y?

The views of the Indian Judiciary are, however, not consistent in this respect. There are contradictory judgments by Indian courts/Tribunal in this regard.

(ii) International Articles/Essays/Reports

International Article/Essays/Reports are referred as extrinsic aid for interpretation of tax treaties. Like, in case of *CIT v. Vishakhapatnam Port Trust (1983) 144 ITR 146 (AP)*, the High Court obtained “useful material” through international articles.

(iii) Cahiers published by International Fiscal Association (IFA), Netherlands

“Cahiers de Droit Fiscal International” is the main publication of the IFA, which is published annually and deals with two major topics each year. Cahiers were relied upon in case of *Azadi Bachao Andolan’s* (supra) case by the Supreme Court.

[8] Prof. J. G. Starke in Introduction to International Law 10th Edition

(iv) Protocol

Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues.

A protocol is an integral part of a tax treaty and has the same binding force as the main clauses therein.

Protocol to India France treaty contains the Most Favoured Nation Clause. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision.

MFN clause is usually found in Protocols and Exchange of Notes to DTCs. Under this clause a country agrees to extend the benefits to the residents of the other country, which it had (first country) promised to the residents of third country. It tries to avoid discrimination between residents of different countries.

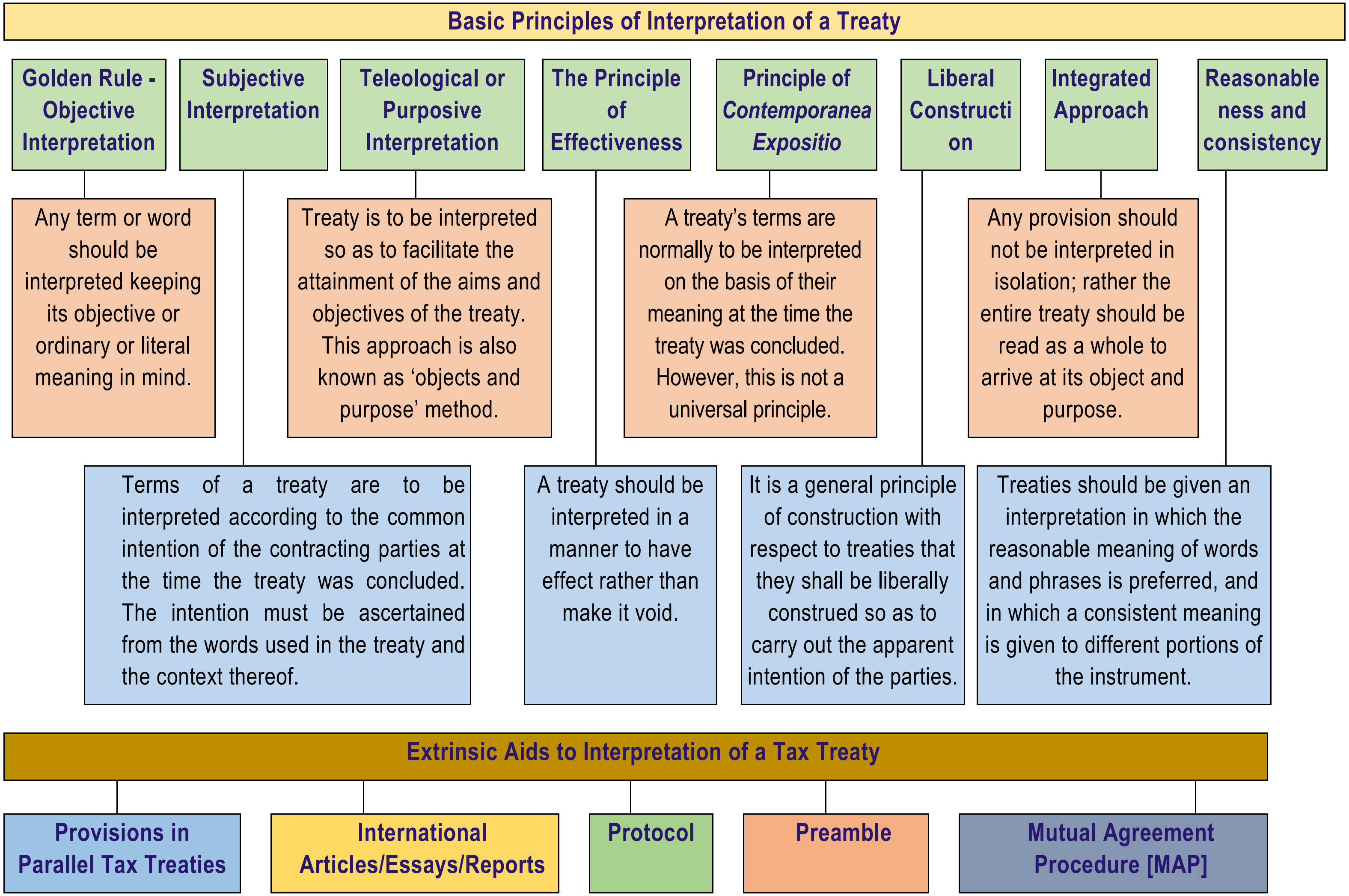
Normally, the benefit under this clause is restricted to a specific group like OECD countries or developing countries. The nature of benefits under MFN clause could either be application of lower rate of tax or narrowing the scope of the income liable to tax or allowing higher deduction in respect of executive and general administrative expenses of head office.

(v) Preamble

Preamble to a tax treaty could guide in interpretation of a tax treaty. In case of *Azadi Bachao Andolan*, the Apex Court observed that 'the preamble to the Indo-Mauritius Double Tax Avoidance Treaty recites that it is for the 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty'. These observations are very significant whereby the Apex Court has upheld 'economic considerations' as one of the objectives of a Tax Treaty.

(vi) Mutual Agreement Procedure [MAP]

MAP helps to interpret any ambiguous term/provision through bilateral negotiations. MAP is more authentic than other aids as officials of both countries are in possession of materials/documents exchanged at the time of signing the tax treaty which would clearly indicate the object or purpose of a particular provision. Successful MAPs also serve as precedence in case of subsequent applications.



Basic Principles of Interpretation of a Treaty

Golden Rule - Objective Interpretation

Any term or word should be interpreted keeping its objective or ordinary or literal meaning in mind.

Subjective Interpretation

Terms of a treaty are to be interpreted according to the common intention of the contracting parties at the time the treaty was concluded. The intention must be ascertained from the words used in the treaty and the context thereof.

Teleological or Purposive Interpretation

Treaty is to be interpreted so as to facilitate the attainment of the aims and objectives of the treaty. This approach is also known as ‘objects and purpose’ method.

The Principle of Effectiveness

A treaty should be interpreted in a manner to have effect rather than make it void.

Principle of *Contemporanea Expositio*

A treaty’s terms are normally to be interpreted on the basis of their meaning at the time the treaty was concluded. However, this is not a universal principle.

Liberal Construction

It is a general principle of construction with respect to treaties that they shall be liberally construed so as to carry out the apparent intention of the parties.

Integrated Approach

Any provision should not be interpreted in isolation; rather the entire treaty should be read as a whole to arrive at its object and purpose.

Reasonableness and consistency

Treaties should be given an interpretation in which the reasonable meaning of words and phrases is preferred, and in which a consistent meaning is given to different portions of the instrument.

Extrinsic Aids to Interpretation of a Tax Treaty

Provisions in Parallel Tax Treaties

International Articles/Essays/Reports

Protocol

Preamble

Mutual Agreement Procedure [MAP]

(3) Commentaries on OECD/UN Models and their importance

Interpretation of any statute, more so international tax treaties requires that we follow some rules of interpretation. Commentaries are one of the important rules of interpretation of tax treaties.

There are two commentaries available – one by OECD and the other by UN, based on their respective models. OECD Commentary is authentic and revised from time to time. UN Commentary is by and large based on OECD commentary. UN commentary was published in 1980 and has been revised from time to time. One can refer to the commentaries for interpretation and application of various provision contained in a DTAA.

Views expressed in the commentaries carry great authority. Where Contracting States adopt the text of the Article as per OECD Model convention without any change, and if these countries happen to be OECD Countries, the OECD commentary is directly applicable. In case of a DTAA between developed and developing countries, normally UN model is followed. UN Model and UN Commentary both being largely based on OECD Model and Commentary respectively, OECD Commentary is also quite helpful in interpretation of treaties based on UN Model.

OECD Model Commentary has been widely used in interpretation of tax treaties. The Commentary on the OECD Model Convention states that: “the Commentaries have been cited in the published decisions of the courts of the great majority of Member countries. In many decisions, the Commentaries have been extensively quoted and analysed, and have frequently played a key role in the judge’s deliberations.”

The OECD has framed a model convention to guide countries to draft DTAAs. In the *Azadi Bachao Andolan* case, the Supreme Court has made reference to the OECD convention while interpreting terms used in DTAA.

Both UN and OECD Model Commentaries are a great help in interpretation of tax treaties. Their importance in interpretation of tax treaties can hardly be over emphasized *[Credit Lyonnais v. DCIT (2005) 94 ITD 401 (Mum)]*. OECD, however, plays a greater role in providing standardized or systematized approach in interpretation of tax treaties.

Model Commentaries give the authoritative interpretation of the provisions of DTAAs *[Sonata Information Technology Ltd. v. ACIT (2006) 103 ITD 324 (Bang)]*

(4) Foreign Courts’ Decisions

In *CIT v. Vishakhapatnam Port Trust’s* case *[1983] 144 ITR 146*, the Andhra Pradesh High Court observed that, “in view of the standard OECD Models which are being used in various countries, a new area of genuine ‘international tax law’ is now in the process of developing. Any person interpreting a tax treaty must now consider decisions and rulings worldwide relating to similar treaties. The maintenance of uniformity in the interpretation of a rule after its international adoption is just as important as the initial removal of divergences. Therefore, the judgments rendered by courts in other countries or rulings given by other tax authorities would be relevant.”

In the under-noted cases, foreign court cases have extensively been quoted for interpretation of treaty provisions:

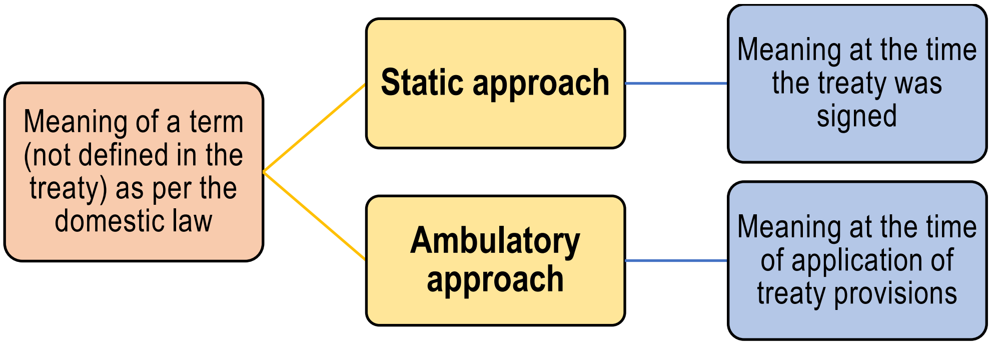
Union of India v. Azadi Bachao Andolan [2003] 263 ITR 706 (SC)

CIT v. Vishakhapatnam Port Trust [1983] 144 ITR 146

Abdul Razak A. Meman's case [2005] 276 ITR 306(AAR)

(5) Ambulatory v. Static Approach

Whenever a reference is made in a treaty to the provisions of domestic tax laws for assigning meaning to a particular term, a question often arises what meaning to be assigned to the said term – the one which prevailed on the date of signing a tax treaty or the one prevailing on the date of application of a tax treaty. There are two views on the subject, namely, Static and Ambulatory.


Meaning of a term (not defined in the treaty) as per the domestic law
Static approach
Meaning at the time the treaty was signed
Ambulatory approach
Meaning at the time of application of treaty provisions

All Model Commentaries including the Technical Explanation on US Model Tax Convention favors ambulatory approach, however with one caution and that is ambulatory approach cannot be applied when there is a radical amendment in the domestic law thereby changing the sum and substance of the term.

India-Australia Treaty, in Article 3(2) adds the expression "from time to time in force" to provide for an "ambulatory" interpretation.

6.5 ROLE OF VIENNA CONVENTION IN APPLICATION AND INTERPRETATION OF TAX TREATIES

The International Law Commission initiated the work on the Vienna Convention on Law of Treaties in the year 1949 which was completed in the year 1969. It came into force in the year 1980. As of January, 2018, it was ratified by 116 Countries.

Since tax treaty is a part of international law, its interpretation should be based on certain set of principles and rules of interpretation. The Vienna Convention on Law of Treaties provides the basic rules of interpretation of any international agreement (including a tax treaty). Therefore, it would be worthy to understand some of the Articles of the Vienna Convention of Law of Treaties which would help appreciate the manner of application and interpretation of tax treaties.

Principles enunciated in the Vienna Convention on Law of Treaties[9]

Article No.	Article Heading	Principle enunciated
26	***Pacta Sunt Servanda (in good faith)***	Every treaty in force is binding upon the parties and must be followed by them in good faith.
28	**Non-retroactivity of treaties**	Unless a different intention appears from the treaty or is otherwise established, treaty provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party. In other words, unless otherwise provided, treaties cannot have retrospective application
29	**Territorial Scope of Treaties**	Unless a different intention appears from the treaty or is otherwise established, a treaty is binding upon each party in respect of its entire territory.
31	**General Rule of Interpretation**	• A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms thereof in the context and in the light of its object and purpose. • The context for the purpose of interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexure (a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty; (b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related thereto. • The following shall be taken into account, together with the context in that: (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; (b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; (c) Any relevant rules of international law applicable to relation between the parties.

[9] https://treaties.un.org/doc/Publication/UNTS/Volume%201155/volume-1155-I-18232-English.pdf

Article No.	Article Heading	Principle enunciated
		• A special meaning shall be given to a term if it is established that the parties so intended.
32	**Supplementary means of interpretation**	Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable.
33	**Interpretation of Treaties Authenticated in two or more languages**	• When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail. • A version of the treaty in a language other than the one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree. • The terms of the treaty are presumed to have the same meaning in each authentic text. • Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference in meaning which the application of Articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.
34	**General Rule regarding third states**	A treaty does not create either obligations or rights for a third State without its consent.
42	**Validity and Continuance in force of treaties**	• The validity of a treaty or of the consent of a State to be bound by a treaty may be impeached only through the application of the Convention· • The termination of a treaty, its denunciation or the withdrawal of a party, may take place only as a result of the application of the provisions of the treaty or of the Convention. The same rule applies to suspension of the operation of a treaty
60	**Termination or Suspension of the**	• A material breach of a bilateral treaty by one of the

Article No.	Article Heading	Principle enunciated
	operation of a treaty as a consequence of a breach	parties entitles the other to invoke the breach as a ground for terminating the treaty or suspending its operation in whole or in part. • A material breach of a multilateral treaty by one of the parties entitles: (a) the other parties by unanimous agreement to suspend the operation of the treaty in whole or in part or to terminate it either: (i) in the relations amongst themselves and the defaulting State, or (ii) as between all the parties; (b) a party specially affected by the breach to invoke it as a ground for suspending the operation of the treaty in whole or in part in the relations between itself and the defaulting State; (c) any party other than the defaulting State to invoke the breach as a ground for suspending the operation of the treaty in whole or in part with respect to itself if the treaty is of such a character that a material breach of its provisions by one party radically changes the position of every other party with respect to further performance of its obligations under the treaty. • A material breach of a treaty, for the purposes of this Article, consists in: (a) a repudiation of the treaty not sanctioned by the Convention; or (b) the violation of a provision essential to the accomplishment of the object or purpose of the treaty. • The foregoing paragraphs are without prejudice to any provision in the treaty applicable in the event of a breach.
61	**Supervening impossibility of performance**	• A party may invoke the impossibility of performing provision of a treaty as a ground for terminating or withdrawing from it, if the impossibility results from the permanent disappearance or destruction of an object indispensable for the execution of the treaty. If the impossibility is temporary, it may be invoked only as a ground for suspending its operation.

Article No.	Article Heading	Principle enunciated
		• Impossibility of performance may not be invoked by a party as a ground for terminating, withdrawing from or suspending the operation of a treaty if the impossibility is the result of a breach by that party either of an obligation under the treaty or of any other international obligation owed to any other party thereto.
62	**Fundamental change of circumstances**	• A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless – (a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and (b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty. • A fundamental change of circumstances may not be invoked as a ground for terminating or withdrawing from a treaty – (a) if the treaty establishes a boundary; or (b) if the fundamental change is the result of a breach by the party invoking it either of an obligation under the treaty or of any other international obligation owed to any other party to the treaty. • If, under the foregoing paragraphs, a party may invoke a fundamental change of circumstances as a ground for terminating or withdrawing from a treaty it may also invoke the change as a ground for suspending its operation.
64	**Emergence of new peremptory norm of general international law**	If a new peremptory norm of general international law emerges, any existing treaty which is in conflict with that norm becomes void and stands terminated

EXERCISE

Question 1

What do you mean by double taxation? Discuss the connecting factors which lead to double taxation.

Answer

The taxability of a foreign entity in any country depends upon two distinct factors, namely, whether it is doing business **with that country** or **in that country**. Internationally, the term used to determine the jurisdiction for taxation is "connecting factors". There are two types of connecting factors, namely, "Residence" and "Source". It means a company can be subject to tax either on its residence link or its source link with a country. Broadly, if a company is doing business **with** another country (i.e. host/source country), then it would be subject to tax in its home country alone, based on its residence link. However, if a company is doing business **in a** host/source country, then, besides being taxed in the home country on the basis of its residence link, it will also be taxed in the host country on the basis of its source link.

- **Juridical double taxation:** When source rules overlap, double taxation may arise i.e. tax is imposed by two or more countries as per their domestic laws in respect of the same transaction, income arises or is deemed to arise in their respective jurisdictions. This is known as "juridical double taxation".

  In order to avoid such double taxation, a company can invoke provisions of Double Taxation Avoidance Agreements (DTAAs) (also known as **Tax Treaty** or Double Taxation Convention–DTC) with the host/source country, or in the absence of such an agreement, an Indian company can invoke provisions of section 91, providing unilateral relief in the event of double taxation.

- **Economic double taxation:** 'Economic double taxation' happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different persons (because of lack of subject identity)

Question 2

"In addition to allocating the taxing rights and elimination of double taxation, there are various other important considerations while entering into tax treaty". Elucidate.

Answer

In addition to allocating the taxing rights and elimination of double taxation, there are various other important considerations while entering into a tax treaty, as mentioned below:

- Ensuring non-discrimination between residents and non-residents
- Resolution of disputes arising on account of different interpretation of tax treaty by the treaty partner.

- Providing assistance in the collection of the fair and legitimate share of tax.

Further, in addition to above, there are some other principles which must be considered by countries in their tax system –

(i) **Equity and fairness:** Same income earned by different taxpayers must be taxed at the same rate regardless of the source of income.

(ii) **Neutrality and efficiency:** Neutrality factor provides that economic processes should not be affected by external factors such as taxation. Neutrality is two-fold.

(a) Capital export neutrality and

(b) Capital import neutrality (CIN).

Capital export neutrality (CEN) provides that business decision must not be affected by tax factors between the country of residence and the target country; whereas CIN provides that the level of tax imposed on non-residents as well as the residents must be similar.

(iii) **Promotion of mutual economic relation, trade and investment:** In some cases, it is observed that avoidance of double taxation is not the only objective. The other objective may be to give impetus to a country's overall economic growth and development.

Question 3

What is the General Rule of Interpretation under Vienna Convention of Law of Treaties?

Answer

Article 31 of Vienna Convention of Law of Treaties contains the General Rule of Interpretation. It lays down that following general rule of interpretation:

- A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms thereof in the context and in the light of its object and purpose.
- The context for the purpose of interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexure

  (a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

  (b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related thereto.

- The following shall be taken into account, together with the context in that:

  (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) Any relevant rules of international law applicable to relation between the parties.

- A special meaning shall be given to a term if it is established that the parties so intended.

Question 4

What are the Extrinsic Aids to interpretation of a tax treaty?

Answer

A wide range of extrinsic material is permitted to be used in interpretation of tax treaties. According to Article 32 of the Vienna Convention, the supplementary means of interpretation include the preparatory work of the treaty and the circumstances of its conclusion.

According to Prof. Starke, one may resort to following extrinsic aids to interpret a tax treaty provided that clear words are not thereby contradicted:

(i) Interpretative Protocols, Resolutions and Committee Reports, setting out agreed interpretations;

(ii) A subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions [Art. 31(3) of the VCLT];

(iii) Subsequent conduct of the state parties, as evidence of the intention of the parties and their conception of the treaty;

(iv) Other treaties, in *pari materia* (i.e., relating to the same subject matter), in case of doubt.

Provisions in Parallel Tax Treaties

If the language used in two tax treaties (say treaties: X and Y) are same and one treaty is more elaborative or clear in its meaning (say treaty X) can one rely on the interpretation/explanations provided in a treaty X while applying provisions of a treaty Y?

However, the views of the Indian Judiciary are not consistent in this respect. There are contradictory judgments by Indian courts/tribunal in this regard.

International Articles/Essays/Reports

International Article/Essays/Reports are referred as extrinsic aid for interpretation of tax treaties. Like, in case of *CIT v. Vishakhapatnam Port Trust (1983) 144 ITR 146 (AP)*, the High Court obtained "useful material" through international articles.

Cahiers published by International Fiscal Association (IFA), Netherlands

"Cahiers de Droit Fiscal International" is the main publication of the IFA, which is published annually and deals with two major topics each year. Cahiers were relied upon in case of *Azadi Bachao Andolan's* (supra) case by the Supreme Court.

Protocol

Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues.

A protocol is an integral part of a tax treaty and has the same binding force as the main clauses therein.

Protocol to India France treaty contains the Most Favoured Nation Clause. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision.

Preamble

Preamble to a tax treaty could guide in interpretation of a tax treaty. In case of *Azadi Bachao Andolan*, the Apex Court observed that 'the preamble to the Indo-Mauritius Double Tax Avoidance Treaty recites that it is for the 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty'. These observations are very significant whereby the Apex Court has upheld 'economic considerations' as one of the objectives of a Tax Treaty.

Mutual Agreement Procedure [MAP]

MAP helps to interpret any ambiguous term/provision through bilateral negotiations. MAP is more authentic than other aids as officials of both countries are in possession of materials/documents exchanged at the time of signing the tax treaty which would clearly indicate the object or purpose of a particular provision. Successful MAPs also serve as precedence in case of subsequent applications.

CHAPTER 7

FUNDAMENTALS OF BEPS

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- ❑ **gain** a broad understanding of the concept of Base Erosion and Profit Shifting (BEPS);
- ❑ **appreciate** the significance of action plans of BEPS;
- ❑ **comprehend and appreciate** the provisions incorporated in the Indian tax laws in line with the different Action Plans of BEPS.

7.1 BACKGROUND

Impact of Globalisation

Globalisation has benefited our domestic economies, boosted trade and increased foreign direct investments in many countries. The unrestricted movement of capital and labour, the shift of manufacturing bases from high-cost to low-cost locations, the gradual removal of trade barriers, technological and telecommunication developments, and the ever-increasing importance of managing risks and of developing, protecting and exploiting intellectual property, have had an important impact on the way cross-border activities take place. In this way, it accelerated growth, created jobs and fostered innovation. Globalisation is not new, but the pace of integration of national economies and markets has increased substantially in recent years. It has a significant impact on a country's corporate income tax regimes.

Growth of E-Commerce and consequent aggressive tax planning

Way back in 1920s, the League of Nations recognised that the interaction of domestic tax systems can lead to double taxation with adverse effects on growth and global prosperity. Globally, countries concur on the need to eliminate double taxation and the need to achieve this on the basis of accepted international laws that are clear and predictable, giving certainty to both governments and businesses. International tax law is, therefore, a pillar in facilitating the development of the global economy. With the economy, the enterprises also became more globally integrated. Multi-national enterprises (MNE) now represent a significant proportion of global GDP. Further, intra-firm trade comprises of a growing proportion of overall trade. Also, the increasing significance of the service component of the economy, and of digital products which are deliverable over the Internet, has made it much easier for businesses to locate many productive activities in geographic locations that are distant from the physical location of their customers. These developments have been accompanied by the increasing sophistication of tax planners in identifying and exploiting the legal arbitrage opportunities and the boundaries of acceptable tax planning, thus, encouraging MNEs to minimise their tax burden by resorting to aggressive tax planning.

Adverse Effects of BEPS

Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid. This has become a critical issue since governments have to cope with less revenue and a higher cost to ensure compliance. Moreover, BEPS undermines the integrity of the tax system, as reporting of low corporate taxes is considered to be unfair. In developing countries, the lack of tax revenue leads to significant under-funding of public investment that could help foster economic growth. Further, when tax laws permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers, especially individual taxpayers in that jurisdiction bear a greater share of the burden. This gives rise to tax fairness issues on account of individuals having to bear a higher tax burden. Also, enterprises that operate only in domestic markets, including family-owned businesses or new innovative businesses, may have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

Need for international collaboration to protect tax sovereignty of its countries

Taxation is at the core of countries' sovereignty, but the interaction of domestic tax laws in certain cases leads to gaps and frictions. While developing their domestic tax laws, sovereign states may not adequately take into consideration the effect of other countries' laws. The interaction of separate sets of laws enforced by sovereign countries causes frictions, including potential double taxation for corporations operating in many countries. It also causes gaps, in cases where corporate income is untaxed, both in the country of source and in the country of residence, or is taxed only at nominal rates. In the domestic context, coherence is generally achieved through a principle of matching – a payment that is deductible by the payer is usually taxable in the hands of the recipient, unless explicitly exempted. There is no similar principle of coherence at the international level, which leaves considerable scope for arbitrage by taxpayers, though sovereign states have united to ensure coherence in a narrow field, namely, to prevent double taxation. BEPS relates primarily to instances where the interaction of different tax rules leads to double non-taxation. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place. International standards have tried to reduce these frictions in a manner that respects tax sovereignty; however, gaps still remain. Therefore, there is a need for countries to collaborate on tax matters so that they are able to get their due share of taxes.

8.2 OVERVIEW OF BEPS

In the background of the above repercussions, in February 2013, the OECD published a report on "Addressing Base Erosion and Profit Shifting" iterating the need for analyzing the issue of tax base erosion and profit shifting by global corporations. The OECD followed it up with publishing draft Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan) in July 2013 which came to final fruition in October 2015. The BEPS action plan identifies fifteen actions to address BEPS in a comprehensive manner and sets a deadline to implement those actions.

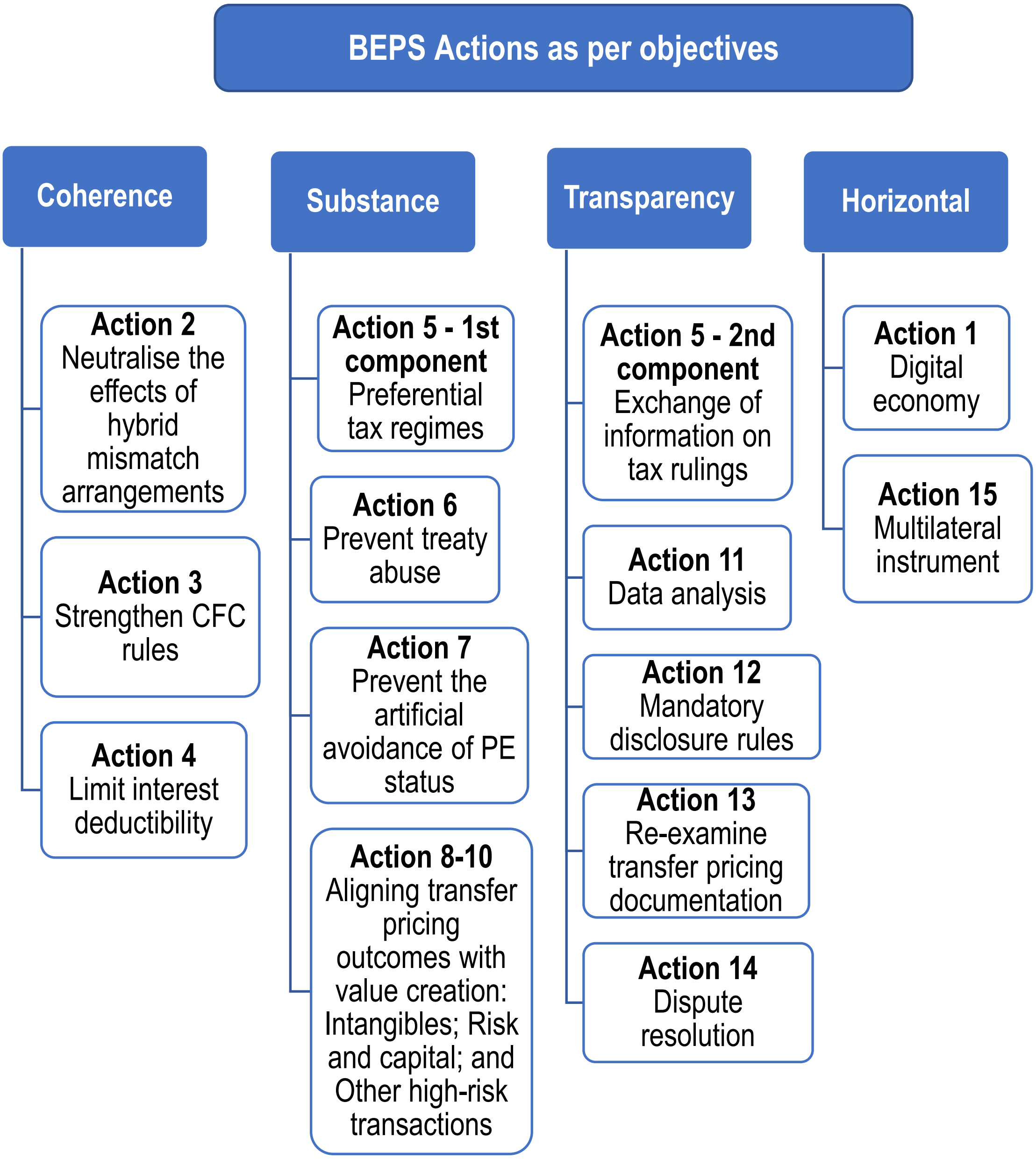
The Action Plans were structured around three fundamental pillars viz.:

(i) Introducing coherence in the domestic rules that affect cross-border activities.

(ii) Reinforcing of 'substance' requirements in existing international standards; Alignment of taxation with location of value creation and economic activity; and

(iii) Improving transparency and tax certainty.

A brief classification of the various action plans based on the fundamental pillars is as under:



BEPS Actions as per objectives

Coherence

Action 2 Neutralise the effects of hybrid mismatch arrangements

Action 3 Strengthen CFC rules

Action 4 Limit interest deductibility

Substance

Action 5 - 1st component Preferential tax regimes

Action 6 Prevent treaty abuse

Action 7 Prevent the artificial avoidance of PE status

Action 8-10 Aligning transfer pricing outcomes with value creation: Intangibles; Risk and capital; and Other high-risk transactions

Transparency

Action 5 - 2nd component Exchange of information on tax rulings

Action 11 Data analysis

Action 12 Mandatory disclosure rules

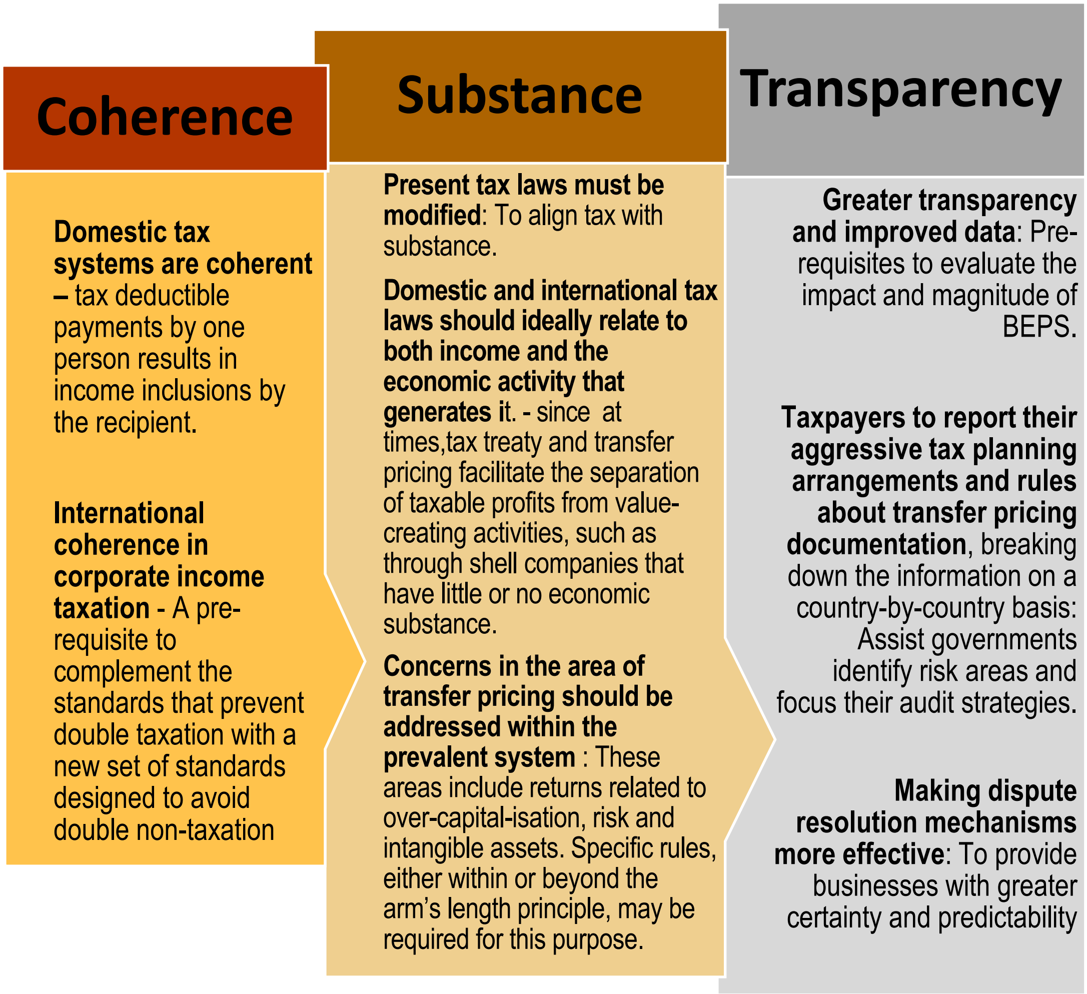
Action 13 Re-examine transfer pricing documentation

Action 14 Dispute resolution

Horizontal

Action 1 Digital economy

Action 15 Multilateral instrument



Coherence

Domestic tax systems are coherent – tax deductible payments by one person results in income inclusions by the recipient.

International coherence in corporate income taxation - A pre-requisite to complement the standards that prevent double taxation with a new set of standards designed to avoid double non-taxation

Substance

Present tax laws must be modified: To align tax with substance.

Domestic and international tax laws should ideally relate to both income and the economic activity that generates it. - since at times,tax treaty and transfer pricing facilitate the separation of taxable profits from value-creating activities, such as through shell companies that have little or no economic substance.

Concerns in the area of transfer pricing should be addressed within the prevalent system : These areas include returns related to over-capital-isation, risk and intangible assets. Specific rules, either within or beyond the arm's length principle, may be required for this purpose.

Transparency

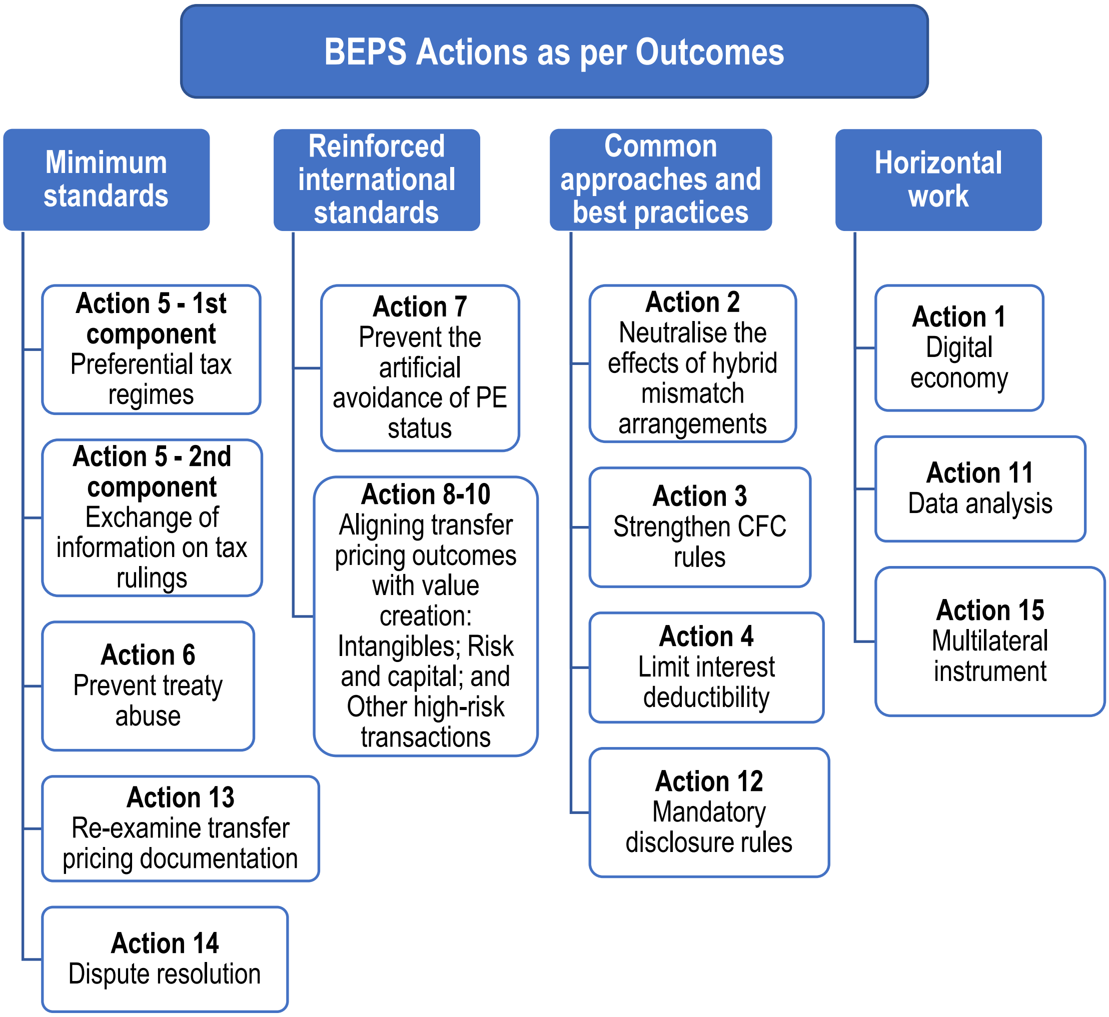
Greater transparency and improved data: Pre-requisites to evaluate the impact and magnitude of BEPS.

Taxpayers to report their aggressive tax planning arrangements and rules about transfer pricing documentation, breaking down the information on a country-by-country basis: Assist governments identify risk areas and focus their audit strategies.

Making dispute resolution mechanisms more effective: To provide businesses with greater certainty and predictability

The BEPS measures range from new minimum standards to a revision of pre-existing international standards, and to common approaches which will facilitate the convergence of national rules and guidance drawing on best practices.

A brief classification of the various action plans based on the basis of outcomes is as under:



BEPS Actions as per Outcomes

Mimimum standards

- **Action 5 - 1st component** Preferential tax regimes
- **Action 5 - 2nd component** Exchange of information on tax rulings
- **Action 6** Prevent treaty abuse
- **Action 13** Re-examine transfer pricing documentation
- **Action 14** Dispute resolution

Reinforced international standards

- **Action 7** Prevent the artificial avoidance of PE status
- **Action 8-10** Aligning transfer pricing outcomes with value creation: Intangibles; Risk and capital; and Other high-risk transactions

Common approaches and best practices

- **Action 2** Neutralise the effects of hybrid mismatch arrangements
- **Action 3** Strengthen CFC rules
- **Action 4** Limit interest deductibility
- **Action 12** Mandatory disclosure rules

Horizontal work

- **Action 1** Digital economy
- **Action 11** Data analysis
- **Action 15** Multilateral instrument

An unprecedented amount of interest and participation has been witnessed by OECD with more than sixty countries, both OECD members and G-20 countries, being directly involved as a part of technical groups in the development of congruent international tax standards. The Inclusive Framework on BEPS works to ensure that the international tax framework for MNEs remains relevant for today and the future, thereby promoting economic efficiency and global welfare. It will also ensure that governments continue to efficiently raise revenues not only from traditional but also from digital businesses, both for direct tax and indirect tax purposes.

The summary explanatory statement indicates the level of political commitment by OECD, G20 and other States involved in the 2015 work to the various reports. The OECD has iterated the following terms to indicate the commitment by various participant countries:

New minimum standard - New minimum standard implies application of a new rule to be implemented by all states, since non-implementation may result in negative spill overs (including adverse impact of competitiveness) on other countries. Each of the four BEPS minimum standards [namely, Actions 5, 6, 13 and 14] is subject to peer review in order to ensure timely and accurate implementation and thus safeguard the level playing field. All members of the Inclusive Framework on BEPS commit to implementing the minimum standards, and commit to participating in the peer review.

Revision of a standard which already exists – Existing standards have been updated and will be implemented but with the caveat that all BEPS participants have not endorsed the underlying standards on tax treaties or transfer pricing; and

Best practice – A best practice is not a standard but optional recommendation for states to follow. Guidance based on best practices will support those countries proposing to act in the areas of mandatory disclosure initiatives or controlled foreign company (CFC) legislation.

(1) ACTION PLAN 1 – ADDRESSING THE CHALLENGES OF THE DIGITAL ECONOMY

Digital economy: Dissolving link between income-producing activity and physical location

At present, in the digital domain, business may be conducted without regard to national boundaries and may dissolve the link between an income-producing activity and a specific location. Hence, business in digital domain doesn’t actually occur in any physical location but instead takes place in "cyberspace." Given the rise of e-commerce, an entire digital economy has emerged in the last decade. Since there is a concept of ‘intangibility’ attached to the digital model of business, tax authorities often faced challenges rightly bringing to tax the profits earned from a digital business. To address the same, the first action plan of the BEPS project was developed by the OECD which outlines the methods and principles based on which physical and digital economies can be taxed at par. Before the same, physical locations of the servers of such digital businesses were considered to establish the tax jurisdiction in which the profits of digital businesses could be taxed. However, it was observed that servers were therefore placed in tax efficient jurisdictions, even though the main income generation and customers were from other jurisdictions.

Taxation issues in E-Commerce

These new business models have created new tax challenges. The typical taxation issues relating to e-commerce are:

(i) the difficulty in characterizing the nature of payment and establishing a nexus or link between a taxable transaction, activity and a taxing jurisdiction,

(ii) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

The digital business, thus, challenges physical presence-based permanent establishment rules. If permanent establishment (PE) principles are to remain effective in the new economy, the fundamental PE components developed for the old economy i.e., place of business, location, and permanency must be reconciled with the new digital reality.

OECD Recommendations under Action Plan 1 of the BEPS project

The The OECD has recommended several options to tackle the direct tax challenges which include:

Modifying the existing Permanent Establishment (PE) rule to provide whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.

A virtual fixed place of business PE in the concept of PE i.e., creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website

Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider or **imposition of a equalisation levy** on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having PE in other contracting state.

Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.

Indian Taxation Regime

Insertion of Chapter VIII in the Finance Act, 2016 on Equalisation Levy to address this challenge

In order to address the challenges of the digital economy, Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

Meaning of "Specified Service"

(1) Online advertisement;

(2) Any provision for digital advertising space or any other facility or service for the purpose of online advertisement;

Specified Service also includes any other service as may be notified by the Central Government.

Further, in order to reduce burden of small players in the digital domain, it is also provided that no such levy shall be made if the aggregate amount of consideration for specified services received or receivable by a non-resident from a person resident in India or from a non-resident having a permanent establishment in India does not exceed ₹ 1 lakh in any previous year.

"Significant economic presence" to constitute "business connection"

The scope of provisions of section 9(1)(i), prior to amendment by the Finance Act, 2018, were restrictive as it essentially provided for physical presence based nexus rule for taxation of business income of the non-resident in India. *Explanation 2* to the said section which defines 'business connection' was also narrow in its scope since it limited the taxability of certain activities or transactions of non-resident to those carried out through a dependent agent. Therefore, emerging business models such as digitized businesses, which do not require physical presence of itself or any agent in India, were not covered within the scope of section 9(1)(i).

In view of the above, the Finance Act, 2018 has amended section 9(1)(i) to provide that 'significant economic presence' in India shall also constitute 'business connection'. For this purpose, "significant economic presence" means-

	Transaction/activity	Condition
(i)	any transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India	the aggregate of payments arising from such transaction or transactions during the previous year exceeds the amount as may be prescribed
(ii)	systematic and continuous soliciting of its business activities or engaging in interaction with users in India through digital means	The users would be of such number as may be prescribed.

Notes:

(i) Only so much of income as is attributable to such transactions or activities shall be deemed to accrue or arise in India.

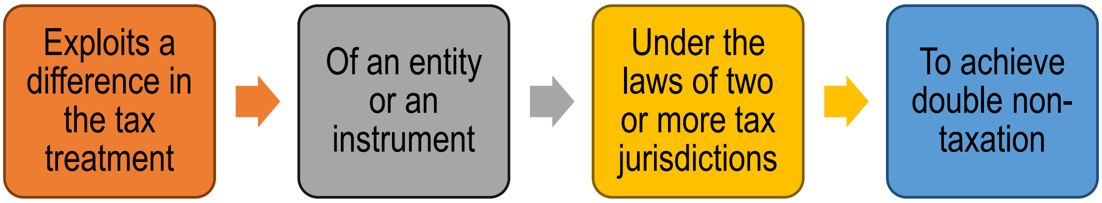
(ii) Such transactions or activities shall constitute significant economic presence in India, whether or not the agreement for such transactions or activities is entered in India or whether or not the non-resident has a residence or place of business in India or renders services in India.

(2) ACTION PLAN 2 - NEUTRALISE THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS

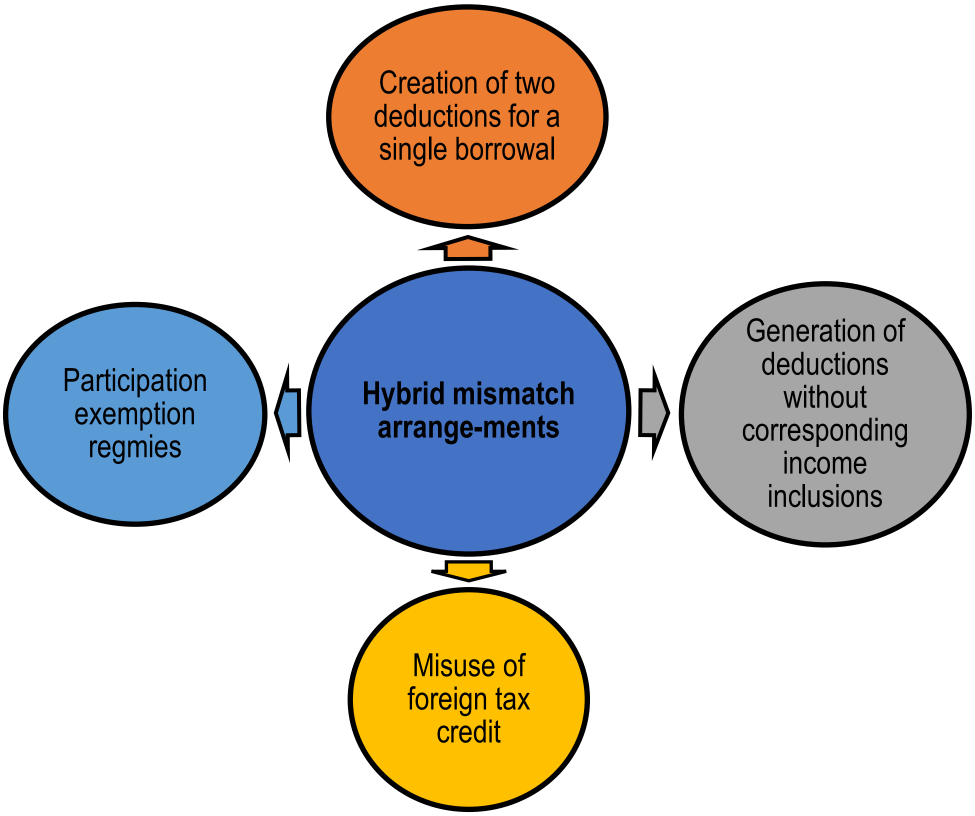
Before understanding what Action Plan 2 recommends, we must understand what a hybrid mismatch is.

Hybrid Mismatch Arrangement: Meaning

A hybrid mismatch is an arrangement that:


Exploits a difference in the tax treatment
Of an entity or an instrument
Under the laws of two or more tax jurisdictions
To achieve double non-taxation

Hybrid mismatch arrangements are sometimes used to achieve unintended double non-taxation or long-term tax deferral in one or more of the following ways -


Creation of two deductions for a single borrowal
Participation exemption regmies
Hybrid mismatch arrange-ments
Generation of deductions without corresponding income inclusions
Misuse of foreign tax credit

Specific country laws that allow taxpayers to opt for the tax treatment of certain domestic and foreign entities may aid hybrid mismatches. It may not be easy to find out which country has in fact lost tax revenue, since the laws of each country involved have been complied with; however, there is a reduction of the overall tax paid by all parties involved as a whole, which ultimately has an adverse effect on competition, economic efficiency, transparency and fairness.

Recommended general amendments are as follows:

- **A rule denying transparency to entities where the non-resident investors' resident country treats the entity as opaque;**

Example

Let us say, X Co., a parent company in country X indirectly holds Y Co., an operating company in country Y. Between X Co. and Y Co. is a hybrid entity that is treated as transparent or disregarded for country X tax purposes and as non-transparent for country Y tax purposes. X Co. holds all or almost all equity interest in the hybrid entity which in turn holds all or almost all equity interests in Y Co. The hybrid entity borrows money from a third party and the loan is used to invest equity into Y Co (or to buy the shares in Y Co from either another company of the same group or from an unrelated third party). The hybrid entity pays interest on the loan. Except for the interest, the hybrid entity does not claim any other significant deduction and does not have any significant income.

With respect to Country Y, for tax purposes, Hybrid Entity is subject to corporate income tax. Its interest expenses can be used to offset other country Y group companies' income under the country Y group tax relief regime. On the other hand, country X treats the hybrid entity as transparent or disregarded, with the result that its interest expenses are allocated to X Co, which deducts the interest expense to offset unrelated income. The net effect is that there are two deductions for the same contractual obligation in two different countries.

Therefore, by virtue of rule denying transparency to an entity which is treated as opaque in the subsidiary company's country, the double deduction can be avoided.

- **A rule denying an exemption or credit for foreign underlying tax for dividends that are deductible by the payer;**

Example

N Co, a company resident in country N is funded by M Co., a company resident in country M with an instrument that qualifies as equity in country M but as debt in country N. A payment made under the instrument would be deductible as interest expense for N Co under country N tax law. The corresponding receipts are treated as exempt dividends under the tax laws of country M. Consequently, deduction is available under the tax laws of country N without a corresponding income inclusion in country M.

Therefore, by virtue of rule denying an exemption or credit for foreign underlying tax for dividends that are deductible by the payer, exemption of such income in country M would not be possible.

- **A rule denying a foreign tax credit for withholding tax where that tax is also credited to some other entity**; and
- **Amendments to CFC and similar regimes attributing local shareholders the income of foreign entities that are treated as transparent under their local law.**

Treaty changes **-** Action Plan 2 recommends a new provision in the case of income earned by a transparent entity. As per the new provision, treaty benefits will only be afforded to so much of the income of the entity as the income of a resident of that State. A specific or general saving rule is proposed so that a State can tax a resident entity generally unrestricted by treaty.

Anti-hybrid rules - The report further issued a series of dedicated domestic anti-hybrid rules which would work in two stages. The primary rules would deny deductions to payers in situations where either

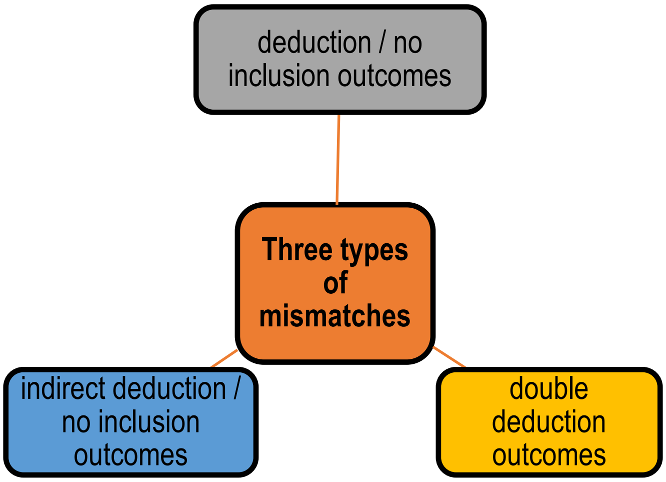
(i) Those payments will not be included in the recipient's ordinary income, or

(ii) The same amount is being simultaneously deducted by another entity.

Treatment of Branch mismatches : 2017 Report

Branch mismatches arise where the ordinary rules for allocating income and expenditure between the branch and head office result in a portion of the net income of the taxpayer escaping the charge to taxation in both the branch and residence jurisdiction. These branch mismatches occur where two jurisdictions take a different view as to the existence of, or the allocation of income or expenditure between, the branch in head office of the same taxpayer.

Unlike hybrid mismatches, which result from conflicts in the legal treatment of entities or instruments, branch mismatches are the result of differences in the way the branch and head office account for a payment made by or to the branch. The 2017 report identifies five basic types of branch mismatch arrangements that give rise to one of three types of mismatches:


deduction / no inclusion outcomes
Three types of mismatches
indirect deduction / no inclusion outcomes
double deduction outcomes

The 2017 report includes specific recommendations for improvements to domestic law intended to reduce the frequency of branch mismatches as well as targeted branch mismatch rules which adjust the tax consequences in either the residence or branch jurisdiction in order to neutralise the hybrid mismatch without disturbing any of the other tax, commercial or regulatory outcomes.

(3) ACTION PLAN 3 - STRENGTHEN CONTROLLED FOREIGN COMPANY (CFC) RULES

Shifting investment income and passive income to subsidiaries in low tax or no tax jurisdictions: Deferral of home country taxation

Under the tax laws of several countries, a shareholder of a corporation is not taxed on the corporation's income until the income is distributed as a dividend. Therefore, it was common for publicly traded companies to form foreign subsidiaries in tax havens and shift "portable" income to those subsidiaries. Generally, income shifted were mainly investment income (interest and dividends) and passive income (rents and royalties), as well as sales and services income involving related parties. Tax in parent country on this income was avoided until the tax haven country paid a dividend to the shareholding company. This dividend could be avoided indefinitely by loaning the earnings to the shareholder without actually declaring a dividend.

Many countries (where global multi-nationals are based) have high tax rates as compared to certain other countries, which used their low tax rates as a means of attracting inward investment. As a result, when dividends were repatriated from these lower tax countries, the recipient generally suffered additional tax on those profits. Therefore, many companies have a tendency to leave the profits from these low-taxed subsidiaries offshore, with the objective of deferring home country taxation.

Obviously, Governments were disturbed that multinationals based in their countries kept large amounts of profits offshore. In order to address this issue, governments in various countries have introduced legislation aimed at eliminating the benefits of deferral, by currently taxing income in the parent country even when the income has not been repatriated or remitted to that country. These rules are generally referred to as Controlled Foreign Corporation (CFC) rules.

CFC Rules: Addressing BEPS

Controlled foreign company (CFC) rules respond to the risk that taxpayers with a controlling interest in a foreign subsidiary can strip the base of their country of residence and, in some cases, other countries by shifting income into a CFC. Without such rules, CFCs provide opportunities for profit shifting and long-term deferral of taxation.

The OECD Final Report does not propose a minimum standard for controlled foreign company (CFC) regimes. However, OECD regards CFC rules as being important in tackling BEPS and has made a series of **best practice recommendations** in relation to the 'building blocks' of an effective CFC regime. The major reason why the OECD was unable to provide more than best practice was fundamental disagreement over the policy of CFC regimes, in particular whether states should use the regime to protect other states' tax bases from earnings stripping.

Indian Taxation Regime

- At present, there are no CFC rules in the Income-tax Act, 1961;
- CFC rules formed part of the proposed Direct Tax Code.
- CFC regime has been debated over last many years in India and is one of the last remaining concepts from the DTC to be incorporated in the Income-tax Act, 1961.
- In order to encourage repatriation of profits, section 115BBD provides a concessional tax rate of 15% (gross basis) on dividends received from a specified foreign company i.e., a foreign company in which the Indian company holds 26% or more in the nominal value of the equity share capital of the company.

(4) ACTION PLAN 4 – INTEREST DEDUCTIONS AND OTHER FINANCIAL PAYMENTS

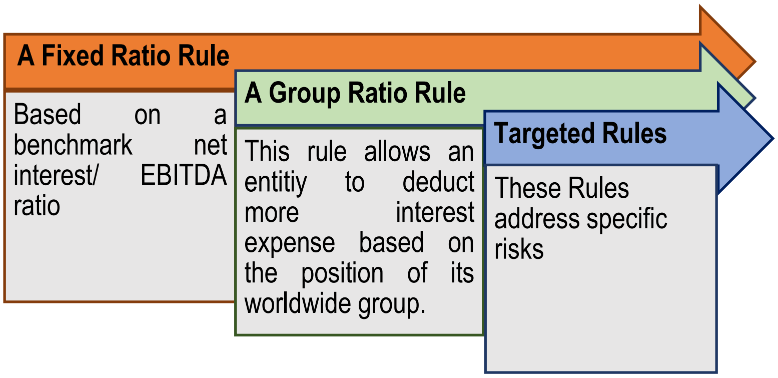
The OECD is concerned that multinational groups are able to erode their tax base (i.e., reduce their taxable profits) with interest expense, for example by:

- Locating third party debt in high tax countries;
- Using intra-group loans to achieve interest deductions in excess of the group's actual third party interest expense;
- Using related party or third party debt to finance the production of exempt or deferred income.

BEPS Action Plan 4 calls for the development of recommendations for the design of domestic rules to prevent tax base erosion through the use of interest expense and other financial payments that are economically equivalent to interest.

Common Approach: Linking an entity's net interest deduction to its level of economic activity

The mobility and fungibility of money enables multinational groups to achieve favourable tax results by adjusting the amount of debt in a group entity. The 2015 Report established a common approach which directly links an entity's net interest deductions to its level of economic activity, based on taxable earnings before interest income and expense, depreciation and amortisation (EBITDA). This approach includes three elements:



A Fixed Ratio Rule

Based on a benchmark net interest/ EBITDA ratio

A Group Ratio Rule

This rule allows an entitiy to deduct more interest expense based on the position of its worldwide group.

Targeted Rules

These Rules address specific risks

Indian Taxation Regime

Section 94B of the Income-tax Act, 1961: Addressing Thin Capitalization

Debt financing of cross-border transactions is often favorable than equity financing for taxpayer. In view of the above, in line with the recommendations of OECD BEPS Action Plan 4, section 94B has been inserted in the Income-tax Act, 1961 by the Finance Act, 2017 to provide a cap on the interest expense that can be claimed by an entity to its associated enterprise. The total interest paid in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise for that previous year, whichever is less, shall not be deductible.

Applicability

The provision is applicable to an Indian company, or a permanent establishment of a foreign company, being the borrower, who pays interest in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower. Further, the debt is deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender, being a non-associated enterprise, or deposits a corresponding and matching amount of funds with such lender.

Carry forward of disallowed interest expenditure

The provision allows for carry forward of disallowed interest expense for 8 assessment years immediately succeeding the assessment year for which the disallowance is first made and deduction against the income computed under the head "Profits and gains of business or profession” to the extent of maximum allowable interest expenditure.

Threshold limit

In order to target only large interest payments, it provides for a threshold of interest expenditure of ₹ 1 crore in respect of any debt issued by a non-resident associated enterprise exceeding which the provision would be applicable. Banks and Insurance business are excluded from the ambit of the said provisions keeping in view of special nature of these businesses.

(5) ACTION PLAN 5 – COUNTER HARMFUL TAX PRACTICES

The Action 5 Report is one of the four BEPS minimum standards. The minimum standard of the Action 5 Report consists of two parts. One part relates to preferential tax regimes, where a peer review is undertaken to identify features of such regimes that can facilitate base erosion and profit shifting, and therefore have the potential to unfairly impact the tax base of other jurisdictions. The second part includes a commitment to transparency through the compulsory spontaneous exchange of relevant information on taxpayer-specific rulings which, in the absence of such information exchange, could give rise to BEPS concerns.

Indian Taxation Regime

In India, the Finance Act, 2016 has introduced a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development. The purpose of the concessional taxation regime is to encourage entities to retain and commercialise existing patents and for developing new innovative patented products. Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture and exploitation of patents in India.

Section 115BBF of the Income-tax Act, 1961: In line with nexus approach of BEPS Action 5

The nexus approach has been recommended by the OECD under BEPS Action Plan 5. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. Accordingly, section 115BBF of the Income-tax Act, 1961 provides that where the total income of the eligible assessee includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess). For this purpose, developed means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

(6) ACTION PLAN 6 – PREVENTING TREATY ABUSE

Protection against treaty shopping: Minimum Standard

Given the risk to revenues posed by treaty shopping, countries have committed to ensure a minimum level of protection against treaty shopping (the minimum standard). That commitment will require countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

Countries will implement this common intention by including in their treaties:

(i) the combined approach of Limitation of Benefits (LOB) and Principal Purpose Test (PPT) rule,

(ii) the PPT rule alone, or

(iii) the LOB rule supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.

Implementation of Action 6 Minimum Standard

The first peer review on the implementation of the Action 6 minimum standard reveals that a large majority of Inclusive Framework members have begun to translate their commitment on treaty shopping into actions and are now in the process of modifying their treaty network. In total, on 30

June 2018, 82 jurisdictions had some treaties that were already compliant with the minimum standard or that were going to shortly comply.

The first peer review shows the efficiency of the Multilateral Instrument (MLI) [For detailed understanding of MLI, refer to discussion in Action Plan 15] in implementing the minimum standard and the other treaty-related BEPS measures. As per OECD, it is by far the preferred tool of Inclusive Framework members for implementing the minimum standard. The majority of the jurisdictions that have signed the MLI have listed almost all their treaties under the MLI.

As on 1st January, 2019, the provisions of the MLI started to take effect with respect to some treaties. For the treaties for which the MLI is effective, tax administration can now use effective treaty provisions to put an end to treaty-shopping.

Indian Tax Regime

LoB clause introduced in India-Mauritius Tax Treaty - On 10th May, 2016, India and Mauritius has signed a protocol amending the India-Mauritius tax treaty at Mauritius. In the said treaty, for the first time, it has been provided that gains from the alienation of shares acquired on or after 1.4.2017 in a company which is a resident of India may be taxed in India. The tax rate on such capital gains arising during the period from 1.4.2017-31.3.2019 should, however, not exceed 50% of the tax rate applicable on such capital gains in India. A Limitation of Benefit (LOB) Clause has been introduced which provides that a resident of a Contracting State shall not be entitled to the benefits of 50% of the tax rate applicable in transition period if its affairs are arranged with the primary purpose of taking advantage of concessional rate of tax. Further, a shell or a conduit company claiming to be a resident of a Contracting State shall not be entitled to this benefit. A shell or conduit company has been defined as any legal entity falling within the meaning of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State. A resident of a Contracting State is deemed to be a shell/conduit company if its expenditure on operations in that Contracting State is less than Mauritian rupee 15,00,000 or Indian ₹ 7,00,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

LoB clause in India-Singapore Tax Treaty - On similar lines, India and Singapore has signed a protocol amending the India-Singapore tax treaty. Capital gains on alienation of shares would be taxable in a similar manner as laid out in India-Mauritius tax treaty, subject to LoB clause. The transition period benefit is also similar to that contained in India-Mauritius Tax Treaty. In respect of shares acquired after 1.4.2017 and sold before 1.4.2019, the expenditure test needs to be met for the 12 month period immediately preceding the date of transfer.

(7) ACTION PLAN 7 – PREVENT THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT (PE) STATUS

This report includes changes to the definition of permanent establishment (PE) in the OECD Model Tax Convention that will address strategies used to avoid having a taxable presence in a country under tax treaties.

These changes will ensure that where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise will be considered to have a taxable presence in that country unless the intermediary is performing these activities in the course of an independent business. The changes will also restrict the application of a number of exceptions to the definition of permanent establishment to activities that are preparatory or auxiliary nature and will ensure that it is not possible to take advantage of these exceptions by the fragmentation of a cohesive operating business into several small operations; they will also address situations where the exception applicable to construction sites is circumvented through the splitting-up contracts between closely related enterprises.

Thus, the following steps have been advocated:

- ***Reworking exceptions to PE definition*** – An anti-fragmentation rule to be adopted to aggregate all activities carried by an enterprise in a state, along with activities undertaken by its closely related entities undertaking business operation that create tax mismatch and are cohesive in nature. The above test can also be applied to understand whether the activities undertaken by an enterprise in a state are 'preparatory or auxiliary'.
- ***Analyzing arrangements entered through contractual agreements*** –A Commissionnaire arrangement may be broadly defined as an arrangement through which a person sells products in a State in its own name but on behalf of a foreign enterprise that is the owner of these products. Through such an arrangement, a foreign enterprise is able to sell its products in a State without technically having a permanent establishment to which such sales may be attributed for tax purposes and without, therefore, being taxable in that State on the profits derived from such sales. Since the person that concludes the sales does not own the products that it sells, that person cannot be taxed on the profits derived from such sales and may only be taxed on the remuneration that it receives for its services (usually a commission). Commissionnaire arrangements have been a major cause of concern for tax administrations in many countries.

Progress in implementation of BEPS Action Plan 7

The changes to the PE definitions were integrated in the 2017 OECD Model Tax Convention and in Part IV of the MLI (Articles 12 to 15). The Multilateral Instrument (MLI) is a flexible instrument that allows jurisdictions to adopt BEPS treaty-related measures to counter BEPS and strengthen their treaty network. The MLI was signed by nearly 90 jurisdictions and about half of the MLI Signatories have so far adopted the MLI articles that implement the permanent establishment changes [For detailed understanding of MLI, refer to discussion under Action 15].

(8) ACTION PLAN 8-10 - TRANSFER PRICING OUTCOMES IN LINE WITH VALUE CREATION/INTANGIBLES/RISK AND CAPITAL AND OTHER HIGH-RISK TRANSACTIONS

The aforesaid Action plans represent the OECD's work on transfer pricing which has been a core focus of the BEPS Action Plans. The specific Actions focus on Intangibles, Risks and capital and other high-risk transactions. These are the hard areas of transfer pricing and are summarized together in the Final Report 'Aligning Transfer Pricing Outcomes with Value Creation'.

Clarification and Strengthening of existing standards on transfer pricing

Transfer pricing rules, which are set out in Article 9 of tax treaties based on the OECD and UN Model Tax Conventions and the Transfer Pricing Guidelines, are used to determine on the basis of the ALP the conditions, including the price, for transactions within an MNE group. The existing standards in this area have been clarified and strengthened, including the guidance on the arm's length principle and an approach to ensure the appropriate pricing of hard-to-value-intangibles has been agreed upon within the arm's length principle. The work has focused on three key areas.

Action Plan	Details
8	Addresses transfer pricing issues relating to controlled transactions involving intangibles, since intangibles are by definition mobile and they are generally difficult-to-value. Misallocation of the profits generated by valuable intangibles is a significant cause of BEPS.
9	Contractual allocations of risk are respected only when they are supported by actual decision-making and thus exercising control over these risks. Moreover, Action 9 addresses the level of returns to funding provided by a capital-rich MNE group member, where those returns do not correspond to the level of activity undertaken by the funding company.
10	This action focuses on other high-risk areas, which include: the scope for addressing profit allocations resulting from controlled transactions which are not commercially rational, the scope for targeting the use of transfer pricing methods in a way which results in diverting profits from the most economically important activities of the MNE group, and the use of certain type of payments between members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with the value-creation.

OECD Transfer Pricing Guidelines

In addition, the OECD Transfer Pricing Guidelines released in 2017 provide guidance on the application of the "arm's length principle", which represents the international consensus on the valuation, for income tax purposes, of cross-border transactions between associated enterprises. In today's economy where multinational enterprises play an increasingly prominent role, transfer pricing continues to be high on the agenda of tax administrations and taxpayers alike. Governments need to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdiction and that the tax base reported by MNEs in their country reflects the economic activity undertaken therein and taxpayers need clear guidance on the proper application of the arm's length principle.

(9) ACTION PLAN 11 – MEASURING AND MONITORING BEPS

The adverse fiscal and economic impacts of BEPS have been the focus of the OECD/G20 BEPS Project since its inception. While anecdotal evidence has shown that tax planning activities of some multinational enterprises (MNEs) take advantage of the mismatches and gaps in the international tax rules, separating taxable profits from the underlying value-creating activity, The Addressing Base Erosion and Profit Shifting report (OECD, 2013) recognised that the scale of the negative global impacts on economic activity and government revenues have been uncertain.

Although measuring the scale of BEPS proves challenging given the complexity of BEPS and the serious data limitations, the fiscal effects of BEPS are significant. BEPS causes other adverse economic effects, including tilting the playing field in favour of tax-aggressive MNEs, exacerbating the corporate debt bias, misdirecting foreign direct investment, and reducing the financing of needed public infrastructure.

Indicators of BEPS activity

Six indicators of BEPS activity highlight BEPS behaviour using different sources of data, employing different metrics, and examining different BEPS channels. When combined and presented as a dashboard of indicators, they confirm the existence of BEPS, and its continued increase in scale in recent years.

(i) **The profit rates of MNE affiliates located in lower-tax countries are higher than their group's average worldwide profit rate.** For example, the profit rates reported by MNE affiliates located in lower-tax countries are twice as high as their group's worldwide profit rate on average.

(ii) **The effective tax rates paid by large MNE entities are estimated to be lower than similar enterprises with only domestic operations** - This tilts the playing-field against local businesses and non-tax aggressive MNEs, although some of this may be due to MNEs' greater utilisation of available country tax preferences.

(iii) **Foreign direct investment (FDI) is increasingly concentrated** - FDI in countries with net FDI to GDP ratios of more than 200% increased from 38 times higher than all other countries in 2005 to 99 times higher in 2012.

(iv) **The separation of taxable profits from the location of the value creating activity is particularly clear with respect to intangible assets, and the phenomenon has grown rapidly** - For example, the ratio of the value of royalties received to spending on research and development in a group of low-tax countries was six times higher than the average ratio for all other countries, and has increased three-fold between 2009 and 2012.

(v) **Royalties received by entities located in these low-tax countries accounted for 3% of total royalties** - This provides evidence of the existence of BEPS, though not a direct measurement of the scale of BEPS.

(vi) **Debt from both related and third-parties is more concentrated in MNE affiliates in higher statutory tax-rate countries**. The interest-to-income ratio for affiliates of the largest global MNEs in higher-tax rate countries is almost three times higher than their MNE's worldwide third-party interest-to-income ratio.

(10) ACTION PLAN 12 – DISCLOSURE OF AGGRESSIVE TAX PLANNING ARRANGEMENTS

A significant challenge faced by tax authorities worldwide is the lack of timely, comprehensive and relevant information on aggressive tax planning strategies. Timely access to such information would facilitate quick response to tax risks through informed risk assessment, audits, or changes to legislation or regulations. BEPS Action Plan 12 recognises the advantages of tools designed to facilitate the information flow on tax risks to tax administrations and tax policy makers. The Report provides a modular framework for guidance drawn from best practices for use by countries without mandatory disclosure rules to design a regime that suits their requirement to get early information on potentially aggressive or abusive tax planning schemes and their users. The recommendations in this Report do not represent a minimum standard and countries can decide whether or not to introduce mandatory disclosure regimes. Where a country opts for mandatory disclosure rules, the recommendations provide the necessary flexibility to balance a country's need for better and more timely information with the compliance burdens for taxpayers. It also sets out specific best practice recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and co-operation between tax administrations.

(11) ACTION PLAN 13 – RE-EXAMINE TRANSFER PRICING DOCUMENTATION

This report contains revised standards for transfer pricing documentation incorporating a master file, local file, and a template for country-by-country reporting of revenues, profits, taxes paid and certain measures of economic activity. The revised standardised approach requires taxpayers to articulate consistent transfer pricing positions and will provide tax administrations with useful information to assess transfer pricing and other BEPS risks, make determinations about where audit resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries. Country-by-country reports will be disseminated through an automatic government-to-government exchange mechanism. The implementation package included in this report sets out guidance to ensure that the reports are provided in a timely manner, that confidentiality is preserved and that the information is used appropriately, by incorporating model legislation and model Competent Authority Agreements forming the basis for government-to-government exchanges of the reports.

Requirements as per OECD report on Action 13 of BEPS Action Plan

The OECD report provides for:

(a) revised standards for transfer pricing documentation; and

(b) a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity.

Three-tier structure mandated by BEPS

The BEPS report recommends that countries adopt a standardised approach to transfer pricing documentation; it mandates the following three-tier structure:-

	Document	Information
(1)	Master File	Standardised information relevant for all multinational enterprises (MNE) group members. Master file requires MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies. The master file is to be delivered by MNEs directly to local tax administrations.
(2)	Local file	Local file requires maintaining of transactional information specific to each country in detail covering related-party transactions and the amounts involved in those transactions. In addition, relevant financial information regarding specific transactions, a comparability analysis and analysis of the selection and application of the most appropriate transfer pricing method should also be captured. The local file is to be delivered by MNEs directly to local tax administrations.
(3)	Country-by-country report	The BEPS Action 13 report provides a template for multinational enterprises (MNEs) to report annually and for each tax jurisdiction in which they do business the information set out therein. This report is called the Country-by-Country (CbC) Report. To facilitate the implementation of the CbC Reporting standard, the BEPS Action 13 report includes a CbC Reporting Implementation Package which consists of (i) model legislation which could be used by countries to require the ultimate parent entity of an MNE group to file the CbC Report in its jurisdiction of residence including backup filing requirements and (ii) three model Competent Authority Agreements that could be used to facilitate implementation of the exchange of CbC Reports, respectively based on the: a) Multilateral Convention on Administrative Assistance in Tax Matters; b) Bilateral tax conventions; and c) Tax Information Exchange Agreements (TIEAs).

		Following information are required in the CbC report: Information relating to the global allocation of the MNE's income and taxes paid; and Indicators of the location of economic activity within the MNE group. CBC report requires MNEs to provide an annual report of economic indicators viz. the amount of revenue, profit before income tax, income tax paid and accrued in relation to the tax jurisdiction in which they do business. CBC reports are required to be filed in the jurisdiction of tax residence of the ultimate parent entity, being subsequently shared between other jurisdictions through automatic exchange of information mechanism.

Advantages of the three-tier structure [as per BEPS Report]:

(a) Taxpayers will be required to articulate consistent transfer pricing positions;

(b) Tax administrations would get useful information to assess transfer pricing risks;

(c) Tax administrations would be able to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.

Indian Taxation Regime

Transfer Pricing provisions under the Income-tax Act, 1961

Chapter X of the Income-tax Act, 1961 comprising sections 92 to 92F contain provisions relating to transfer pricing regime.

Section 92D requires maintenance of prescribed information and document relating to the international transaction and specified domestic transaction by every person who has entered into an international transaction. ***Also, a constituent entity of an international group is required to keep and maintain the prescribed information and document in respect of the international group.***

Implementation of international consensus in India

India is one of the active members of BEPS initiative and part of international consensus. For the purpose of implementing the international consensus, a specific reporting regime in respect of CbC reporting and also the master file has been incorporated in the Income-tax Act, 1961. The essential elements have been incorporated in the Income-tax Act, 1961 while remaining aspects would be dealt with in detail in the Income-tax Rules, 1962.

Note – *Refer to Chapter 1 Transfer Pricing, wherein the following have been discussed at length -*

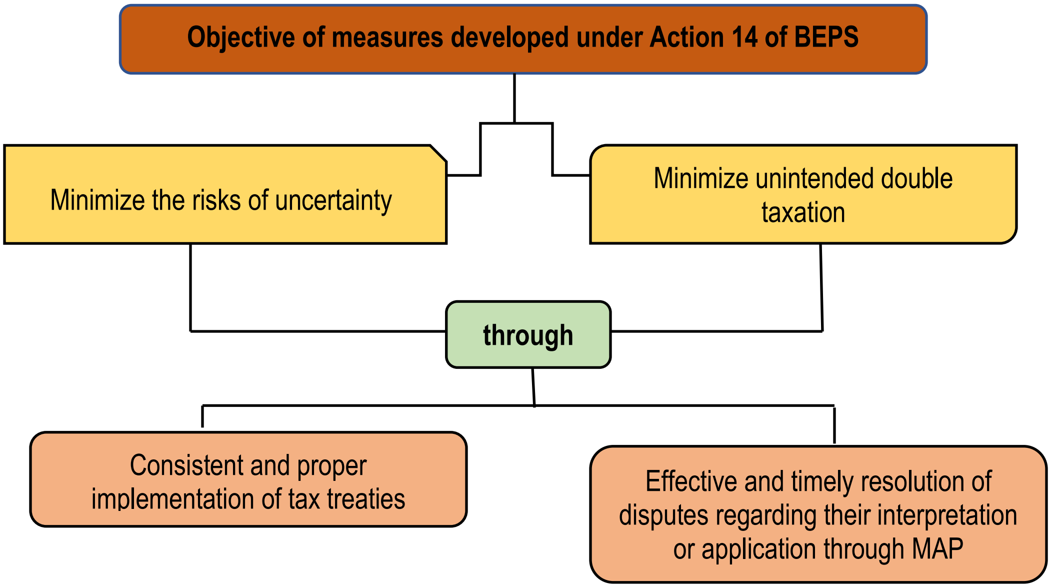
(i) Elements relating to CbC reporting requirement and related matters which have been incorporated in section 286 of the Income-tax Act, 1961

(ii) Maintenance and furnishing of Master file: Consequent provisions incorporated in section 92D of the Income-tax Act, 1961.

Threshold limit of consolidated group revenue for applicability of CbC reporting requirement

The CbC reporting requirement for a reporting year does not apply unless the consolidated revenues of the preceding accounting year of the group, based on consolidated financial statement, exceeds a threshold to be prescribed. The current international consensus is for a threshold of € 750 million equivalent in local currency. This threshold for total consolidated group revenue of the international group prescribed under section 286 of the Income-tax Act, 1961 read with Rule 10DB of the Income-tax Rules, 1962 is ₹ 5,500 crores.

(12) ACTION PLAN 14 – MAKING DISPUTE RESOLUTION MORE EFFECTIVE


Objective of measures developed under Action 14 of BEPS
Minimize the risks of uncertainty
Minimize unintended double taxation
through
Consistent and proper implementation of tax treaties
Effective and timely resolution of disputes regarding their interpretation or application through MAP

Eliminating opportunities for cross-border tax avoidance and evasion and the effective and efficient prevention of double taxation are significant to developing an international tax system that facilitates economic growth and a buoyant global economy. Countries concur that the measures introduced to address BEPS pursuant to the BEPS Action Plans should not result in unnecessary uncertainty for compliant taxpayers and in unintended double taxation. Improving dispute resolution mechanisms is, therefore, a critical component of the work on BEPS issues.

(13) ACTION PLAN 15 – DEVELOPING A MULTILATERAL INSTRUMENT

MLI's role in tackling BEPS

Abuse of tax treaties is an important source of BEPS. The MLI helps the fight against BEPS by implementing the tax treaty-related measures developed through the BEPS project in existing bilateral tax treaties in a synchronized and efficient manner. These measures will prevent treaty abuse, improve dispute resolution, prevent the artificial avoidance of permanent establishment status and neutralize the effects of hybrid mismatch arrangements.

Action 15 of the BEPS Action Plan provides for an analysis of the tax and public international law issues related to the development of a multilateral instrument to enable countries that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties.

Formation of ad hoc Group to develop MLI

Based on this analysis, a mandate for the formation of an ad hoc Group to develop a multilateral instrument on tax treaty measures to tackle BEPS, was approved by the OECD Committee on Fiscal Affairs and endorsed by the G20 Finance Ministers and Central Bank Governors in February 2015.

In line with Action 15 report, an ad-hoc group was formed with a pre-defined purpose of development of such Multilateral Instrument (MLI) and that adopted the text of the Convention and accompanying Explanatory Statement in November 2016. India was part of the Ad Hoc Group of more than 100 countries and jurisdictions from G20, OECD, BEPS associates and other interested countries, which worked on an equal footing on the finalization of the text of the Multilateral Convention, starting May 2015. The text of the Convention and the accompanying Explanatory Statement was adopted by the Ad hoc Group on 24th November 2016.

Signatories to the MLI

Once drafted, the said document was thereafter kept open for signatures from 31 December 2016. In the first signing ceremony of the MLI on 7th June, 2017, 67 countries have signed the MLI and 9 countries have expressed their intention to sign the instrument. As on 27th September, 2018, 84 countries have signed the MLI and 6 countries have expressed their intention to sign the instrument.

At the time of signature, signatories submitted a list of their tax treaties in force that they would like to designate as Covered Tax Agreements (CTAs), i.e. to be amended through the MLI.

The Convention enables all signatories, *inter alia*, to meet treaty-related minimum standards that were agreed as part of the Final BEPS package, including the minimum standard for the prevention of treaty abuse under Action 6.

Features of MLI

The Multilateral Convention is, thus, an outcome of the OECD / G20 Project to tackle Base Erosion and Profit Shifting (the "BEPS Project") i.e., tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

The MLI modifies tax treaties that are “Covered Tax Agreements”. A Covered Tax Agreement is an agreement for the avoidance of double taxation that is in force between Parties to the MLI and for which both Parties have made a notification that they wish to modify the agreement using the MLI.

The MLI is a flexible instrument which will modify tax treaties according to a jurisdiction's policy preferences with respect to the implementation of the tax treaty-related BEPS measures. The MLI provides for different types of flexibility:

(i) jurisdictions can choose amongst alternative provisions in certain MLI articles;

(ii) jurisdictions can choose to apply optional provisions (for instance, the provisions on mandatory binding arbitration);

(iii) jurisdictions may also choose to reserve the right not to apply MLI provisions (to opt out through a "reservation") with respect to all of their Covered Tax Agreements or with respect to a subset of their Covered Tax Agreements. Jurisdictions only have the possibility to opt out of provisions that do not reflect a BEPS minimum standard, with the possibility to withdraw their reservation (and opt in) later.

Amendment of MLI position

The provisional MLI position of each Signatory indicates the tax treaties it intends to cover, the options it has chosen and the reservations it has made. Signatories can amend their MLI position until ratification. Even after ratification, parties can choose to opt in with respect to optional provisions or to withdraw reservations.

Indian Taxation Regime

The Multilateral Convention to implement tax treaty related measures to prevent Base Erosion and Profit Shifting (BEPS) was signed by India at Paris, France on 7th June, 2017. India had ratified the said Convention and had deposited the instrument of ratification along-with the list of Covered Tax Agreements, reservations and notifications (India's Position under the said Convention) to the Depositary on 25th June, 2019. The date of entry into force of the said Convention for India is 1st October, 2019, being the first day of the month following the expiry of a period of three calendar months beginning on 25th June, 2019, being the date of deposit by India of the instrument of ratification.

The provisions of the said Convention would have effect in India with respect to a Covered Tax Agreement in accordance with the provisions of Article 35 of the said Convention. Accordingly, in exercise of the powers conferred by section 90(1) of the Income-tax Act, 1961, the Central Government has, vide Notification No.57/2019 dated 9.8.2019 (available at https://www.incometaxindia.gov.in/communications/notification/notification57_2019.pdf*), notified that the provisions of the said Convention shall be given effect to in the Union of India, in accordance with India's Position under the said Convention, as set out in the Annexure thereto.*

As per Article 35 of the MLI, the provisions of this Convention shall have effect in each Contracting Jurisdiction with respect to a Covered Tax Agreement:

a) *with respect to taxes withheld at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs* ***on or after the first day of the next calendar year*** *that begins on or after the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement; and*

b) *with respect to all other taxes levied by that Contracting Jurisdiction, for taxes levied with respect to taxable periods beginning* ***on or after*** **the expiration of a period of six calendar months** (or a shorter period, if all Contracting Jurisdictions notify the Depositary that they intend to apply such shorter period) from the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement.

Therefore, the earliest date when the provisions of this Convention can take effect in India is 1st April, 2020 (six months from 1st October, 2019, the date of entry into force for India)[1]*.*

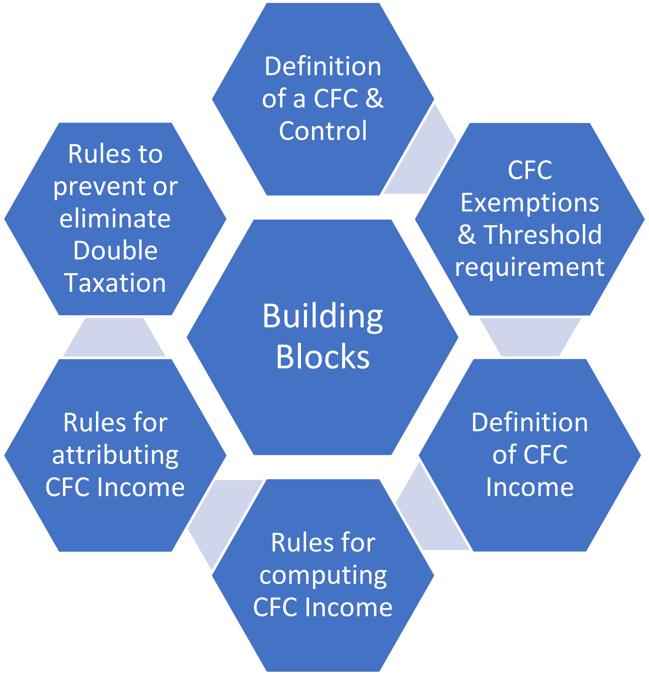
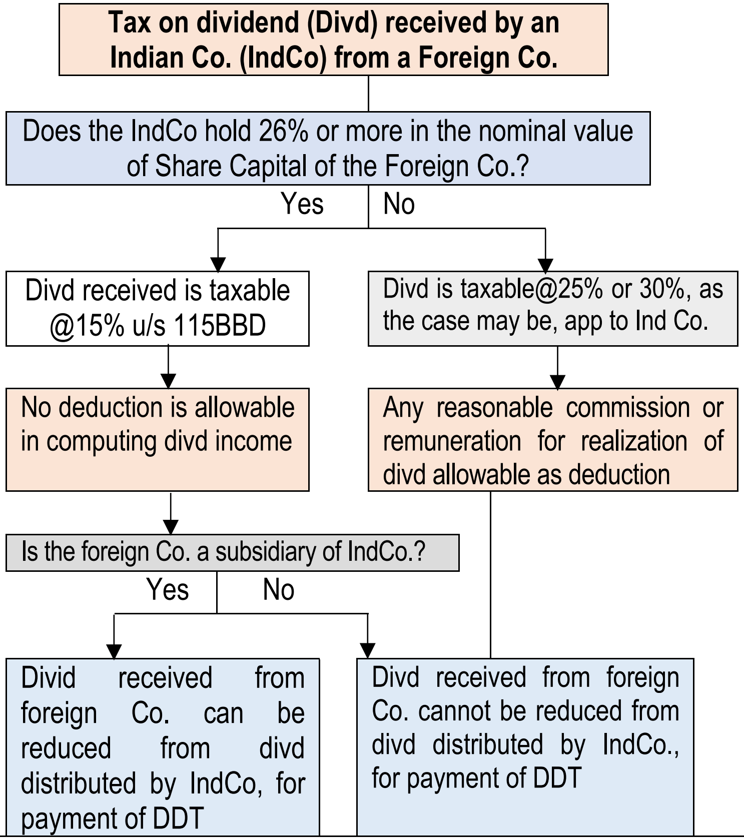
Resources: The discussion on BEPS Action Plans contained in this chapter is essentially based on the Action Plans developed in the context of the OECD/G20 BEPS Project and available at the website http://www.oecd.org/tax/beps/beps-actions.htm

[1] Since the provisions of this Convention takes effect only from F.Y.2020-21, the same have not been discussed in detail in this Study Material.

SUMMARY

<table>
<tr><th colspan="4">BEPS Action Plan 1 : Addressing the challenges of the digital economy</th></tr>
<tr><th colspan="2">OECD Recommendation</th><th colspan="2">Provision incorporated in Indian Tax Laws</th></tr>
<tr><td rowspan="3">i</td><td rowspan="3">Modifying existing Permanent Establishment (PE) rule to provide whether an enterprise engaged in fully de-materialized digital activities would constitute a PE if it maintained significant digital presence in another country's economy</td><td colspan="2">**“Significant economic presence” (SEP) to constitute “business connection”**</td></tr>
<tr><td>**Upto A.Y.2018-19**</td><td>**From A.Y.2019-20**</td></tr>
<tr><td rowspan="2">As per sec 9(1)(i) of the Income-tax Act, 1961, as it stood prior to amendment by the Finance Act, 2018, physical presence in India was necessary to fall within the scope of “business connection” to attract deemed accrual provisions for income of Non-resident to be subject to tax in India.</td><td rowspan="2">The Finance Act, 2018 has amended section 9(1)(i) to provide that **significant economic presence** would also constitute **business connection** from A.Y.2019-20[2].</td></tr>
<tr><td>ii</td><td>A virtual fixed place of business PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction & carries on business through that website.</td></tr>
<tr><td>iii</td><td>Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider</td><td colspan="2" rowspan="2">**Equalisation Levy**
Chapter VIII of the Finance Act, 2016 provides for Equalisation levy@6% of the amount of consideration for specified services received or receivable by a Non-resident not having PE in India or providing services not effectively connected with PE in India, from:
• a resident in India who carries on business or profession or
• from a Non-resident having PE in India.
The Resident or Non-resident having PE in India has to deduct Equalisation Levy@6% from consideration for specified services paid to Non-resident and remit the same to the Central Government within the prescribed time.</td></tr>
<tr><td>iv</td><td>Imposition of a Equalisation Levy on consideration for certain digital transactions received by a Non-resident from a resident or Non-resident having PE in the other contracting state</td></tr>
</table>

[2] Rules in this regard are yet to be notified

BEPS Action Plan 3: Strengthen CFC rules	
OECD Recommendation	**Provisions incorporated in the Income-tax Act, 1961**
CFCs are foreign subsidiaries in tax havens in which the taxpayer has controlling interest. Since tax is generally levied on distributed dividend, tax in parent country could be avoided until the tax haven country actually paid dividend to the shareholders. The OECD regards CFC Rules as important in tackling BEPS and has made a series of best practice recommendations in relation to the building blocks of an effective CFC regime.  Definition of a CFC & Control CFC Exemptions & Threshold requirement Definition of CFC Income Rules for computing CFC Income Rules for attributing CFC Income Rules to prevent or eliminate Double Taxation Building Blocks	There are no CFC Rules in the Income-tax Act, 1961. However, section 115BBD has been inserted in Income-tax Act, 1961 to encourage repatriation of profits by Indian companies which have significant voting power in foreign Companies.  Tax on dividend (Divd) received by an Indian Co. (IndCo) from a Foreign Co. Does the IndCo hold 26% or more in the nominal value of Share Capital of the Foreign Co.? Yes No Divd received is taxable @15% u/s 115BBD Divd is taxable@25% or 30%, as the case may be, app to Ind Co. No deduction is allowable in computing divd income Any reasonable commission or remuneration for realization of divd allowable as deduction Is the foreign Co. a subsidiary of IndCo.? Yes No Divid received from foreign Co. can be reduced from divd distributed by IndCo, for payment of DDT Divd received from foreign Co. cannot be reduced from divd distributed by IndCo., for payment of DDT

BEPS Action Plan 4: Interest deductions and other financial payments

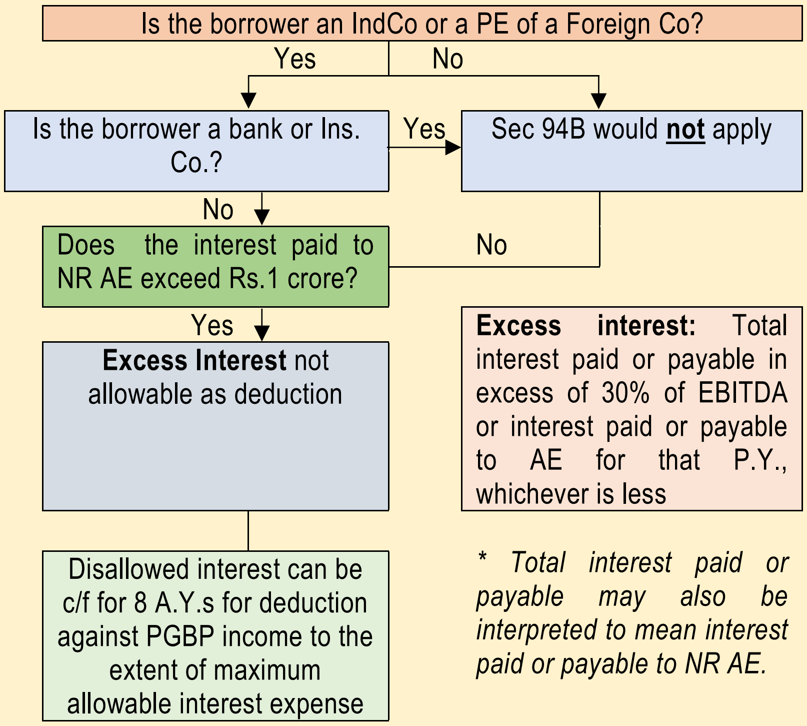
Common Approach in 2015 Report

The common approach which directly links an entity's net interest deductions to its level of economic activity, based on taxable EBITDA includes three elements:

	Rule	Basis
i	Fixed Ratio Rule	based on benchmark net interest/EBITDA Ratio
ii	Group Ratio Rule	allows an entity to deduct more interest expense based on the position of its world wide group
iii	Targeted Rules	address specific risks

Provisions incorporated in the Income-tax Act, 1961

Sec 94B – Limitation of interest deduction [based on Fixed Ratio Rule]



Is the borrower an IndCo or a PE of a Foreign Co?

Yes

No

Is the borrower a bank or Ins. Co.?

Yes

Sec 94B would **not** apply

No

Does the interest paid to NR AE exceed Rs.1 crore?

No

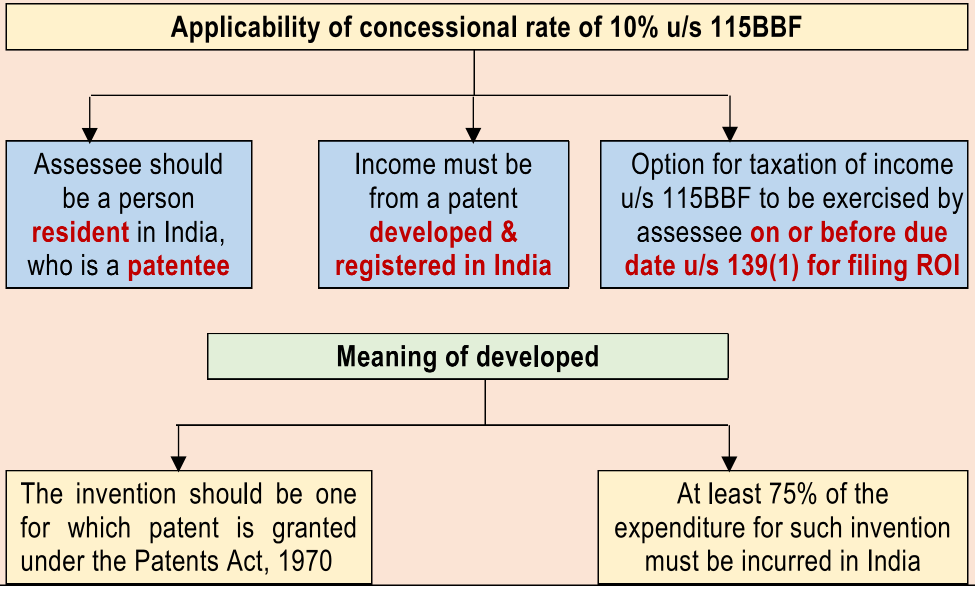
Yes

Excess Interest not allowable as deduction

Disallowed interest can be c/f for 8 A.Y.s for deduction against PGBP income to the extent of maximum allowable interest expense

Excess interest: Total interest paid or payable in excess of 30% of EBITDA or interest paid or payable to AE for that P.Y., whichever is less

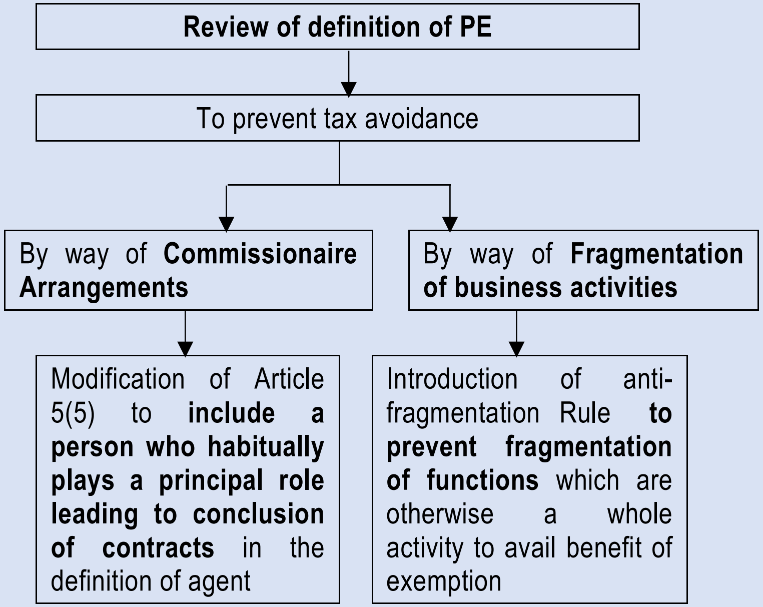
** Total interest paid or payable may also be interpreted to mean interest paid or payable to NR AE.*

BEPS Action Plan 5: Counter harmful tax practices	
OECD BEPS Action 5 Report	**Provisions incorporated in the Income-tax Act, 1961**
Action 5 report identifies factors for determining a potential harmful tax practice that results in low or no effective tax rate, lack of transparency, negotiable tax rate or base etc. For instance, in case of R&D activities, the nexus approach recommended by the OECD under BEPS Action 5 requires attribution and taxation of income arising from exploitation of IP in the jurisdiction where substantial R & D activities are undertaken instead of the jurisdiction of legal ownership.	**Sec 115BBF of the Income-tax Act, 1961 – Tax on income from patent** Where the Total Income of the eligible assessee includes any income by way of royalty in respect of a patent developed & registered in India, then, such royalty is taxable@ 10% (plus applicable surcharge & cess).  **Applicability of concessional rate of 10% u/s 115BBF** Assessee should be a person **resident** in India, who is a **patentee** Income must be from a patent **developed & registered in India** Option for taxation of income u/s 115BBF to be exercised by assessee **on or before due date u/s 139(1) for filing ROI** **Meaning of developed** The invention should be one for which patent is granted under the Patents Act, 1970 At least 75% of the expenditure for such invention must be incurred in India

BEPS Action Plan 6: Preventing treaty abuse	
OECD Minimum Standard	**LoB clause incorporated in Indian Tax Treaties**
Given the risk to revenues posed by treaty shopping, countries have committed to ensure a minimum level of protection against treaty shopping by including in their treaties: (i) the combined approach of **Limitation of Benefits (LOB)** and **Principal Purpose Test (PPT)** rule, (ii) the **PPT rule** alone, or (iii) the **LOB rule** supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties	**LoB clause in India-Mauritius Tax Treaty** • On 10.5.2016, the India-Mauritius tax treaty was amended and for the first time, it has been provided that gains from the alienation of shares acquired on or after 1.4.2017 in a company which is a resident of India may be taxed in India. • The tax rate on such capital gains arising from 1.4.2017-31.3.2019 should, however, not exceed 50% of the applicable tax rate on capital gains in India. • LOB Clause provides that a resident of a Contracting State shall not be entitled to the benefits of 50% of the tax rate applicable in transition period if its affairs are arranged with the primary purpose of taking advantage of concessional rate of tax. • A shell or a conduit Co. claiming to be a resident of a Contracting State shall not be entitled to this benefit. • A shell or conduit Co. is any legal entity falling within the meaning of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State. **LoB clause in India-Singapore Tax Treaty** • The India-Singapore tax treaty has been amended to provide that capital gains on alienation of shares would be taxable in a similar manner as laid out in India-Mauritius tax treaty, subject to LoB clause. • The transition period benefit is also similar to that contained in India-Mauritius Tax Treaty.

BEPS Action Plan 7: Prevent the Artificial Avoidance of PE Status

OECD Recommendation



Review of definition of PE

To prevent tax avoidance

By way of **Commissionaire Arrangements**

Modification of Article 5(5) to **include a person who habitually plays a principal role leading to conclusion of contracts** in the definition of agent

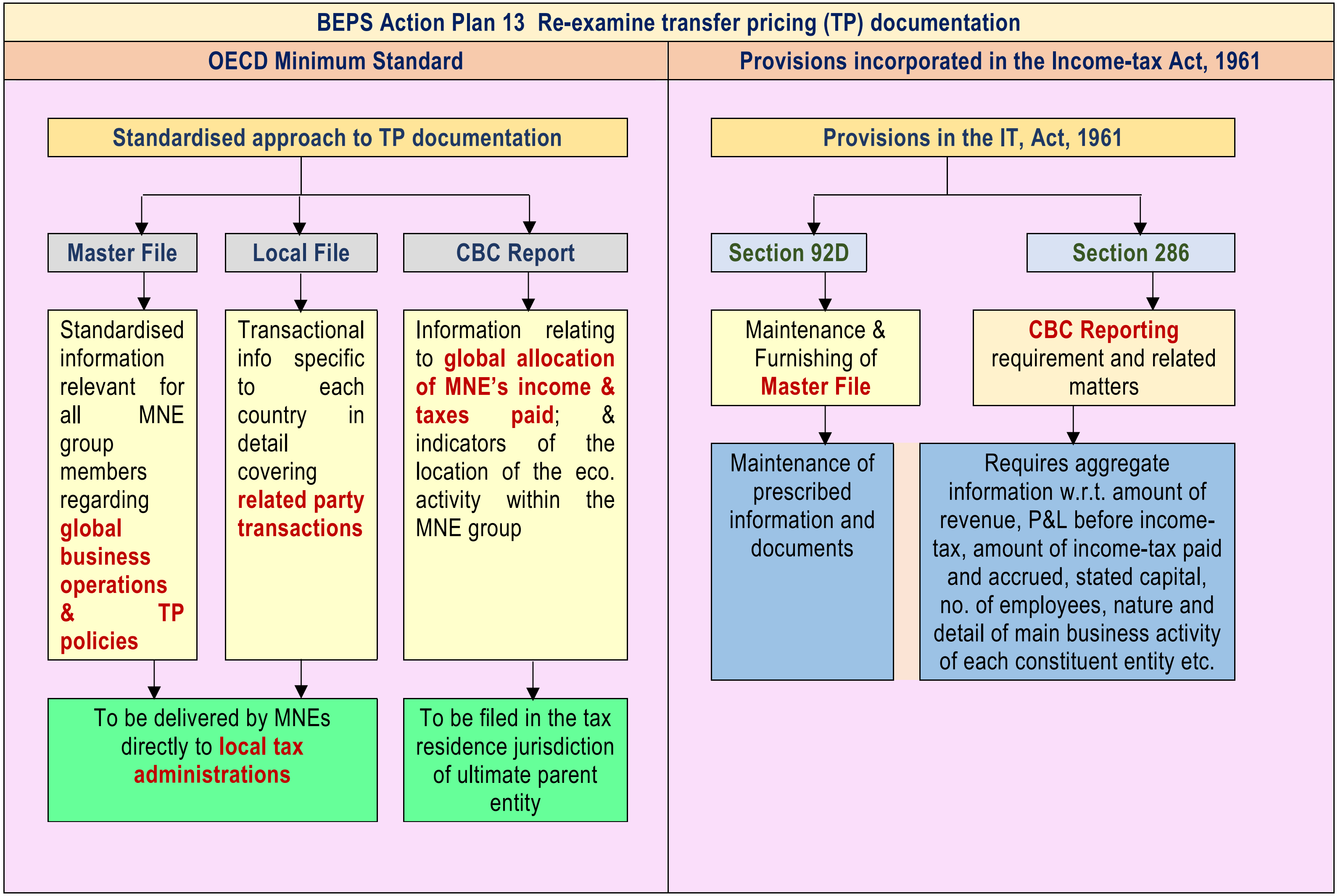
By way of **Fragmentation of business activities**

Introduction of anti-fragmentation Rule **to prevent fragmentation of functions** which are otherwise a whole activity to avail benefit of exemption

Provision incorporated in the Income-tax Act, 1961

Expanding the scope of business connection (BC) u/s 9(1)(i) of Income-tax Act, 1961

Upto A.Y.2018-19	From A.Y.2019-20
BC is established, inter alia, where a person acting on behalf of NR has and habitually exercises the authority to conclude contracts on behalf of the NR.	BC also include any business activities carried through a person who, acting on behalf of the NR, habitually concludes contracts or **habitually plays the principal role leading to conclusion of contracts** by the NR. Such contracts should be- (i) in the name of the NR; or (ii) for transfer of ownership of, or for the granting of right to use, property owned by that NR or that the NR has the right to use; or (iii) for provision of services by that NR



BEPS Action Plan 13 Re-examine transfer pricing (TP) documentation

OECD Minimum Standard

Standardised approach to TP documentation

- Master File → Standardised information relevant for all MNE group members regarding **global business operations & TP policies**
- Local File → Transactional info specific to each country in detail covering **related party transactions**
- Master File and Local File → To be delivered by MNEs directly to **local tax administrations**
- CBC Report → Information relating to **global allocation of MNE's income & taxes paid**; & indicators of the location of the eco. activity within the MNE group → To be filed in the tax residence jurisdiction of ultimate parent entity

Provisions incorporated in the Income-tax Act, 1961

Provisions in the IT, Act, 1961

- Section 92D → Maintenance & Furnishing of **Master File** → Maintenance of prescribed information and documents
- Section 286 → **CBC Reporting** requirement and related matters → Requires aggregate information w.r.t. amount of revenue, P&L before income-tax, amount of income-tax paid and accrued, stated capital, no. of employees, nature and detail of main business activity of each constituent entity etc.

BEPS Action Plan 15 Developing a Multilateral Instrument (MLI)	
BEPS Report	**Entry into Force of MLI**
The MLI helps fight against BEPS by implementing tax treaty-related measures developed through the BEPS Project in existing bilateral treaties in a synchronized and efficient manner to – • **prevent treaty abuse,** • **improve dispute resolution** • **prevent the artificial avoidance of PE status** • **neutralize the effects of hybrid mismatch arrangements**. The MLI is flexible instrument which modifies tax treaties that are "**Covered Tax Agreements**". A Covered Tax Agreement is an agreement for the avoidance of double taxation that is in force between Parties to the MLI and for which both Parties have made a notification that they wish to modify the agreement using the MLI.	➢ The Multilateral Convention to implement tax treaty related measures to prevent Base Erosion and Profit Shifting (BEPS) was signed by India at Paris, France on 7th June, 2017. ➢ India had ratified the said Convention and had deposited the instrument of ratification along-with the list of Covered Tax Agreements, reservations and notifications (India's Position under the said Convention) to the Depositary on 25th June, 2019. ➢ The date of entry into force of the said Convention for India is 1st October, 2019, being the first day of the month following the expiry of a period of three calendar months beginning on 25th June, 2019, being the date of deposit by India of the instrument of ratification. ➢ The earliest date when the provisions of this Convention can take effect in India is 1st April, 2020 (six months from 1st October, 2019, the date of entry into force for India)

EXERCISE

Question 1

What do you understand by base erosion and profit shifting? Describe briefly its adverse effects.

Answer

Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid.

Adverse Effects of BEPS:

(1) Governments have to cope with less revenue and a higher cost to ensure compliance.

(2) In developing countries, the lack of tax revenue leads to significant under-funding of public investment that could help foster economic growth.

(3) BEPS undermines the integrity of the tax system, as reporting of low corporate taxes is considered to be unfair. When tax laws permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers, especially individual taxpayers in that jurisdiction bear a greater share of the burden. This gives rise to tax fairness issues on account of individuals having to bear a higher tax burden.

(4) Enterprises that operate only in domestic markets, including family-owned businesses or new innovative businesses, may have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

Question 2

What are the significant OECD Recommendations under Action Plan 1 of BEPS? Which recommendation has been adopted in Indian tax laws?

Answer

The OECD has recommended several options to tackle the direct tax challenges which include:

(1) Modifying the existing Permanent Establishment (PE) rule to provide that whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.

(2) A virtual fixed place of business PE in the concept of PE i.e., creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.

(3) Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having permanent establishment in other contracting state.

Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.

In order to address these challenges, Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

Meaning of "Specified Service":

(1) Online advertisement;

(2) Any provision for digital advertising space or any other facility or service for the purpose of online advertisement;

Specified Service also includes any other service as may be notified by the Central Government.

Further, in order to reduce burden of small players in the digital domain, it is also provided that no such levy shall be made if the aggregate amount of consideration for specified services received or receivable by a non-resident from a person resident in India or from a non-resident having a permanent establishment in India does not exceed ₹ 1 lakh in any previous year.

Note: The Finance Act, 2018 has amended section 9(1)(i) to provide that significant economic presence would also constitute business connection from A.Y.2019-20. However, Rules in this regard are yet to be notified

Question 3

Discuss the provision incorporated in the Income-tax Act, 1961 in line with the OECD recommendations under Action Plan 4 of BEPS.

Answer

In line with the recommendations of OECD BEPS Action Plan 4, section 94B has been inserted in the Income-tax Act, 1961 by the Finance Act, 2017 to provide a cap on the interest expense that can be claimed by an entity to its associated enterprise. The total interest paid in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise for that previous year, whichever is less, shall not be deductible.

The provision is applicable to an Indian company, or a permanent establishment of a foreign company, being the borrower, who pays interest in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower. Further, the debt is deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender, being a non-associated enterprise, or deposits a corresponding and matching amount of funds with such lender.

The provision allows for carry forward of disallowed interest expense for 8 assessment years immediately succeeding the assessment year for which the disallowance is first made and deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure.

In order to target only large interest payments, it provides for a threshold of interest expenditure of ₹ 1 crore in respect of any debt issued by a non-resident associated enterprise exceeding which the provision would be applicable. Banks and Insurance business are excluded from the ambit of the said provisions keeping in view of special nature of these businesses.

Question 4

Describe the three tier structure for transfer pricing documentation mandated by BEPS Action Plan 13.

Answer

Action 13 contains a three-tiered standardized approach to transfer pricing documentation which consists of:

(a) **Master file**: Master file requires MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies. The master file is to be delivered by MNEs directly to local tax administrations.

(b) **Local file**: Local file requires maintaining of transactional information specific to each country in detail covering related-party transactions and the amounts involved in those transactions. In addition, relevant financial information regarding specific transactions, a comparability analysis and analysis of the selection and application of the most appropriate transfer pricing method should also be captured. The local file is to be delivered by MNEs directly to local tax administrations.

(c) **Country-by-country (CBC) report**: CBC report requires MNEs to provide an annual report of economic indicators viz. the amount of revenue, profit before income tax, income tax paid and accrued in relation to the tax jurisdiction in which they do business. CBC reports are required to be filed in the jurisdiction of tax residence of the ultimate parent entity, being subsequently shared between other jurisdictions through automatic exchange of information mechanism.

Question 5

Explain the nexus approach recommended by OECD in BEPS Action Plan 5 which has been adopted in the Income-tax Act, 1961.

Answer

In India, the Finance Act, 2016 has introduced a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development. The purpose of the concessional taxation regime is to encourage entities to retain and commercialise existing patents and for developing new innovative patented products. Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture and exploitation of patents in India.

The nexus approach has been recommended by the OECD under BEPS Action Plan 5. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. Accordingly, section 115BBF has been inserted in the Income-tax Act, 1961 to provide that where the total income of the eligible assessee (being a person resident in India who is the true and first inventor of the invention and whose name is entered in the patent register as the patentee in accordance with the Patents Act, 1970 and includes every such person, being the true and the first inventor of the invention, where more than one person is registered as patentee under Patents Act, 1970 in respect of that patent.) includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess). For this purpose, developed means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

Question 6

What are the ways in which hybrid mismatch arrangements are used to achieve unintended double non-taxation or long-term tax deferral?

Answer

Hybrid mismatch arrangements are sometimes used to achieve unintended double non-taxation or long-term tax deferral in one or more of the following ways -

(1) Creation of two deductions for a single borrowal;

(2) Generation of deductions without corresponding income inclusions;

(3) Misuse of foreign tax credit; and

(4) Participation exemption regimes.

CHAPTER 8

OVERVIEW OF MODEL TAX CONVENTIONS

LEARNING OUTCOMES

After studying this chapter, you would be able to:

- **appreciate** the need for Model Tax Convention;
- **appreciate** the key features of the OECD and UN Model Tax Conventions;
- **identify** the subject of the various articles of the OECD and UN Model Tax Conventions;
- **appreciate** the broad similarities and differences between the principles enshrined in certain articles of the OECD Model Tax Convention *vis-à-vis* the corresponding articles of the UN Model Tax Convention.

8.1 INTRODUCTION

In order to enable various countries to enter into treaties, which are standardized to some extent, Organization for Economic Cooperation and Development (OECD) and the United Nations (UN) have developed certain Model Tax Treaties. These treaties can be used by various countries as a starting point in their negotiations with other countries. While these Models are not legally binding, they have been extensively used by various countries as a reference point while entering into Tax Treaties. In some cases, they have been incorporated verbatim or with minor changes. However, in other cases, countries have made suitable changes in the draft model according to their economic environment and commercial and tax considerations.

The significant model conventions have been briefly discussed hereunder:

→ **OECD Model** - The emergence of present form of OECD Model Convention can be traced back to 1927, when the Fiscal Committee of the League of Nations prepared the first draft of Model Form applicable to all countries. In 1946 the model convention was published in Geneva by the Fiscal Committee of U.N. Social & Economic Council and later by the Organisation for European Economic Co-operation (O.E.E.C) in 1963. However, in 1961, the Organisation for Economic Co-operation and Development (O.E.C.D) was established, with developed countries as its members, to succeed the O.E.E.C., and OECD approved the draft presented to the OEEC. In 1977, the final draft was prepared in the present form which has been revised several times; the latest being in the year 2017.

OECD Model is essentially a model treaty **between two developed nations.** This model advocates the residence principle, i.e., it lays emphasis on the right of state of residence to tax the income.

→ **UN Model** – In 1968, the United Nations set up an Adhoc Group of Experts from various developed and developing countries to prepare a draft model convention between developed and developing countries. In 1980, this Group finalised the UN Model Convention in its present form. It has further been revised a number of times, the latest being in the year 2017.

The UN Model is a compromise between the source principle and the residence principle. However, it gives more weight to the source principle as against the residence principle of the OECD Model. UN Model is designed to encourage flow of investments from the developed countries to developing countries. It takes into account sharing of tax-revenue with the country providing capital.

The United Nations Model Convention seeks to be balanced in its approach. As a corollary to the principle of taxation at source, the Articles of the Convention are based on a recognition by the source country that

(a) taxation of income from foreign capital should take into account expenses allocable to the earnings of the income so that such income is taxed on a net basis,

(b) taxation should not be so high as to discourage investment and

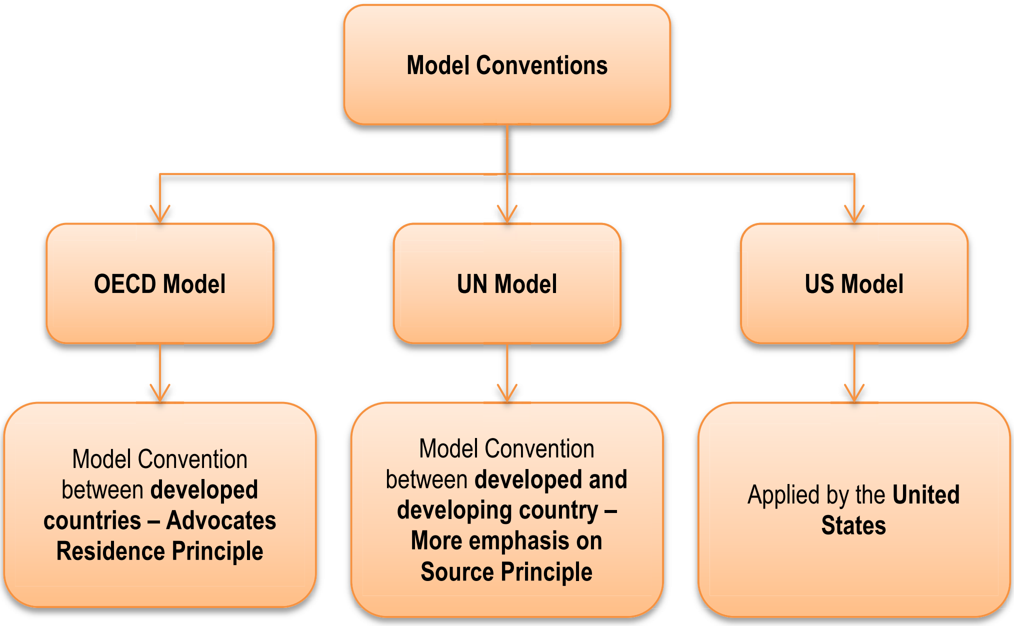
(c) it should take into account the appropriateness of the sharing of revenue with the country providing the capital.

In addition, the United Nations Model Convention embodies the idea that it would be appropriate for the residence country to extend a measure of relief from double taxation through either a foreign tax credit or an exemption, as is also the case with the OECD Model Convention.

→ **US Model** – This Model Convention is used by the United States while entering into tax treaties with various countries. The US Model Convention has been revised in the year 2016.

These Models have a significant influence on international treaty practice, and have important common provisions. The similarities between these Models highlight the areas of consistency. The areas of divergence indicate some critical differences in approach or emphasis which need special focus. These differences are mainly in relation to the taxing rights which would be available to a country under domestic law and the extent to which any country should forego, under a bilateral tax treaty, in order to avoid double taxation and encourage investment.

The above model conventions have been illustrated in the following diagram:


Model Conventions
OECD Model
UN Model
US Model
Model Convention between developed countries – Advocates Residence Principle
Model Convention between developed and developing country – More emphasis on Source Principle
Applied by the United States

OECD Model contains VII chapters comprise of 32 articles and UN Model also contains VII chapters but comprise of 31 articles. List of articles of OECD MC and UN MC is given below:

Article	OECD Model, 2017	UN Model, 2017
	Chapter I : Scope of the Convention	
1	Persons covered	Persons covered
2	Taxes covered	Taxes covered
	Chapter II : Definitions	
3	General definitions	General definitions
4	Resident	Resident
5	Permanent establishment	Permanent establishment
	Chapter III : Taxation of Income	
6	Income from immovable property	Income from immovable property
7	Business profits	Business profits
8	International shipping and air transport	International shipping and air transport (Alternatives A & B)
9	Associated enterprises	Associated enterprises
10	Dividends	Dividends
11	Interest	Interest
12	Royalties	Royalties
12A		Fees for technical services
13	Capital gains	Capital gains
14		Independent personal services
15	Income from employment	Dependent personal services
16	Directors' fees	Directors' fees and remuneration of top-level managerial officials
17	Entertainers and sportspersons	Artistes and sportspersons
18	Pensions	Pensions and social security payments (Alternatives A & B)
19	Government service	Government service
20	Students	Students

21	Other income	Other income
	Chapter IV : Taxation of Capital	
22	Capital	Capital
	Chapter V : Methods for the Elimination of Double Taxation	
23A	Exemption method	Exemption method
23B	Credit method	Credit method
	Chapter VI : Special Provisions	
24	Non-discrimination	Non-discrimination
25	Mutual agreement procedure	Mutual agreement procedure (Alternatives A & B)
26	Exchange of information	Exchange of information
27	Assistance in the collection of taxes	Assistance in the collection of taxes
28	Members of diplomatic missions and consular posts	Members of diplomatic missions and consular posts
29	Entitlement to benefits	Entitlement to benefits
30	Territorial extension	Entry into force
	Chapter VII : Final Provisions	
31	Entry into force	Termination
32	Termination	

Now, let us discuss the comparative analysis of some of the significant Articles in the Model Tax conventions

8.2 COMPARATIVE ANALYSIS OF SOME OF THE SIGNIFICANT ARTICLES OF OECD AND UN MODEL CONVENTIONS

Title and Preamble to the Model Conventions

The title of the UN Model Convention reads as follows:

"Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and capital and the prevention of tax avoidance and evasion"

There is now a specific reference to "the prevention of tax avoidance and evasion" in the title to emphasize its significance in the Model Convention.

The Preamble to the UN Model Convention reads as follows:

"(State A) and (State B),

Desiring to further develop their economic relationship and to enhance their cooperation in tax matters,

Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax avoidance or evasion (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)"

The Title and Preamble to the OECD Model Convention is almost identical to that of the UN Model Convention. The only minor difference is the reference to "tax evasion and avoidance" in the place of "tax avoidance and evasion" in the Title and Preamble.

The Preamble now clearly indicates that the UN and OECD Model Conventions do not intend to create opportunities for non-taxation or reduced taxation through tax avoidance or evasion including through treaty shopping arrangements.

This language of the Preamble would help ensuring that the provisions of the Conventions are interpreted and applied to prevent abusive treaty shopping arrangements.

Significant Articles in the Model Conventions

Over the years, both Model Conventions have seen a lot of convergence and the language is identical in quite a few Articles. However, there are key differences in approach and language in some Articles which will be the focus of our discussion, in the section below.

The jurisdiction or country of residence of the taxpayer is referred to as the Residence State and the jurisdiction or country where the source of income is located is referred to as the Source State.

Article 1: Persons Covered

The OECD and UN Model Convention would apply to persons who are residents of one or both of the Contracting States.

For the purposes of these Conventions, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State. However, the same would be treated as income only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.

Example

State A and State B have concluded a treaty identical to the Model Tax Convention. State A considers that an entity established in State B is a company, and taxes that entity on interest *that it receives from a debtor resident in State A. Under the domestic law of State B, however, the entity is treated as a partnership, and the two members in that entity, who share equally all its income, are each taxed on half of the interest. One of the members is a resident of State B and the other one is a resident of a country with which States A and B do not have a treaty. The paragraph provides that in such case, half of the interest shall be considered, for the purposes of Article 11, to be income of a resident of State B.*

***Note** – The above example forms part of the Commentary to the UN Model Tax Convention.*

With the exception of benefits granted under certain Articles of these conventions, these Conventions would not affect the taxation, by a Contracting State, of its resident.

Article 2: Taxes Covered

The OECD and UN Conventions would apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

Taxes on income and on capital cover all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

The existing taxes to which the Conventions would apply in case of each Contracting State are specifically to be mentioned.

The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of significant changes made to their tax law.

Article 4: Residence

A taxpayer has to demonstrate that he is a resident of one or both Contracting States to be able to gain access to a tax treaty and avail the benefits thereunder.

The concept of 'resident of a Contracting State' has various functions and assumes significance in the following three scenarios:

- In determining a convention's scope of application;
- In solving cases where double taxation arises as a consequence of double residence;
- In solving cases where double taxation arises as a consequence of taxation in the state of residence and also in the state of source of income.

As per paragraph 1 of the UN Model Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

Paragraph 1 of the OECD Model Convention is worded on similar lines. However, it does not contain reference to place of incorporation.

Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows:

(a) He shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);

(b) If the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;

(c) If he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;

(d) If he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

As per paragraph 3 of this Article, where by reason of the provisions of paragraph 1, a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement, the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention. They shall do so having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such mutual agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

The situation of dual residence may arise in case of companies in case where one Contracting State attaches importance to the place of incorporation and the other State to the place of effective management. The tie-breaker rule traditionally has been ‘place of effective management’. Even India has used place of effective management in some of its treaties. In the latest update by OECD and UN, this has changed to a case by case approach considering the number of tax avoidance cases involving dual resident companies. Determination under the case by case approach will be requested by the concerned taxpayer through Article 25 (Mutual Agreement Procedure). Competent authorities will then rely on a range of factors to resolve the question of dual residency.

The last sentence of paragraph 3 of this Article provides that in the absence of mutual agreement, the taxpayer would not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States. This will not, however, prevent the taxpayer from being considered a resident of each Contracting State for purposes other than granting treaty reliefs or exemptions to that person.

Article 5: Permanent Establishment

The concept of “Permanent Establishment” (PE), defined in Article 5, has considerable importance as business profits (Article 7) of an enterprise cannot be taxed by a Source State unless it proves the existence of a PE.

The comparable term to PE under the Indian tax law is “business connection” [Section 9(1)(i)]. Generally speaking, the concept of “business connection” is wider than PE and hence, a business connection may exist even without a PE, but the absence of a “business connection” may indicate absence of a PE.

As the PE concept gives the Source State the right to tax, it is an important Article for developing countries. Hence, the UN Model Convention varies from the OECD Model Convention in the following respects:

- As per Article 5(3)(a) of the OECD Model Convention, a building site or construction or installation project constitutes a PE if it lasts more than twelve months. The UN Model Convention is wider as it covers “assembly and installation project” and “supervisory” activities in connection thereto and requires the activity in question to continue only for six months.

- Article 5(3)(b) of the UN Model makes a specific reference to Service PE which is absent in the OECD Model. Article 5(3)(b) of the UN Model reads as follows –

  “The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12 month period commencing or ending in the fiscal year concerned”.

  In the absence of a Service PE reference in OECD Model, the presence has to be ascertained through general principles under Article 5(1).

- Article 5(1) states the "basic rule" for a PE and expresses the primary meaning of PE. The definition of PE in Article 5 does not use the qualifying words "unless the context otherwise requires". As such, the definition needs to be followed in all cases unless specifically excluded.

  Paraphrasing Article 5(1), a PE exists if the following conditions are satisfied cumulatively:

  ➢ There is an “enterprise”.

  ➢ Such enterprise is carrying on a "business";

- ➢ There is a "place of business";
- ➢ Such place of business is at the disposal of the enterprise (may be owned / rented but must be one which the enterprise has the effective power to use);
- ➢ The place of business is "fixed", that is, it must be established at a distinct place with a certain degree of permanence

The business of the enterprise is carried on wholly or partially through this fixed place of business.

A PE does not exist unless all the aforesaid conditions are satisfied.

- As per Article 5(2), the term "permanent establishment" includes especially:

  a) a place of management;

  b) a branch;

  c) an office;

  d) a factory;

  e) a workshop, and

  f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

- Agency PE under OECD and UN Models targets activities done by a dependent agent of the enterprise in the Source State. The recent update expands the definition of dependent agent PE to include instances when an agent habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts routinely concluded without material modification by the enterprise.

- The UN Model Convention has an additional Article 5(6) relating to insurance which is absent in OECD Model.

  As per this Article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person.

  In the absence of similar Article in the OECD Model, a PE of an insurance Enterprise has to be determined in accordance with provisions of Article 5(1) or 5(2) of the OECD model.

Article 7: Business Profits

Business profits of an enterprise can only be taxed by the Residence State. Right of Source State to tax business profits of an enterprise only exists if a PE exists in its jurisdiction.

As per the approach under the OECD Model Convention, once a PE is proven, the Source State can tax only such profits as are attributable to the PE. The UN Model Convention amplifies this attribution principle by a **limited** Force of Attraction rule (FOA).

The FOA rule implies that when a foreign enterprise sets up a PE in State of Source, it brings itself within the fiscal jurisdiction of that State (State of Source) to such a degree that profits that the enterprise derives from Source State of Source, whether through the PE or not, can be taxed by it (State of Source State).

As per Article 7 of the UN Model Convention, if the enterprise carries on business in the other Contracting State through a PE, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to:

(a) that PE;

(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that PE; or

(c) other business activities carried on in that other State of the same or similar kind as those effected through that PE.

Article 11: Interest

Paragraph 1 of this Article provides the right to Residence State to tax interest. Paragraph 2, however, also confers right to the Source State to tax interest. Generally, the interest is taxed in the Source State at a given rate on gross basis. However, if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged cannot exceed a specified percentage of the gross amount of the interest. The OECD Model specifies the percentage as 10%, but the UN Model leaves this percentage to be established through bilateral negotiations.

It may be noted that the definition of interest in both the models viz. OECD and UN Model is similar in that it essentially means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment are not regarded as interest for the purpose of this Article.

Article 12: Royalties

This Article provides the right of Contracting States to tax income from royalty.

Key differences between the two Models are as follows:

- As per the OECD Model, royalties arising in Source State and beneficially owned by resident of the Residence State are taxable only in Residence State. However, the UN Model provides that royalties may be taxed in the Residence State. Hence, the UN Model departs from the principle of exclusive right to tax provided to Residence State in the OECD Model. Thus, under the UN Model, the Source State may also tax royalties. However, if the beneficial owner is a resident of the Residence State, the tax charged by the Source State cannot exceed the specified percentage of the gross amount of royalties. This specified percentage is to be established through bilateral negotiations.

- The definition of 'royalties' under the OECD Model does not include the following: (a) rentals for films or tapes used for radio or television broadcasting and (b) equipment rentals like rentals for industrial, commercial or scientific equipment.

Article 12A: Fees for Technical Services

India is the pioneer of the FTS concept which was added to the Income-tax Act, 1961 since 1976. Some of our tax treaties do contain a specific provision for FTS.

In its 2017 update, the UN Model has inserted a specific article pertaining to Fees for Technical Services (FTS). There is no specific reference to FTS in the OECD Model.

Paragraph 1 of Article 12A provides that the FTS may be taxed in the Residence State but does not provide that the FTS is exclusively taxable in the Residence State.

Paragraph 2 establishes the right of the country in which FTS arises to tax in accordance with its domestic law, subject to the limitation on the maximum rate of tax, if the beneficial owner is a resident of the other Contracting State. The maximum rate of tax is to be established through bilateral negotiations.

FTS is defined as payments for managerial, technical or consultancy services but excludes payment to an employee, payment for teaching in an educational institution or for teaching by an educational institution, payments by an individual for services for personal use. Management involves application of knowledge, skill or expertise in the control or administration of the conduct of a commercial enterprise or organization. Technical involves the application of specialized knowledge, skill or expertise with respect to a particular art, science, profession or occupation. Fees received for services provided by regulated professions such as law, accounting, architecture, medicine, engineering would constitute FTS. The ordinary meaning of "consultancy" involves the provision of advice or services of a specialized nature.

An example of FTS can be seen from the following facts: R Company is a financial institution resident in State R. R Company provides a wide variety of financial services to its customers, including acceptance of deposits, extension of credit, guarantees, foreign exchange, negotiable instruments. R Company's business is conducted primarily in State R, but it also has clients in other countries, including State S. State R and State S have a tax treaty which contains an article akin to Article 12A. Payments received for services provided by a financial institution would constitute FTS if the services involve use of knowledge, skill and expertise to provide research, analysis or advice to a specific client related to particular circumstances. This has to be distinguished from provision of non-specialized services such as payment and transmission services, debit and credit card services, etc.

Article 13: Capital Gains

This is the most commonly used Article and it provides for the taxation of income arising from transfer of a capital asset, including transfer of shares. The right to tax income from capital gains may be exclusively with the Residence State, or shared between the Residence and Source States.

The Article does not specify what is a capital gain and how is to be computed, this being left to the applicable domestic law. The Article contains rules for taxation of gains made from alienation of different assets such as immovable property, immovable property forming part of a PE, ships and aircrafts, etc. In respect of shares, both Models have been updated and are identical. Rights are conferred to the Source State if more than 50 percent of the value of shares during the preceding 365 days is derived from immovable property in such Source State.

Article 14: Independent Personal Services

Article 14 is only present now in the UN Model. It was deleted from the OECD Model on 29-4-2000 on the basis of OECD Report (2000) on "Issues Related to Article 14 of the OECD Model Tax Convention". The Effect of deletion of Article 14 is that income derived from Professional Services etc., is now dealt with as 'Business Profits' (Article 7) under the OECD MC.

This Article deals with the taxation of income derived by a person for professional or specified services which are offered in the Source State through some presence. This article on Independent personal services in the UN Model states as under:

(1) Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:

  (a) If he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or

  (b) If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.

(2) The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Thus, the Article covers independent activities involving professional skills rendered by individuals on a principal to principal basis. The meaning of the term "professional services" is illustrated by some examples of typical liberal professions. The enumeration has an explanatory character only and is not exhaustive. It excludes industrial and commercial activities that are covered under the Article on Business Profits. Likewise, professional services while in employment which are covered under the Article on Dependent Personal Services, e.g. a physician serving as a medical officer in a factory. Income of Artists, Athletes and Sportsmen, etc. is not covered by this Article. Also, income from Fees from Technical Services is also not covered.

Article 21: Other Income

This Article deals with taxation of items of income which are not specifically taxable under any other specific Article. Key differences are as under:

- OECD approach envisages that the exclusive right to tax is with the Residence State. UN Model contains an additional paragraph, Article 21(3), which provides that Source State may also tax other income.
- Article 21(2) of both OECD and UN Model provides that for income effectively connected with a PE maintained in a Contracting State by a resident of the other Contracting State, taxation is governed by the provisions of Article 7 (Business Profits). Additionally, UN Model provides that if the aforesaid income is effectively connected with a fixed base situated in a Contracting State by a resident of the other Contracting State, taxation would be governed by the provisions of Article 14 (Independent personal services).

Articles 23A & 23B : Elimination of Double Taxation

In many cases, the application of tax treaty may result into double taxation for tax payers. In such a case, in order to provide relief to such tax payers, Articles 23A and 23B which contains provisions relating to elimination of double taxation have to applied. Articles 23A and 23B provide for the mechanism through which tax credit/exemption may be available in the Residence State for taxes deducted in the Source State.

The OECD and UN Model Conventions specify two approaches- Exemption method (Article 23A) and Credit method (Article 23B). Under the exemption method, tax exemption may be available in the Residence State. Under the credit method, tax credit may be available in the Residence State for taxes deducted in the Source State. These methods are not mutually exclusive and there may be cases where a treaty may adopt exemption method for certain types of income and credit method for other incomes.

The double taxation referred to here, is juridical double taxation, meaning the same income or capital is taxable in the hands of the same person by more than one State. It does not thus, encompass situations of economic double taxation, i.e. where two different persons are taxable in respect of the same income or capital. If two States wish to solve problems of economic double taxation, they must do so in bilateral negotiations.

Article 25: Mutual Agreement Procedure

There may be a situation wherein a tax payer may believe that the treatment accorded by either or both Contracting States is not in accordance with the provisions of the tax treaty. In such a case, there is a need for dispute resolution which is addressed by this Article. This Article requires competent authorities of both countries to endeavor to resolve the conflict by engaging in bilateral negotiations.

The UN Model Convention provides two alternatives - Alternative A and Alternative B, for the article on Mutual Agreement Procedure which were introduced in 2011. Under OECD Model the taxpayer may make a request to either Contracting State while UN Model (Alternative A) contemplates taxpayer going to Residence State or the country of his nationality. Alternative B of UN Model Article 25 contemplates reference to an arbitration process as part of the Mutual Agreement Procedure. The decision arrived at, through the process is binding unless a person directly affected does not accept it.

Key differences between the OECD Model Convention (Article 25) and UN Model Convention (Article 25B - Alternative B) are as follows:

- Article 25B(5) of the UN Model provides that an arbitration may be initiated if the competent authorities are unable to reach an agreement on a case within three years from the presentation of that case. However, Article 25(5) of the OECD Model provides a time limit of two years from the date when all the information required by the competent authorities in order to address the case need to be provided to both competent authorities.
- Article 25B(5) of the UN Model provides that arbitration must be requested by the competent authority of one of the Contracting States. Once such a request is made, the taxpayer will be notified. However, as per Article 25(5) of the OECD Model, arbitration must be requested in writing by the person who initiated the case.
- Article 25B(5) of the UN Model allows the competent authorities to depart from the arbitration decision if they agree to do so within six months after the decision has been communicated to them.

Article 26: Exchange of Information

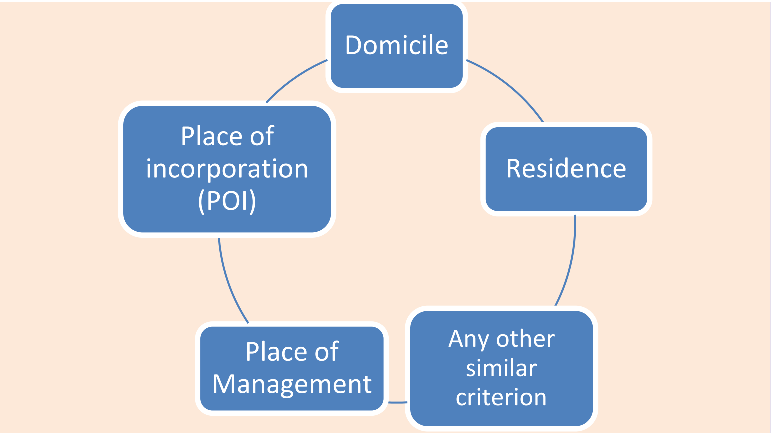
In order to complete tax cases, a country may require certain information which may be available with the treaty partner. Article 26 provides for the information which may be exchanged and the manner in which such a request has to be made. The purpose of Article 26 is to facilitate effective exchange of information between Contracting States. From the perspective of many developing countries, Article 26 is particularly important not only for curtailing cross-border tax evasion and avoidance, but also to curtail the capital flight that is often accomplished through such evasion and avoidance.

The OECD and UN Model Conventions are similar with respect to this Article. A Contracting State cannot be expected to provide confidential financial information to another Contracting State unless it has confidence that the information will not be disclosed to unauthorized persons. A Contracting State can avoid the exchange of information obligations by showing that the information pertains to communication between an attorney and his client which is protected from disclosure under domestic law. However, lack of interest or use in such information cannot form the basis for a Contracting State to not co-operate with the exchange of information obligations.

> **Resources:** The discussion on Model Tax Conventions in the above chapter is essentially based on the text and commentaries of the OECD and UN Model Tax Conventions, 2017 available at the websites http://www.oecd.org/tax/treaties/ and http://www.un.org, respectively.

SUMMARY

<table>
<tr><th colspan="2">Article</th><th>OECD MC <i>vis-à-vis</i> UN MC
Common paras & Significant differences</th></tr>
<tr><td></td><td colspan="2">Chapter I : Scope of the Convention</td></tr>
<tr><td>1</td><td>Persons covered</td><td>✚ Resident of CS - For application of treaty, a person has to be a resident of one or both of the Contracting States (CSs).
✚ Fiscally transparent entity - Income derived by or through a fiscally transparent entity under the tax law of either CS to be considered to be income of a resident of a CS, to the extent such income is treated, for purposes of taxation by that State, as the income of a resident of that State.</td></tr>
<tr><td>2</td><td>Taxes covered</td><td>✚ Taxes on income and capital - The MCs apply to taxes on income and on capital imposed on behalf of a CS or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.
✚ Coverage of taxes - Taxes on income and on capital covers:
<table>
<tr><th>Taxes imposed</th><th>Taxes included</th></tr>
<tr><td>• On total income
• on total capital
• on elements of income or of capital</td><td>• taxes on gains from alienation of movable or immovable property
• taxes on total amounts of wages or salaries paid by enterprises
• taxes on capital appreciation</td></tr>
</table></td></tr>
<tr><td></td><td colspan="2">Chapter II : Definitions</td></tr>
<tr><td>4</td><td>Resident</td><td>✚ Resident of either CS - A taxpayer has to demonstrate that he is a resident of one or both CSs to be able to gain access to a tax treaty and avail benefits thereunder.
✚ Meaning of "Resident of a Contracting State"- Any person who, under the laws of that State, is liable to tax therein by reason of his:</td></tr>
</table>


Domicile
Residence
Any other similar criterion
Place of Management
Place of incorporation (POI)

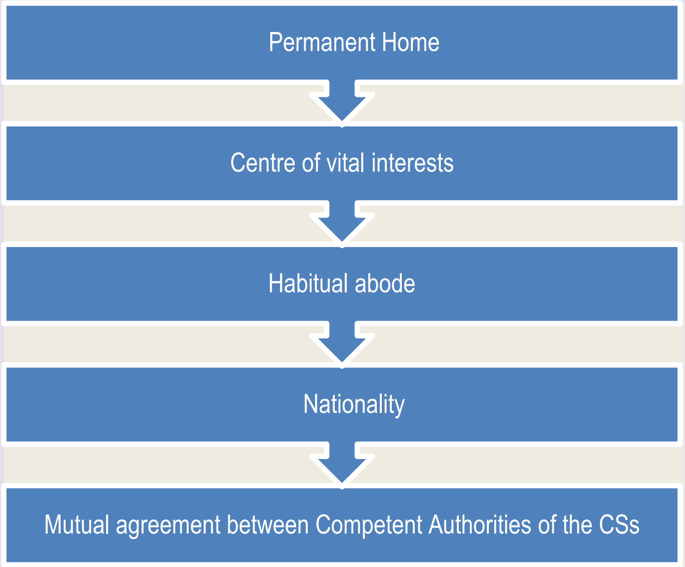
This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

Note *- OECD MC does not contain reference to place of incorporation*

Tie-breaker Rule

In case of individuals

Where an individual is a resident of both CSs as per domestic tax laws of that CS, then, his residential status shall be determined by applying the tie-breaker rule in the following sequence:


Permanent Home
Centre of vital interests
Habitual abode
Nationality
Mutual agreement between Competent Authorities of the CSs

In case of companies

- Dual residence arises where one CS attaches importance to POI and the other CS to the POEM.
- The tie-breaker test involves a case by case approach considering the no. of tax avoidance cases involving dual resident Cos.

- Request has to be made by the tax payer through Article 25 (MAP).
- Competent Authorities will rely on range of factors to resolve the question of dual residency.

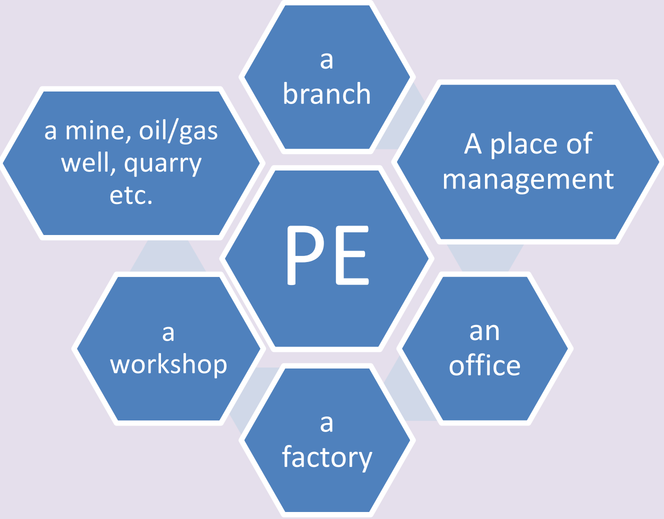
5 **Permanent establishment (PE)**

Meaning of PE [Article 5(1)]

- There should be an "**enterprise**" (Entr).
- Such Entr should be carrying on a "**business**";
- There should be a "**place of business** (POB)";
- Such place of business (POB) should be at the **disposal of the Entr** (may be owned / rented but must be one which the Entr has the effective power to use);
- The POB should be "fixed", i.e., it must be established at a distinct place with a certain **degree of permanence**
- The business of the enterprise is carried on wholly or partially through this fixed POB.

A PE does not exist unless all the aforesaid conditions are satisfied.

Specific inclusions in the meaning of PE [Article 5(2)]



Expansion of scope of Agency PE

- Agency PE targets activities done by a dependent agent (DA) of the Entr in the Source State (SS).
- DAPE now includes instances when an agent habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts routinely concluded without material modification by the enterprise.

PE of an Insurance Enterprise

UN MC	OECD MC
UN MC has an additional Article 5(6) relating to insurance. An insurance Entr of a CS is deemed to have a PE in	In the absence of similar Article in the OECD MC, a PE of an insurance Entr is to be determined

the other CS if it collects premiums in the territory of that other CS or insures risks situated therein through a person.	in accord with Article 5(1) or 5(2).

Chapter III : Taxation of Income

7 Business profits

- **Right of CS to tax business profits (BPs)**

OECD MC	UN MC
BPs of an Entr can only be taxed by the Residence State **(RS)**. Right of Source State **(SS)** to tax BPs of an enterprise only exists if a PE exists in its jurisdiction.	
Once a PE is proven, the **SS** can tax only such profits as are attributable to the PE	✚ The attribution principle is amplified by a **limited** Force of Attraction rule (FOA). ✚ The FOA rule implies that when a foreign enterprise sets up a PE in SS, it brings itself within the fiscal jurisdiction of that State to such a degree that profits that the Entr derives therefrom, whether through the PE or not, can be taxed by it (i.e., the SS). ✚ Accordingly, if the Entr carries on business in the other CS through a PE, the profits of the Entr may be taxed in the other CS but only so much of them as is attributable to: (a) that PE; (b) sales in that other CS of goods or merchandise of the same or similar kind as those sold through that PE; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that PE.

11 Interest

- **Right of CSs to tax interest**

Para of Article	Right of CS to tax interest
1	Confers the right to RS to tax interest
2	Confers right to the SS to tax interest. Generally, interest is taxed in the SS at a given rate on gross basis. However, if the beneficial owner of the interest is a resident of the other CS, the tax so charged ≤ specified % of the gross interest. The specified % as per OECD MC is 10%, but the UN MC leaves this % to be established through bilateral negotiations.

- **Definition of interest in OECD & UN MCs -** Interest means income from debt claims of every kind,
  - whether or not secured by mortgage and
  - whether or not carrying a right to participate in the debtor's profits.

Specific inclusions in the definition of interest as per OECD & UN MCs

- income from govt securities
- income from bonds or debentures
- premiums and prizes attaching to such securities, bonds or debentures.

Note - *Interest does not include penalty charges for late payment.*

12 Royalties (Roy)

	OECD MC	UN MC
Right of CS to tax Roy. income	Roy. arising in SS and beneficially owned by resident of the RS is taxable only in RS. Thus, **RS has exclusive right to tax royalty income**.	Roy **may also be taxed in the SS**. However, if the beneficial owner is a resident of the RS, the tax charged by SS ≤ the specified %, (to be established through bilateral negotiations) of gross royalty.
Definition of Roy	Definition of Royalty does not include: (a) rentals for films/tapes used for radio/ TV broadcasting; and (b) rentals for industrial, commercial or scientific equipment.	Royalty includes: (a) rentals for films or tapes used for radio or TV broadcasting and (b) equipment rentals like rentals for industrial, commercial or scientific equipment.

12A FTS

In its 2017 update, the UN MC has inserted a specific article pertaining to Fees for Technical Services (FTS). There is no specific reference to FTS in OECD MC.

Right of CS to tax FTS [UN Model]

Para of Article	Right of CS to tax FTS
1	Confers right to the RS to tax FTS. However, does not state that FTS is exclusively taxable in the RS.
2	Establishes the right of the SS to tax FTS in accordance with its domestic law, subject to limitation on the max. rate of tax, to be established through bilateral negotiations, if the beneficial owner is a resident of the other CS.

<table>
<tr>
<td></td>
<td></td>
<td>
Meaning of FTS [UN Model]
<table>
<tr><td colspan="2">FTS means payments for managerial, technical or consultancy services</td></tr>
<tr><td colspan="2"><u>Exclusions from the meaning of FTS</u>:</td></tr>
<tr><td>i</td><td>payment to an employee</td></tr>
<tr><td>ii</td><td>payment for teaching in an or by an educational institution</td></tr>
<tr><td>iii</td><td>payment by an individual for services for personal use</td></tr>
</table>
</td>
</tr>
<tr>
<td>13</td>
<td>Capital gains</td>
<td>
This Article provides for the taxation of income arising from transfer of a capital asset, including transfer of shares.

Right of CS to tax income from Capital Gains

The right to tax capital gains may be exclusively with the RS, or shared between the RS and SS.
The Article does not specify what is a capital gain and how is to be computed, this being left to the applicable domestic law.
The Article contains rules for taxation of gains from alienation of different assets such as immovable property, immovable property forming part of a PE, ships & aircrafts, etc.
In respect of shares, the 2017 OECD and UN MCs are identical. Rights are conferred to the SS if more than 50% of the value of shares during the preceding 365 days is derived from immovable property in such SS.

</td>
</tr>
<tr>
<td>14</td>
<td>Independent personal services</td>
<td>
This Article present only in the UN MC deals with the taxation of income derived by a person for professional or specified services which are offered in the SS through some presence.

Right of CS to tax income from professional services (IPS) [UN MC]
<table>
<tr><td>Right of RS</td><td>Income derived by a resident of a CS in respect of professional services or other activities of an independent character is taxable only in the RS.</td></tr>
<tr><td>Right of SS</td><td>In the following circumstances, however, IPS may also be taxed in the other CS (i.e., the SS):
<table>
<tr><th>Circumstance</th><th>Extent of income taxable in SS</th></tr>
<tr><td>If he has a fixed base regularly available to him in the SS for the purpose of performing his activities</td><td>Only so much of the income as is attributable to that fixed base may be taxed in the SS.</td></tr>
<tr><td>If his stay in the SS is for a period > 183 days in any 12 month period commencing or ending in the fiscal year concerned</td><td>Only so much of the income as is derived from his activities performed in the SS may be taxed in that State</td></tr>
</table>
</td></tr>
</table>
</td>
</tr>
</table>

<table>
<tr>
<td></td>
<td></td>
<td>
Definition of “Professional Services” [UN MC]
The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.
<i>Note</i> <i>– OECD MC does not contain a separate article on IPS. The same is dealt with as “Business Profits (Article 7)” under the OECD MC.</i>
</td>
</tr>
<tr>
<td>21</td>
<td>Other income (OI)</td>
<td>
This Article deals with taxation of items of income which are not specifically taxable under any other specific Article [i.e., upto Article 20].
<table>
<tr><th></th><th>OECD MC</th><th>UN MC</th></tr>
<tr><td>Right to tax OI</td><td>Exclusive right to tax is with the RS.</td><td>Contains an additional para, Article 21(3), which provides that SS may also tax other income</td></tr>
<tr><td rowspan="2">Right to tax income [other than income from immovable property] effectively connected with PE</td><td colspan="2">Article 21(2) of both OECD and UN MC provides that for income effectively connected with a PE maintained in a CS by a resident of the other CS, taxation is governed by the provisions of Article 7 (Business Profits).</td></tr>
<tr><td></td><td>Additionally, UN Model provides that if the aforesaid income is effectively connected with a fixed base situated in a CS by a resident of the other CS, taxation would be governed by the provisions of Article 14 (IPS).</td></tr>
</table>
</td>
</tr>
<tr>
<td></td>
<td colspan="2">Chapter V : Methods for the Elimination of Double Taxation</td>
</tr>
<tr>
<td>23A/ 23B</td>
<td>Exemption method/ Credit Method</td>
<td>
In many cases, the application of tax treaty may result into double taxation (DT) for tax payers. In such a case, Articles 23A and 23B provide for the mechanism through which tax credit/exemption may be available in the RS for taxes deducted in the SS.
Two approaches for elimination of DT under MCs:
<table>
<tr><th>Exemption method (Article 23A)</th><th>Credit method (Article 23B)</th></tr>
<tr><td>Tax exemption may be available in the RS for taxes deducted in the SS.</td><td>Tax credit may be available in the RS for taxes deducted in the SS.</td></tr>
</table>
</td>
</tr>
</table>

These methods are not mutually exclusive and there may be cases where a treaty may adopt exemption method for certain types of income and credit method for other incomes.

- **Juridical DT and Economic DT:**

	Juridical DT	Economic DT
Meaning	The same income or capital is taxable in the hands of the same person by more than one State	Two different persons are taxable in respect of the same income or capital
Example	FTS may be taxable in the hands of the recipient both in the RS as well as in SS, based on the domestic laws of the CSs.	In respect of dividend distributed by a Co., DDT may be payable by the Co. in SS, whereas the dividend may be taxable in the hands of the shareholder of the other CS, on the basis of his residence.
Type of DT addressed by Article 23A & 23B	Articles 23A & 23B address Juridical DT.	The Articles do not address Economic DT. If two States wish to solve problems of economic DT, they must do so in bilateral negotiations.

Chapter VI : Special Provisions

25 **Mutual agreement procedure (MAP)**

Where a tax payer believes that the treatment accorded by either or both CSs is not in accordance with the provisions of the tax treaty, this Article provides for dispute resolution through bilateral negotiations between competent authorities (CAS) of both CSs.

	OECD MC	UN MC
Request for MAP	The taxpayer may make a request to either CS	**Alternative A** - Taxpayer has to approach RS or the country of his nationality **Alternative B** - Reference to an arbitration process as part of MAP. The decision arrived at through the process is binding unless a person directly affected does not accept it.
Time limit	Stipulates a time limit of 2 years from the date when all the information required by the CAS in order to address the case need to be provided to both CAS.	An arbitration may be initiated if the competent authorities (CAS) are unable to reach an agreement on a case within 3 years from presentation of that case [Alternative B]

<table>
<tr>
<td></td>
<td></td>
<td>
<table>
<tr><td>Who can request for Arbitration ?</td><td>Arbitration must be requested in writing by the person who initiated the case</td><td>Arbitration must be requested by the CAS of one of the CS. Once such a request is made, the taxpayer will be notified [Alternative B]</td></tr>
<tr><td>Departure from arbitration by CAS</td><td>No specific provision for departure from arbitration.</td><td>The CAS may depart from the arbitration decision if they agree to do so within 6 months after the decision has been communicated to them [Alternative B]</td></tr>
</table>
</td>
</tr>
<tr>
<td>26</td>
<td>Exchange of information (EOI)</td>
<td>✚ Purpose of Article 26
In order to complete tax cases, a country may require certain info which may be available with the treaty partner.
Article 26 provides for:
• the info which may be exchanged
• the manner in which such a request has to be made.
✚ Importance of Article 26:
• facilitates effective exchange of information between CSs.
• curtails cross-border tax evasion and avoidance,
• curtails the capital flight that is often accomplished through tax evasion & avoidance. This is particularly relevant in the perspective of developing countries.
✚ Similar provisions contained in OECD and UN MCs
• A CS cannot be expected to provide confidential financial info to another CS unless it has confidence that the info will not be disclosed to unauthorized persons.
• A CS can avoid the EOI obligations by showing that the info pertains to communication between an attorney and his client which is protected from disclosure under domestic law.
• Lack of interest or use in such info cannot, however, form the basis for a CS to not co-operate with the EOI obligations.</td>
</tr>
</table>

EXERCISE

Question 1

Explain briefly the significant difference between the UN and OECD Model Tax Convention.

Answer

OECD Model is essentially a model treaty between two developed nations whereas UN Model is a model convention between a developed country and a developing country.

Further, OECD Model advocates the residence principle, i.e., it lays emphasis on the right of state of residence to tax the income, whereas the UN Model is a compromise between the source principle and residence principle, giving more weight to the source principle as against the residence principle.

Question 2

When does it become necessary to apply the tie-breaker rule? Discuss the manner of application of the tie-breaker rule.

Answer

Every jurisdiction, in its domestic tax law, prescribes the mechanism to determine residential status of a person. If a person is considered to be resident of both the Contracting States, relief should be sought from Article 4 of the Tax Treaty. A series of tie-breaker rules are provided in Paragraph 2 Article 4 of Model Convention to determine single state of residence for an individual.

The tie-breaker rule would be applied in the following manner:

(i) The first test is based on where the individual has a **permanent home**. Permanent home would mean a dwelling place available to him at all times continuously and not occasionally and includes place taken on rent for a prolonged period of time.

(ii) If that test is inconclusive for the reason that the individual has permanent home available to him in both Contracting States, he will be considered a resident of the Contracting State where his personal and economic relations are closer, in other words, the place where lies **his centre of vital interests**. Thus, preference is given to family and social relations, occupation, place of business, place of administration of his properties, political, cultural and other activities of the individual.

(iii) Paragraph (ii) establishes a secondary criterion for two quite distinct and different situations:

- The case where the individual has a permanent home available to him in both Contracting States and it is not possible to determine in which one he has his centre of vital interests;
- The case where the individual has a permanent home available to him in neither Contracting State.

In the aforesaid scenarios, preference is given to the Contracting State where the individual has an **habitual abode**.

(iv) If the individual has habitual abode in both Contracting States or in neither of them, he shall be treated as a resident of the Contracting State of which he is **a national**.

(v) If the individual is a national of both or neither of the Contracting States, the matter is left to be **considered by the competent authorities** of the respective Contracting States.

Question 3

Explain the meaning of "interest" and "fees for technical services" under the UN Model Convention.

Answer

As per Article 11 of the UN Model Convention, "Interest" essentially means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment are not regarded as interest for the purpose of this Article.

As per Article 12A of the UN Model Convention, "Fees for technical services" is defined as payments for managerial, technical or consultancy services but excludes payment to an employee, payment for teaching in an educational institution or for teaching by an educational institution, payments by an individual for services for personal use.

ANNEXURE

Annexure

A. Income Computation and Disclosure Standard I relating to accounting policies

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. This Income Computation and Disclosure Standard deals with significant accounting policies.

Fundamental Accounting Assumptions

2. The following are fundamental accounting assumptions, namely:—

(a) Going Concern

"Going concern" refers to the assumption that the person has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the business, profession or vocation and intends to continue his business, profession or vocation for the foreseeable future.

(b) Consistency

"Consistency" refers to the assumption that accounting policies are consistent from one period to another;

(c) Accrual

"Accrual" refers to the assumption that revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the previous year to which they relate.

Accounting Policies

3. The accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by a person.

Considerations in the Selection and Change of Accounting Policies

4. Accounting policies adopted by a person shall be such so as to represent a true and fair

view of the state of affairs and income of the business, profession or vocation. For this purpose,

(i) the treatment and presentation of transactions and events shall be governed by their substance and not merely by the legal form; and

(ii) marked to market loss or an expected loss shall not be recognised unless the recognition of such loss is in accordance with the provisions of any other Income Computation and Disclosure Standard.

5. An accounting policy shall not be changed without reasonable cause.

Disclosure of Accounting Policies

6. All significant accounting policies adopted by a person shall be disclosed.

7. Any change in an accounting policy which has a material effect shall be disclosed. The amount by which any item is affected by such change shall also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact shall be indicated. If a change is made in the accounting policies which has no material effect for the current previous year but which is reasonably expected to have a material effect in later previous years, the fact of such change shall be appropriately disclosed in the previous year in which the change is adopted and also in the previous year in which such change has material effect for the first time.

8. Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item.

9. If the fundamental accounting assumptions of Going Concern, Consistency and Accrual are followed, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact shall be disclosed.

Transitional Provisions

10. All contract or transaction existing on the 1st day of April, 2016 or entered into on or after the 1st day of April, 2016 shall be dealt with in accordance with the provisions of this standard after taking into account the income, expense or loss, if any, recognised in respect of the said contract or transaction for the previous year ending on or before the 31st March,2016.

B. Income Computation and Disclosure Standard II relating to valuation of inventories

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head “Profits and gains of Business or profession” or “Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of Income Tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. This Income Computation and Disclosure Standard shall be applied for valuation of inventories, except :

(a) Work-in-progress arising under 'construction contract' including directly related service contract which is dealt with by the Income Computation and Disclosure Standard on construction contracts;

(b) Work-in-progress which is dealt with by other Income Computation and Disclosure Standard;

(c) Shares, debentures and other financial instruments held as stock-in-trade which are dealt with by the Income Computation and Disclosure Standard on securities;

(d) Producers' inventories of livestock, agriculture and forest products, mineral oils, ores and gases to the extent that they are measured at net realisable value;

(e) Machinery spares, which can be used only in connection with a tangible fixed asset and their use is expected to be irregular, shall be dealt with in accordance with the Income Computation and Disclosure Standard on tangible fixed assets.

Definitions

2(1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

(a) "Inventories" are assets:

(i) held for sale in the ordinary course of business;

(ii) in the process of production for such sale;

(iii) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

(b) "Net realisable value" is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

2(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meanings assigned to them in that Act.

Measurement

3. Inventories shall be valued at cost, or net realisable value, whichever is lower.

Cost of Inventories

4. Cost of inventories shall comprise of all costs of purchase, costs of services, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Costs of Purchase

5. The costs of purchase shall consist of purchase price including duties and taxes, freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates and other similar items shall be deducted in determining the costs of purchase.

Costs of Services

6. The costs of services shall consist of labour and other costs of personnel directly engaged in providing the service including supervisory personnel and attributable overheads.

Costs of Conversion

7. The costs of conversion of inventories shall include costs directly related to the units of production and a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads shall be those indirect costs of production that remain relatively constant regardless of the volume of production. Variable production overheads shall be those indirect costs of production that vary directly or nearly directly, with the volume of production.

8. The allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion shall be based on the normal capacity of the production facilities. Normal capacity shall be the production expected to be achieved on an average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production shall be used when it approximates to normal capacity. The amount of fixed production overheads allocated to each unit of production shall not be increased as a consequence of low production or idle plant. Unallocated overheads shall be recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed production overheads allocated to each unit of production is decreased so that

inventories are not measured above the cost. Variable production overheads shall be assigned to each unit of production on the basis of the actual use of the production facilities.

9. Where a production process results in more than one product being produced simultaneously and the costs of conversion of each product are not separately identifiable, the costs shall be allocated between the products on a rational and consistent basis. Where by-products, scrap or waste material are immaterial, they shall be measured at net realisable value and this value shall be deducted from the cost of the main product.

Other Costs

10. Other costs shall be included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition

11. Interest and other borrowing costs shall not be included in the costs of inventories, unless they meet the criteria for recognition of interest as a component of the cost as specified in the Income Computation and Disclosure Standard on borrowing costs.

Exclusions from the Cost of Inventories

12. In determining the cost of inventories in accordance with paragraphs 4 to paragraphs 11, the following costs shall be excluded and recognised as expenses of the period in which they are incurred, namely:—

(a) Abnormal amounts of wasted materials, labour, or other production costs;

(b) Storage costs, unless those costs are necessary in the production process prior to a further production stage;

(c) Administrative overheads that do not contribute to bringing the inventories to their present location and condition ;

(d) Selling costs.

Cost Formulae

13. The Cost of inventories of items

(i) that are not ordinarily interchangeable; and

(ii) goods or services produced and segregated for specific projects shall be assigned by specific identification of their individual costs.

14. ‘Specific identification of cost’ means specific costs are attributed to identified items of inventory.

15. Where there are a large numbers of items of inventory which are ordinarily interchangeable, specific identification of costs shall not be made.

First-in First-out and Weighted Average Cost Formula

16. Cost of inventories, other than the inventory dealt with in paragraph 13, shall be assigned by using the First-in First-out (FIFO), or weighted average cost formula. The formula used shall reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.

17. The FIFO formula assumes that the items of inventory which were purchased or produced first are consumed or sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average shall be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances.

Techniques for the Measurement of Cost

18(1) Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate the actual cost. Standard costs take into account normal levels of consumption of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of the current conditions.

18(2) The retail method can be used in the retail trade for measuring inventories of large number of rapidly changing items that have similar margins and for which it is impracticable to use other costing methods. The cost of the inventory is determined by reducing from the sales value of the inventory, the appropriate percentage gross margin. The percentage used takes into consideration inventory, which has been marked down to below its original selling price. An average percentage for each retail department is to be used.

Net Realisable Value

19. Inventories shall be written down to net realisable value on an item-by-item basis. Where ‘items of inventory' relating to the same product line having similar purposes or end uses and are produced and marketed in the same geographical area and cannot be practicably evaluated separately from other items in that product line, such inventories shall be grouped together and written down to net realisable value on an aggregate basis.

20. Net realisable value shall be based on the most reliable evidence available at the time of valuation. The estimates of net realisable value shall also take into consideration the purpose for which the inventory is held. The estimates shall take into consideration

fluctuations of price or cost directly relating to events occurring after the end of previous year to the extent that such events confirm the conditions existing on the last day of the previous year.

21. Materials and other supplies held for use in the production of inventories shall not be written down below the cost, where the finished products in which they shall be incorporated are expected to be sold at or above the cost. Where there has been a decline in the price of materials and it is estimated that the cost of finished products will exceed the net realisable value, the value of materials shall be written down to net realisable value which shall be the replacement cost of such materials.

Value of Opening Inventory

22. The value of the inventory as on the beginning of the previous year shall be

(i) the cost of inventory available, if any, on the day of the commencement of the business when the business has commenced during the previous year; and

(ii) the value of the inventory as on the close of the immediately preceding previous year, in any other case.

Change of Method of Valuation of Inventory

23. The method of valuation of inventories once adopted by a person in any previous year shall not be changed without reasonable cause.

Valuation of Inventory in Case of Certain Dissolutions

24. In case of dissolution of a partnership firm or association of person or body of individuals, notwithstanding whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the net realisable value.

Transitional Provisions

25. Interest and other borrowing costs, which do not meet the criteria for recognition of interest as a component of the cost as per para 11, but included in the cost of the opening inventory as on the 1st day of April, 2016, shall be taken into account for determining cost of such inventory for valuation as on the close of the previous year beginning on or after 1st day of April, 2016 if such inventory continue to remain part of inventory as on the close of the previous year beginning on or after 1st day of April, 2016.

Disclosure

26. The following aspects shall be disclosed, namely:—

(a) the accounting policies adopted in measuring inventories including the cost formulae used. Where Standard Costing has been used as a measurement of cost, details of such inventories and a confirmation of the fact that standard cost approximates the actual cost; and

(b) the total carrying amount of inventories and its classification appropriate to a person.

C. Income Computation and Disclosure Standard III relating to construction contracts

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of the Income-tax Act, 1961('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. This Income Computation and Disclosure Standard should be applied in determination of income for a construction contract of a contractor.

Definitions

2 (1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

(a) "Construction contract" is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use and includes :

(i) contract for the rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects;

(ii) contract for destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

(b) "Fixed price contract" is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which may be subject to cost escalation clauses.

(c) "Cost plus contract" is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus a mark up on these costs or a fixed fee.

(d) "Retentions" are amounts of progress billings which are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified.

(e) "Progress billings" are amounts billed for work performed on a contract whether or not they have been paid by the customer.

(f) "Advances" are amounts received by the contractor before the related work is performed.

2(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meaning respectively assigned to them in the Act.

3. A construction contract may be negotiated for the construction of a single asset. A construction contract may also deal with the construction of a number of assets which are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

4. Construction contracts are formulated in a number of ways which, for the purposes of this Income Computation and Disclosure Standard, are classified as fixed price contracts and cost plus contracts. Some construction contracts may contain characteristics of both a fixed price contract and a cost plus contract, for example, in the case of a cost plus contract with an agreed maximum price.

Combining and Segmenting Construction Contracts

5. The requirements of this Income Computation and Disclosure Standard shall be applied separately to each construction contract except as provided for in paragraphs 6, 7 and 8

herein. For reflecting the substance of a contract or a group of contracts, where it is necessary, the Income Computation and Disclosure Standard should be applied to the separately identifiable components of a single contract or to a group of contracts together.

6. Where a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

7. A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:

(a) the group of contracts is negotiated as a single package;

(b) the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and

(c) the contracts are performed concurrently or in a continuous sequence.

8. Where a contract provides for the construction of an additional asset at the option of the customer or is amended to include the construction of an additional asset, the construction of the additional asset should be treated as a separate construction contract when:

(a) the asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or

(b) the price of the asset is negotiated without having regard to the original contract price.

Contract Revenue

9. Contract revenue shall be recognised when there is reasonable certainty of its ultimate collection.

10. Contract revenue shall comprise of:

(a) the initial amount of revenue agreed in the contract, including retentions; and

(b) variations in contract work, claims and incentive payments:

(i) to the extent that it is probable that they will result in revenue; and

(ii) they are capable of being reliably measured.

11. Where contract revenue already recognised as income is subsequently written off in the books of accounts as uncollectible, the same shall be recognised as an expense and not as an adjustment of the amount of contract revenue.

Contract Costs

12. Contract costs shall comprise of :

(a) costs that relate directly to the specific contract;

(b) costs that are attributable to contract activity in general and can be allocated to the contract;

(c) such other costs as are specifically chargeable to the customer under the terms of the contract; and

(d) allocated borrowing costs in accordance with the Income Computation and Disclosure Standard on Borrowing Costs.

These costs shall be reduced by any incidental income, not being in the nature of interest, dividends or capital gains, that is not included in contract revenue.

13. Costs that cannot be attributed to any contract activity or cannot be allocated to a contract shall be excluded from the costs of a construction contract.

14. Contract costs include the costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract. Costs that are incurred in securing the contract are also included as part of the contract costs, provided

(a) they can be separately identified; and

(b) it is probable that the contract shall be obtained.

When costs incurred in securing a contract are recognised as an expense in the period in which they are incurred, they are not included in contract costs when the contract is obtained in a subsequent period.

15. Contract costs that relate to future activity on the contract are recognised as an asset. Such costs represent an amount due from the customer and are classified as contract work in progress.

Recognition of Contract Revenue and Expenses

16. Contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date.

17. The recognition of revenue and expenses by reference to the stage of completion of a contract is referred to as the percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed.

18. The stage of completion of a contract shall be determined with reference to:

(a) the proportion that contract costs incurred for work performed upto the reporting date bear to the estimated total contract costs; or

(b) surveys of work performed; or

(c) completion of a physical proportion of the contract work.

Progress payments and advances received from customers are not determinative of the stage of completion of a contract.

19. When the stage of completion is determined by reference to the contract costs incurred upto the reporting date, only those contract costs that reflect work performed are included in costs incurred upto the reporting date. Contract costs which are excluded are:

(a) contract costs that relate to future activity on the contract; and

(b) payments made to subcontractors in advance of work performed under the subcontract.

20. During the early stages of a contract, where the outcome of the contract cannot be estimated reliably contract revenue is recognised only to the extent of costs incurred. The early stage of a contract shall not extend beyond 25 % of the stage of completion.

Changes in Estimates

21. The percentage of completion method is applied on a cumulative basis in each previous year to the current estimates of contract revenue and contract costs. Where there is change in estimates, the changed estimates shall be used in determination of the amount of revenue and expenses in the period in which the change is made and in subsequent periods.

Transitional Provisions

22.1 Contract revenue and contract costs associated with the construction contract, which commenced on or after 1st day of April, 2016 shall be recognised in accordance with the provisions of this standard.

22.2 Contract revenue and contract costs associated with the construction contract, which commenced on or before the 31st day of March, 2016 but not completed by the said date, shall be recognised based on the method regularly followed by the person prior to the previous year beginning on the 1st day of April, 2016.

Disclosure

23. A person shall disclose:

(a) the amount of contract revenue recognised as revenue in the period; and

(b) the methods used to determine the stage of completion of contracts in progress.

24. A person shall disclose the following for contracts in progress at the reporting date, namely:—

(a) amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;

(b) the amount of advances received; and

(c) the amount of retentions.

D. Income Computation and Disclosure Standard IV relating to revenue recognition

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1(1) This Income Computation and Disclosure Standard deals with the bases for recognition of revenue arising in the course of the ordinary activities of a person from

(i) the sale of goods;

(ii) the rendering of services;

(iii) the use by others of the person's resources yielding interest, royalties or dividends.

1(2) This Income Computation and Disclosure Standard does not deal with the aspects of revenue recognition which are dealt with by other Income Computation and Disclosure Standards.

Definitions

2(1) The following term is used in this Income Computation and Disclosure Standard with the meanings specified:

(a) "Revenue" is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of a person from the sale of goods, from the rendering of services, or from the use by others of the person's resources yielding interest, royalties or dividends. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.

2(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meanings assigned to them in that Act.

Sale of Goods

3. In a transaction involving the sale of goods, the revenue shall be recognised when the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership. In a situation, where transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership, revenue in such a situation shall be recognised at the time of transfer of significant risks and rewards of ownership to the buyer.

4. Revenue shall be recognised when there is reasonable certainty of its ultimate collection.

5. Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim for escalation of price and export incentives, revenue recognition in respect of such claim shall be postponed to the extent of uncertainty involved.

Rendering of Services

6. Subject to Para 7, revenue from service transactions shall be recognised by the percentage completion method. Under this method, revenue from service transactions is matched with the service transaction costs incurred in reaching the stage of completion, resulting in the determination of revenue, expenses and profit which can be attributed to the proportion of work completed. Income Computation and Disclosure Standard on construction contract also requires the recognition of revenue on this basis. The requirements of that Standard shall mutatis mutandis apply to the recognition of revenue and the associated expenses for a service transaction. However, when services are provided by an indeterminate number of acts over a specific period of time, revenue may be recognised on a straight line basis over the specific period.

7. Revenue from service contracts with duration of not more than ninety days may be recognised when the rendering of services under that contract is completed or substantially completed.

The Use of Resources by Others Yielding Interest, Royalties or Dividends

8. (1) Subject to sub paragraph (2), interest shall accrue on the time basis determined by the amount outstanding and the rate applicable.

(2) Interest on refund of any tax, duty or cess shall be deemed to be the income of the previous year in which such interest is received.

(3) Discount or premium on debt securities held is treated as though it were accruing over the period to maturity.

9. Royalties shall accrue in accordance with the terms of the relevant agreement and shall be recognised on that basis unless, having regard to the substance of the transaction, it is more appropriate to recognise revenue on some other systematic and rational basis.

10. Dividends are recognised in accordance with the provisions of the Act.

Transitional Provisions

11. The transitional provisions of Income Computation and Disclosure Standard on construction contract shall *mutatis mutandis* apply to the recognition of revenue and the associated costs for a service transaction undertaken on or before the 31st day of March, 2016 but not completed by the said date.

12. Revenue for a transaction, other than a service transaction referred to in Para 10, undertaken on or before the 31st day of March, 2016 but not completed by the said date shall be recognised in accordance with the provisions of this standard for the previous year commencing on the 1st day of April, 2016 and subsequent previous year. The amount of revenue, if any, recognised for the said transaction for any previous year commencing on or before the 1st day of April, 2015 shall be taken into account for recognising revenue for the said transaction for the previous year commencing on the 1st day of April, 2016and subsequent previous years.

Disclosure

13. Following disclosures shall be made in respect of revenue recognition, namely:—

(a) in a transaction involving sale of good, total amount not recognised as revenue during the previous year due to lack of reasonably certainty of its ultimate collection along with nature of uncertainty;

(b) the amount of revenue from service transactions recognised as revenue during the previous year;

(c) the method used to determine the stage of completion of service transactions in progress; and

(d) for service transactions in progress at the end of previous year:

(i) amount of costs incurred and recognised profits (less recognised losses) upto end of previous year;

(ii) the amount of advances received; and

(iii) the amount of retentions.

E. Income Computation and Disclosure Standard V relating to tangible fixed assets

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. This Income Computation and Disclosure Standard deals with the treatment of tangible fixed assets.

Definitions

2(1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

(a) "Tangible fixed asset" is an asset being land, building, machinery, plant or furniture held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.

(b) "Fair value" of an asset is the amount for which that asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meanings assigned to them in that Act.

Identification of Tangible Fixed Assets

3. The definition in clause (a) of sub-paragraph (1) of paragraph 2 provides criteria for determining whether an item is to be classified as a tangible fixed asset.

4. Stand-by equipment and servicing equipment are to be capitalised. Machinery spares shall be charged to the revenue as and when consumed. When such spares can be used only in connection with an item of tangible fixed asset and their use is

expected to be irregular, they shall be capitalised.

Components of Actual Cost

5. The actual cost of an acquired tangible fixed asset shall comprise its purchase price, import duties and other taxes, excluding those subsequently recoverable, and any directly attributable expenditure on making the asset ready for its intended use. Any trade discounts and rebates shall be deducted in arriving at the actual cost.

6. The cost of a tangible fixed asset may undergo changes subsequent to its acquisition or construction on account of

(i) price adjustment, changes in duties or similar factors; or

(ii) exchange fluctuation as specified in Income Computation and Disclosure Standard on the effects of changes in foreign exchange rates.

7. Administration and other general overhead expenses are to be excluded from the cost of tangible fixed assets if they do not relate to a specific tangible fixed asset. Expenses which are specifically attributable to construction of a project or to the acquisition of a tangible fixed asset or bringing it to its working condition, shall be included as a part of the cost of the project or as a part of the cost of the tangible fixed asset.

8. The expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, shall be capitalised. The expenditure incurred after the plant has begun commercial production, that is, production intended for sale or captive consumption, shall be treated as revenue expenditure.

Self- constructed Tangible Fixed Assets

9. In arriving at the actual cost of self-constructed tangible fixed assets, the same principles shall apply as those described in paragraphs 5 to 8. Cost of construction that relate directly to the

specific tangible fixed asset and costs that are attributable to the construction activity in general and can be allocated to the specific tangible fixed asset shall be included in actual cost. Any internal profits shall be eliminated in arriving at such costs.

Non- monetary Consideration

10. When a tangible fixed asset is acquired in exchange for another asset, the fair value of the tangible fixed asset so acquired shall be its actual cost.

11. When a tangible fixed asset is acquired in exchange for shares or other securities, the fair value of the tangible fixed asset so acquired shall be its actual cost.

Improvements and Repairs

12. An Expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is added to the actual cost.

13. The cost of an addition or extension to an existing tangible fixed asset which is of a capital nature and which becomes an integral part of the existing tangible fixed asset is to be added to its actual cost. Any addition or extension, which has a separate identity and is capable of being used after the existing tangible fixed asset is disposed of, shall be treated as separate asset.

Valuation of Tangible Fixed Assets in Special Cases

14. Where a person owns tangible fixed assets jointly with others, the proportion in the actual cost, accumulated depreciation and written down value is grouped together with similar fully owned tangible fixed assets.

15. Where several assets are purchased for a consolidated price, the consideration shall be apportioned to the various assets on a fair basis.

Transitional Provisions

16. The actual cost of tangible fixed assets, acquisition or construction of which commenced on or before the 31st day of March, 2016 but not completed by the said date, shall be recognised in accordance with the provisions of this standard. The amount of actual cost, if any, recognised for the said assets for any previous year commencing on or before the 1st day of April, 2015 shall be taken into account for recognising actual cost of the said assets for the previous year commencing on the 1st day of April, 2016 and subsequent previous years.

Depreciation

17. Depreciation on a tangible fixed *asset shall be computed in accordance with the provisions of the Act.*

Transfers

18. Income arising on transfer of a tangible fixed *asset shall be computed in accordance with the provisions of the Act.*

Disclosures

19. Following disclosure shall be made in respect of tangible fixed assets, namely:—

(a) description of asset or block of assets;

(b) rate of depreciation;

(c) actual cost or written down value, as the case may be;

(d) additions or deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of—

(i) Central Value Added Tax credit claimed and allowed under the CENVAT Credit Rules, 2004;

(ii) change in rate of exchange of currency;

(iii) subsidy or grant or reimbursement, by whatever name called;

(e) depreciation Allowable; and

(f) written down value at the end of year.

F. Income Computation and Disclosure Standard VI relating to the effects of changes in foreign exchange rates

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head “Profits and gains of business or profession” or “Income from other sources” and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of the Income-tax Act, 1961 (‘the Act’) and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. This Income Computation and Disclosure Standard deals with:

(a) treatment of transactions in foreign currencies;

(b) translating the financial statements of foreign operations;

(c) treatment of foreign currency transactions in the nature of forward exchange contracts.

Definitions

2. (1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

(a) **“Average rate”** is the mean of the exchange rates in force during a period.

(b) “Closing rate” is the exchange rate at the last day of the previous year.

(c) “Exchange difference” is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency of a person at different exchange rates.

(d) “Exchange rate” is the ratio for exchange of two currencies.

(e) “Foreign currency” is a currency other than the reporting currency of a person.

(f) “Foreign operations of a person” is a branch, by whatever name called, of that person, the activities of which are based or conducted in a country other than India.

(g) “Foreign currency transaction” is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when a person:—

(i) buys or sells goods or services whose price is denominated in a foreign currency; or

(ii) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or

(iii) becomes a party to an unperformed forward exchange contract; or

(iv) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

(h) “Forward exchange contract” means an agreement to exchange different currencies at a forward rate, and includes a foreign currency option contract or another financial instrument of a similar nature;

(i) “Forward rate” is the specified exchange rate for exchange of two Currencies at a specified future date;

(j) “Indian currency” shall have the meaning as assigned to it in section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999);

(k) “Monetary items” are money held and assets to be received or liabilities to be paid in fixed or determinable amounts of money. Cash, receivables, and payables are examples of monetary items;

(l) “Non-monetary items” are assets and liabilities other than monetary items. Fixed assets, inventories, and investments in equity shares are examples of non-monetary items;

(m)“Reporting currency” means Indian currency except for foreign operations where it shall mean currency of the country where the operations are carried out.

(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meaning assigned to them in the Act.

Foreign Currency Transactions

Initial Recognition

3(1) A foreign currency transaction shall be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.

(2) An average rate for a week or a month that approximates the actual rate at the date of the transaction may be used for all transaction in each foreign currency occurring during that period. If the exchange rate fluctuates significantly, the actual rate at the date of the transaction shall be used.

Conversion at Last Date of Previous Year

4. At last day of each previous year:—

(a) foreign currency monetary items shall be converted into reporting currency by applying the closing rate;

(b) where the closing rate does not reflect with reasonable accuracy, the amount in reporting currency that is likely to be realised from or required to disburse, a foreign currency monetary item owing to restriction on remittances or the closing rate being unrealistic and it is not possible to effect an exchange of currencies at that rate, then the relevant monetary item shall be reported in the reporting currency at the amount which is likely to be realised from or required to disburse such item at the last date of the previous year; and

(c) non-monetary items in a foreign currency shall be converted into reporting currency by using the exchange rate at the date of the transaction.

(d) non-monetary item being inventory which is carried at net realisable value denominated in a foreign currency shall be reported using the exchange rate that existed when such value was determined.

Recognition of Exchange Differences

5. (i) In respect of monetary items, exchange differences arising on the settlement thereof or on conversion thereof at last day of the previous year shall be recognised as income or as expense in that previous year.

(ii) In respect of non-monetary items, exchange differences arising on conversion thereof at the last day of the previous year shall not be recognised as income or as expense in that previous year.

Exceptions to Paragraphs 3, 4 and 5

6. Notwithstanding anything contained in paragraph 3, 4 and 5; initial recognition, conversion and recognition of exchange difference shall be subject to provisions of section 43A of the Act or Rule 115 of Income-tax Rules, 1962, as the case may be.

Financial Statements of Foreign Operations

7. The financial statements of a foreign operation shall be translated using the principles and procedures in paragraphs 3 to 6 as if the transactions of the foreign operation had been those of the person himself.

Forward Exchange Contracts

8. (1) Any premium or discount arising at the inception of a forward exchange contract shall be amortised as expense or income over the life of the contract. Exchange differences on such a contract shall be recognised as income or as expense in the previous year in which the exchange rates change. Any profit or loss arising on cancellation or renewal shall be recognised as income or as expense for the previous year.

(2) The provisions of sub-para (1) shall apply provided that the contract:

(a) is not intended for trading or speculation purposes; and

(b) is entered into to establish the amount of the reporting currency required or available at the settlement date of the transaction.

(3) The provisions of sub-para (1) shall not apply to the contract that is entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction. For this purpose, firm commitment, shall not include assets and liabilities existing at the end of the previous year.

(4) The premium or discount that arises on the contract is measured by the difference between the exchange rate at the date of the inception of the contract and the forward rate specified in the contract. Exchange difference on the contract is the difference between:

(a) the foreign currency amount of the contract translated at the exchange rate at the last day of the previous year, or the settlement date where the transaction is settled during the previous year; and

(b) the same foreign currency amount translated at the date of inception of the contract or the last day of the immediately preceding previous year, whichever is later.

(5) Premium, discount or exchange difference on contracts that are intended for trading or speculation purposes, or that are entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction shall be recognised at the time of settlement.

Transitional Provisions

9. (1) All foreign currency transactions undertaken on or after 1st day of April, 2016 shall be recognised in accordance with the provisions of this standard.

(2) Exchange differences arising in respect of monetary items or non-monetary items, on the settlement thereof during the previous year commencing on the 1st day of April, 2016 or on conversion thereof at the last day of the previous year commencing on the 1st day of April, 2016 , shall be recognised in accordance with the provisions of this standard after taking into account the amount recognised on the last day of the previous year ending on the 31st March, 2016 for an item, if any, which is carried forward from said previous year.

(3) The financial statements of foreign operations for the previous year commencing on the 1st day of April, 2016 shall be translated using the principles and procedures specified in this standard after taking into account the amount recognised on the last day of the previous year ending on the 31st March, 2016 for an item, if any, which is carried forward from said previous year.

(4) All forward exchange contracts existing on the 1st day of April, 2016 or entered on or after 1st day of April, 2016 shall be dealt with in accordance with the provisions of this standard after taking into account the income or expenses, if any, recognised in respect of said contracts for the previous year ending on or before the 31st March,2016.

G. Income Computation and Disclosure Standard VII relating to government grants

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head “Profits and gains of business or profession” or “Income from other sources” and not for the purpose of maintenance of books of account.

In case of conflict between the provisions of the Income Tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. This Income Computation and Disclosure Standard deals with the treatment of Government grants. The Government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks, waiver, concessions, reimbursements, etc.

2. This Income Computation and Disclosure Standard does not deal with:—

   (a) Government assistance other than in the form of Government grants; and

   (b) Government participation in the ownership of the enterprise.

Definitions

3(1) The following terms are used in the Income Computation and Disclosure Standard with the meanings specified:

   (a) *"Government" refers to the Central* Government, State Governments, agencies and similar bodies, whether local, national or international.

   (b) "Government grants" are assistance by Government in cash or kind to a person for past or future compliance with certain conditions. They exclude those forms of Government assistance which cannot have a value placed upon them and the transactions with Government which cannot be distinguished from the normal trading transactions of the person.

3(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meaning assigned to them in the Act.

Recognition of Government Grants

4(1) Government grants should not be recognised until there is reasonable assurance that (i) the person shall comply with the conditions attached to them, and (ii) the grants shall be received.

4(2) Recognition of Government grant shall not be postponed beyond the date of actual receipt.

Treatment of Government Grants

5. Where the *Government grant relates to a depreciable fixed asset or assets of a person, the grant shall be deducted from the actual cost of the asset or assets concerned or from the written down value of block of assets to which concerned asset or assets belonged to.*

6. Where the Government grant relates to a non-depreciable asset or assets of a person requiring fulfillment of certain obligations, the grant shall be recognised as income over the same period over which the cost of meeting such obligations is charged to income.

7. Where the Government grant is of such a nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total Government grant, the same proportion as such asset bears to all the assets in respect of or with reference to which the Government grant is so received, shall be deducted from the actual cost of the asset or shall be reduced from the written down value of block of assets to which the asset or assets belonged to.

8. The Government grant that is receivable as compensation for expenses or losses incurred in a previous financial year or for the purpose of giving immediate financial support to the person with no further related costs, shall be recognised as income of the period in which it is receivable.

9. The Government grants other than covered by paragraph 5, 6, 7, and 8 shall be recognised as income over the periods necessary to match them with the related costs which they are intended to compensate.

10. The Government grants in the form of non-monetary assets, given at a concessional rate, shall be accounted for on the basis of their acquisition cost.

Refund of Government Grants

11. The amount refundable in respect of a Government grant referred to in paragraphs 6, 8 and 9 shall be applied first against any unamortised deferred credit remaining in respect of the Government grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount shall be charged to profit and loss statement.

12. The amount refundable in respect of a Government grant related to a depreciable fixed asset or assets shall be recorded by increasing the actual cost or written down value of block of assets by the amount refundable. Where the actual cost of the asset is increased, depreciation on the revised actual cost or written down value shall be provided prospectively at the prescribed rate.

Transitional Provisions

13. All the Government grants which meet the recognition criteria of para 4 on or after 1st day of April, 2016 shall be recognised for the previous year commencing on or after 1st day of April, 2016 in accordance with the provisions of this standard after taking into account the amount, if any, of the said Government grant recognised for any previous year ending on or before 31st day of March,2016.

Disclosures

14. Following disclosure shall be made in respect of Government grants, namely:—

(a) nature and extent of Government grants recognised during the previous year by way of deduction from the actual cost *of the asset or assets or from the written down value of block of assets during the previous year;*

(b) nature and extent of Government grants recognised during the previous year as income;

(c) nature and extent of Government grants not recognised during the previous year by way of deduction from the actual cost *of the asset or assets or from the written down value of block of assets and* reasons thereof; and

(d) nature and extent of Government grants not recognised during the previous year as income and reasons thereof.

H. Income Computation and Disclosure Standard VIII relating to securities

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head “Profits and gains of business or profession” or “Income from other sources” and not for the purpose of maintenance of books of account.

In the case of conflict between the provisions of the Income-tax Act, 1961 (‘the Act’) and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Part A

Scope

1. This part of Income Computation and Disclosure Standard deals with securities held as stock-in-trade.

2. This part of Income Computation and Disclosure Standard does not deal with:

(a) the bases for recognition of interest and dividends on securities which are covered by the Income Computation and Disclosure Standard on revenue recognition;

(b) securities held by a person engaged in the business of insurance;

(c) securities held by mutual funds, venture capital funds, banks and public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 (1 of 1956) or the Companies Act, 2013 (18 of 2013).

Definitions

3(1) The following terms are used in this part of Income Computation and Disclosure Standard with the meanings specified:

(a) "Fair value" is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

(b) "Securities" shall have the meaning assigned to it in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and shall include share of a company in which public are not substantially interested but shall not include derivatives referred to in sub-clause (ia) of that clause (h).

3(2) Words and expressions used and not defined in this part of Income Computation and Disclosure Standard but defined in the Act shall have the meaning respectively assigned to them in the Act.

Recognition and Initial Measurement of Securities

4. A security on acquisition shall be recognised at actual cost.

5. The actual cost of a security shall comprise of its purchase price and include acquisition charges such as brokerage, fees, tax, duty or cess.

6. Where a security is acquired in exchange for other securities, the fair value of the security so acquired shall be its actual cost.

7. Where a security is acquired in exchange for another asset, the fair value of the security so acquired shall be its actual cost.

8. Where unpaid interest has accrued before the acquisition of an interest-bearing security and is included in the price paid for the security, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; the pre-acquisition portion of the interest is deducted from the actual cost.

Subsequent Measurement of Securities

9. At the end of any previous year, securities held as stock-in-trade shall be valued at actual cost initially recognised or net realisable value at the end of that previous year, whichever is lower.

10. For the purpose of para 9, the comparison of actual cost initially recognised and net realisable value shall be done categorywise and not for each individual security. For this purpose, securities shall be classified into the following categories, namely:-

(a) shares;

(b) debt securities;

(c) convertible securities; and

(d) any other securities not covered above.

11. The value of securities held as stock-in-trade of a business as on the beginning of the previous year shall be:

(a) the cost of securities available, if any, on the day of the commencement of the business when the business has commenced during the previous year; and

(b) the value of the securities of the business as on the close of the immediately preceding previous year, in any other case.

12. Notwithstanding anything contained in para 9, 10 and 11, at the end of any previous year, securities not listed on a recognised stock exchange; or listed but not quoted on a recognised stock exchange with regularity from time to time, shall be valued at actual cost initially recognised.

13. For the purposes of para 9, 10 and 11 where the actual cost initially recognised cannot be ascertained by reference to specific identification, the cost of such security shall be determined on the basis of first-in-first-out method or weighted average cost formula.

Part B

Scope

1. This part of Income Computation and Disclosure Standard deals with securities held by a scheduled bank or public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 (1 of 1956) or the Companies Act, 2013 (18 of 2013).

Definitions

2(1) The following terms are used in this part of Income Computation and Disclosure Standard with the meanings specified:

(a) "Scheduled Bank" shall have the meaning assigned to it in clause (ii) of the Explanation to clause (viia) of sub-section (1) of section 36 of the Act.

(b) "Securities" shall have the meaning assigned to it in clause (h) of Section 2 of the Securities Contract (Regulation) Act, 1956 (42 of 1956) and shall include share of a company in which public are not substantially interested;

2(2) Words and expressions used and not defined in this part of Income Computation and Disclosure Standard but defined in the Act shall have the meaning respectively assigned to them in the Act.

Classification, Recognition and Measurement of Securities

3. Securities shall be classified, recognised and measured in accordance with the extant guidelines issued by the Reserve Bank of India in this regard and any claim for deduction in excess of the said guidelines shall not be taken into account. To this extent, the provisions of Income Computation and Disclosure Standard VI on the effect of changes in foreign exchange rates relating to forward exchange contracts shall not apply."

I. Income Computation and Disclosure Standard IX relating to borrowing costs

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of account.

In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. (1) This Income Computation and Disclosure Standard deals with treatment of

borrowing costs.

(2) This Income Computation and Disclosure Standard does not deal with the actual or imputed cost of owners' equity and preference share capital.

Definitions

2. (1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

(a) "Borrowing costs" are interest and other costs incurred by a person in connection with the borrowing of funds and include:

(i) commitment charges on borrowings;

(ii) amortised amount of discounts or premiums relating to borrowings;

(iii) amortised amount of ancillary costs incurred in connection with the arrangement of borrowings;

(iv) finance charges in respect of assets acquired under finance leases or under other similar arrangements.

(b) "Qualifying asset" means:

(i) land, building, machinery, plant or furniture, being tangible assets;

(ii) know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;

(iii) inventories that require a period of twelve months or more to bring them to a saleable condition.

(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meaning assigned to them in the Act.

Recognition

3. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation shall be determined in accordance with this Income Computation and Disclosure Standard. Other borrowing costs shall be recognised in accordance with the provisions of the Act.

4. For the purposes of this Income Computation and Disclosure Standard, "capitalisation" in the context of inventory referred to in item (iii) of clause (b) of sub-paragraph (1) of

paragraph 2means addition of borrowing cost to the cost of inventory.

Borrowing Costs Eligible for Capitalisation

5. Subject to paragraph 8, the extent to which funds are borrowed specifically for the purposes of acquisition, construction or production of a qualifying asset, the amount of borrowing costs to be capitalised on that asset shall be the actual borrowing costs incurred during the period on the funds so borrowed.

"6. Subject to Para 8, in respect of borrowing other than those referred to in Para 5, if any, the amount of borrowing costs to be capitalised shall be computed in accordance with the following formula namely :—

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

Where

A = borrowing costs incurred during the previous year except on borrowings referred to in Para 5 above;

B = (i) the average of costs of qualifying asset as appearing in the balance sheet of a person on the first day and the last day of the previous year;

(ii) in case the qualifying asset does not appear in the balance sheet of a person on the first day, half of the cost of qualifying asset; or

(iii) in case the qualifying asset does not appear in the balance sheet of a person on the last day of the previous year, the average of the costs of qualifying asset as appearing in the balance sheet of a person on the first day of the previous year and on the date of put to use or completion, as the case may be, excluding the extent to which the qualifying assets are directly funded out of specific borrowings;

C = the average of the amount of total assets as appearing in the balance sheet of a person on the first day and the last day of the previous year, other than assets to the extent they are directly funded out of specific borrowings;

Explanation — For the purpose of this paragraph, a qualifying asset shall be such asset that necessarily require a period of twelve months or more for its acquisition, construction or production.

Commencement of Capitalisation

7. The capitalisation of borrowing costs shall commence:

   (a) in a case referred to in paragraph 5, from the date on which funds were borrowed;

   (b) in a case referred to in paragraph 6, from the date on which funds were utilised.

Cessation of Capitalisation

8. Capitalisation of borrowing costs shall cease:

   (a) in case of a qualifying asset referred to in item (i) and (ii) of clause (b) of sub-paragraph (1) of paragraph 2, when such asset is first put to use;

   (b) in case of inventory referred to in item (iii) of clause (b) of sub-paragraph (1) of paragraph 2, when substantially all the activities necessary to prepare such inventory for its intended sale are complete.

9. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part shall cease:—

   (a) in case of part of a qualifying asset referred to in item (i) and (ii) of clause (b) of sub- paragraph (1) of paragraph 2, when such part of a qualifying asset is first put to use;

   (b) in case of part of inventory referred to in item (iii) of clause (b) of sub-paragraph (1) of paragraph 2, when substantially all the activities necessary to prepare such part of inventory for its intended sale are complete.

Transitional Provisions

10. All the borrowing costs incurred on or after 1st day of April, 2016 shall be capitalised for the previous year commencing on or after 1st day of April, 2016 in accordance with the provisions of this standard after taking into account the amount of borrowing costs capitalised, if any, for the same borrowing for any previous year ending on or before 31st day of March,2016.

Disclosure

11. The following disclosure shall be made in respect of borrowing costs, namely:—

   (a) the accounting policy adopted for borrowing costs; and

   (b) the amount of borrowing costs capitalised during the previous year.

J. Income Computation and Disclosure Standard X relating to provisions, contingent liabilities and contingent assets

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. This Income Computation and Disclosure Standard deals with provisions, contingent liabilities and contingent assets, except those:

(a) resulting from financial instruments;

(b) resulting from executory contracts;

(c) arising in insurance business from contracts with policyholders; and

(d) covered by another Income Computation and Disclosure Standard.

2. This Income Computation and Disclosure Standard does not deal with the recognition of revenue which is dealt with by Income Computation and Disclosure Standard - Revenue Recognition.

3. The term 'provision' is also used in the context of items such as depreciation, impairment of assets and doubtful debts which are adjustments to the carrying amounts of assets and are not addressed in this Income Computation and Disclosure Standard.

Definitions

4(1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

(a) "Provision" is a liability which can be measured only by using a substantial degree of estimation.

(b) "Liability" is a present obligation of the person arising from past events, the settlement of which is expected to result in an outflow from the person of resources embodying economic benefits.

(c) "Obligating event" is an event that creates an obligation that results in a person having no realistic alternative to settling that obligation.

(d) "Contingent liability" is:

(i) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the person; or

(ii) a present obligation that arises from past events but is not recognised because:

(A) it is not reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(B) a reliable estimate of the amount of the obligation cannot be made.

(e) "Contingent asset" is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the person.

(f) "Executory contracts" are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

(g) "Present obligation" is an obligation if, based on the evidence available, its existence at the end of the previous year is considered reasonably certain.

4(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meaning respectively assigned to them in the Act.

Recognition

Provisions

5. A provision shall be recognised when:

(a) a person has a present obligation as a result of a past event;

(b) it is reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recognised.

6. No provision shall be recognised for costs that need to be incurred to operate in the future.

7. It is only those obligations arising from past events existing independently of a person's future actions, that is the future conduct of its business, that are recognised as provisions

8. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is enacted.

Contingent Liabilities

9. A person shall not recognise a contingent liability.

Contingent Assets

10. A person shall not recognise a contingent asset.

11. Contingent assets are assessed continually and when it becomes reasonably certain that inflow of economic benefit will arise, the asset and related income are recognised in the previous year in which the change occurs.

Measurement

Best Estimate

12. The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the previous year. The amount of a provision shall not be discounted to its present value.

13. The amount recognised as asset and related income shall be the best estimate of the value of economic benefit arising at the end of the previous year. The amount and related income shall not be discounted to its present value.

Reimbursements

14. Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when it is reasonably certain that reimbursement will be received if the person settles the obligation. The amount recognised for the reimbursement shall not exceed the amount of the provision.

15. Where a person is not liable for payment of costs in case the third party fails to pay, no provision shall be made for those costs.

16. An obligation, for which a person is jointly and severally liable, is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.

Review

17. Provisions shall be reviewed at the end of each previous year and adjusted to reflect the current best estimate. If it is no longer reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

18. An asset and related income recognised as provided in para 11 shall be reviewed at the end of each previous year and adjusted to reflect the current best estimate. If it is no longer reasonably certain that an inflow of economic benefits will arise, the asset and related income shall be reversed.

Use of Provisions

19. A provision shall be used only for expenditures for which the provision was originally recognised.

Transitional Provisions

20. All the provisions or assets and related income shall be recognised for the previous year commencing on or after 1st day of April, 2016 in accordance with the provisions of this standard after taking into account the amount recognised, if any, for the same for any previous year ending on or before 31st day of March,2016.

Disclosure

21(1) Following disclosure shall be made in respect of each class of provision, namely:-

(a) a brief description of the nature of the obligation;

(b) the carrying amount at the beginning and end of the previous year;

(c) additional provisions made during the previous year, including increases to existing provisions;

(d) amounts used, that is incurred and charged against the provision, during the previous year;

(e) unused amounts reversed during the previous year; and

(f) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

21(2) Following disclosure shall be made in respect of each class of asset and related income recognised as provided in para 11, namely:—

(a) a brief description of the nature of the asset and related income;

(b) the carrying amount of asset at the beginning and end of the previous year;

(c) additional amount of asset and related income recognised during the year, including increases to assets and related income already recognised; and

(d) amount of asset and related income reversed during the previous year.

Final Course

(Revised Scheme of Education and Training)

Study Material

(Modules 1 to 4)

Paper 7

Direct Tax Laws and International Taxation

Part – I: Direct Tax Laws

[As amended by the Finance (No.2) Act, 2019]

Assessment Year 2020-21

Module – 2

(Relevant for May, 2020 and
November, 2020 examinations)

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This study material has been prepared by the faculty of the Board of Studies. The objective of the study material is to provide teaching material to the students to enable them to obtain knowledge in the subject. In case students need any clarifications or have any suggestions for further improvement of the material contained herein, they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the study material has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

Permission of the Institute is essential for reproduction of any portion of this material.

© *The Institute of Chartered Accountants of India*

All rights reserved. No part of this book may be reproduced, stored in a retrieval system, or transmitted, in any form, or by any means, electronic, mechanical, photocopying, recording, or otherwise, without prior permission, in writing, from the publisher.

Edition	:	October, 2019
Website	:	www.icai.org
E-mail	:	bosnoida@icai.in
Committee/ Department	:	Board of Studies
ISBN No.	:	
Price (All Modules)	:	₹
Published by	:	The Publication Department on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi 110 002, India.
Printed by	:	

CONTENTS

PART I : DIRECT TAX LAWS

MODULE – 1

Chapter 1 : Basic Concepts

Chapter 2 : Residence and Scope of Total Income

Chapter 3 : Incomes which do not form part of Total Income

Chapter 4 : Salaries

Chapter 5 : Income from House Property

Chapter 6 : Profits and Gains of Business or Profession

Chapter 7 : Capital Gains

Chapter 8 : Income from Other Sources

MODULE – 2

Chapter 9 : Income of Other Persons included in assessee's Total Income

Chapter 10 : Aggregation of income; set-off, or carry forward and set-off, of Losses

Chapter 11 : Deductions from Gross Total Income

Chapter 12 : Assessment of Various Entities

Chapter 13: Assessment of Charitable or Religious Trusts or Institutions, Political Parties and Electoral Trusts

Chapter 14 : Tax Planning, Tax Avoidance & Tax Evasion

MODULE – 3

Chapter 15 : Deduction, Collection and Recovery of tax

Chapter 16 : Income-tax Authorities

Chapter 17 : Assessment Procedure

Chapter 18 : Appeals and Revision

Chapter 19 : Settlement of Tax Cases

Chapter 20 : Penalties

Chapter 21 : Offences and Prosecution

Chapter 22 : Liability in Special Cases

Chapter 23 : Miscellaneous Provisions

PART II: INTERNATIONAL TAXATION

MODULE - 4

Chapter 1 : Transfer Pricing & Other Anti-Avoidance Measures

Chapter 2: Non-resident Taxation

Chapter 3 : Double Taxation Relief

Chapter 4 : Advance Rulings

Chapter 5 : Equalisation levy

Chapter 6 : Application and Interpretation of Tax Treaties

Chapter 7 : Fundamentals of Base Erosion and Profit Shifting

Chapter 8 : Overview of Model Tax Conventions

DETAILED CONTENTS : MODULE - 2

CHAPTER 9- INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME

Learning Outcomes 9.1

Contents:

9.1 Clubbing of Income-An introduction 9.2

9.2 Income of other person's includible in assessee's total income 9.2

9.3 Income of other person's includible in individual's total income] 9.3

9.4 Cross transfers 9.10

9.5 Conversion of self-acquired property into the property of a Hindu undivided family [Section 64(2)] 9.11

9.6 Income includes loss 9.12

9.7 Distinction between section 61 and section 64 .... 9.12

9.8 Liability of person in respect of income included in the income of another person [Section 65] 9.12

Exercise 9.14

CHAPTER 10-AGGREGATION OF INCOME, SET OFF AND CARRY FORWARD OF LOSSES

Learning Outcomes 10.1

Contents:

10.1 Aggregation of Income 10.2

10.2 Concept of set-off and carry forward of losses 10.2

10.3 Inter-source adjustments [Section 70] 10.2

10.4 Inter-head adjustments [Section 71] 10.3

10.5 Carry forward and set off of loss from house property [Section 71B] 10.5

10.6 Carry forward and set-off of business losses [Section 72] 10.5

10.7 Carry forward and set-off of accumulated business losses and unabsorbed depreciation in certain cases of amalgamation/demerger, etc. [Section 72A] 10.8

10.8 Carry forward and set off of accumulated business losses and unabsorbed depreciation of a banking company against the profit of a banking institution under a scheme of amalgamation [Section 72AA].. 10.11

10.9 Carry forward and set off of accumulated loss and unabsorbed depreciation in business reorganisation of Co-operative Banks [Section 72AB]................ 10.12

10.10 Losses in speculation business [Section 73] 10.14

10.11 Carry forward & set-off of losses by specified businesses [Section 73A] 10.15

10.12 Losses under head 'Capital Gains' [Section 74] 10.16

10.13 Losses from the activity of owning and maintaining race horses [Section 74A(3)]... 10.17

10.14 Carry forward and set-off of losses in case of change in constitution of firm or succession [Section 78] 10.19

10.15 Carry forward and set-off of losses in case of closely held companies [Section 79].. 10.19

10.16 Order of set-off of losses 10.21

10.17 Submission of Return for Losses (Section 80)... 10.23

Exercise 10.24

Significant Select Cases 10.29

CHAPTER 11 – DEDUCTIONS FROM GROSS TOTAL INCOME

Learning Outcomes 11.1

Contents:

11.1 General provisions...11.2

11.2 Deductions in respect of payments..11.5

11.3 Deductions in respect of certain incomes 11.48

11.4 Deductions in respect of other income...11.85

11.5 Other Deductions...11.89

Exercise 11.90

Significant Select Cases...11.98

CHAPTER 12 – ASSESSMENT OF VARIOUS ENTITITES

Learning Outcomes 12.1

Contents:

12.1 Assessment of Companies 12.2

12.2 Tax on income distributed by specified company or a mutual fund [Chapter XII-E: Sections 115R, 115S, 115T] 12.59

12.3 Taxation Regime for Securitization Trusts and its Investors 12.62

12.4 Scheme for taxation of Real Estate Investment Trust (REIT) and Infrastructure Investment Trust (INVIT) [Chapter XII-FA: Section 115UA] 12.65

12.5 Special taxation regime for Investment Funds and income received from such funds [Chapter XII-FB] [Sections 115UB, 10(23 FBA) & 10(23FBB)] 12.75

12.6 Assessment of other entities 12.82

12.7 Other provisions related to various entities 12.125

Exercise 12.134

Significant Select Cases 12.162

Annexure 1: Special Provisions for taxation of income of certain domestic companies A-2

Annexure 2: Rate of Surcharge applicable to Individuals/ HUFs/AOPs/BOIs for A.Y.2020-21 .... A-8

Annexure 3: Rates of surcharge applicable on tax on total income of an AOPs/BOIs(having any income under section 115AD) for payment of advance tax for A.Y.2020-21 .... A-10

CHAPTER 13- CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS, POLITICAL PARTIES AND ELECTROAL TRUSTS

Learning Outcomes 13.1

Contents:

13.1 Introduction 13.2

13.2 Income of Universities, Hospitals, Educational Institutions, Medical Institutions etc. [Section 10(23C)]. 13.2

13.3 Charitable or Religious Trusts and Institutions [Sections 11 to 13] 13.7

13.4 Tax on accreted income of certain trusts and Institutions [Chapter XII-EB] 13.42

13.5 Exemption to political parties [Section 13A] 13.52

13.6 Exemption for voluntary contributions received by Electoral Trusts [Section 13B]........ 13.54

Exercise 13.61

Significant Select Cases 13.67

CHAPTER 14 – TAX PLANNING, TAX EVASION AND TAX AVOIDANCE

Learning Outcomes........ 14.1

Contents:

14.1 Tax planning, Tax evasion and tax avoidance-An Overview 14.2

14.2 Tax planning considerations in respect of salary income 14.20

14.3 Tax planning considerations in relation to business 14.23

14.4 General Anti-avoidance Rules 14.44

Exercise 14.62

CHAPTER 9

INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME

LEARNING OUTCOMES

After studying this chapter, you would be able to -

❑ **examine** the cases where clubbing provisions would be attracted;

❑ **examine** the circumstances when income of minor child, has to be included in the hands of parent and exemption available in respect of such included income;

❑ **examine** the circumstances when the income of HUF has to be included in the hands of its member(s);

❑ **apply** the clubbing provisions to determine the amount of income which need to be included in the hands of another person;

❑ **examine** the cases of cross transfers to determine the person in whose hands the income arising from assets transferred has to be included and the portion of income that has to be included;

❑ **compute** the income under different heads of income after applying the clubbing provisions.

9.1 CLUBBING OF INCOME – AN INTRODUCTION

Under the Income-tax Act, 1961, an assessee is generally taxed in respect of his own income. However, there are certain cases where as assessee has to pay tax in respect of income of another person. The provisions for the same are contained in sections 60 to 65 of the Act. These provisions have been enacted to counteract the tendency on the part of the tax-payers to dispose of their property or transfer their income in such a way that their tax liability can be avoided or reduced.

Example:

In the case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive i.e. as the income increases, the applicable rate of tax increases. Some taxpayers in the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been incorporated in the Act, under which income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person who has diverted his income for the purpose of computing tax liability.

9.2 INCOME OF OTHER PERSON'S INCLUDIBLE IN ASSESSEE'S TOTAL INCOME

(1) Transfer of income without transfer of asset [Section 60]

(i) If any person transfers the income from any asset without transferring the asset itself, such income is to be included in the total income of the transferor.

(ii) It is immaterial whether the transfer is revocable or irrevocable and whether it was made before the commencement of this Act or after its commencement.

Example:

Mr. A confers the right to receive rent in respect of his house property on his wife, Mrs. A, without transferring the house itself to her. In this case, the rent received by Mrs. A will be clubbed with the income of Mr. A.

(2) Income arising from revocable transfer of assets [Section 61]

All income arising to any person by virtue of a revocable transfer of assets is to be included in the total income of the transferor.

Meaning of revocable transfer [Section 63]

Transfer is deemed to be revocable if—

(i) it contains any provision for the retransfer, directly or indirectly, of the whole or any part of the income or assets to the transferor, or

(ii) it gives, in any way to the transferor, a right to reassume power, directly or indirectly, over the whole or any part of the income or the assets.

This clubbing provision will operate even if only part of income of the transferred asset had been applied for the benefit of the transferor. Once the transfer is revocable, the entire income from the transferred asset is includible in the total income of the transferor.

Exceptions where clubbing provisions are not attracted even in case of revocable transfer [section 62]

Section 61 will not apply to any income arising to any person in the following two cases -

(i) **Transfer not revocable during the life time of the beneficiary or the transferee –** If there is a transfer of asset which is not revocable during the life time of the transferee, the income from the transferred asset is not includible in the total income of the transfer or provided the transferor derives no direct or indirect benefit from such income.

If the transferor receives direct or indirect benefit from such income, such income is to be included in his total income even though the transfer may not be revocable during the life time of the transferee.

(ii) **Transfer made before April 1, 1961 and not revocable for a period exceeding six years -** Income arising from the transfer of an asset before 1.4.61, which was not revocable for a period exceeding six years, is not includible in the total income of the transferor provided the transferor does not derive direct or indirect benefit from such income.

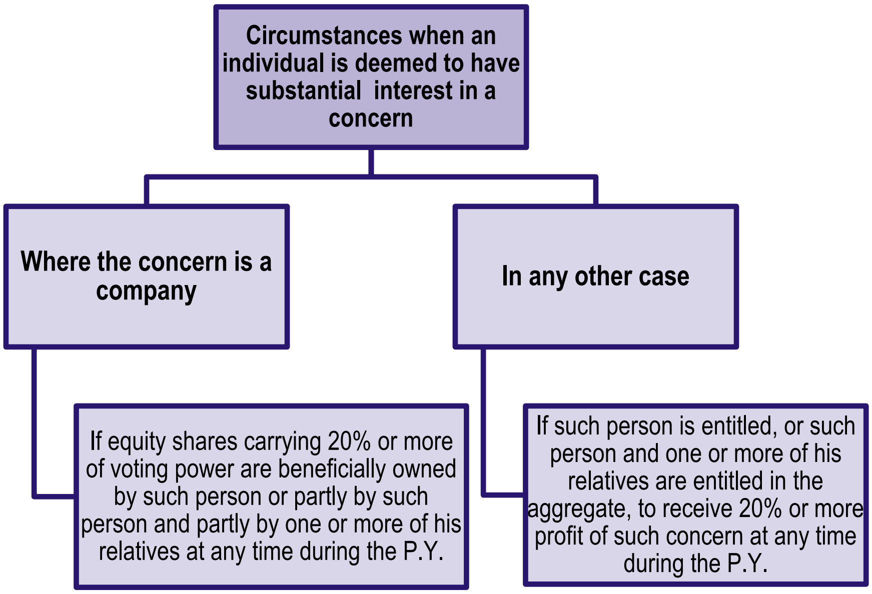
In both the above cases, as and when the power to revoke the transfer arises, the income arising by virtue of such transfer will be included in the total income of the transferor.

9.3 INCOME OF OTHER PERSON'S INCLUDIBLE IN INDIVIDUAL'S TOTAL INCOME

(1) Clubbing of income arising to spouse

(I) Income by way of remuneration from a concern in which the individual has substantial interest [Section 64(1)(ii)]

(i) **Remuneration in cash or kind to spouse from a concern in which the individual has substantial interest to be clubbed:** In computing the total income of any individual, all such income which arises, directly or indirectly, to the spouse of such individual by way of salary, commission, fees or any other form of remuneration, whether in cash or in kind, from a concern in which such individual has a substantial interest shall be included.


Circumstances when an individual is deemed to have substantial interest in a concern
Where the concern is a company
In any other case
If equity shares carrying 20% or more of voting power are beneficially owned by such person or partly by such person and partly by one or more of his relatives at any time during the P.Y.
If such person is entitled, or such person and one or more of his relatives are entitled in the aggregate, to receive 20% or more profit of such concern at any time during the P.Y.

The term **'relative'** in relation to an individual means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual [Section 2(41)].

(ii) **Clubbing provisions will not apply where remuneration is received on account of technical or professional qualifications:** Clubbing provisions, however, does not apply where the spouse of the said individual possesses technical or professional qualifications and the income to the spouse is solely attributable to the application of his/her technical or professional knowledge or experiences. In such an event, the income arising to such spouse is to be assessed in his/her hands.

(iii) **Both husband and wife have substantial interest in a concern:** Where both husband and wife have substantial interest in a concern and both are in receipt of income by way of salary etc. from the said concern, such income will be includible in the hands of that spouse, whose total income, excluding such income is higher.

Where any such income is once included in the total income of either spouse, income arising in the succeeding year shall not be included in the total income of the other spouse unless the Assessing Officer is satisfied, after giving that spouse an opportunity of being heard, that it is necessary to do so.

ILLUSTRATION 1

Mr. A holds shares carrying 25% voting power in X Ltd. Mrs. A is working as a computer software programmer in X Ltd. at a salary of ₹ 30,000 p.m. She is, however, not qualified for the job. The other income of Mr. A & Mrs. A are ₹ 7,00,000 & ₹ 4,00,000, respectively. Compute the gross total income of Mr. A and Mrs. A for the A.Y.2020-21.

SOLUTION

Mr. A holds shares carrying 25% voting power in X Ltd i.e. a substantial interest in the company. His wife is working in the same company without any professional qualifications for the same. Thus, by virtue of the clubbing provisions of the Act, the salary received by Mrs. A from X Ltd. will be clubbed in the hands of Mr. A.

Computation of Gross total income of Mr. A

Particulars	₹	₹
Salary received by Mrs. A (₹ 30,000 × 12)	3,60,000	
Less: Standard deduction under section 16(ia)	50,000	3,10,000
Other Income		7,00,000
Gross total income		**10,10,000**

The gross total income of Mrs. A is ₹ 4,00,000.

ILLUSTRATION 2

Will your answer be different if Mrs. A was qualified for the job?

SOLUTION

If Mrs. A possesses professional qualifications for the job, then the clubbing provisions shall not be applicable.

Gross total income of Mr. A = ₹ 7,00,000 (other income)

Gross total income of Mrs. A = Salary received by Mrs. A [₹ 30,000×12] *less* ₹ 50,000, being the standard deduction under section 16(ia) *plus* other income [₹ 4,00,000] = ₹ 7,10,000

ILLUSTRATION 3

Mr. B holds shares carrying 30% voting power in Y Ltd. Mrs. B is working as accountant in Y Ltd. getting income from salary (computed) of ₹ 3,44,000 without any qualification in accountancy. Mr. B also receives ₹ 30,000 as interest on securities. Mrs. B owns a house property which she has let out. Rent received from tenants is ₹ 6,000 p.m. Compute the gross total income of Mr. B and Mrs. B for the A.Y. 2020-21.

SOLUTION

Since Mrs. B is not professionally qualified for the job, the clubbing provisions shall be applicable.

Computation of Gross total income of Mr. B

Particulars	₹
Income from Salary of Mrs. B (Computed)	3,44,000
Income from other sources	
- Interest on securities	30,000
	3,74,000

Computation of gross total income of Mrs. B

Particulars	₹	₹
Income from Salary [clubbed in the hands of Mr. B]		Nil
Income from house property		
Gross Annual Value [₹ 6,000 × 12]	72,000	
Less: Municipal taxes paid	-	
Net Annual Value (NAV)	**72,000**	
***Less:* Deductions under section 24**		
- 30% of NAV i.e., 30% of ₹ 72,000	21,600	
- Interest on loan	-	50,400
Gross total income		**50,400**

(II) Income arising to the spouse from an asset transferred without adequate consideration [Section 64(1)(iv)]

(i) **Transfer of asset (other than house property):** Where there is a transfer of an asset (other than house property), directly or indirectly, from one spouse to the other, otherwise than for adequate consideration or in connection with an agreement to live apart, any income arising to the transferee-spouse from the transferred asset, either directly or indirectly, shall be included in the total income of the transferor-spouse.

(ii) **Transfer of house property:** In the case of transfer of house property, the provisions are contained in section 27. If an individual transfers a house property to his spouse, without adequate consideration or otherwise than in connection with an agreement to live apart, the transferor shall be deemed to be the owner of the house property and its annual value will be taxed in his hands.

(iii) **Income from accretion of the transferred asset:** It may be noted that any income from the accretion of the transferred asset is not to be clubbed with the income of the transferor.

The income arising on transferred assets alone have to be clubbed. However, income earned by investing such income (arising from transferred asset) cannot be clubbed.

(iv) **Meaning of adequate consideration:** It is also to be noted that natural love and affection do not constitute adequate consideration. Therefore, where an asset is transferred without adequate consideration, the income from such asset will be clubbed in the hands of the transferor.

(v) **Transferred asset invested in business:** Where the assets transferred, directly or indirectly, by an individual to his spouse are invested by the transferee in the business, proportionate income arising from such investment is to be included in the total income of the transferor. If the investment is in the nature of contribution of capital, proportionate interest on capital will be clubbed with the income of the transferor.

Such proportion has to be computed by taking into account the value of the aforesaid investment **as on the first day of the previous year** to the total investment in the business or by way of capital contribution in a firm as a partner, as the case may be, by the transferee as on that day.

ILLUSTRATION 4

Mr. Vaibhav started a proprietary business on 01.04.2018 with a capital of ₹ 5,00,000. He incurred a loss of ₹ 2,00,000 during the year 2018-19. To overcome the financial position, his wife Mrs. Vaishaly, a software engineer, gave a gift of ₹ 5,00,000 on 01.04.2019, which was immediately invested in the business by Mr. Vaibhav. He earned a profit of ₹ 4,00,000 during the year 2019-20. Compute the amount to be clubbed in the hands of Mrs. Vaishaly for the Assessment Year 2020-21. If Mrs. Vaishaly gave the said amount as loan, what would be the amount to be clubbed?

SOLUTION

Section 64(1)(iv) of the Income-tax Act, 1961 provides for the clubbing of income in the hands of the individual, if the income earned is from the assets (other than house property) transferred directly or indirectly to the spouse of the individual, otherwise than for adequate consideration or in connection with an agreement to live apart.

In this case, Mr. Vaibhav received a gift of ₹ 5,00,000 on 1.4.2019 from his wife Mrs. Vaishaly, which he invested in his business immediately. The income to be clubbed in the hands of Mrs. Vaishaly for the A.Y. 2020-21 is computed as under:

Particulars	Mr. Vaibhav's capital contribution (₹)	Capital contribution out of gift from Mrs. Vaishaly (₹)	Total (₹)
Capital as on 1.4.2019	3,00,000 (5,00,000 – 2,00,000)	5,00,000	8,00,000
Profit for P.Y.2019-20 to be apportioned on the basis of capital employed on the first day of the previous year i.e. as on 1.4.2019 (3:5)	1,50,000 $\left(4,00,000 \times \frac{3}{8}\right)$	2,50,000 $\left(4,00,000 \times \frac{5}{8}\right)$	4,00,000

Therefore, the income to be clubbed in the hands of Mrs. Vaishaly for the A.Y.2020-21 is ₹ 2,50,000.

In case Mrs. Vaishaly gave the said amount of ₹ 5,00,000 as a *bona fide* loan, then, clubbing provisions would not be attracted.

Note: *The provisions of section 56(2)(x) would not be attracted in the hands of Mr. Vaibhav, since he has received a sum of money exceeding ₹ 50,000 without consideration from a relative i.e., his wife.*

(III) Transfer of assets for the benefit of spouse [Section 64(1)(vii)]

All income arising directly or indirectly to any persons or association of persons, from the assets transferred, directly or indirectly, to such person or association of persons by an individual without adequate consideration is includible in the income of the transferor to the extent such income is used by the transferee for the immediate or deferred benefit of the transferor's spouse.

(2) Clubbing of income arising to son's wife

(I) Income arising to son's wife from the assets transferred without adequate consideration by the father-in-law or mother-in-law [Section 64(1)(vi)]

(i) **Asset transferred without adequate consideration:** Where an asset is transferred, directly or indirectly, by an individual to his or her son's wife without adequate consideration, the income from such asset is to be included in the total income of the transferor.

(ii) **Asset transferred invested in the business:** For this purpose, where the assets transferred directly or indirectly by an individual to his or her son's wife are invested by the transferee in the business, proportionate income arising from such investment is to be included in the total income of the transferor. If the investment is in the nature of contribution of capital, the proportionate interest on capital will be clubbed with the income of the transferor.

Such proportion has to be computed by taking into account the value of the aforesaid investment **as on the first day of the previous year** to the total investment in the business or by way of capital contribution in a firm as a partner, as the case may be, by the transferee as on that day.

(II) Transfer of assets for the benefit of son's wife [Section 64(1)(viii)]

All income arising directly or indirectly, to any person or association of persons from the assets transferred, directly or indirectly, without adequate consideration, to such person or association of persons by an individual will be included in the total income of the individual to the extent such income is used by the transferee for the immediate or deferred benefit of the transferor's son's wife.

Note: *Where any asset is transferred by any person to any person without consideration or for inadequate consideration, the provisions of 56(2)(x) would get attracted in the hands of transferee, if conditions specified thereunder are satisfied.*

ILLUSTRATION 5

Mrs. Kasturi transferred her immovable property to ABC Co. Ltd. subject to a condition that out of the rental income, a sum of ₹ 36,000 per annum shall be utilized for the benefit of her son's wife.

Mrs. Kasturi claims that the amount of ₹ 36,000 (utilized by her son's wife) should not be included in her total income as she no longer owned the property.

Examine with reasons whether the contention of Mrs. Kasturi is valid in law.

SOLUTION

The clubbing provisions under section 64(1)(viii) are attracted in case of transfer of any asset, directly or indirectly, otherwise than for adequate consideration, to any person to the extent to which the income from such asset is for the immediate or deferred benefit of son's wife. Such income shall be included in computing the total income of the transferor-individual.

Therefore, income of ₹ 36,000 meant for the benefit of daughter-in-law is chargeable to tax in the hands of transferor i.e., Mrs. Kasturi in this case.

The contention of Mrs. Kasturi is, hence, not valid in law.

Note - *In order to attract the clubbing provisions under section 64(1)(viii), the transfer should be otherwise than for adequate consideration. In this case, it is presumed that the transfer is otherwise than for adequate consideration and therefore, the clubbing provisions are attracted. In such case, the provisions of section 56(2)(x) will also get attracted in the hands of ABC Co Ltd., if stamp duty value exceeds ₹ 50,000 and the other conditions specified thereunder are satisfied.*

If it is presumed that the transfer was for adequate consideration, the provisions of section 64(1)(viii) would not be attracted.

(3) Clubbing of minor's income

(i) All income of a minor is to be included in the income of his parent.

(ii) However, the income derived by the minor from manual work or from any activity involving his skill, talent or specialised knowledge or experience will not be included in the income of his parent.

(iii) The income of the minor will be included in the income of that parent, whose total income is greater.

(iv) Once clubbing of minor's income is done with that of one parent, it will continue to be clubbed with that parent only, in subsequent years. The Assessing Officer, may, however, club the minor's income with that of the other parent, if, after giving the other parent an opportunity to be heard, he is satisfied that it is necessary to do so.

(v) Where the marriage of the parents does not subsist, the income of the minor will be includible in the income of that parent who maintains the minor child in the relevant previous year.

(vi) However, the income of a minor child suffering from any disability of the nature specified in section 80U shall not be included in the hands of the parent but shall be assessed in the hands of the child.

(vii) It may be noted that the clubbing provisions are attracted even in respect of income of minor married daughter.

Child in relation to an individual includes a step-child and an adopted child of that individual. [Section 2(15B)]

Exemption in respect of clubbed income of minor [Section 10(32)]

In case the income of an individual (i.e. the parent) includes the income of his/her minor child in terms of section 64(1A), such parent shall be entitled to exemption of ₹ 1,500 in respect of each minor child. However, if income of any minor so includible is less than ₹ 1,500, then the entire income shall be exempt.

ILLUSTRATION 6

Mr. A has three minor children – two twin daughters and one son. Income of the twin daughters is ₹ 2,000 p.a. each and that of the son is ₹ 1,200 p.a. Compute the income, in respect of minor children, to be clubbed in the hands of Mr. A.

SOLUTION

Taxable income, in respect of minor children, in the hands of Mr. A is

Particulars	₹	₹
Twin minor daughters [₹ 2,000 × 2]	4,000	
Less: Exempt under section 10(32) [₹ 1,500 × 2]	3,000	1,000
Minor son	1,200	
Less: Exempt under section 10(32)	1,200	Nil
Income to be clubbed in the hands of Mr. A		**1,000**

9.4 CROSS TRANSFERS

In the case of cross transfers also (e.g., A making gift of ₹ 50,000 to the wife of his brother B for the purchase of a house by her and a simultaneous gift by B to A's minor son of shares in a foreign company worth ₹ 50,000 owned by him), the income from the assets transferred would be assessed in the hands of the deemed transferor if the transfers are so intimately connected as to form part of a single transaction, and each transfer constitutes consideration for the other by being mutual or otherwise. Thus, in the instant case, the transfers have been made by A and B to persons who are not their spouse or minor child so as to circumvent the provisions of this section, showing that such transfers constituted consideration for each other.

The Supreme Court, in case of *CIT* v. *Keshavji Morarji [1967] 66 ITR 142,* observed that if two transactions are inter-connected and are parts of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted. Accordingly, the income arising to Mrs. B from the house property should be included in the total income of B and the dividend from shares transferred to A's minor son would be taxable in the hands of A. This is because A and B are the indirect transferors to their minor child and spouse, respectively, of income-yielding assets, so as to reduce their burden of taxation.

ILLUSTRATION 7

Mr. Vasudevan gifted a sum of ₹ 6 lakhs to his brother's wife on 14-6-2019. On 12-7-2019, his brother gifted a sum of ₹ 5 lakhs to Mr. Vasudevan's wife. The gifted amounts were invested as fixed deposits in banks by Mrs. Vasudevan and wife of Mr. Vasudevan's brother on 01-8-2019 at 9% interest. Discuss the consequences of the above under the provisions of the Income-tax Act, 1961 in the hands of Mr. Vasudevan and his brother.

SOLUTION

In the given case, Mr. Vasudevan gifted a sum of ₹ 6 lakhs to his brother's wife on 14.06.2019 and simultaneously, his brother gifted a sum of ₹ 5 lakhs to Mr. Vasudevan's wife on 12.07.2019. The gifted amounts were invested as fixed deposits in banks by Mrs. Vasudevan and his brother's wife. These transfers are in the nature of cross transfers. Accordingly, the income from the assets transferred would be assessed in the hands of the deemed transferor because the transfers are so intimately connected to form part of a single transaction and each transfer constitutes consideration for the other by being mutual or otherwise.

If two transactions are inter-connected and are part of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted. It was so held by the Apex Court in *CIT vs. Keshavji Morarji (1967) 66 ITR 142*.

Accordingly, the interest income arising to Mrs. Vasudevan in the form of interest on fixed deposits would be included in the total income of Mr. Vasudevan and interest income arising in the hands of his brother's wife would be taxable in the hands of Mr. Vasudevan's brother as per section 64(1), to the extent of amount of cross transfers i.e., ₹ 5 lakhs.

This is because both Mr. Vasudevan and his brother are the indirect transferors of the income to their respective spouses with an intention to reduce their burden of taxation.

However, the interest income earned by his spouse on fixed deposit of ₹ 5 lakhs alone would be included in the hands of Mr. Vasudevan's brother and not the interest income on the entire fixed deposit of ₹ 6 lakhs, since the cross transfer is only to the extent of ₹ 5 lakhs.

9.5 CONVERSION OF SELF-ACQUIRED PROPERTY INTO THE PROPERTY OF A HINDU UNDIVIDED FAMILY [SECTION 64(2)]

Section 64(2) deals with the case of conversion of self-acquired property into property of a Hindu undivided family.

(1) Where an individual, who is a member of the HUF, converts at any time after 31-12-1969, his individual property into property of the HUF of which he is a member or throws such property into the common stock of the family or otherwise transfers such individual property, directly or indirectly, to the family otherwise than for adequate consideration, the income from such property shall continue to be included in the total income of the individual.

(2) Where the converted property has been partitioned, either by way of total or partial partition, the income derived from such converted property as is received by the spouse on partition will be deemed to arise to the spouse from assets transferred indirectly by the individual to the spouse and consequently, such income shall also be included in the total income of the individual who effected the conversion of such property.

(3) Where income from the converted property is included in the total income of an individual under section 64(2), it will be excluded from the total income of the family or, as the case may be, of the spouse of the individual.

9.6 INCOME INCLUDES LOSS

It is significant to note that as per the *Explanation 2* to section 64, 'income' would include 'loss'. Accordingly, where the specified income to be included in the total income of the individual is a loss, such loss will be taken into account while computing the total income of the individual. It is significant to note that this *Explanation* applies to clubbing provisions under both sections 64(1) and 64(2).

9.7 DISTINCTION BETWEEN SECTION 61 AND SECTION 64

It may be noted that the main distinction between the two sections is that section 61 applies only to a revocable transfer made by any person while section 64 applies to revocable as well as irrevocable transfers made only by individuals.

9.8 LIABILITY OF PERSON IN RESPECT OF INCOME INCLUDED IN THE INCOME OF ANOTHER PERSON [SECTION 65]

Sections 61 to 64 provide for clubbing of income of one person in the hands of the other in circumstances specified therein. However, service of notice of demand (in respect of tax on such income) may be made upon the person to whom such asset is transferred (i.e. the transferee). In such a case, the transferee is liable to pay that portion of tax levied on the transferor which is attributable to the income so clubbed.

Similar provision will be applicable in case of deemed ownership of house property under section 27 i.e., transfer of house property otherwise than for adequate consideration to spouse, not being in connection with agreement to live apart or to minor child not being a minor married daughter.

ILLUSTRATION 8

Mr. Ravi has gifted his only house property to his wife, Mrs. Ravi, and his married daughter, Mrs. Divya. The Assessing Officer has served a notice of demand on Mr. Ravi for payment of tax for the income derived from the said house property. Examine the validity of the Assessing Officer's action.

Answer

As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, or to a minor child not being a married daughter shall be deemed to be the owner of the house property so transferred.

Mr. Ravi, in this case, would be the deemed owner only in respect of the share of house property transferred to his wife Mrs. Ravi without consideration and not for the share of the house property transferred to his married daughter Mrs. Divya.

Since Mr. Ravi is the deemed owner of the share of house property transferred to his wife without consideration, the income derived from the house property, to the extent attributable to the share of property transferred to his wife without consideration, would be taxable in his hands under the head "Income from house property".

As per section 65, the notice of demand can, however, be served on Mrs. Ravi for payment of that portion of tax levied on Mr. Ravi attributable to the income derived [by virtue of section 27(i)], from the share of house property transferred to Mrs. Ravi, and standing in her name.

However, the income derived from house property, attributable to the share of property transferred to his married daughter without consideration, would be taxable in the hands of his daughter. Such income would not be taxable in the hands of Mr. Ravi. Mr. Ravi will not be responsible for the payment of tax attributable to aforesaid share of income of daughter from house property.

Thus, the action of the Assessing Officer in serving notice of demand on Mr. Ravi for payment of tax for the entire income derived from the said house property is not valid.

EXERCISE

Question 1

Mrs. E, wife of Mr. F, is a partner in a firm. Her capital contribution to the firm as on 01-04-2019 was ₹ 5 lacs, out of which ₹ 3 lacs was contributed out of her own sources and ₹ 2 lacs was contributed out of gift from her husband.

As further capital was needed by the firm, she further invested ₹ 2 lacs on 01.05.2019 out of the funds gifted by her husband. The firm paid interest on capital of ₹ 80,000 and share of profit of ₹ 60,000 for the financial year 2019-20.

Advise Mr. F as to the applicability of the provisions of section 64(1)(iv) and the manner thereof in respect of the above referred transactions.

Answer

As per section 64(1)(iv), in computing the total income of any individual, there shall be included all such income as arises, directly or indirectly, subject to the provisions of section 27(i), to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart.

In this instant case, Mr. F has gifted money to his wife, Mrs. E. Mrs. E, in turn, invested such gifted money in the capital of a partnership firm, of which she is a partner. Mrs. E has also contributed a sum of ₹ 3 lacs out of her own resources to the capital of the firm.

As per *Explanation 3* to section 64(1), for the purpose of clubbing under section 64(1)(iv), where the assets transferred, directly or indirectly, by an individual to his spouse are invested by the transferee in the nature of contribution of capital as a partner in a firm, proportionate interest on capital will be clubbed with the income of the transferor. Such proportion has to be computed by taking into account the value of the aforesaid investment as on the first day of the previous year to the total investment by way of capital contribution as a partner in the firm as on that day.

In view of the above provision, interest received by Mrs. E from the firm shall be included in total income of Mr. F to the extent of ₹ 32,000 i.e., ₹ 80,000 x ₹ 2,00,000/ ₹ 5,00,000.

Share of profit amounting to ₹ 60,000 is exempt from income-tax under the provisions of section 10(2A). The provisions of section 64 will not apply, if the income from the transferred asset itself is exempt from tax.

Note: *It is assumed that rate of interest on capital contributed by Mrs. E does not exceed 12% p.a.*

Question 2

Mr. A has gifted a house property valued at ₹ 50 lakhs to his wife, Mrs. B, who in turn has gifted the same to Mrs. C, their daughter-in-law. The house was let out at ₹ 25,000 per month throughout the year. Compute the total income of Mr. A and Mrs. C.

Will your answer be different if the said property was gifted to his son, husband of Mrs. C?

Answer

As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, shall be deemed to be the owner of the house property so transferred.

Therefore, in this case, Mr. A would be the deemed owner of the house property transferred to his wife Mrs. B without consideration.

As per section 64(1)(vi), income arising to the son's wife from assets transferred, directly or indirectly, to her by an individual otherwise than for adequate consideration would be included in the total income of such individual.

Income from let-out property is ₹ 2,10,000 [i.e., ₹ 3,00,000, being the actual rent calculated at ₹ 25,000 per month *less* ₹ 90,000, being deduction under section 24 @30% of ₹ 3,00,000]

In this case, income of ₹ 2,10,000 from let-out property arising to Mrs. C, being Mr. A's son's wife, would be included in the income of Mr. A, applying the provisions of section 27(i) and section 64(1)(vi). Such income would, therefore, not be taxable in the hands of Mrs. C.

In case the property was gifted to Mr. A's son, the clubbing provisions under section 64 would not apply, since the son is not a minor child. Therefore, the income of ₹ 2,10,000 from letting out of property gifted to the son would be taxable in the hands of the son.

It may be noted that the provisions of section 56(2)(x) would not be attracted in the hands of the recipient of house property, since the receipt of property in each case was from a "relative" of such individual. Therefore, the stamp duty value of house property would not be chargeable to tax in the hands of the recipient of immovable property, even though the house property was received by her or him without consideration.

Note - *The first part of the question can also be answered by applying the provisions of section 64(1)(vi) directly to include the income of ₹ 2,10,000 arising to Mrs. C in the hands of Mr. A. [without first applying the provisions of section 27(i) to deem Mr. A as the owner of the house property transferred to his wife Mrs. B without consideration], since section 64(1)(vi) speaks of clubbing of income arising to son's wife from indirect transfer of assets to her by her husband's parent, without consideration. Gift of house property by Mr. A to Mrs. C, via Mrs. B, can be viewed as an indirect transfer by Mr. A to Mrs. C.*

Question 3

Mr. Korani transferred 2,000 debentures of ₹ 100 each of Wild Fox Ltd. to his wife Mrs. Rekha Korani on 3.10.2018 without consideration. The company paid interest of ₹ 30,000 in September, 2019 which was deposited by Mrs. Korani with Kartar Finance Co. in October, 2019. Kartar Finance Co. paid interest of ₹ 3,000 upto March, 2020. How would both the interest income be charged to tax in A.Y. 2020-21?

Answer

As per section 64(1)(iv), income arising from assets transferred without adequate consideration by an individual to his spouse is liable to be clubbed in the hands of the individual. It may be noted that income on the asset transferred has to be clubbed but if there is accretion to the asset, any further income derived on such accretion should not be clubbed.

Therefore, applying the provisions of section 64(1)(iv), ₹ 30,000, being the interest on debentures received by Mrs. Rekha Korani in September, 2019 will be clubbed with the income of Mr. Korani, since he had transferred the debentures of the company without consideration to her in October, 2018.

However, the interest of ₹ 3,000 upto March, 2020 earned by Mrs. Rekha Korani on the interest on the debentures deposited by her with Kartar Finance Company shall be taxable in her individual capacity and will not be clubbed with the income of Mr. Korani.

Question 4

Mr. Rose, out of his own funds, had taken an FDR for ₹ 10,00,000 bearing interest @10% p.a. payable half-yearly in the name of his wife Lilly. The interest earned during the financial year 2019-20 of ₹ 1,00,000 was invested by Mrs. Lilly in the business of packed spices which resulted in a net profit of ₹ 55,000 for the year ended 31.03.2020. How shall the interest on FDR and income from business be taxed for the Assessment Year 2020-21?

Answer

Section 64(1)(iv) specifies that the income derived by the spouse of an assessee from the assets transferred directly or indirectly without adequate consideration or intention to live apart shall be clubbed with the income of the transferor. Therefore, the interest income of ₹ 1 lac on the FDR of ₹ 10 lacs for the F.Y.2019-20 shall be clubbed with the income of Mr. Rose.

When Mrs. Lilly invested the interest income in a business and earned profits therefrom, such profits shall not be clubbed with the income of her husband but shall be taxable in her individual capacity. This is so because the income from the accretion of the transferred assets is not to be clubbed with the income of the transferor *[CIT v. M. S. S. Rajan (2001) 252 ITR 126 (Mad)]*.

Question 5

Naresh is a fashion designer having lucrative business. His wife is a model. Naresh pays her monthly salary of ₹ 10,000. The Assessing Officer while admitting that the salary is an admissible deduction, in computing the total income of Naresh had applied the provisions of section 64(1), and had clubbed the income (salary) of his wife in Naresh hands.

Discuss the correctness of the action of the Assessing Officer.

Answer

This question is based on the principles laid down by Madras High Court in the case of *CIT v. Smt. R. Bharati (1999) 240 ITR 697* where the interpretation of the terms "professional qualifications" and "knowledge" came up for consideration as per proviso to section 64(1).

These words do not necessarily connote a qualification conferred by a recognized university after examining the candidate who has undergone a course of study in a technical subject or course of study preparing him for a profession of law, accountancy etc. Accordingly, the term "qualification" must be given a wide meaning as referring to the qualities which are required to be possessed by a person performing the work that he does, so long as that work is capable of being regarded as technical or professional.

The word "professional" is a term capable of very broad meaning and would encompass a variety of occupations. A large number of occupations are being practiced which form a source of livelihood and are capable of being regarded, as professions as long as they require certain degree of skill. A person having skill, experience and competence in a line of work can be regarded as professionally qualified for the purpose of section 64(1)(ii).

Applying the rationale of the Madras High Court ruling, a model, having skill, competence and experience in her line can be considered as a professional. Hence, the action of the Assessing Officer is not correct.

CHAPTER 10

AGGREGATION OF INCOME, SET OFF OR CARRY FORWARD OF LOSSES

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **identify** the permissible inter-source and inter-head adjustments for set-off of losses and the restrictions in inter-source and inter-head set-off of losses;
- **determine** the unabsorbed losses which can be carried forward to the subsequent assessment year for set-off against income of that year and the maximum period of carry forward of such losses;
- **appreciate** the provisions regarding carry forward and set-off of losses in case of closely held companies and eligible start-ups as also in case of change in constitution of firms;
- **appreciate** the conditions which are required to be satisfied by the amalgamating company and the amalgamated company for carry forward and set-off of loss of the amalgamating company by the amalgamated company;
- **appreciate** the special provisions for carry forward and set-off of losses of a banking company against the profits of a banking institution under a scheme of amalgamation;
- **compute** the gross total income of an assessee after applying the provisions relating to set-off and carry forward and set-off of losses.

10.1 AGGREGATION OF INCOME

In certain cases, some amounts are deemed as income in the hands of the assessee though they are actually not in the nature of income. These cases are contained in sections 68, 69, 69A, 69B, 69C and 69D. These are discussed in detail in Chapter 1. The Assessing Officer may require the assessee to furnish explanation in such cases. If the assessee does not offer any explanation or the explanation offered by the assessee is not satisfactory, the amounts referred to in these sections would be deemed to be the income of the assessee. Such amounts have to be aggregated with the assessee's income.

10.2 CONCEPT OF SET OFF AND CARRY FORWARD OF LOSSES

Specific provisions have been made in the Income-tax Act, 1961 for the set-off and carry forward of losses. In simple words, "Set-off" means adjustment of losses against the profits from another source/head of income in the same assessment year. If losses cannot be set-off in the same year due to inadequacy of eligible profits, then such losses are carried forward to the next assessment year for adjustment against the eligible profits of that year. The maximum period for which different losses can be carried forward for set-off has been provided in the Act.

10.3 INTER SOURCE ADJUSTMENTS [SECTION 70]

(1) Inter-source set-off of losses

Under this section, the losses incurred by the assessee in respect of one source shall be set-off against income from any other source under the same head of income, since the income under each head is to be computed by grouping together the net result of the activities of all the sources covered by that head. In simpler terms, loss from one source of income can be adjusted against income from another source, both the sources being under the same head.

Examples:

1. *Loss from one house property can be set off against the income from another house property.*
2. *Loss from one business, say textiles, can be set off against income from any other business, say printing, in the same year as both these sources of income fall under one head of income. Therefore, the loss in one business may be set-off against the profits from another business in the same year.*

(2) Impermissible inter-source set-off

Inter-source set-off, however, is not permissible in the following cases -

(i) **Long-term capital loss [Section 70(3)]**

Short-term capital loss is allowed to be set off against both short-term capital gain and long-term capital gain. However, long-term capital loss can be set-off only against long-term capital gain and not short-term capital gain.

(ii) **Speculation loss [Section 73(1)]**

A loss in speculation business can be set-off only against the profits of any other speculation business and not against any other business or professional income.

However, losses from other business can be adjusted against profits from speculation business.

(iii) **Loss from the activity of owning and maintaining race horses [Section 74A(3)]**

Such loss can be set-off only against income from the activity of owing and maintaining race horses.

(iv) **Losses from specified business [Section 73A(1)]**

A loss in any specified business referred in section 35AD can be set-off only against any other specified business.

However, losses from other business can be set-off against profits from specified business.

> It must be noted that **loss from an exempt source** cannot be set-off against profits from a taxable source of income. For example, share of loss from a partnership firm cannot be set-off against business income, since share of income of the firm is exempt under section 10(2A).

10.4 INTER HEAD ADJUSTMENTS [SECTION 71]

Loss under one head of income can be adjusted or set off against income under another head. However, the following points should be considered:

(1) **Loss under any head other than capital gains:** Where the net result of the computation under any head of income (other than 'Capital Gains') is a loss, the assessee can set-off such loss against his income assessable for that assessment year under any other head, including 'Capital Gains'.

(2) **Loss under the head "Profits and gains from business or profession:** Where the net result of the computation under the head "Profits and gains of business or profession" is a loss, such loss cannot be set off against income under the head "Salaries".

(3) **Loss under the head "Capital Gains":** Where the net result of computation under the head 'Capital Gains' is a loss, such capital loss cannot be set-off against income under any other head.

(4) **Loss under the head "Income from house property":** Where the net result of the computation under the head "Income from house property" is a loss and the assessee has income assessable under any other head of income, the amount of such loss exceeding ₹ 2 lakhs would not be allowable to be set-off against income under the other head. In other words, the maximum loss from house property which can be set-off against income from any other head is ₹ 2 lakhs.

(5) **Speculation loss, loss from the activity of owning and maintaining race horses and losses from specified business referred to in section 35AD** cannot be set off against income under any other head.

ILLUSTRATION 1

Mr. A (aged 35 years) submits the following particulars pertaining to the A.Y.2020-21:

Particulars	*₹*
Income from salary (computed)	*4,00,000*
Loss from self-occupied property	*(-)70,000*
Loss from let-out property	*(-) 1,50,000*
Business loss	*(-)1,00,000*
Bank interest (FD) received	*80,000*

Compute the total income of Mr. A for the A.Y.2020-21.

SOLUTION

Computation of total income of Mr. A for the A.Y.2020-21

Particulars	Amount (₹)	Amount (₹)
Income from salary	4,00,000	
Less: Loss from house property of ₹ 2,20,000 to be restricted to ₹ 2 lakhs by virtue of section 71(3A)	(-) 2,00,000	2,00,000
Balance loss of ₹ 20,000 from house property to be carried forward to next assessment year		
Income from other sources (interest on fixed deposit with bank)	80,000	
Business loss set-off (Business loss of ₹ 20,000 to be carried forward for set-off against business income of the next assessment year)	(-) 1,00,000	-
Gross total income [See Note below]		**2,00,000**
Less: Deduction under Chapter VI-A		Nil
Total income		**2,00,000**

Note: *Gross Total Income includes salary income of ₹ 2,00,000 after adjusting loss of ₹ 2,00,000 from house property. The balance loss of ₹ 20,000 from house property to be carried forward to next assessment year for set-off against income from house property of that year.*

Business loss of ₹ 1,00,000 is set off against bank interest of ₹ 80,000 and remaining business loss of ₹ 20,000 will be carried forward as it cannot be set off against salary income.

10.5 CARRY FORWARD AND SET OFF OF LOSS FROM HOUSE PROPERTY [SECTION 71B]

(1) **Set-off and Carry Forward & Set-off of losses:** In any assessment year, if there is a loss under the head 'Income from house property', such loss will first be set-off against income from any other head to the extent of ₹ 2,00,000 during the same year. The unabsorbed loss will be carried forward to the following assessment year to be set-off against income under the head 'Income from house property'.

(2) **Maximum period for carry forward & set-off of losses:** The loss under this head is allowed to be carried forward upto 8 assessment years immediately succeeding the assessment year in which the loss was first computed.

Example:

Loss from one house property can be adjusted against the profits from another house property in the same assessment year. Any loss under the head 'Income from house property' can be set off against any income under any other head to the extent of ₹ 2,00,000 in the same assessment year. However, if after such set off, there is still any loss under the head "Income from house property", then, the same shall be carried forward to the next year.

Note - It is to be remembered that once a particular loss is carried forward, it can be set off only against the income from the same head in the forthcoming assessment years.

10.6 CARRY FORWARD AND SET OFF OF BUSINESS LOSSES [SECTION 72]

Under the Act, the assessee has the right to carry forward the losses under the business and profession in cases where such loss cannot be set-off due to the absence or inadequacy of income under any other head in the same year. The loss so carried forward can be set-off against the profits of subsequent previous years.

Section 72 covers the carry forward and set-off of losses arising from a business or profession.

Conditions

The assessee's right to carry forward business losses under this section is, however, subject to the following conditions:-

(1) The loss should have been incurred in business, profession or vocation.

(2) The loss should not be in the nature of a loss in the business of speculation.

(3) **Loss from one business can be carried forward & set-off against the income from any other business:** The loss may be carried forward and set-off against the income from business or profession though not necessarily against the profits and gains of the same business or profession in which the loss was incurred.

However, a loss carried forward cannot, under any circumstances, be set-off against the income from any head other than "Profits and gains of business or profession".

(4) **Person who incurred the loss alone is entitled to carry forward & set-off the loss:** The loss can be carried forward and set off only against the profits of the assessee who incurred the loss. That is, only the person who has incurred the loss is entitled to carry forward or set off the same. Consequently, the successor of a business cannot carry forward or set off the losses of his predecessor except in the case of succession by inheritance.

(5) **Maximum period for carry forward & set-off of losses:** A business loss can be carried forward for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.

(6) **Rehabilitation of business [Proviso to section 72(1)]**

If there is a loss sustained in a business which is discontinued in the circumstances mentioned under section 33B and such business is re-established, reconstructed or revived by the assessee within 3 years from the end of previous year of discontinuation, the loss attributable to such business

(i) shall be allowed to be set off against the profits and gains, if any, of that business or any other business carried on by him and assessable for that assessment year, and

(ii) if the loss cannot be wholly so set off, the amount of balance loss to be carried to the following assessment year and so on for 7 assessment years immediately succeeding provided such re-established business is continued to be carried by the assessee.

Note: Circumstances referred to in section 33B

The business is formed as re-establishment, reconstruction or revival by the assessee of the business of such industrial undertaking which is discontinued by reason of extensive damage to or destruction of, any building, machinery, plant or furniture owned by the assessee and used for the purpose of such business.

Such damage or destruction should be affected as a direct result of flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature or riot or civil disturbance or accidental fire or explosion or action by an enemy or action taken in combating an enemy.

ILLUSTRATION 2

Mr. B, a resident individual, furnishes the following particulars for the P.Y.2019-20:

Particulars	*₹*
Income from salary (computed)	*45,000*
Income from house property	*(24,000)*
Income from business – non-speculative	*(22,000)*
Income from speculative business	*(4,000)*
Short-term capital losses	*25,000*
Long-term capital gains u/s 112	*19,000*

What is the total income chargeable to tax for the A.Y.2020-21?

SOLUTION

Total income of Mr. B for the A.Y. 2020-21

Particulars	Amount (₹)	Amount (₹)
Income from salaries	45,000	
Income from house property	(24,000)	21,000
Profits and gains of business and profession		
Business loss to be carried forward **[Note 1]**	(22,000)	
Speculative loss to be carried forward **[Note 2]**	(4,000)	
Capital Gains		
Long term capital gain	19,000	
Short term capital loss	(25,000)	
Short term capital loss to be carried forward **[Note 3]**	(6,000)	-
Taxable income		**21,000**

Note 1: Business loss cannot be set-off against salary income. Therefore, loss of ₹ 22,000 from the non-speculative business cannot be set off against the income from salaries. Hence, such loss has to be carried forward to the next year for set-off against business profits, if any.

Note 2: Loss of ₹ 4,000 from the speculative business can be set off only against the income from the speculative business. Hence, such loss has to be carried forward.

Note 3: Short term capital loss can be set off against both short term capital gain and long term capital gain. Therefore, short term capital loss of ₹ 25,000 can be set-off against long-term capital gains to the extent of ₹ 19,000. The balance short term capital loss of ₹ 6,000 cannot be set-off against any other income and has to be carried forward to the next year for set-off against capital gains, if any.

10.7 CARRY FORWARD AND SET OFF OF ACCUMULATED BUSINESS LOSSES AND UNABSORBED DEPRECIATION IN CERTAIN CASES OF AMALGAMATION/ DEMERGER, ETC. [SECTION 72A]

(1) Amalgamation

Applicability: This section applies where there has been an amalgamation of –

(i) a company owning an industrial undertaking or a ship or a hotel with another company; or

(ii) an amalgamation of a banking company with a specified bank; or

(iii) public sector companies engaged in the business of operation of aircrafts.

Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by amalgamated company in case of amalgamation: It provides that the accumulated loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or depreciation, as the case may be, of the amalgamated company for the previous year in which the amalgamation took place. Other provisions of the Act relating to set off and carry forward shall also apply accordingly.

Conditions for availing benefit under this section

(i) Conditions to be fulfilled by the amalgamating company

(a) The amalgamating company should have been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for 3 or more years.

(b) The amalgamating company has held continuously as on the date of amalgamation, at least 3/4th of the book value of the fixed assets held by it, 2 years prior to the date of amalgamation.

(ii) Conditions to be fulfilled by the amalgamated company

(a) The amalgamated company should hold at least 3/4th in the book value of fixed assets of the amalgamating company acquired as a result of amalgamation for a minimum period of 5 years from the effective date of amalgamation.

(b) The amalgamated company continues the business of the amalgamating company for at least 5 years.

(c) The amalgamated company must also fulfill such other conditions prescribed under Rule 9C for the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose -

(1) The amalgamated company shall achieve the level of production of at least 50% of the installed capacity (capacity of production as on the date of amalgamation) of the said undertaking before the end of 4 years from the date of amalgamation and continue to maintain the said minimum level of production till the end of 5 years from the date of amalgamation. Central Government has the power to modify this requirement on an application made by the amalgamated company.

(2) The amalgamated company shall furnish to the Assessing Officer a certificate in the prescribed form verified by a Chartered Accountant in this regard.

Consequences of non-fulfillment of specified conditions: In case the above specified conditions are not fulfilled, that part of carry forward of loss and unabsorbed depreciation remaining to be utilized by the amalgamated company shall lapse and such loss or depreciation as has been set-off shall be treated as the income in the year in which there is a failure to fulfill the conditions.

(2) Demerger

Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by resulting company in case of demerger: Where there has been a demerger of an undertaking,

- the accumulated loss and the unabsorbed depreciation directly relatable to the undertaking transferred by the demerged company to the resulting company shall be allowed to be carried forward and set off in the hands of the resulting company.
- if the accumulated loss or unabsorbed depreciation is not directly relatable to the undertaking, the same will be apportioned between the demerged company and the resulting company in the same proportion in which the value of the assets retained by the demerged company and have been transferred to the resulting company.

Conditions for availing benefit under this section: The Central Government is empowered to notify such conditions as it considers necessary to ensure that the demerger is for genuine business purpose.

(3) Re-organisation of business

Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by company in case of succession: In case of re-organisation of business, whereby a firm is succeeded by a company as per the provisions of section 47(xiii), or a sole proprietary concern is succeeded by a company as per the provisions of section 47(xiv), then the accumulated business loss and the unabsorbed depreciation of the firm / proprietary concern, as the case may be, shall be deemed to be the loss or depreciation allowance of the successor company for the previous year in which the business re-organisation took place. Other provisions of the Act relating to set-off and carry forward will apply accordingly.

Consequences of non-fulfillment of specified conditions: If it is found that any of the conditions laid down in the corresponding sub-sections (xiii) or (xiv) of section 47 have not been complied with, the set-off of loss or allowance of depreciation made in any previous year in the hands of the successor company shall be deemed to be the income of the company chargeable to tax in the year in which the conditions have been violated.

(4) Conversion of a company into LLP [Section 72A(6A)]

Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by LLP in case of conversion: In case of re-organisation of business, whereby a private company or unlisted company is succeeded by a LLP as per the provisions of section 47(xiiib), then the successor LLP would be allowed to carry forward and set-off the business loss and unabsorbed depreciation of the predecessor company.

Consequences of non-fulfillment of specified conditions: If the entity fails to fulfill the conditions specified in section 47(xiiib), the benefit of set-off of business loss/unabsorbed depreciation availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfill any of the conditions.

(5) Meanings of certain terms

Term	Particulars
Accumulated loss	It means so much of the loss of - the predecessor firm or - the proprietary concern or - the private company or unlisted company or - the amalgamating company or - the demerged company, as the case may be, under the head "Profit and gains of business or profession" (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72, if the re-organisation of business or amalgamation or demerger had not taken place.
Industrial undertaking	It means any undertaking which is engaged in - (i) the manufacture or processing of goods; (ii) the manufacture of computer software; (iii) the business of generation or distribution of electricity or any other form of power; (iv) providing telecommunication services, whether basic or cellular,

	including radio paging, domestic satellite service, network of trunking, broad band network and internet services. (v) mining; (vi) the construction of ships, aircraft or rail systems.
Unabsorbed depreciation	Unabsorbed depreciation means so much of the allowance for depreciation of - the predecessor firm or - the proprietary concern or - the private company or unlisted company or - the amalgamating company or - the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the re-organisation of business or amalgamation or demerger had not taken place
Specified bank	It means the State Bank of India (SBI) constituted under the SBI Act, 1955 or a subsidiary bank as defined in the SBI (Subsidiary Banks) Act, 1959 or a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.

10.8 CARRY FORWARD AND SET OFF OF ACCUMULATED BUSINESS LOSSES AND UNABSORBED DEPRECIATION OF A BANKING COMPANY AGAINST THE PROFIT OF A BANKING INSTITUTION UNDER A SCHEME OF AMALGAMATION [SECTION 72AA]

(1) **Applicability:** This section provides for carry forward and set off of accumulated loss and unabsorbed depreciation allowance of a banking company against the profits of a banking institution under a scheme of amalgamation sanctioned by the Central Government.

(2) **Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by banking institution in case of amalgamation:** Where a banking company has been amalgamated with a banking institution under a scheme sanctioned and brought into force by the Central Government under section 45(7) of the Banking Regulation Act, 1949, the accumulated loss and unabsorbed depreciation of the amalgamating banking company shall be deemed to be the loss or the allowance for depreciation of the banking institution for the

previous year in which the scheme of amalgamation is brought into force, and all the provisions contained in the Income-tax Act, 1961, relating to set off and carry forward of loss and unabsorbed depreciation shall apply accordingly.

(3) **Meaning of certain terms:**

Term	Particulars
Accumulated loss	It means so much of the loss of the amalgamating banking company under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such amalgamating banking company, would have been entitled to carry forward and set-off under the provisions of section 72 if the amalgamation had not taken place.
Banking company	It has the same meaning assigned to it in section 5(c) of the Banking Regulation Act, 1949
Banking institution	It has the same meaning assigned to it in section 45(15) of the Banking Regulation Act, 1949.
Unabsorbed depreciation	It means so much of the allowance for depreciation of the amalgamating banking company which remains to be allowed and which would have been allowed to such banking company if the amalgamation had not taken place.

10.9 CARRY FORWARD AND SET OFF OF ACCUMULATED LOSS AND UNABSORBED DEPRECIATION IN BUSINESS REORGANISATION OF CO-OPERATIVE BANKS [SECTION 72AB]

(1) **Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by a co-operative bank in case of reorganisation:** Under this section, in a case where the amalgamation has taken place during the previous year, set-off of accumulated loss and the unabsorbed depreciation of the predecessor co-operative bank will be allowed in the hands of the successor co-operative bank as if the amalgamation had not taken place. All the other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation would apply accordingly.

(2) **Conditions for availing benefit under this section**

(i) **Conditions to be fulfilled by the predecessor co-operative bank**

(a) It should have been engaged in the business of banking for three or more years; and

(b) It has held at least 3/4thof the book value of fixed assets as on the date of the business reorganisation, continuously for 2 years prior to the date of business reorganisation;

(ii) Conditions to be fulfilled by the successor co-operative bank

(a) It should hold at least 3/4thof the book value of fixed assets of the predecessor co-operative bank acquired through business reorganisation, continuously for a minimum period of 5 years immediately succeeding the date of business reorganisation;

(b) It continues the business of the predecessor co-operative bank for a minimum period of 5 years from the date of business reorganisation; and

(c) It fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor co-operative bank or to ensure that the business reorganisation is for genuine business purpose.

(3) Quantum allowed of accumulated loss and unabsorbed depreciation: The amount of set-off of the accumulated loss and unabsorbed depreciation allowable to the resulting co-operative bank has to be calculated in the following manner -

(i) **In a case where the whole of the amount of such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting co-operative bank** - the entire accumulated loss or unabsorbed depreciation of the demerged co-operative bank is allowed to be set-off.

(ii) **In a case where the accumulated loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting co-operative bank** - the amount which bears the same proportion to the accumulated loss or unabsorbed depreciation of the demerged co-operative bank as the assets of the undertaking transferred to the resulting co-operative bank bears to the assets of the demerged co-operative bank.

Example:

If A Co-op Bank is the demerged co-operative bank and B Co-op Bank is the resulting co-operative bank, the amount of set-off of the accumulated loss and unabsorbed depreciation allowable to B Co-op. bank would be –

$$\begin{array}{c}\text{Unabsorbed business loss/depreciation}\\ \text{of A Co-op bank}\end{array} \times \frac{\text{Assets of the undertaking transferred to B Co-op bank}}{\text{Assets of A Co-op bank}}$$

(4) Additional conditions for availing benefit under this section: The Central Government may specify other conditions by notification in the Official Gazette as it considers necessary, to ensure that the business reorganisation is for genuine business purposes.

(5) **Period before and after business reorganization to constitute two different previous years:** The period commencing from the beginning of the previous year and ending on the date immediately preceding the date of business reorganisation, and the period commencing from the date of such business reorganisation and ending with the previous year shall be deemed to be two different previous years for the purposes of set off and carry forward of loss and allowance for depreciation.

Example:

If the date on which business re-organisation took place is 1.11.2019, then the period between 1.4.2019 and 31.10.2019 and the period between 1.11.2019 and 31.3.2020 would be deemed to be two different previous years for the purposes of set-off and carry forward of unabsorbed business losses and depreciation.

(6) **Consequences of non-fulfillment of specified conditions:** In a case where the conditions specified in (2) above or notified under (4) above are not complied with, the set-off of accumulated loss or unabsorbed depreciation allowed in any previous year to the successor co-operative bank shall be deemed to be the income of the successor co-operative bank chargeable to tax for the year in which the conditions are not complied with.

(7) **Meaning of certain terms**

Term	Particulars
Accumulated loss	It means so much of loss of the amalgamating co-operative bank or the demerged co-operative bank, as the case may be, under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such amalgamating co-operative bank or the demerged co-operative bank, would have been entitled to carry forward and set-off under the provisions of section 72 as if the business reorganisation had not taken place.
Unabsorbed depreciation	It means so much of the allowance for depreciation of the amalgamating co-operative bank or the demerged co-operative bank, as the case may be, which remains to be allowed and which would have been allowed to such bank as if the business reorganisation had not taken place.

10.10 LOSSES IN SPECULATION BUSINESS [SECTION 73]

The meaning of the expression 'speculative transaction' as defined in section 43(5) and the treatment of income from speculation business has already been discussed under the head "Profits and gains of business or profession".

(1) **Set-off and Carry forward & set-off of loss from speculation business:** Since speculation is deemed to be a business distinct and separate from any other business

carried on by the assessee, the losses incurred in speculation can be neither set off in the same year against any other non-speculation income nor be carried forward and set off against other income in the subsequent years.

Therefore, if the losses sustained by an assessee in a speculation business cannot be set-off in the same year against any other speculation profit, they can be carried forward to subsequent years and set-off only against income from any speculation business carried on by the assessee.

(2) **Maximum period for carry forward & set-off of losses:** The loss in speculation business can be carried forward only for a **maximum period of 4 years** from the end of the relevant assessment year in respect of which the loss was computed. Loss from the activity of trading in derivatives, however, is not to be treated as speculative loss.

(3) **When a business of a company deemed to be carrying on a speculation business:** The *Explanation* to this section provides that where any part of the business of a company consists in the purchase and sale of the shares of other companies, such a company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares.

However, this deeming provision does not apply to the following companies –

(i) A company whose gross total income consists of mainly income chargeable under the heads “Income from house property”, “Capital gains” and “Income from other sources”;

(ii) A company, the principal business of which is –

(a) the business of trading in shares; or

(b) the business of banking; or

(c) the granting of loans and advances.

Thus, these companies would be exempted from the operation of this *Explanation*. Accordingly, if these companies carry on the business of purchase and sale of shares of other companies, they would not be deemed to be carrying on speculation business.

10.11 CARRY FORWARD & SET OFF OF LOSSES BY SPECIFIED BUSINESSES [SECTION 73A]

(1) **Set-off and Carry forward & set-off of losses of specified business:** Any loss computed in respect of the specified business referred to in section 35AD shall be set off only against profits and gains, if any, of any other specified business. The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year and so on.

(2) **Loss can be set-off indefinitely:** There is no time limit specified for carry forward and set-off and therefore, such loss can be carried forward indefinitely for set-off against income from specified business.

> **Note -** The loss of an assessee claiming deduction under section 35AD in respect of a specified business can be set-off against the profit of another specified business under section 73A, irrespective of whether the latter is eligible for deduction under section 35AD. An assessee can, therefore, set-off the losses of a hospital or hotel which begins to operate after 1st April, 2010 and which is eligible for deduction under section 35AD, against the profits of the existing business of operating a hospital (with atleast 100 beds for patients) or a hotel (of two-star or above category), even if the latter is not eligible for deduction under section 35AD.

10.12 LOSSES UNDER THE HEAD 'CAPITAL GAINS' [SECTION 74]

Carry forward & set-off of losses: Section 74 provides that where for any assessment year, the net result under the head 'Capital gains' is short term capital loss or long term capital loss, the loss shall be carried forward to the following assessment year to be set off in the following manner:

(1) **Short-term capital loss:** Where the loss so carried forward is a short-term capital loss, it shall be set off against any capital gains, short term or long term, arising in that year.

(2) **Long-term capital loss:** Where the loss so carried forward is a long-term capital loss, it shall be set off only against long term capital gain arising in that year.

(3) **Loss under head capital gains:** Net loss under the head capital gains cannot be set off against income under any other head.

(4) **Maximum period for carry forward & set-off of loss**: Any unabsorbed loss shall be carried forward to the following assessment year up to a maximum of 8 assessment years immediately succeeding the assessment year for which the loss was first computed.

> ***Note*** *- With effect from 1st April 2018, the long-term capital gain exceeding ₹ 1,00,000 arising on sale of equity shares or units of equity oriented fund or unit of business trust on which STT is paid*
>
> - *in respect of equity shares, both at the time of acquisition and sale and*
> - *in respect of units of equity oriented fund or unit of business trust, at the time of sale*
>
> *is taxable under section 112A @10%. Long-term capital loss on sale of such shares/units can, therefore, be set-off and carried forward for set-off against long-term capital gains by virtue of section 70(3) and section 74.*

ILLUSTRATION 3

During the P.Y. 2019-20, Mr. C has the following income and the brought forward losses:

Particulars	*₹*
Short term capital gains on sale of shares	*1,50,000*
Brought forward Long term capital loss of A.Y.2018-19	*(96,000)*
Short term capital loss of A.Y.2019-20	*(37,000)*
Long term capital gain	*75,000*

What is the capital gain taxable in the hands of Mr. C for the A.Y.2020-21?

SOLUTION

Taxable capital gains of Mr. C for the A.Y. 2020-21

Particulars	₹	₹
Short term capital gains on sale of shares	1,50,000	
Less: Brought forward short term capital loss of the A.Y.2019-20	(37,000)	1,13,000
Long term capital gain	75,000	
Less: Brought forward long term capital loss of A.Y.2018-19 **[See Note below]**	(75,000)	Nil
Taxable short-term capital gains		**1,13,000**

Note: Long-term capital loss cannot be set off against short-term capital gain. Hence, the unadjusted long term capital loss of A.Y.2018-19 of ₹ 21,000 (i.e. ₹ 96,000 – ₹ 75,000) has to be carried forward to the next year to be set-off against long-term capital gains of that year.

10.13 LOSSES FROM THE ACTIVITY OF OWNING AND MAINTAINING RACE HORSES [SECTION 74A(3)]

(1) **Set-off and Carry forward & set-off of loss:** According to provisions of section 74A(3), the losses incurred by an assessee from the activity of owning and maintaining race horses cannot be set-off against the income from any other source other than the activity of owning and maintaining race horses.

(2) **Maximum period for carry forward & set-off of losses:** Such loss can be carried forward for a maximum period of 4 assessment years immediately succeeding the assessment year for which the loss was first computed, for being set-off against the income from the activity of owning and maintaining race horses.

(3) Meaning of certain terms

Term	Meaning
Amount of loss incurred by the assessee in the activity of owning and maintaining race horses	**(i) In case assessee has no income by way of stake money –** amount of revenue expenditure incurred by the assessee wholly & exclusively for the purpose of maintaining race horses. **(ii) In case assessee has income by way of stake money -** The amount by which such income by way of stake money falls short of the amount of revenue expenditure incurred by the assessee wholly & exclusively for the purpose of maintaining race horses. i.e. Loss = Stake money – revenue expenditure for the purpose of maintaining race horses.
Horse race	A horse race upon which wagering or betting may be lawfully made.
Income by way of stake money	The gross amount of prize money received on a race horse or race horses by the owner thereof on account of the horse or horses or any one or more of the horses winning or being placed second or in any lower position in horse races.

ILLUSTRATION 4

Mr. D has the following income for the P.Y.2019-20-

Particulars	***₹***
Income from the activity of owning and maintaining the race horses	*75,000*
Income from textile business	*85,000*
Brought forward textile business loss	*(50,000)*
Brought forward loss from the activity of owning and maintaining the race horses (relating to A.Y.2017-18)	*(96,000)*

What is the total income in the hands of Mr. D for the A.Y. 2020-21?

SOLUTION

Total income of Mr. D for the A.Y. 2020-21

Particulars	**₹**	**₹**
Income from the activity of owning and maintaining race horses	75,000	
Less: Brought forward loss from the activity of owning and maintaining race horses	96,000	
Loss from the activity of owning and maintaining race horses to be carried forward to A.Y.2021-22	(21,000)	
Income from textile business	85,000	
Less: Brought forward business loss from textile business	50,000	35,000
Total income		**35,000**

Note: Loss from the activity of owning and maintaining race horses cannot be set-off against any other source/head of income.

10.14 CARRY FORWARD AND SET OFF OF LOSSES IN CASE OF CHANGE IN CONSTITUTION OF FIRM OR SUCCESSION [SECTION 78]

(1) **Change in constitution of firm:** Where there is a change in the constitution of a firm, so much of the loss proportionate to the share of a retired or deceased partner remaining unabsorbed, shall not be allowed to be carried forward by the firm. However, unabsorbed depreciation can be carried forward.

(2) **Succession otherwise by inheritance:** Where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by inheritance, such other person shall not be allowed to carry forward and set off against his income, any loss incurred by the predecessor.

(3) **Succession by inheritance:** Where there is a succession by inheritance, the legal heirs are entitled to set-off the business loss of the predecessor. Such carry forward and set-off is possible even if the legal heirs constitute themselves as a partnership firm. In such a case, the firm can carry forward and set-off the business loss of the predecessor.

10.15 CARRY FORWARD AND SET OFF OF LOSSES IN CASE OF CLOSELY HELD COMPANIES [SECTION 79]

(1) ***Carry forward and set-off of losses in case of closely held company not being an eligible start-up referred to in section 80-IAC***

In the case of a company in which the public are not substantially interested and not being an eligible start-up referred to in section 80-IAC, no loss incurred in any year prior to the previous year shall be carried forward and set-off against the income of the previous year, unless

- *on the last day of the previous year, the shares of the company carrying not less than 51% of the voting power were beneficially held by persons*
- *who beneficially held shares of the company carrying not less than 51% of the voting power on the last day of the year or years in which the loss was incurred.*

(2) ***Carry forward and set-off of losses in case of closely held company being an eligible start-up referred to in section 80-IAC***

In case of a company in which the public are not substantially interested but being an eligible start-up as referred to in section 80-IAC, any unabsorbed loss of the company shall be allowed to be carried forward and set off against the income of the previous year if either of the conditions are satisfied –

(a) *on the last day of the previous year, the shares of the company carrying not less than 51% of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than 51% of the voting power on the last day of the year or years in which the loss was incurred; or*

(b) all the shareholders of such company who held shares carrying voting power on the last day of the previous year or years in which the loss was incurred continue to hold those shares on the last day of such previous year in which the loss is to be set-off and such loss has been incurred during the period of 7 years beginning from the year of incorporation of such company.

(3) Non-applicability of restriction

This restriction shall, however, not apply :

(i) where a change in the voting power and shareholding takes place in a previous year consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making such gift;

(ii) where any change in shareholding takes place in an Indian company, being a subsidiary of a foreign company, as a result of amalgamation or demerger of the foreign company. However, this is subject to the condition that 51% of the shareholders of the amalgamating/ demerged company continue to be shareholders of the amalgamated/ resulting foreign company.

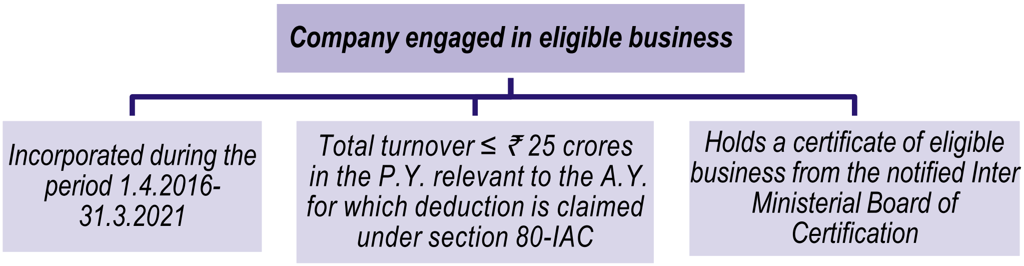
(iii) where a change in shareholding takes place in a previous year pursuant to a resolution plan approved under the Insolvency and Bankruptcy Code, 2016, after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.

(iv) to a company, and its subsidiary and the subsidiary of such subsidiary, where

(a) the Tribunal, on an application moved by the Central Government under section 241 of the Companies Act, 2013, has suspended the Board of Directors of such company and has appointed new directors nominated by the Central Government, under section 242 of the said Act; and

(b) a change in shareholding of a company, and its subsidiary and the subsidiary of such subsidiary, has taken place in a previous year pursuant to a resolution plan approved by the Tribunal under section 242 of the Companies Act, 2013 after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.

(4) Meaning of eligible start-up*:*



Company engaged in eligible business

Incorporated during the period 1.4.2016-31.3.2021

Total turnover ≤ ₹ 25 crores in the P.Y. relevant to the A.Y. for which deduction is claimed under section 80-IAC

Holds a certificate of eligible business from the notified Inter Ministerial Board of Certification

*(5) **Meaning of eligible business:***

A business carried out by an eligible start-up engaged in –

- *Innovation, development or improvement of products or processes or services or*
- *a scalable business model with a high potential of employment generation or wealth creation*

(6) A company shall be a subsidiary of another company, if such other company holds more than half in nominal value of the equity share capital of the company.

10.16 ORDER OF SET OFF OF LOSSES

As per the provisions of section 72(2), brought forward business loss is to be set-off before setting off unabsorbed depreciation. Therefore, the order in which set-off will be effected is as follows -

(1) Current year depreciation/ Current year capital expenditure on scientific research and current year expenditure on family planning, to the extent allowed.

(2) Brought forward loss from business/profession [Section 72(1)]

(3) Unabsorbed depreciation [Section 32(2)]

(4) Unabsorbed capital expenditure on scientific research [Section 35(4)].

(5) Unabsorbed expenditure on family planning [Section 36(1)(ix)]

ILLUSTRATION 5

Mr. E has furnished his details for the A.Y.2020-21 as under:

Particulars	*₹*
Income from salaries (computed)	*1,50,000*
Income from speculation business	*60,000*
Loss from non-speculation business	*(40,000)*
Short term capital gain	*80,000*
Long term capital loss of A.Y.2018-19	*(30,000)*
Winning from lotteries	*20,000*

What is the taxable income of Mr. E for the A.Y.2020-21?

SOLUTION

Computation of taxable income of Mr. E for the A.Y.2020-21

Particulars	₹	₹
Income from salaries		1,50,000
Income from speculation business	60,000	

Less: Loss from non-speculation business	(40,000)	20,000
Short-term capital gain		80,000
Winnings from lotteries		20,000
Taxable income		**2,70,000**

Note: Long term capital loss can be set off only against long term capital gain. Therefore, long term capital loss of ₹ 30,000 has to be carried forward to the next assessment year.

ILLUSTRATION 6

Compute the gross total income of Mr. F for the A.Y.2020-21 from the information given below –

Particulars	***₹***
Income from house property (computed)	*1,25,000*
Income from business (before providing for depreciation)	*1,35,000*
Short term capital gains on sale of shares	*56,000*
Long term capital loss from sale of property (brought forward from A.Y.2017-18)	*(90,000)*
Income from tea business	*1,20,000*
Dividends from Indian companies carrying on agricultural operations	*80,000*
Current year depreciation	*26,000*
Brought forward business loss (loss incurred six years ago)	*(45,000)*

SOLUTION

Gross Total Income of Mr. F for the A.Y. 2020-21

Particulars	**₹**	**₹**
Income from house property		1,25,000
Income from business		
Profits before depreciation	1,35,000	
Less: Current year depreciation	26,000	
Less: Brought forward business loss	45,000	
	64,000	
Income from tea business (40% is business income)	48,000	1,12,000
Income from the capital gains		
Short term capital gains		56,000
Gross Total Income		**2,93,000**

Notes:

(1) Dividend from Indian companies of ₹ 80,000 is exempt from tax under section 10(34).

(2) 60% of the income from tea business is treated as agricultural income and therefore, exempt from tax;

(3) Long-term capital loss can be set-off only against long-term capital gains. Therefore, long-term capital loss of ₹ 90,000 brought forward from A.Y.2017-18 cannot be set-off in the A.Y.2020-21. It has to be carried forward for set-off against long-term capital gains, if any, during A.Y.2021-22.

10.17 SUBMISSION OF RETURN FOR LOSSES [SECTION 80]

As per section 80, the assessee must have filed a return of loss under section 139(3) in order to carry forward and set off of:

- business loss to be carried forward under section 72(1)
- speculation business loss to be carried forward under section 73(2)
- loss from specified business to carried forward under section 73A(2)
- loss under the head "Capital Gains" to be carried forward under section 74(1) and
- loss incurred in the activity of owning and maintaining race horses to be carried forward under section 74A(3).

In other words, the non-filing of a return of loss disentitles the assessee from carrying forward the above specified losses sustained by him. Such a return should be filed within the time allowed under section 139(1).

However, this condition does not apply to a loss from house property to be carried forward under section 71B and unabsorbed depreciation can be carried forward even if return of loss has not been filed as required under section 139(3).

EXERCISE

Question 1

X carrying on a business as sole proprietor, died on 31st March, 2019. On his death, the same business was continued by his legal heirs, by forming a firm. As on 31st March 2019, a determined business loss of ₹ 5 lacs is to be carried forward under the Income-tax Act, 1961.

Does the firm consisting of all legal heirs of Mr. X, get a right to have this loss adjusted against its current income?

Answer

Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then, the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that generally, set-off of business losses should be claimed by the same person who suffered the loss and the only exception to this provision is when the business passes on to another person by inheritance.

The facts of case given in the question are similar to the case *CIT v. Madhukant M. Mehta (2001) 247 ITR 805*, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor would be available to the firm.

In this case, the business of X was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 78(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of ₹ 5 lacs of X.

Question 2

ABC Limited was amalgamated with XYZ Limited on 01.04.2019. All the conditions of section 2(1B) were satisfied.

ABC Limited has the following carried forward losses as assessed till the Assessment Year 2019-20:

	Particulars	*₹ (in lacs)*
(i)	*Speculative Loss*	*4*
(ii)	*Unabsorbed Depreciation*	*18*
(iii)	*Unabsorbed expenditure of capital nature on scientific research*	*2*
(iv)	*Business Loss*	*120*

XYZ Limited has computed a profit of ₹ 140 lacs for the financial year 2019-20 before setting off the eligible losses of ABC Limited but after providing depreciation at 15% per annum on ₹ 150 lacs, being the consideration at which plant and machinery were transferred to XYZ Limited. The written down value as per Income-tax record of ABC Limited as on 1st April, 2019 was ₹ 100 lacs.

The above profit of XYZ Limited includes speculative profit of ₹ 10 lacs.

Compute the total income of XYZ Limited for Assessment Year 2020-21 and indicate the losses/ other allowances to be carried forward by it.

Answer

Computation of total income of XYZ Limited for the A.Y. 2020-21

Particulars	₹(in lacs)	
Business income before setting-off brought forward losses of ABC Ltd.		140.00
Add: Excess depreciation claimed in the scheme of amalgamation of ABC Limited with XYZ Limited.		
Value at which assets are transferred by ABC Ltd.	150	
WDV in the books of ABC Ltd.	100	
Excess accounted	50	
Excess depreciation claimed in computing taxable income of XYZ Ltd. [₹ 50 lacs × 15 %] [*Explanation 2* to section 43(6)]		7.50
		147.50
Set-off of brought forward business loss of ABC Ltd. **(See Notes 2 & 4)**		(120.00)
Set-off of unabsorbed depreciation under section 32(2) read with section 72A **(See Notes 2 & 4)**		(18.00)
Set-off of unabsorbed capital expenditure under section 35(1)(iv) read with section 35(4) **(See Note 5)**		(2.00)
Business income		7.50

Notes:

1. It is presumed that the amalgamation is within the meaning of section 72A of the Income-tax Act, 1961.

2. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward

and set-off by the amalgamated company for a period of 8 years and indefinitely, respectively.

3. As per section 72A(7), the accumulated loss to be carried forward specifically excludes loss sustained in a speculative business. Therefore, speculative loss of ₹ 4 lacs of ABC Ltd. cannot be carried forward by XYZ Ltd.

4. Section 72(2) provides that where any allowance or part thereof unabsorbed under section 32(2) (i.e., unabsorbed depreciation) or section 35(4) (i.e., unabsorbed scientific research capital expenditure) is to be carried forward, effect has to be first given to brought forward business losses under section 72.

5. Section 35(4) provides that the provisions of section 32(2) relating to unabsorbed depreciation shall apply in relation to deduction allowable under section 35(1)(iv) in respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set-off and carried forward in the same manner as unabsorbed depreciation.

6. The restriction contained in section 73 is only regarding set-off of loss computed in respect of speculative business. Such a loss can be set-off only against profits of another speculation business and not non-speculation business. However, there is no restriction under the Income-tax Act, 1961 regarding set-off of normal business losses against speculative income. Therefore, normal business losses can be set-off against profits of a speculative business.

   Consequently, there is no loss or allowance to be carried forward by XYZ Ltd. to the F.Y. 2020-21.

Question 3

Examine in brief about the treatment to be given in the following case under the Income-tax Act, 1961, for A.Y.2020-21:

A loss of ₹ 85,000 was sustained by Simran in the activity of owning and maintaining camels for races.

Answer

Section 74A(3) lays down the provisions for set-off and carry forward of loss from the activity of owning and maintaining race horses. According to provisions of section 74A(3), the losses incurred by an assessee from the activity of owning and maintaining race horses cannot be set-off against the income from any other source other than the activity of owning and maintaining race horses. Since the scope of this section is confined to the activity of owning and maintaining race horses only, therefore, set-off and carry forward of loss from the activity of owning and maintaining camels is not covered under section 74A(3).

It is possible to take a view that the loss from the activity of owning and maintaining camels for races may be governed by section 72 provided such activity amounts to business. Accordingly, the loss from the activity of owning and maintaining of camels for races can be set-off against any income (other than income from salary) of current year and unadjusted amount shall be carried forward for set off against any business income for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.

Question 4

M/s. JKLM, a firm, consists of four partners namely, J, K, L and M. They shared profits and losses equally during the year ended 31.3.2019. The assessed business loss of the firm for the assessment year 2019-20 which it is entitled to carry forward amounts to ₹ 3,60,000. A new deed of partnership was executed among J, K, L and M on 1.4.2019 in terms of which they agreed to share profits and losses in the ratio of 15:15:20:50 respectively.

Compute the amount of business loss relating to the assessment year 2019-20, which the firm is entitled to set off against its business income for the assessment year 2020-21. The business income of the firm for the assessment year 2020-21 is ₹ 3,30,000. Your answer should be supported by reasons.

Answer

The firm is entitled to set off its brought forward business loss amounting to ₹ 3,60,000 relating to the assessment year 2019-20 to the extent of ₹ 3,30,000 against its business income of ₹ 3,30,000 for the assessment year 2020-21, as per the provisions of section 72(1).

The balance unabsorbed business loss of ₹ 30,000 relating to the assessment year 2019-20 will be carried forward to assessment year 2021-22.

Section 78(1) which deals with carry forward and set-off of losses in the case of change in constitution of firm is applicable only where there is retirement or death of a partner. **It is not applicable to a case where there is a change in the ratio of sharing profits and losses amongst the existing partners.** Therefore, section 78(1) is not applicable to the case of M/s. JKLM.

Question 5

An assessee sustained a loss under the head "Income from house property" in the previous year relevant to the assessment year 2019-20, which could not be set off against income from any other head in that assessment year. The assessee did not furnish the return of loss within the time allowed under section 139(1) in respect of the relevant assessment year. However, the assessee filed the return within the time allowed under section 139(4). Can the assessee carry forward such loss for set off against income from house property of the assessment year 2020-21?

Answer

Section 139(3) stipulates that an assessee claiming carry forward of loss under the heads “Profits and gains of business or profession” or “Capital gains” should furnish the return of loss within the time stipulated under section 139(1). There is no reference to loss under the head “Income from house property” in section 139(3). The assessee, in the instant case, has filed the return showing loss from property within the time prescribed under section 139(4). The assessee is, therefore, entitled to carry forward such loss for set off against the income from house property of the subsequent assessment year.

SIGNIFICANT SELECT CASES

Can the loss suffered by an erstwhile partnership firm, which was dissolved, be carried forward for set-off by the individual partner who took over the business of the firm as a sole proprietor, considering the succession as a succession by inheritance?
Pramod Mittal v. CIT (2013) 356 ITR 456 (Delhi)

Facts of the case: In the present case, the assessee was previously a partner in a firm. As per the dissolution deed of the partnership firm, with effect from 18th September, 2004, he took over the entire business of the partnership firm in his individual capacity including fixed assets, current assets and liabilities and the other partner was paid his dues. He then ran the business as a sole proprietor with effect from that date. The assessee, relying upon section 78(2) and the decisions of the Supreme Court in *CIT v. Madhukant M. Mehta (2001) 247 ITR 805 (SC)* and *Saroj Aggarwal v. CIT (1985) 156 ITR 497 (SC),* claimed the set-off of the losses suffered by the erstwhile partnership firm against his income earned as an individual proprietor, considering the case as inheritance of business.

However, considering that only the person who has suffered the loss is entitled to carry forward and set-off the same, the claim of the assessee was disallowed by the Assessing Officer. The Tribunal concurred with the Assessing Officer's view.

High Court's Observations: The High Court observed that upon dissolution, the partnership firm ceased to exist. Also, the partnership firm and the proprietorship concern are two separate and distinct units for the purpose of assessment. As per section 170(1), the partnership firm shall be assessed as such from 1st April of the previous year till the date of dissolution (i.e., 18th September, 2004). Thereafter, the income of the sole-proprietorship shall be taxable in the hands of the assessee as an individual. Thus, section 170(1) provides as to who will be assessable in respect of the income of the previous year from business, when there is a change in the person carrying on business by succession.

Section 78(2), however, deals with carry forward of losses in case of succession of business. It provides that only the person who has incurred the losses, and no one else, would be entitled to carry forward the same and set it off. An exception provided thereunder is in the case of succession by inheritance.

Therefore, section 170(1) providing the person in whose hands income is assessable in case of succession and section 78(2) providing for carry forward of losses in case of succession of business, deal with different situations and resultantly, there is no contradiction between these sections.

The income earned by the sole proprietor would include his share of loss as an individual but not the loss suffered by the erstwhile partnership firm in which he was a partner. The exception given in section 78(2), permitting carry forward of losses by the successor in case of inheritance, is not applicable in the present case since the partnership firm was dissolved and ceased to continue.

Taking over of business by a partner cannot be considered as a case of inheritance due to death as per the law of succession. The High Court opined that the decision in *Madhukant M. Mehta's case* and *Saroj Aggarwal's case* cannot be applied since this is not a case of succession by inheritance.

High Court's Decision: Therefore, the loss suffered by the erstwhile partnership firm before dissolution of the firm cannot be carried forward by the successor sole-proprietor, since it is not a case of succession by inheritance. The assessee sole-proprietor is, therefore, not entitled to set-off the loss of the erstwhile partnership firm against his income.

Note - *In Madhukant M. Mehta's case, the sole proprietor had expired and after his death the heirs succeeded the business as a partnership concern. Therefore, the losses suffered by the deceased proprietor was allowed to be set-off by the partnership firm since the case falls within the exception mentioned under section 78(2), i.e., a case of succession by inheritance.*

Also, in Saroj Aggarwal's case, upon death of a partner, his legal heirs were inducted as partners in the partnership firm. The partnership firm was not dissolved on the death of the partner. The partnership firm which suffered the losses continued with induction of the legal heirs of the deceased partner. This, being a case of succession by inheritance, the benefit of carry forward of losses was given to the re-constituted partnership firm.

In the present case, however, the partnership firm was dissolved and the take over of the running business of the firm by the erstwhile partner as a sole proprietor was not a case of succession by inheritance. Hence, the carry forward of losses of the firm by the sole proprietor was not allowed in this case.

CHAPTER 11

DEDUCTIONS FROM GROSS TOTAL INCOME

LEARNING OUTCOMES

After studying this chapter, you would be able to:

- **appreciate** the general provisions contained in "A – General" of Chapter VI-A relating to deductions to be made in computing total income;
- **analyse and apply** the provisions of Chapter VI-A contained in "B – Deductions in respect of certain payments" in problem solving and addressing related issues;
- **appreciate** the provisions of Chapter VI-A contained in "C – Deductions in respect of certain incomes" and "CA – Deductions in respect of other incomes", and **analyse and apply** the provisions in problem solving and addressing related issues;
- **compute** the deduction allowable in the case of a person with disability under section 80U;
- **compute** the aggregate deduction available under Chapter VI-A to an assessee, and thereafter, arrive at the total income of the assessee.

11.1 GENERAL PROVISIONS

As we have seen earlier, section 10 exempts certain incomes. Such income are excluded from total income and do not enter into the computation process at all. On the other hand, Chapter VI-A contains deductions from gross total income. The important point to be noted here is that if there is no gross total income, then no deductions will be permissible.

This Chapter contains deductions in respect of certain payments, deductions in respect of certain incomes, deductions in respect of other income and other deductions.

Section 80A

(1) Section 80A(1) provides that in computing the total income of an assessee, there shall be allowed from his gross total income, the deductions specified in sections 80C to 80U.

(2) According to section 80A(2), the aggregate amount of the deductions under this chapter shall not, in any case, exceed the gross total income of the assessee.

Thus, an assessee cannot have a loss as a result of the deduction under Chapter VI-A and claim to carry forward the same for the purpose of set-off against his income in the subsequent year.

(3) Section 80A(3) provides that in the case of AOP/BOI, if any deduction is admissible under section 80G/80GGA/80GGC/80-IA/80-IB/80-IC/80-ID/80-IE, no deduction under the same section shall be made in computing the total income of a member of the AOP or BOI in relation to the share of such member in the income of the AOP or BOI.

(4) The profits and gains allowed as deduction under section 10AA or under any provision of Chapter VI-A under the heading "C.-Deductions in respect of certain incomes" in any assessment year, shall not be allowed as deduction under any other provision of the Act for such assessment year [Section 80A(4)];

(5) The deduction, referred to in (4) above, shall not exceed the profits and gains of the undertaking or unit or enterprise or eligible business, as the case may be [Section 80A(4)];

(6) No deduction under any of the provisions referred to in (4) above, shall be allowed if the deduction has not been claimed in the return of income [Section 80A(5)];

(7) The transfer price of goods and services between such undertaking or unit or enterprise or eligible business and any other business of the assessee shall be determined at the market value of such goods or services as on the date of transfer. This is notwithstanding anything to the contrary contained in section 10AA or in any provision of Chapter VI-A under the heading “C- Deductions in respect of certain incomes” [Section 80A(6)].

(8) For this purpose, the expression "market value" has been defined to mean,-

(a) in relation to any goods or services sold or supplied, the price that such goods or services would fetch if these were sold by the undertaking or unit or enterprise or eligible business in the open market, subject to statutory or regulatory restrictions, if any;

(b) in relation to any goods or services acquired, the price that such goods or services would cost if these were acquired by the undertaking or unit or enterprise or eligible business from the open market, subject to statutory or regulatory restrictions, if any;

(c) if it is a specified domestic transaction referred to in section 92BA, - in relation to any goods or services sold, supplied or acquired means the arm's length price as defined in section 92F(ii) of such goods or services.

(9) Where a deduction under any provision of this Chapter under the heading "C – Deductions in respect of certain incomes" is claimed and allowed in respect of the profits of such specified business for any assessment year, no deduction under section 35AD is permissible in relation to such specified business for the same or any other assessment year.

In short, once the assessee has claimed the benefit of deduction under section 35AD for a particular year in respect of a specified business, he cannot claim benefit under Chapter VI-A under the heading "C.-Deductions in respect of certain incomes" for the same or any other year and *vice versa*.

Section 80AB

This section provides that for the purpose of calculation of deductions specified in Chapter VI-A under the heading "C - Deductions in respect of certain incomes", the income computed in accordance with the provisions of the Act (before making any deduction under Chapter VI-A) shall alone be regarded as income received by the assessee and which is included in his gross total income. Accordingly, the deductions specified in the aforesaid sections will be calculated with reference to the net income as computed in accordance with the provisions of the Act (before making deduction under Chapter VI-A) and not with reference to the gross amount of such income. This is notwithstanding anything contained in the respective sections of Chapter VI-A.

Section 80AC: Furnishing return of income on or before due date mandatory for claiming deduction under Chapter VI-A under the heading "C.- Deductions in respect of certain incomes"

(1) Section 80AC stipulates compulsory filing of return of income on or before the due date specified under section 139(1), as a pre-condition for availing benefit of deductions under any provision of Chapter VI-A under the heading "C. – Deductions in respect of certain incomes".

Table showing the deductions contained in Chapter VI-A under the heading "C. – Deductions in respect of certain income"

Section	Deduction
80-IA	Deductions in respect of profits and gains from undertakings or enterprises engaged in infrastructure development/ operation/ maintenance, generation/ transmission/ distribution of power etc.
80-IAB	Deduction in respect of profits and gains derived by an undertaking or enterprise engaged in development of SEZ
80-IAC	Deduction in respect of profits and gains derived by an eligible start-up from an eligible business
80-IB	Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings
80-IBA	Deduction in respect of profits and gains from housing projects
80-IC	Deduction in respect of profits and gains from certain undertakings or enterprises in certain special category States [Himachal Pradesh and Uttaranchal]
80-IE	Deduction in respect of profits and gains from manufacture or production of eligible article or thing, substantial expansion to manufacture or produce any eligible article or thing or carrying on of eligible business in North-Eastern States
80JJA	Deduction in respect of profits and gains from business of collecting and processing of bio-degradable waste
80JJAA	Deduction in respect of employment of new employees
80LA	Deduction in respect of certain income of Offshore Banking Units and International Financial Services Centre
80P	Deduction in respect of income of co-operative societies
80PA	Deduction in respect of certain income of Producer Companies
80QQB	Deduction in respect of royalty income, etc., of authors of certain books other than text books
80RRB	Deduction in respect of royalty on patents

(2) The effect of this provision is that in case of failure to file return of income on or before the stipulated due date, the undertakings would lose the benefit of deduction under these sections.

ILLUSTRATION 1

Examine the following statements with regard to the provisions of the Income-tax Act, 1961:

(a) For grant of deduction u/s 80-IB, filing of audit report in prescribed form is must for a corporate assessee; filing of return within the due date laid down in section 139(1) is not required.

(b) *Filing of belated return under section 139(4) of the Income-tax Act, 1961 will debar an assessee from claiming deduction under section 80-IE.*

SOLUTION

(a) **The statement is not correct.** Section 80AC stipulates compulsory filing of return of income on or before the due date specified under section 139(1), as a pre-condition for availing the benefit of deduction, *inter alia*, under section 80-IB.

(b) **The statement is correct.** As per section 80AC, the assessee has to furnish his return of income on or before the due date specified under section 139(1), to be eligible to claim deduction under, *inter alia,* section 80-IE.

Section 80B(5)

"Gross total income" means the total income computed in accordance with the provisions of the Act without making any deduction under Chapter VI-A. "Computed in accordance with the provisions of the Act" implies—

(1) that deductions under appropriate computation section have already been given effect to;

(2) that income of other persons, if includible under sections 60 to 64, has been included;

(3) the intra head and/or inter head losses have been adjusted; and

(4) that unabsorbed business losses, unabsorbed depreciation etc., have been set-off.

Let us first consider the deductions allowable in respect of certain payments.

11.2 DEDUCTIONS IN RESPECT OF PAYMENTS

(1) Deduction in respect of investment in specified assets [Section 80C]

Section 80C provides for a deduction from the Gross Total Income, of savings in specified modes of investments. The deduction under section 80C is available only to an individual or HUF. The maximum permissible deduction under section 80C is ₹ 1,50,000.

Deduction in respect of investment/contributions

The following are the investments/ contributions eligible for deduction –

(i) Premium paid in respect of Life Insurance policy

Premium paid on insurance on the life of the individual, spouse or any child (minor or major) and in the case of HUF, any member thereof. This will include a life policy and an endowment policy.

> ***Exemption on receipts from Life insurance policy (LIC) [Section 10(10D)]:*** *Any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy shall not be included in the total income of a person.*

The following is a tabular summary of the exemption available under section 10(10D) and deduction allowable under section 80C *vis-à-vis* the date of issue of such policies –

		Exemption u/s 10(10D)	Deduction u/s 80C
In respect of policies issued before 1.4.2003		Any sum received under a LIP including the sum allocated by way of bonus is exempt.	Premium paid to the extent of 20% of "actual capital sum assured"
In respect of policies issued between 1.4.2003 and 31.3.2012		Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 20% of "actual capital sum assured".	
In respect of policies issued on or after 1.4.2012 but before 1.4.2013		Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 10% of "minimum capital sum assured" under the policy on the happening of the insured event at any time during the term of the policy.	Premium paid to the extent of 10% of "minimum capital sum assured"
In respect of policies issued on or after 1.4.2013	(a)	**Where the insurance is on the life of a person with disability or severe disability as referred to in section 80U or a person suffering from disease or ailment as specified under section 80DDB.**	
		Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 15% of "actual capital sum assured" under the policy on the happening of the insured event at any time during the term of the policy.	Premium paid to the extent of 15% of "actual capital sum assured"
	(b)	**Where the insurance is on the life of any person, other than mentioned in (a) above**	
		Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption	Premium paid to the extent of 10% of "actual

		would not be available if the premium payable for any of the years during the term of the policy exceeds 10% of "actual capital sum assured" under the policy on the happening of the insured event at any time during the term of the policy.	capital sum assured".

Notes:

(a) **Amounts not to be considered while computing actual capital sum assured:** For the purpose of calculating the actual capital sum assured,

(1) the value of any premiums agreed to be returned or

(2) the value of any benefit by way of bonus or otherwise, over and above the sum actually assured,

shall not be taken into account.

(b) **Meaning of actual capital sum assured:** In respect of the life insurance policies to be issued on or after 1st April, 2012, the actual capital sum assured shall mean the minimum amount assured under the policy on happening of the insured event at any time during the term of the policy, not taking into account -

(1) the value of any premium agreed to be returned; or

(2) any benefit by way of bonus or otherwise over and above the sum actually assured which is to be or may be received under the policy by any person.

In effect, in case the insurance policy has varied sum assured during the term of policy then the minimum of the sum assured during the life time of the policy shall be taken into consideration for calculation of the "actual capital sum assured", in respect of life insurance policies to be issued on or after 1st April, 2012.

(c) **Sum received on death of a person -** Any sum received under a LIP including the sum allocated by way of bonus on death of a person is exempt.

(d) **Exemption is not available in respect of amount received from an insurance policy taken for disabled person under section 80DD:** Any sum received under section 80DD(3) shall not be exempt under section 10(10D). Accordingly, if the dependent disabled, in respect of whom an individual has paid or deposited any amount in any scheme of LIC or any other insurer, predeceases the individual, the amount so paid or deposited shall be deemed to be the income of the individual of the previous year in which such amount is received. Such amount would not be exempt under 10(10D).

(e) **Exemption is not available in respect of the sum received under a Keyman insurance policy:** *Explanation 1* to section 10(10D) defines "Keyman insurance policy" as a life insurance policy taken by one person on the life of another person who is or was the employee of the first-mentioned person or is or was connected in any manner whatsoever with the business of the first-mentioned person. The term includes within its scope a keyman insurance policy which has been assigned to any person during its term, with or without consideration. Therefore, such policies shall continue to be treated as a keyman insurance policy even after the same is assigned to the keyman. Consequently, the sum received by the keyman on such policies, being "keyman insurance policies", would not be exempt under section 10(10D).

ILLUSTRATION 2

Compute the eligible deduction under section 80C for A.Y.2020-21 in respect of life insurance premium paid by Mr. Ganesh during the P.Y.2019-20, the details of which are given hereunder -

	Date of issue of policy	*Person insured*	*Actual capital sum assured (₹)*	*Insurance premium paid during 2019-20 (₹)*
(i)	*30/3/2012*	*Self*	*5,00,000*	*51,000*
(ii)	*1/5/2015*	*Spouse*	*1,50,000*	*20,000*
(iii)	*1/6/2017*	*Handicapped Son (section 80U disability)*	*4,00,000*	*80,000*

SOLUTION

	Date of issue of policy	Person insured	Actual capital sum assured (₹)	Insurance premium paid during 2019-20 (₹)	Deduction u/s 80C for A.Y.2020-21 (₹)	Remark (restricted to % of sum assured)
(i)	30/3/2012	Self	5,00,000	51,000	51,000	20%
(ii)	1/5/2015	Spouse	1,50,000	20,000	15,000	10%
(iii)	1/6/2017	Handicapped son (section 80U disability)	4,00,000	80,000	60,000	15%
Total					**1,26,000**	

(ii) Premium paid in respect of a contract for deferred annuity

Premium paid to effect and keep in force a contract for a deferred annuity on the life of the individual and/or his or her spouse or any child, provided such contract does not contain any provision for the exercise by the insured of an option to receive cash payments in lieu of the payment of the annuity.

It is pertinent to note here that a contract for a deferred annuity need not necessarily be with an insurance company. It follows therefore that such a contract can be entered into with any person.

(iii) Any sum deducted from the salary payable of a Government employee for securing a deferred annuity

Amount deducted by or on behalf of the Government from the salary of a Government employee in accordance with the conditions of his service for securing a deferred annuity or making provisions for his spouse or children. The excess, if any, over one-fifth of the salary is to be ignored.

(iv) Contribution to SPF/PPF/RPF

Contributions to any provident fund to which the Provident Funds Act, 1925 applies and recognized provident fund qualifies for deduction under section 80C.

Contribution made to any Provident Fund set up by the Central Government and notified in his behalf (i.e., the Public Provident Fund established under the Public Provident Fund Scheme, 1968) also qualifies for deduction under section 80C. Such contribution can be made in the name of the individual, his spouse and any child of the individual; and any member of the family, in case of a HUF. The maximum limit for deposit in PPF is ₹ 1,50,000 in a year.

ILLUSTRATION 3

An individual assessee, resident in India, has made the following deposit/payment during the previous year 2019-20:

Particulars	*₹*
Contribution to the public provident fund	*1,50,000*
Insurance premium paid on the life of the spouse (policy taken on 1.4.2015) (Assured value ₹ 2,00,000)	*25,000*

What is the deduction allowable under section 80C for A.Y.2020-21?

SOLUTION

Computation of deduction under section 80C for A.Y.2020-21

Particulars	₹
Deposit in public provident fund	1,50,000

Insurance premium paid on the life of the spouse (Maximum 10% of the assured value ₹ 2,00,000, as the policy is taken after 31.3.2012)	20,000
Total	**1,70,000**
However, the maximum permissible deduction u/s 80C is restricted to	1,50,000

(v) Contribution to approved superannuation Fund

Contribution by an employee to an approved superannuation fund qualifies for deduction under section 80C.

(vi) Any sum paid or deposited in Sukanya Samridhi Account

Subscription to any such security of the Central Government or any such deposit scheme as the Central Government as may notify in the Official Gazette. Accordingly, Sukanya Samriddhi Scheme has been notified to provide that any sum paid or deposited during the previous year in the said Scheme, by an individual in the name of –

(a) any girl child of the individual; or

(b) any girl child for whom such individual is the legal guardian

would be eligible for deduction under section 80C.

(vii) Subscription to National Savings Certificates VIII

Subscription to any Savings Certificates under the Government Savings Certificates Act, 1959 notified by the Central Government in the Official Gazette (i.e. National Savings Certificate (VIII Issue) issued under the Government Savings Certificates Act, 1959).

(viii) Contribution in Unit-linked Insurance Plan, 1971

Contributions in the name of the individual, his spouse or any child of the individual for participation in the Unit-linked Insurance Plan 1971. In case of a HUF, the contribution can be in the name of any member.

(ix) Contribution in Unit-linked Insurance Plan of LIC Mutual Fund

Contributions in the name of the individual, his spouse or any child of the individual for participation in any Unit linked Insurance Plan of the LIC Mutual Fund. In case of a HUF, the contribution can be in the name of any member.

(x) Contribution to approved annuity plan of LIC

Contributions to approved annuity plans of LIC (New Jeevan Dhara and New Jeevan Akshay, New Jeevan Dhara I and New Jeevan Akshay I, II and III) or any other insurer (Tata AIG Easy Retire Annuity Plan of Tata AIG Life Insurance Company Ltd.) as the Central Government may, by notification in the Official Gazette, specify in this behalf.

(xi) Subscription towards notified units of mutual fund or UTI

Subscription to any units of any mutual fund referred to in section 10(23D) or from the Administrator or the specified company under any plan formulated in accordance with such scheme notified by the Central Government;

(xii) Contribution to notified pension fund set up by mutual fund or UTI

Contribution by an individual to a pension fund set up by any Mutual Fund referred to in section 10(23D) or by the Administrator or the specified company as the Central Government may specify (i.e., UTI-Retirement Benefit Pension Fund set up by the specified company referred to in section 2(h) of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 as a pension fund).

> **"Specified company"** means a company formed and registered under the Companies Act, 1956[1] and whose entire capital is subscribed by such financial institutions or banks as may be specified by the Central Government, by notification in the Official Gazette, for the purpose of transfer and vesting of the undertaking
>
> **"Administrator"** means a person or a body of persons appointed as Administrator by the Central Government. The Central Government shall appoint a person or a body of persons, as the "Administrator of the specified undertaking of the Unit Trust of India" for the purpose of taking over the administration thereof and the Administrator shall carry on the management of the specified undertaking of the Trust for and on behalf of the Central Government.
>
> **"Specified undertaking"** includes all business, assets, liabilities and properties of the Trust representing and relatable to the schemes and Development Reserve Fund.

(xiii) Contribution to National Housing Bank (Tax Saving) Term Deposit Scheme, 2008

Subscription to any deposit scheme or contribution to any pension fund set up by the National Housing Bank i.e., National Housing Bank (Tax Saving) Term Deposit Scheme, 2008.

(xiv) Subscription to notified deposit scheme

Subscription to any such deposit scheme of

- a public sector company which is engaged in providing long-term finance for construction, or purchase of houses in India for residential purposes or
- any such deposit scheme of any authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing

[1] Now Companies Act, 2013

accommodation or for the purpose of planning, development or improvement of cities, towns and villages or for both.

The deposit scheme should be notified by the Central Government, for example, public deposit scheme of HUDCO.

(xv) Payment of tuition fees to any university, college, school or other educational institutions within India for full-time education for maximum 2 children

Payment of tuition fees by an individual assessee at the time of admission or thereafter to any university, college, school or other educational institutions within India for the purpose of full-time education of any **two children** of the individual. This benefit is only for the amount of tuition fees for full-time education and shall not include any payment towards development fees or donation or payment of similar nature and payment made for education to any institution situated outside India.

(xvi) Repayment of housing loan including stamp duty, registration fee and other expenses

Any payment made towards the cost of purchase or construction of a new residential house property. The income from such property –

(1) should be chargeable to tax under the head "Income from house property";

(2) would have been chargeable to tax under the head "Income from house property" had it not been used for the assessee's own residence.

The approved types of payments are as follows:

(1) Any instalment or part payment of the amount due under any self-financing or other schemes of any development authority, Housing Board or other authority engaged in the construction and sale of house property on ownership basis; or

(2) Any instalment or part payment of the amount due to any company or a cooperative society of which the assessee is a shareholder or member towards the cost of house allotted to him; or

(3) Repayment of amount borrowed by the assessee from:

(a) The Central Government or any State Government;

(b) Any bank including a co-operative bank;

(c) The Life Insurance Corporation;

(d) The National Housing Bank;

(e) Any public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes which is eligible for deduction under section 36(1)(viii);

(f) Any company in which the public are substantially interested or any cooperative society engaged in the business of financing the construction of houses;

(g) The assessee's employer, where such employer is an authority or a board or a corporation or any other body established or constituted under a Central or State Act;

(h) The assessee's employer where such employer is a public company or public sector company or a university established by law or a college affiliated to such university or a local authority or a co-operative society.

(4) Stamp duty, registration fee and other expenses for the purposes of transfer of such house property to the assessee.

Inadmissible payments: However, the following amounts do not qualify for rebate:

(1) admission fee, cost of share and initial deposit which a shareholder of a company or a member of a co-operative society has to pay for becoming a shareholder or member; or

(2) the cost of any addition or alteration or renovation or repair of the house property after the completion of the house or after the house has been occupied by the assessee or any person on his behalf or after it has been let out; or

(3) any expenditure in respect of which deduction is allowable under section 24.

(xvii) Subscription to certain equity shares or debentures

Subscription to equity shares or debentures forming part of any eligible issue of capital approved by the Board on an application made by a public company or as subscription to any eligible issue of capital by any public financial institution in the prescribed form.

A lock-in period of three years is provided in respect of such equity shares or debentures. In case of any sale or transfer of shares or debentures within three years of the date of acquisition, the aggregate amount of deductions allowed in respect of such equity shares or debentures in the previous year or years preceding the previous year in which such sale or transfer has taken place shall be deemed to be the income of the assessee of such previous year and shall be liable to tax in the assessment year relevant to such previous year.

A person shall be treated as having acquired any shares or debentures on the date on which his name is entered in relation to those shares or debentures in the register of members or of debenture-holders, as the case may be, of the public company.

(xviii) Subscription to certain units of mutual fund

Subscription to any units of any mutual fund referred to in section 10(23D) and approved by the Board on an application made by such mutual fund in the prescribed form.

It is necessary that such units should be subscribed only in the eligible issue of capital of any company.

Eligible issue of capital for (xvii) and (xviii) means an issue made by a public company formed and registered in India or a public financial institution and the entire proceeds of the issue are utilised wholly and exclusively for the purposes of any business referred to in section 80-IA(4).

(xix) Investment in five year Term Deposit

Investment in term deposit -

(1) for a period of not less than five years with a scheduled bank; and

(2) which is in accordance with a scheme framed and notified by the Central Government in the Official Gazette

qualifies as an eligible investment for availing deduction under section 80C.

The maximum limit for investment in term deposit is ₹ 1,50,000.

Scheduled bank means -

(1) the State Bank of India constituted under the State Bank of India Act, 1955, or

(2) a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959, or

(3) a corresponding new bank constituted under section 3 of the -

  (a) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, or

  (b) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, or

(4) any other bank, being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934.

(xx) Subscription to notified bonds issued by NABARD

Subscription to such bonds issued by NABARD (as the Central Government may notify in the Official Gazette) qualifies for deduction under section 80C.

(xxi) Deposit in Senior Citizens Savings Scheme Rules, 2004

Deposit in an account under the Senior Citizens Savings Scheme Rules, 2004 qualifies for deduction under section 80C.

(xxii) Investment in five year Post Office time deposit

Investment in five year time deposit in an account under Post Office Time Deposit Rules, 1981 qualifies for deduction under section 80C.

(xxiii) Contribution to additional account under NPS

Contribution by a Central Government employee to additional account under NPS (specified account) referred to in section 80CCD for a fixed period of not less than 3 years and which is in accordance with the scheme notified by the Central Government for this purpose qualifies for deduction under section 80C. It may be noted that only the contribution to the additional account under NPS will qualify for deduction under section 80C.

There are two types of NPS account i.e., Tier I and Tier II, to which an individual can contribute. Section 80CCD provides deduction in respect of contribution to individual pension account [Tier I account] under the NPS [referred to in section 20(2)(a) of the Pension Fund Regulatory and Development Authority Act, 2013 (PFRDA)] whereas deduction under section 80C is allowable in respect of contribution by Central Government employee to additional account [Tier II account] of NPS [referred to in section 20(3) of the PFRDA], which does not qualify for deduction under section 80CCD. Thus, Tier II account is the additional account under NPS, contribution to which would qualify for deduction under section 80C only in the hands of a Central Government employee.

Termination of Insurance Policy or Unit Linked Insurance Plan or transfer of House Property or withdrawal of deposit:

Where, in any previous year, an assessee:

(1) terminates his contract of insurance referred to in (i) above, by notice to that effect or where the contract ceases to be in force by reason of not paying the premium, by not reviving the contract of insurance, -

(a) in case of any single premium policy, within two years after the date of commencement of insurance; or

(b) in any other case, before premiums have been paid for two years; or

(2) terminates his participation in any Unit Linked Insurance Plan referred to in (viii) or (ix) above, by notice to that effect or where he ceases to participate by reason of failure to pay any contribution, by not reviving his participation, before contributions in respect of such participation have been paid for five years, or

(3) transfers the house property referred to in (xvi) above, before the expiry of five years from the end of the financial year in which possession of such property is obtained by him, or receives back, whether by way of refund or otherwise, any sum specified in (xvi) above,

then, no deduction will be allowed to the assessee in respect of sums paid during such previous year and the total amount of deductions of income allowed in respect of the previous year or years preceding such previous year, shall be deemed to be income of the assessee of such previous year and shall be liable to tax in the assessment year relevant to such previous year.

Further, where any amount is withdrawn by the assessee from his account under the Senior Citizens Savings Scheme or under the Post Office Time Deposit Rules before the expiry of a period of 5 years from the date of its deposit, the amount so withdrawn shall be deemed to be the income of the assessee of the previous year in which the amount is withdrawn. Accordingly, the amount so withdrawn would be chargeable to tax in the assessment year relevant to such previous year. The amount chargeable to tax would also include that part of the amount withdrawn which represents interest accrued on the deposit.

However, if any part of the amount relating to interest so received or withdrawn has been subject to tax in any of the earlier years, such amount shall not be taxed again.

If any amount has been received by the nominee or legal heir of the assessee, on the death of such assessee, the amount would not be chargeable to tax. But if the amount relating to interest on deposit was not included in the total income of the assessee in any of any earlier years, then such interest would be chargeable to tax.

ILLUSTRATION 4

Mr. A, aged about 40 years, has earned a lottery income of ₹ 1,20,000 (gross) during the P.Y. 2019-20. He also has interest on Fixed Deposit of ₹ 30,000. He invested an amount of ₹ 10,000 in Public Provident Fund account and ₹ 24,000 in National Savings Certificate. What is the total income of Mr. A for the A.Y.2020-21?

SOLUTION

Computation of total income of Mr. A for A.Y.2020-21

Particulars	₹	₹
Income from Other Sources		
- Interest on Fixed Deposit		30,000
- Lottery income		1,20,000
Gross Total Income		**1,50,000**
Less: **Deductions under Chapter VIA [See Note below]**		
Under section 80C		
- Deposit in Public Provident Fund	10,000	
- Investment in National Savings Certificate	24,000	
	34,000	
Restricted to		30,000
Total Income		**1,20,000**

Note: *Though the value of eligible investments is ₹ 34,000, however, deduction under Chapter VIA cannot exceed the gross total income exclusive of long term capital gains, short-term capital gains covered under section 111A, winnings of lotteries etc. of the assessee.*

Therefore, the maximum permissible deduction u/s 80C = ₹ 1,50,000 – ₹ 1,20,000 = ₹ 30,000.

(2) Deduction in respect of contribution to certain pension funds [Section 80CCC]

(i) **Eligible assessee -** Where an assessee, being an individual, has in the previous year paid or deposited any amount out of his income chargeable to tax to effect or keep in force a contract for any annuity plan of LIC of India or any other insurer for receiving pension from the fund set up by LIC or such other insurer, he shall be allowed a deduction in the computation of his total income.

For this purpose, the interest or bonus accrued or credited to the assessee's account shall not be reckoned as contribution.

Note: Where any amount paid or deposited by the assessee has been taken into account for the purposes of this section, a deduction under section 80C shall not be allowed with reference to such amount.

(ii) **Maximum Deduction:** The maximum permissible deduction is ₹ 1,50,000 (Further, the overall limit of ₹ 1,50,000 prescribed in section 80CCE will continue to be applicable i.e. the maximum permissible deduction under sections 80C, 80CCC and 80CCD(1) put together is ₹ 1,50,000).

(iii) **Deemed Income:** Where any amount standing to the credit of the assessee in the fund in respect of which a deduction has been allowed, together with interest or bonus accrued or credited to the assessee's account is received by the assessee or his nominee on account of the surrender of the annuity plan in any previous year or as pension received from the annuity plan, such amount will be deemed to be the income of the assessee or the nominee in that previous year in which such withdrawal is made or pension is received. It will be chargeable to tax as income of that previous year.

(3) Deduction in respect of contribution to pension scheme notified by the Central Government [Section 80CCD]

(i) **Pension Scheme of Central Government:** As per the "Restructured Defined Contribution Pension System" applicable to new entrants to Government service, it is mandatory for persons entering the service of the Central Government on or after 1st January, 2004, to contribute 10% of their salary every month towards their pension account. A matching contribution is required to be made by the Government to the said account. The benefit of this scheme is also available to individuals employed by any other employer as well as to self-employed individuals.

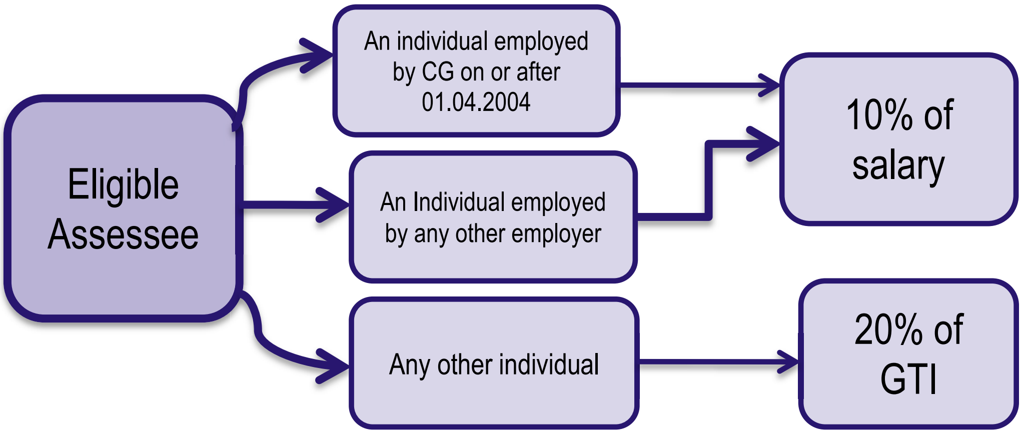
(ii) Deduction: Section 80CCD provides deduction in respect of contribution made to the pension scheme notified by the Central Government.

Accordingly, in exercise of the powers conferred by section 80CCD(1), the Central Government has notified the 'Atal Pension Yojana (APY)' as a pension scheme, contribution to which would qualify for deduction under section 80CCD in the hands of the individual.

(iii) Quantum of deduction

(a) Section 80CCD(1) provides a deduction for the amount paid or deposited by an employee in his pension account subject to a maximum of 10% of his salary. The deduction in the case of a self-employed individual would be restricted to 20% of his gross total income in the previous year.

Deduction under section 80CCD(1)


Eligible Assessee
An individual employed by CG on or after 01.04.2004
An Individual employed by any other employer
Any other individual
10% of salary
20% of GTI

(b) Section 80CCD(1B) provides for an additional deduction of up to ₹ 50,000 in respect of the whole of the amount paid or deposited by an individual assessee under NPS in the previous year, whether or not any deduction is allowed under section 80CCD(1).

(c) Whereas the deduction under section 80CCD(1) is subject to the overall limit of ₹ 1.50 lakh under section 80CCE, the deduction of upto ₹ 50,000 under section 80CCD(1B) is in addition to the overall limit of ₹ 1.50 lakh provided under section 80CCE.

(d) Under section 80CCD(2), contribution made by the Central Government or any other employer in the previous year to the said account of an employee, is allowed as a deduction in computation of the total income of the assessee.

(e) The entire employer's contribution would be included in the salary of the employee. However, deduction under section 80CCD(2) would be restricted to ***14% of salary, in case of contribution made by the Central Government***, and to 10% of salary, in case of contribution made by any other employer.

Notes:

1. The limit of ₹ 1,50,000 under section 80CCE does not apply to employer's contribution to pension scheme of Central Government which is allowable as deduction under section 80CCD(2).
2. No deduction will be allowed u/s 80C in respect of amounts paid or deposited by the assessee, for which deduction has been allowed u/s 80CCD(1) or 80CCD(1B).
3. For computation of limit under section 80CCD(1) and (2), salary includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites.

(iv) Deemed income: The amount standing to the credit of the assessee in the pension account (for which deduction has already been claimed by him under this section) and accretions to such account, shall be taxed as income in the year in which such amounts are received by the assessee or his nominee on -

(a) closure of the account or

(b) his opting out of the said scheme or

(c) receipt of pension from the annuity plan purchased or taken on such closure or opting out.

However, the amount received by the nominee on the death of the assessee under the circumstances referred to in (a) and (b) above, shall not be deemed to be the income of the nominee.

Further, the assessee shall be deemed not to have received any amount in the previous year if such amount is used for purchasing an annuity plan in the same previous year.

Notes:

1. *Exemption on payment from NPS Trust to an assessee on closure of his account or on his opting out of the pension scheme [Section 10(12A)]*

(i) As per section 80CCD, any payment from National Pension System Trust to an employee on account of closure or his opting out of the pension scheme is chargeable to tax.

(ii) Section 10(12A) provides that any payment from National Pension System Trust to an assessee on account of closure or his opting out of the pension scheme referred to in section 80CCD, to the extent it does not exceed ***60%*** of the total amount payable to him at the time of closure or his opting out of the scheme, shall be exempt from tax.

2. ***Exemption on payment from NPS Trust to an employee on partial withdrawal [Section 10(12B)]***

To provide relief to an employee subscriber of NPS, section 10(12B) provides that any payment from National Pension System Trust **to an employee** under the pension scheme referred to in section 80CCD, on partial withdrawn made out of his account in accordance with the terms and conditions specified under the Pension Fund Regulatory and Development Authority Act, 2013 and the regulations made there under, shall be exempt from tax to the extent it does not exceed **25%** of amount of contributions made by him.

(4) Limit on deductions under sections 80C, 80CCC & 80CCD(1) [Section 80CCE]

This section restricts the aggregate amount of deduction under section 80C, 80CCC and 80CCD(1) to ₹ 1,50,000**.** It may be noted that the deduction of upto ₹ 50,000 under section 80CCD(1B) and employer's contribution to pension scheme, allowable as deduction under section 80CCD(2) in the hands of the employee, would be outside the overall limit of ₹ 1,50,000 stipulated under section 80CCE.

The following table summarizes the ceiling limit under these sections –

Section	Particulars	Ceiling limit (₹)
80C	Investment in LIP, Deposit in PPF/SPF/RPF etc.	1,50,000
80CCC	Contribution to certain pension funds	1,50,000
80CCD(1)	Contribution to NPS of Government	10% of salary **or** 20% of GTI, as the case may be.
80CCE	Aggregate deduction under sections 80C, 80CCC & 80CCD(1)	1,50,000
80CCD(1B)	Contribution to NPS notified by the Central Government (outside the limit of ₹ 1,50,000 under section 80CCE)	50,000
80CCD(2)	***Contribution by the Central Government to NPS A/c of its employees (outside the limit of ₹ 1,50,000 under section 80CCE)***	***14% of salary***
	Contribution by any other employer to NPS A/c of its employees (outside the limit of ₹ 1,50,000 under section 80CCE)	10% of salary

ILLUSTRATION 5

The basic salary of Mr. A is ₹ 1,00,000 p.m. He is entitled to dearness allowance, which is 40% of basic salary. 50% of dearness allowance forms part of pay for retirement benefits. Both Mr. A and *his employer contribute 15% of basic salary to the pension scheme referred to in section 80CCD. Examine the tax treatment in respect of such contribution in the hands of Mr. A.*

SOLUTION

Tax treatment in the hands of Mr. A in respect of employer's and own contribution to pension scheme referred to in section 80CCD

(a) Employer's contribution to such pension scheme would be treated as salary since it is specifically included in the definition of "salary" under section 17(1)(viii). Therefore, ₹ 1,80,000, being 15% of basic salary of ₹ 12,00,000, will be included in Mr. A's salary.

(b) Mr. A's contribution to pension scheme is allowable as deduction under section 80CCD(1). However, the deduction is restricted to 10% of salary. Salary, for this purpose, means basic pay plus dearness allowance, if it forms part of pay.

Therefore, deduction under section 80CCD for Mr. A would be –

Particulars	₹
Basic salary = ₹ 1,00,000 × 12 =	12,00,000
Dearness allowance = 40% of ₹ 12,00,000 = ₹ 4,80,000	
50% of Dearness Allowance forms part of pay = 50% of ₹ 4,80,000	2,40,000
Salary for the purpose of deduction under section 80CCD	**14,40,000**
Deduction under section 80CCD(1) is restricted to 10% of ₹ 14,40,000 (as against actual contribution of ₹ 1,80,000, being 15% of basic salary of ₹ 12,00,000)	1,44,000
As per section 80CCD(1B), a further deduction of upto ₹ 50,000 is allowable. Therefore, deduction under section 80CCD(1B) is ₹ 36,000 (₹ 1,80,000 - ₹ 1,44,000).	36,000

₹ 1,44,000 is allowable as deduction under section 80CCD(1). This would be taken into consideration and be subject to the overall limit of ₹ 1,50,000 under section 80CCE. ₹ 36,000 allowable as deduction under section 80CCD(1B) is outside the overall limit of ₹ 1,50,000 under section 80CCE.

In the alternative, ₹ 50,000 can be claimed as deduction under section 80CCD(1B). The balance ₹ 1,30,000 (₹ 1,80,000 - ₹ 50,000) can be claimed as deduction under section 80CCD(1).

(c) Employer's contribution to pension scheme would be allowable as deduction under section 80CCD(2), subject to a maximum of 10% of salary. Therefore, deduction under section 80CCD(2), would also be restricted to ₹ 1,44,000, even though the entire employer's contribution of ₹ 1,80,000 is included in salary under section 17(1)(viii). However, this deduction of employer's contribution of ₹ 1,44,000 to pension scheme would be outside the overall limit of ₹ 1,50,000 under section 80CCE i.e., this deduction would be over and above the other deductions which are subject to the limit of ₹ 1,50,000.

ILLUSTRATION 6

The gross total income of Mr. X for the A.Y.2020-21 is ₹ 8,00,000. He has made the following investments/ payments during the F.Y.2019-20 –

Particulars	*₹*
(1) Contribution to PPF	*1,10,000*
(2) Payment of tuition fees to Apeejay School, New Delhi, for education of his son studying in Class XI	*45,000*
(3) Repayment of housing loan taken from Standard Chartered Bank	*25,000*
(4) Contribution to approved pension fund of LIC	*1,05,000*

Compute the eligible deduction under Chapter VI-A for the A.Y.2020-21.

SOLUTION

Computation of deduction under Chapter VI-A for the A.Y.2020-21

Particulars	₹
Deduction under section 80C	
- Contribution to PPF	1,10,000
- Payment of tuition fees to Apeejay School, New Delhi, for education of his son studying in Class XI	45,000
- Repayment of housing loan	25,000
	1,80,000
Restricted to ₹ 1,50,000, being the maximum permissible deduction u/s 80C	1,50,000
Deduction under section 80CCC	
- Contribution to approved pension fund of LIC	1,05,000
	2,55,000
As per section 80CCE, the aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to ₹ 1,50,000	
Deduction allowable under Chapter VIA for the A.Y.2020-21	**1,50,000**

(5) Deduction in respect of medical insurance premium [Section 80D]

(i) In case of an Individual

(a) **Deduction in respect of insurance premium paid for family:** A deduction to the extent of ₹ 25,000 is allowed in respect of the following payments–

(1) premium paid to effect or keep in force an insurance on the health of self, spouse and dependant children or

(2) any contribution made to the Central Government Health Scheme or

(3) such other health scheme as may be notified by the Central Government. Contributory Health Service Scheme of the Department of Atomic Energy has been notified by the Central Government.

(b) **Deduction in respect of insurance premium for parents:** A further deduction up to ₹ 25,000 is allowable to effect or to keep in force an insurance on the health of parents of the assessee.

> ***Quantum of deduction in case of senior citizen:*** *An increased deduction of* **₹ 50,000** *(instead of ₹ 25,000) shall be allowed in case any of the persons mentioned above is a* **senior citizen** *i.e., an individual resident in India of the age of 60 years or more at any time during the relevant previous year.*

(c) **Deduction in respect of payment towards preventive health check-up:** Section 80D provides that deduction to the extent of ₹ 5,000 shall be allowed in respect payment made on account of preventive health check-up of self, spouse, dependant children or parents made during the previous year. However, the said deduction of ₹ 5,000 is within the overall limit of ₹ 25,000 or **₹ 50,000**, specified in (a) and (b) above.

(d) **Mode of payment:** For claiming such deduction under section 80D, the payment can be made:

(1) by any mode, including cash, in respect of any sum paid on account of preventive health check-up;

(2) by any mode other than cash, in all other cases.

(e) **Deduction for medical expenditure incurred on senior citizens:** As a welfare measure towards **senior citizens** i.e., person of the age of 60 years or more and resident in India, who are unable to get health insurance coverage, deduction of upto **₹ 50,000** would be allowed in respect of any payment made on account of medical expenditure in respect of a such person(s), if no payment has been made to keep in force an insurance on the health of such person(s).

'Senior citizen' means an individual resident in India who is of the age of 60 years or more at any time during the relevant previous year.

(ii) In case of a HUF

Deduction under section 80D is allowable in respect of premium paid to insure the health of any member of the family. The maximum deduction available to a HUF would be ₹ 25,000 and in case any member is a senior citizen, **₹ 50,000**.

Further, the amount paid on account of medical expenditure incurred on the health of any member(s) of a family who is a **senior citizen** would qualify for deduction subject to a maximum of **₹ 50,000** provided no amount has been paid to effect or keep in force any insurance on the health of such person(s).

(iii) Other conditions

The other conditions to be fulfilled are that such premium should be paid by any mode, other than cash, in the previous year out of his income chargeable to tax. Further, the medical insurance should be in accordance with a scheme made in this behalf by -

(a) the General Insurance Corporation of India and approved by the Central Government in this behalf; or

(b) any other insurer and approved by the Insurance Regulatory and Development Authority.

The following table summarizes the provisions of section 80D –

S. No.	*Nature of payment/ expenditure*	*Expenditure on behalf of*		*Deduction*
I	(i) Any premium paid, otherwise than by way of cash, to keep in force an insurance on the health (ii) Contribution to Central Government Health Scheme (CGHS) (iii) Preventive health check up expenditure	In case of individual	Self, spouse and dependent children	₹ 25,000
		In case of HUF	Family member	
		In case any of the above persons is of the age of 60 years or more + resident in India		₹ 50,000

II	(i) Any premium paid, otherwise than by way of cash, to keep in force an insurance on the health (ii) Preventive health check up	Parents In case either or both the parents is of the age of 60 years or more + Resident in India	₹ 25,000 ₹ 50,000
Maximum ₹ 5,000 allowed as deduction for aggregate of preventive health check up expenditure, by any mode including cash, mentioned in I and II (Subject to overall limit of ₹ 25,000 or ₹ 50,000, as the case may be)			
III	Amount paid on account of **medical expenditure**	For self/ spouse/ parents + who is of the age of 60 years or more + Resident in India + no payment has been made to keep in force an insurance on the health of such person	**₹ 50,000**

Note: In case the individual or any of his family members is a senior citizen, the aggregate of deduction, in respect of payment of premium, contribution to CGHS and medical expenditure incurred, as specified in **(I) & (III)** above, cannot exceed **₹ 50,000**.

In case one of the parents is a senior citizen who is covered under mediclaim policy and another is also a senior citizen but not covered under mediclaim policy, the aggregate of deduction, in respect of payment of medical insurance premium and medical expenditure incurred, as specified in **(II) & (III)** above, cannot exceed **₹ 50,000**.

(iv) Deduction where premium for health insurance is paid in lump sum [Section 80D(4A)]

(a) **Appropriate fraction of lump sum premium allowable as deduction:** In a case where mediclaim premium is paid in lumpsum for more than one year by:

(1) an individual, to effect or keep in force an insurance on his health or health of his spouse, dependent children or parents; or

(2) a HUF, to effect or keep in force an insurance on the health of any member of the family,

then, the deduction allowable under this section for each of the relevant previous year would be equal to the appropriate fraction of such lump sum payment.

(b) **Meaning of certain terms**

Term	Meaning
Appropriate fraction	1 ÷ Total number of relevant previous years
Relevant previous year	*The previous year in which such lump sum amount is paid; and the subsequent previous year(s) during which the insurance would be in force.*

ILLUSTRATION 7

Mr. A, aged 40 years, paid medical insurance premium of ₹ 20,000 during the P.Y.2019-20 to insure his health as well as the health of his spouse. He also paid medical insurance premium of ₹ 47,000 during the year to insure the health of his father, aged 63 years, who is not dependant on him. He contributed ₹ 3,600 to Central Government Health Scheme during the year. He has incurred ₹ 3,000 in cash on preventive health check-up of himself and his spouse and ₹ 4,000 by cheque on preventive health check-up of his father. Compute the deduction allowable under section 80D for the A.Y. 2020-21.

SOLUTION

Deduction allowable under section 80D for the A.Y.2020-21

	Particulars	Actual Payment ₹	Maximum deduction allowable ₹
A.	**Premium paid and medical expenditure incurred for self and spouse**		
(i)	Medical insurance premium paid for self and spouse	20,000	20,000
(ii)	Contribution to CGHS	3,600	3,600
(iii)	Exp. on preventive health check-up of self & spouse	3,000	1,400
		26,600	**25,000**
B.	**Premium paid and medical expenditure incurred for father, who is a senior citizen**		
(i)	Mediclaim premium paid for father, who is over 60 years of age	47,000	47,000
(ii)	Expenditure on preventive health check-up of father	4,000	3,000
		51,000	**50,000**
	Total deduction under section 80D (₹ 25,000 + ₹ 50,000)		75,000

Notes:

(1) The total deduction under A.(i), (ii) and (iii) above should not exceed ₹ 25,000. Therefore, the expenditure on preventive health check-up for self and spouse would be restricted to ₹ 1,400, being (₹ 25,000 – ₹ 20,000 – ₹ 3,600).

(2) The total deduction under B. (i) and (ii) above should not exceed ₹ 50,000. Therefore, the expenditure on preventive health check-up for father would be restricted to ₹ 3,000, being (₹ 50,000 – ₹ 47,000).

(3) In this case, the total deduction allowed on account of expenditure on preventive health check-up of self, spouse and father is ₹ 4,400 (i.e., ₹ 1,400 + ₹ 3,000), which is less than the maximum permissible limit of ₹ 5,000.

ILLUSTRATION 8

Mr. Y, aged 40 years, paid medical insurance premium of ₹ 22,000 during the P.Y.2019-20 to insure his health as well as the health of his spouse and dependant children. He also paid medical insurance premium of ₹ 33,000 during the year to insure the health of his mother, aged 67 years, who is not dependant on him. He incurred medical expenditure of ₹ 20,000 on his father, aged 71 years, who is not covered under mediclaim policy. His father is also not dependent upon him. He contributed ₹ 6,000 to Central Government Health Scheme during the year. Compute the deduction allowable under section 80D for the A.Y.2020-21.

SOLUTION

Deduction allowable under section 80D for the A.Y.2020-21

Particulars			₹
(i)	Medical insurance premium paid for self, spouse and dependent children	₹ 22,000	
(ii)	Contribution to CGHS	₹ 6,000	
		₹ 28,000	
	restricted to		25,000
(iii)	Mediclaim premium paid for mother, who is over 60 years of age	₹ 33,000	
(iv)	Medical expenditure incurred for father, who is over 60 years of age and not covered by any insurance	₹ 20,000	
		₹ 53,000	
	restricted to		50,000
			75,000

(6) Deduction in respect of maintenance including medical treatment of a dependant disabled [Section 80DD]

(i) Eligible assessee: Section 80DD provides deduction to an assessee, who is a resident in India, **being an individual or Hindu undivided family**.

(ii) Payment qualifying for deduction:

(a) Any amount –

- incurred for the medical treatment (including nursing), training and rehabilitation of a dependant, being a person with disability, or
- paid or deposited under a scheme framed in this behalf by the Life Insurance Corporation or any other insurer or the Administrator or the Specified

Company as referred to in section 2(h) of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002, for the maintenance of a dependant, being a person with disability

qualifies for deduction.

(b) The scheme should provide for payment of annuity or a lump sum amount for the benefit of a dependant, being a person with disability, in the event of the death of the individual or member of the HUF, in whose name subscription was made and the assessee must nominate either the dependant, being a person with disability or any other person or a trust to receive the payment on his behalf, for the benefit of the dependant, being a person with disability.

(c) The benefit of deduction under this section is also available to assessees incurring expenditure on maintenance including medical treatment of persons suffering from autism, cerebral palsy and multiple disabilities

(iii) Quantum of deduction: The quantum of deduction is **₹ 75,000** and in case of severe disability (i.e. person with 80% or more disability) the deduction shall be **₹ 1,25,000**.

(iv) Conditions:

(a) For claiming the deduction, the assessee shall have to furnish a copy of the certificate issued by the medical authority under the Persons with Disability (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 along with the return of income under section 139.

(b) Where the condition of disability requires reassessment, a fresh certificate from the medical authority shall have to be obtained after the expiry of the period mentioned in the original certificate in order to continue to claim the deduction.

(c) If the dependant, being a person with disability, predeceases the individual or the member of HUF, in whose name subscription was made, then the amount paid or deposited under the said scheme would be chargeable to tax in the hands of the assessee in the previous year in which such amount is received by the assessee.

(v) Meaning of "Dependant":

	Assessee	Dependant
(1)	Individual	the spouse, children, parents, brother or sister of the individual who is wholly or mainly dependant on such individual and not claimed deduction under section 80U in the computation of his income
(2)	HUF	a member of the HUF, wholly or mainly dependant on such HUF and not claimed deduction under section 80U in the computation of his income

ILLUSTRATION 9

Mr. X is a resident individual. He deposits a sum of ₹ 50,000 with Life Insurance Corporation every year for the maintenance of his handicapped grandfather who is wholly dependant upon him. The disability is one which comes under the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995. A copy of the certificate from the medical authority is submitted. Compute the amount of deduction available under section 80DD for the A.Y. 2020-21.

SOLUTION

Since the amount deposited by Mr. X was for his grandfather, he will not be allowed any deduction under section 80DD. The deduction is available if the individual assessee incurs any expense for a dependant disabled relative. Grandfather does not come within the definition of dependant.

ILLUSTRATION 10

What will be the deduction if Mr. X had made this deposit for his dependant father?

SOLUTION

Since the expense was incurred for a dependant disabled relative, Mr. X will be entitled to claim a deduction of ₹ 75,000 under section 80DD, irrespective of the amount deposited. In case his father has severe disability, the deduction would be ₹ 1,25,000.

(7) Deduction in respect of medical treatment etc. [Section 80DDB]

(i) **Eligible assessee:** This section provides deduction to an assessee, who is resident in India, being an individual and Hindu undivided family. The deduction is available to an individual for medical expenditure incurred on himself or a dependant. It is also available to a Hindu undivided family (HUF) for such expenditure incurred on any of its members.

(ii) **Meaning of "Dependant":**

	Assessee	Dependant
(1)	Individual	the spouse, children, parents, brother or sister of the individual or any of them, wholly or mainly dependant on such individual for his support and maintenance.
(2)	HUF	a member of the HUF, wholly or mainly dependant on such HUF for his support and maintenance.

(iii) **Payment qualifying for deduction:** Any amount actually paid for the medical treatment of such disease or ailment as may be specified in the rules made in this behalf by the Board for himself or a dependant, in case the assessee is an individual or for any member of a HUF, in case the assessee is a HUF will qualify for deduction.

(iv) **Quantum of deduction:** The amount of deduction under this section shall be equal to the amount actually paid or **₹ 40,000**, whichever is less, in respect of that previous year in which such amount was actually paid.

In case the amount is paid in respect of a senior citizen, i.e., a resident individual of the age of 60 years or more at any time during the relevant previous year, then the deduction would be the amount actually paid or **₹ 1,00,000**, whichever is less.

The deduction under this section shall be reduced by the amount received, if any, under insurance from an insurer, or reimbursed by an employer, for the medical treatment of the assessee or the dependant.

(v) **Maximum deduction:** The maximum limit of deduction under section 80DDB for the various categories of dependant are summarized hereunder:

	Dependant	Maximum limit (₹)
(1)	A senior citizen, being a resident individual	1,00,000
(2)	Other than a senior citizen	40,000

(vi) **Condition:** No such deduction shall be allowed unless the assessee obtains the prescription for such medical treatment from a neurologist, an oncologist, a urologist, a hematologist, an immunologist or such other specialist, as may be prescribed.

(8) Deduction in respect of interest loan taken for higher education [Section 80E]

(i) **Eligible assessee:** Section 80E provides deduction to an individual-assessee in respect of any interest on loan paid by him in the previous year out of his income chargeable to tax.

(ii) **Conditions:** The loan must have been taken for the purpose of pursuing his higher education or for the purpose of higher education of his or her relative. The loan must have been taken from any financial institution or approved charitable institution.

(iii) **Meaning of certain terms:**

	Term	Meaning
(a)	**Relative**	Spouse and children of the individual or the student for whom the individual is the legal guardian
(b)	**Higher education**	It means any course of study (including vocational studies) pursued after passing the Senior Secondary Examination or its equivalent from any school, board or university recognised by the Central Government or State Government or local authority or by any other authority authorized by the Central Government or State Government or local authority to do so. Therefore, interest on loan taken for pursuing any course after Class XII or its equivalent, will qualify for deduction under section 80E.

(c)	**Period of deduction**	The deduction is allowed in computing the total income in respect of the initial assessment year (i.e. the assessment year relevant to the previous year, in which the assessee starts paying the interest on the loan) and seven assessment years immediately succeeding the initial assessment year or until the interest is paid in full by the assessee, whichever is earlier.
(d)	**Approved charitable institution**	It means an institution established for charitable purposes and approved by the prescribed authority under section 10(23C) or an institution referred to in section 80G(2)(a).
(e)	**Financial institution**	It means – (a) a banking company to which the Banking Regulation Act, 1949 applies (including a bank or banking institution referred to in section 51 of the Act); or (b) any other financial institution which the Central Government may, by notification in the Official Gazette, specify in this behalf

ILLUSTRATION 11

Mr. B has taken three education loans on April 1, 2019, the details of which are given below:

	Loan 1	**Loan 2**	**Loan 3**
For whose education loan was taken	*B*	*Son of B*	*Daughter of B*
Purpose of loan	*MBA*	*B. Sc.*	*B.A.*
Amount of loan (₹)	*5,00,000*	*2,00,000*	*4,00,000*
Annual repayment of loan (₹)	*1,00,000*	*40,000*	*80,000*
Annual repayment of interest (₹)	*20,000*	*10,000*	*18,000*

Compute the amount deductible under section 80E for the A.Y.2020-21.

SOLUTION

Deduction under section 80E is available to an individual assessee in respect of any interest paid by him in the previous year in respect of loan taken for pursuing his higher education or higher education of his spouse or children. Higher education means any course of study pursued after senior secondary examination.

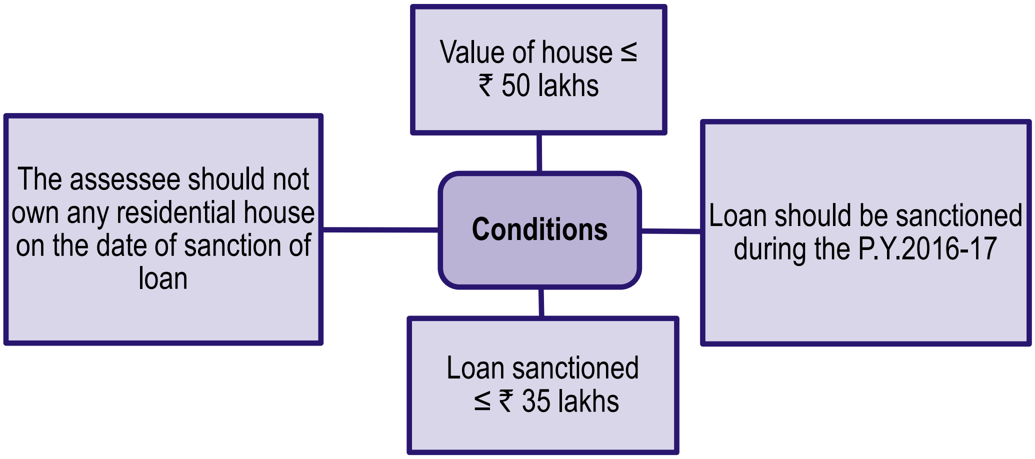
Therefore, interest repayment in respect of all the above loans would be eligible for deduction.

Deduction under section 80E = ₹ 20,000 + ₹ 10,000 + ₹ 18,000 = ₹ 48,000.

(9) Deduction for interest on loan borrowed for acquisition of self-occupied house property by an individual [Section 80EE]

(i) **Eligible assessee:** Section 80EE provides additional deduction in respect of interest on loan taken by an individual for acquisition of residential house property from any financial institution.

(ii) **Conditions:** The conditions to be satisfied for availing this deduction are as follows –



Conditions

Value of house ≤ ₹ 50 lakhs

The assessee should not own any residential house on the date of sanction of loan

Loan should be sanctioned during the P.Y.2016-17

Loan sanctioned ≤ ₹ 35 lakhs

(iii) **Period of benefit:** The benefit of deduction under this section would be available till the repayment of loan continues.

(iv) **Quantum of deduction:** The maximum deduction allowable is ₹ 50,000. The deduction of upto ₹ 50,000 under section 80EE is over and above the deduction of upto ₹ 2,00,000 available under section 24 for interest paid in respect of loan borrowed for acquisition of a self-occupied property.

(v) **Meaning of certain terms:**

	Term	Meaning
(a)	Financial institution	▪ A banking company to which the Banking Regulation Act, 1949 applies; or ▪ Any bank or banking institution referred to in section 51 of the Banking Regulation Act, 1949; or ▪ A housing finance company.
(b)	Housing finance company	A public company formed or registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes.

ILLUSTRATION 12

Mr. A purchased a residential house property for self-occupation at a cost of ₹ 45 lakh on 1.4.2017, in respect of which he took a housing loan of ₹ 35 lakh from Bank of India@11% p.a. on the same date. The loan was sanctioned on 28th March, 2017. Compute the eligible deduction in respect of interest on housing loan for A.Y.2020-21 under the provisions of the Income-tax Act, 1961, assuming that the entire loan was outstanding as on 31.3.2020 and he does not own any other house property.

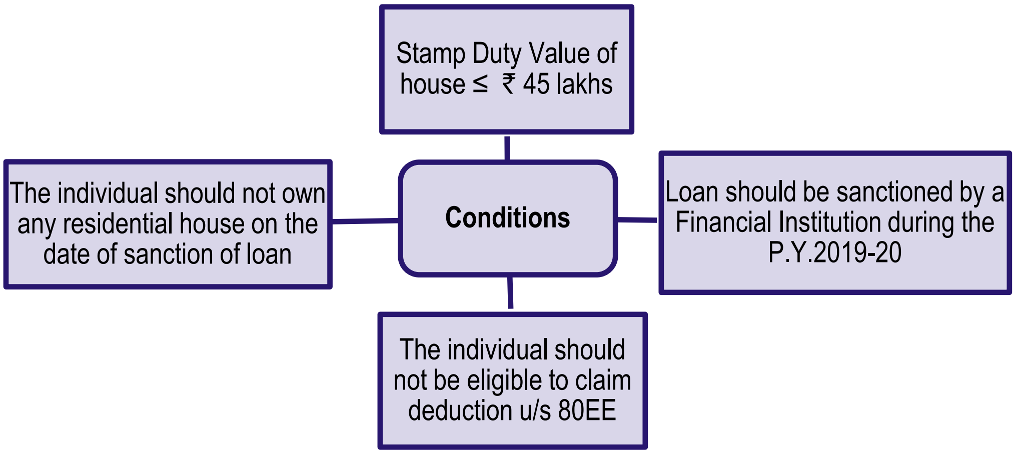
SOLUTION

Particulars	₹
Interest deduction for A.Y.2020-21	
(i) **Deduction allowable while computing income under the head “Income from house property”**	
Deduction under section 24(b) ₹ 3,85,000 [₹ 35,00,000 × 11%]	
Restricted to	2,00,000
(ii) **Deduction under Chapter VI-A from Gross Total Income**	
Deduction under section 80EE ₹1,85,000 (₹ 3,85,000 – ₹ 2,00,000)	
Restricted to	50,000

(10) Deduction in respect of interest payable on loan taken for acquisition of residential house property [Section 80EEA]

(i) ***Eligible assessee****: An individual who has taken a loan for acquisition of residential house property from any financial institution. Interest payable on such loan would qualify for deduction under this section.*

(ii) ***Conditions:*** *The conditions to be satisfied for availing this deduction are as follows –*



Stamp Duty Value of house ≤ ₹ 45 lakhs

The individual should not own any residential house on the date of sanction of loan

Conditions

Loan should be sanctioned by a Financial Institution during the P.Y.2019-20

The individual should not be eligible to claim deduction u/s 80EE *(iii)* ***Period of benefit:*** *The benefit of deduction under this section would be available from A.Y.2020-21 and subsequent assessment years till the repayment of loan continues.*

(iv) ***Quantum of deduction:*** *The maximum deduction allowable is ₹ 1,50,000. The deduction of upto ₹ 1,50,000 under section 80EEA is over and above the deduction available under section 24(b) in respect of interest payable on loan borrowed for acquisition of a residential house property.*

In respect of self-occupied house property, interest deduction under section 24(b) is restricted to ₹ 2,00,000. In case of let out or deemed to be let out property, even though there is no limit under section 24(b), section 71(3A) restricts the amount of loss from house property to be set-off against any other head of income to ₹ 2,00,000. Accordingly, if interest payable in respect of acquisition of eligible house property is more than ₹ 2,00,000, the excess can be claimed as deduction under section 80EEA, subject to fulfilment of conditions.

(v) ***No deduction under any other provision:*** *The interest allowed as deduction under section 80EEA will not be allowed as deduction under any other provision of the Act for the same or any other assessment year.*

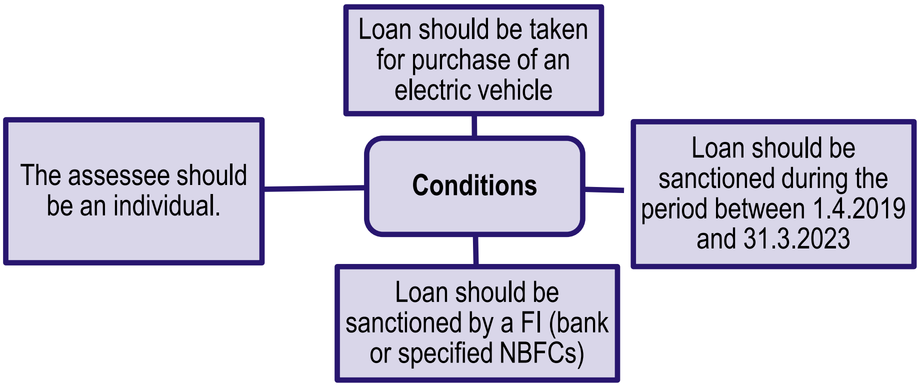
(vi) ***Meaning of certain terms:***

	Term	***Meaning***
(a)	*Financial institution*	• *A banking company to which the Banking Regulation Act, 1949 applies; or* • *Any bank or banking institution referred to in section 51 of the Banking Regulation Act, 1949; or* • *A housing finance company.*
(b)	*Housing finance company*	*A public company formed or registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes.*

(11) Deduction in respect of interest payable on loan taken for purchase of electric vehicle [Section 80EEB]

(i) ***Eligible Assessee****: An individual who has taken a loan for purchase of an electric vehicle from any financial institution. Interest payable on such loan would qualify for deduction under this section.*

(ii) ***Conditions:*** *The conditions to be satisfied for availing this deduction are as follows –*



Conditions

Loan should be taken for purchase of an electric vehicle

The assessee should be an individual.

Loan should be sanctioned during the period between 1.4.2019 and 31.3.2023

Loan should be sanctioned by a FI (bank or specified NBFCs)

(iii) ***Period of benefit:*** *The benefit of deduction under this section would be available from A.Y.2020-21 and subsequent assessment years till the repayment of loan continues.*

(iv) ***Quantum of deduction:*** *Interest payable, subject to a maximum of ₹ 1,50,000.*

(v) ***No deduction under any other provision:*** *The interest allowed as deduction u/s 80EEB will not be allowed as deduction under any other provision of the Act for the same or any other assessment year.*

(v) ***Meaning of certain terms:***

	Term	*Meaning*
(a)	*Financial institution*	• *A banking company to which the Banking Regulation Act, 1949 applies; or* • *Any bank or banking institution referred to in section 51 of the Banking Regulation Act, 1949; or* • *Any deposit taking NBFC* • *A systemically important non-deposit taking NBFC i.e., a NBFC which is not accepting or holding public deposits and having total assets of not less than Rs.500 crore as per the last audited balance sheet and is registered with the RBI.*
(b)	*Electric Vehicle*	*A vehicle which is powered exclusively by an electric motor whose traction energy is supplied exclusively by traction battery installed in the vehicle. The vehicle should have electric regenerative braking system, which during braking provides for the conversion of vehicle kinetic energy into electrical energy.*

ILLUSTRATION 13

The following are the particulars relating to Mr.A, Mr.B, Mr.C and Mr.D, salaried individuals, for A.Y.2020-21 –

Particulars	*Mr. A*	*Mr. B*	*Mr. C*	*Mr. D*
Amount of loan taken	*₹ 43 lakhs*	*₹ 45 lakhs*	*₹ 20 lakhs*	*₹ 15 lakhs*
Loan taken from	*HFC*	*Deposit taking NBFC*	*Deposit taking NBFC*	*Public sector bank*
Date of sanction of loan	*1.4.2019*	*1.4.2019*	*1.4.2019*	*30.3.2019*
Date of disbursement of loan	*1.5.2019*	*1.5.2019*	*1.5.2019*	*1.5.2019*
Purpose of loan	*Acquisition of residential house property for self-occupation*	*Acquisition of residential house property for self-occupation*	*Purchase of electric vehicle for personal use*	*Purchase of electric vehicle for personal use*
Stamp duty value of house property	*₹ 45 lakhs*	*₹ 48 lakhs*	-	-
Cost of electric vehicle	-	-	*₹ 22 lakhs*	*₹ 18 lakhs*
Rate of interest	*9% p.a.*	*9% p.a.*	*10% p.a.*	*10% p.a.*

Compute the amount of deduction, if any, allowable under the provisions of the Income-tax Act, 1961 for A.Y.2020-21 in the hands of Mr. A, Mr. B, Mr. C and Mr. D. Assume that there has been no principal repayment during the P.Y.2019-20.

SOLUTION

Particulars	₹
Mr. A	
Interest deduction for A.Y.2020-21	
(i) Deduction allowable while computing income under the head "Income from house property"	
Deduction u/s 24(b) ₹ 3,54,750	
[₹ 43,00,000 × 9% x 11/12]	
Restricted to	2,00,000
(ii) Deduction under Chapter VI-A from Gross Total Income	
Deduction u/s 80EEA ₹ 1,54,750	
(₹ 3,54,750 – ₹ 2,00,000)	
Restricted to	1,50,000

Mr. B	
Interest deduction for A.Y.2020-21	
(i) Deduction allowable while computing income under the head "Income from house property"	
Deduction u/s 24(b) ₹ 3,71,250 [₹ 45,00,000 × 9% x 11/12]	
Restricted to	2,00,000
(ii) Deduction under Chapter VI-A	
Deduction u/s 80EEA is not permissible since: (i) loan is taken from NBFC (ii) stamp duty value exceeds ₹ 45 lakh.	Nil
Deduction under section 80EEA would not be permissible due to either violation listed above.	
Mr. C	
Deduction under Chapter VI-A	
Deduction u/s 80EEB for interest payable on loan taken for purchase of electric vehicle [₹ 20 lakhs x 10% x 11/12 = ₹ 1,83,333, restricted to ₹ 1,50,000, being the maximum permissible deduction]	1,50,000
Mr. D	
Deduction under Chapter VI-A	
Deduction u/s 80EEB is not permissible since loan was not sanctioned in the P.Y.2019-20.	Nil

(12) Deduction in respect of donations to certain funds, charitable institutions etc. [Section 80G]

(i) **Eligible assessee:** Where an assessee pays any sum as donation to eligible funds or institutions, he is entitled to a deduction, subject to certain limitations, from the gross total income.

(ii) **Quantum of deduction:** There are four categories of deductions. The following table gives the details of the institutions and funds to which donations can be made for the purpose of claiming deduction under section 80G, –

I	Donation qualifying for 100% deduction, without any qualifying limit
(1)	The National Defence Fund set up by the Central Government
(2)	Prime Minister's National Relief Fund.
(3)	Prime Minister's Armenia Earthquake Relief Fund

(4)	The Africa (Public Contributions-India) Fund
(5)	The National Children's Fund
(6)	The National Foundation for Communal Harmony
(7)	Approved University or educational institution of national eminence
(8)	Chief Minister's Earthquake Relief Fund, Maharashtra
(9)	Any fund set up by the State Government of Gujarat exclusively for providing relief to the victims of the Gujarat earthquake
(10)	Any Zila Saksharta Samiti for primary education in villages and towns and for literacy and post-literacy activities
(11)	National Blood Transfusion Council or any State Blood Transfusion Council whose sole objective is the control, supervision, regulation or encouragement of operation and requirements of blood banks
(12)	Any State Government Fund set up to provide medical relief to the poor
(13)	The Army Central Welfare Fund or Indian Naval Benevolent Fund or Air Force Central Welfare Fund established by the armed forces of the Union for the welfare of past and present members of such forces or their dependants.
(14)	The Andhra Pradesh Chief Minister's Cyclone Relief Fund, 1996
(15)	The National Illness Assistance Fund
(16)	The Chief Minister's Relief Fund or Lieutenant Governor's Relief Fund in respect of any State or Union Territory
(17)	The National Sports Fund set up by the Central Government
(18)	The National Cultural Fund set up by the Central Government
(19)	The Fund for Technology Development and Application set up by the Central Government
(20)	National Trust for welfare of persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities
(21)	The Swachh Bharat Kosh, set up by the Central Government, other than the sum spent by the assessee in pursuance of CSR u/s 135(5) of the Companies Act, 2013
(22)	The Clean Ganga Fund, set up by the Central Government, where such assessee is a resident, other than the sum spent in pursuance of CSR u/s 135(5) of the Companies Act, 2013
(23)	The National Fund for Control of Drug Abuse constituted under section 7A of the Narcotic Drugs and Psychotroic Substances Act, 1985

II	**Donation qualifying for 50% deduction, without any qualifying limit**
(1)	The Jawaharlal Nehru Memorial Fund
(2)	Prime Minister's Drought Relief Fund
(3)	Indira Gandhi Memorial Trust
(4)	Rajiv Gandhi Foundation
III	**Donation qualifying for 100% deduction, subject to qualifying limit**
(1)	The Government or to any such local authority, institution or association as may be approved for promotion of family planning
(2)	**Sum paid by a company** as donation to the Indian Olympic Association or any other association/institution established in India, as may be notified by the Government established – - for the development of infrastructure for sports or games, or - the sponsorship of sports and games in India
IV	**Donation qualifying for 50% deduction, subject to qualifying limit**
(1)	Any Institution or Fund established in India for charitable purposes fulfilling prescribed conditions under section 80G(5).
(2)	The Government or any local authority for utilisation for any charitable purpose other than the purpose of promoting family planning.
(3)	An authority constituted in India by or under any other law enacted either for the purpose - of dealing with and satisfying the need for housing accommodation or - of planning, development or improvement of cities, towns and villages, or both.
(4)	Any Corporation established by the Central Government or any State Government for promoting the interests of the members of a minority community as referred in section 10(26BB).
(5)	for renovation or repair of any such temple, mosque, gurdwara, church or other place as notified by the Central Government to be of historic, archaeological or artistic importance or to be a place of public worship of renown throughout any State or States.

(iii) **Qualifying limit:** The eligible donations referred to in III and IV should be aggregated and the sum total should be limited to 10% of the adjusted gross total income. This would be the maximum permissible deduction.

The donations qualifying for 100% deduction would be first adjusted from the maximum permissible deduction and thereafter 50% deduction of the balance would be allowed.

Steps for computation of qualifying limit

Step 1:	Compute adjusted total income i.e., the GTI as reduced by the following: (i) Deductions under Chapter VI-A, except under section 80G (ii) Short-term capital gain taxable under section 111A (iii) Long-term capital gains taxable under sections 112 & 112A (iv) Any income on which income-tax is not payable (v) Income referred to in section 115A(1)(a), 115AB, 115AC,115AD and 115D
Step 2:	Calculate 10% of adjusted total income
Step 3:	Calculate the actual donation, which is subject to qualifying limit (Total of Category III and IV donations, shown in the table above)
Step 4:	Lower of Step 2 or Step 3 is the maximum permissible deduction.
Step 5:	The said deduction is adjusted first against donations qualifying for 100% deduction (i.e., Category III donations). Thereafter, 50% of balance qualifies for deduction under section 80G.

(iv) Conditions: Donation to any institution or fund referred in point no. (1) of (IV) above, shall be eligible for deduction if it is established in India for charitable purposes and fulfill the following conditions:

(1) The institution or fund is:

(a) constituted as a public charitable trust, or

(b) registered under the Societies Registration Act, 1860 or under any corresponding law or under section 25 of the Companies Act, 1956[2], or

(c) a University established by law or

(d) any other educational institution recognized by the Government or by a university established by law or affiliated to any university established by law

(e) an institution financed wholly or in part by the Government or a local authority.

(2) Where such institution or fund derives any income, such income should not be liable to inclusion in its total income under the provisions of section 10(23AA), 10(23C) or 11 or 12.

However, in respect of profits and gains of business, the condition of such income should not be liable to inclusion in its total income under the provisions of section 11 shall not be applicable if –

[2] Section 8 of the Companies Act, 2013

- The institution or fund maintains separate books of account in respect of such business;
- The donation made to it are not used by it, directly or indirectly, for the purpose of such business; and
- The institution or fund issues certificate to the donor in respect of the above compliance.

Further, it may be noted that the assessee will not lose the benefit of deduction if:

(a) subsequent to the donation, any part of the income of the Institution has become chargeable to tax due to non-compliance with any of the provisions of section 11 or section 12 or section 12A.

(b) as a result of the operation of section 13(1)(*c*), exemption under section 11 or section 12 is denied to the institution in relation to any income arising to it from any investment made in a concern in which the person specified under section 13(3) has substantial interest and aggregate of fund so invested does not exceed 5% of the capital of that concern. *[Explanation 2]*

(3) No part of the income or assets of the Institution or Fund is transferable or applicable at any time for any purposes other than charitable purpose.

Such charitable purpose however does not include any purpose the whole or substantially the whole of which is of a religious nature. *[Explanation 3]*

However, where an institution or fund incurs expenditure of a religious nature for an amount not exceeding 5% of its total income in that previous year, such institution or fund shall be deemed to be a fund or institution to which the provisions of this section apply.

(4) For the purposes of this section, an association or institution having as its object the control, supervision, regulation or encouragement in India of such games or sports as the Central Government may, by notification in the Official Gazette, specify in this behalf, shall be deemed to be an institution established in India for a charitable purpose. *[Explanation 4]*

(5) The Institution or Fund is not expressed to be for the benefit of any particular religious community or caste.

An institution or fund established for the benefit of women and children or of Scheduled Castes, Backward classes or Scheduled Tribes is not however to be treated as an institution or fund for the benefit of a religious community or caste. [*Explanation 1*]

(6) The Institution or Fund maintains regular accounts of its receipt and expenditure.

(7) Such institution or fund must be approved by the Commissioner in accordance with the rules made in this behalf.

(v) Other points:

(a) Where an assessee has claimed and has been allowed any deduction under this section in respect of any amount of donation, the same amount will not qualify for deduction under any other provision of the Act for the same or any other assessment year.

(b) Donations in kind shall not qualify for deduction.

(c) No deduction shall be allowed in respect of donation of any sum exceeding **₹ 2,000** unless such sum is paid by any mode other than cash.

(d) The deduction under section 80G can be claimed whether it has any nexus with the business of the assessee or not.

(e) As per *Circular No.2/2005 dated 12.1.2005*, in cases where employees make donations to the Prime Minister's National Relief Fund, the Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund through their respective employers, it is not possible for such funds to issue separate certificate to every such employee in respect of donations made to such funds as contributions made to these funds are in the form of a consolidated cheque. An employee who makes donations towards these funds is eligible to claim deduction under section 80G. It is, hereby, clarified that the claim in respect of such donations as indicated above will be admissible under section 80G on the basis of the certificate issued by the Drawing and Disbursing Officer (DDO)/ Employer in this behalf.

ILLUSTRATION 14

Mr. Shiva aged 58 years, has gross total income of ₹ 7,75,000 comprising of income from salary and house property. He has made the following payments and investments:

(i) Premium paid to insure the life of her major daughter (policy taken on 1.4.2017) (Assured value ₹ 1,80,000) – ₹ 20,000

(ii) Medical Insurance premium for self – ₹ 12,000; Spouse – ₹ 14,000

(iii) Donation to a public charitable institution registered under 80G ₹ 50,000 by way of cheque

(iv) LIC Pension Fund – ₹ 60,000

(v) Donation to National Children's Fund - ₹ 25,000 by way of cheque

(vi) Donation to Jawaharlal Nehru Memorial Fund - ₹ 25,000 by way of cheque

(vii) Donation to approved institution for promotion of family planning - ₹ 40,000 by way of cheque

(viii) Deposit in PPF - ₹ 1,00,000

Compute the total income of Mr. Shiva for A.Y. 2020-21.

SOLUTION

Computation of Total Income of Mr. Shiva for A.Y. 2020-21

Particulars	₹	₹
Gross Total Income		**7,75,000**
***Less*: Deduction under section 80C**		
Deposit in PPF	1,00,000	
Life insurance premium paid for insurance of major daughter (Maximum 10% of the assured value ₹ 1,80,000, as the policy is taken after 31.3.2012)	18,000	
	1,18,000	
Deduction u/s 80CCC in respect of LIC pension fund	60,000	
	1,78,000	
As per section 80CCE, deduction u/s 80C & 80CCC is restricted to		1,50,000
Deduction under section 80D		
Medical Insurance premium in respect of self and spouse	26,000	
Restricted to		25,000
Deduction under section 80G (See Working Note below)		87,500
Total income		**5,12,500**

Working Note: Computation of deduction under section 80G

	Particulars of donation	Amount donated (₹)	% of deduction	Deduction u/s 80G (₹)
(i)	National Children's Fund	25,000	100%	25,000
(ii)	Jawaharlal Nehru Memorial Fund	25,000	50%	12,500
(iii)	Approved institution for promotion of family planning	40,000	100%, subject to qualifying limit	40,000
(iv)	Public Charitable Trust	1,50,000	50% subject to qualifying limit (See Note below)	10,000
				87,500

Note - Adjusted total income = Gross Total Income – Amount of deductions under section 80C to 80U except section 80G i.e., ₹ 6,00,000, in this case.

₹ 60,000, being 10% of adjusted total income is the qualifying limit, in this case.

Firstly, donation of ₹ 40,000 to approved institution for family planning qualifying for 100% deduction subject to qualifying limit, has to be adjusted against this amount. Thereafter, donation to public charitable trust qualifying for 50% deduction, subject to qualifying limit is adjusted. Hence, the contribution of ₹ 50,000 to public charitable trust is restricted to ₹ 20,000 (being, ₹ 60,000 - ₹ 40,000), 50% of which would be the deduction under section 80G. Therefore, the deduction under section 80G in respect of donation to public charitable trust would be ₹10,000, which is 50% of ₹ 20,000.

(13) Deduction in respect of rent paid [Section 80GG]

(i) **Eligible assessee**: Assessee, who is not in receipt of HRA qualifying for exemption under section 10(13A) from employer and who pays rent for accommodation occupied by him for residential purposes.

(ii) **Conditions:** The following conditions have to be satisfied for claiming deduction under section 80GG -

(a) The assessee should not be receiving any house rent allowance exempt under section 10(13A).

(b) The expenditure incurred by him on rent of any furnished or unfurnished accommodation should exceed 10% of his total income arrived at after all deductions under Chapter VI A except section 80GG.

(c) The accommodation should be occupied by the assessee for the purposes of his own residence.

(d) The assessee should fulfill such other conditions or limitations as may be prescribed, having regard to the area or place in which such accommodation is situated and other relevant considerations.

(e) The assessee or his spouse or his minor child or an HUF of which he is a member should not own any accommodation at the place where he ordinarily resides or perform duties of his office or employment or carries on his business or profession; or

(f) If the assessee owns any accommodation at any place other than that referred to above, such accommodation should not be in the occupation of the assessee and its annual value is not required to be determined under section 23(2)(a) or section 23(4)(a).

(g) The assessee should file a declaration in the prescribed form, confirming the details of rent paid and fulfillment of other conditions, with the return of income.

(iii) Quantum of deduction: The deduction admissible will be the least of the following:

(a) Actual rent paid minus 10% of the total income of the assessee before allowing the deduction, or

(b) 25% of such total income (arrived at after making all deductions under Chapter VI-A but before making any deduction under this section), or

(c) Amount calculated at ₹ 5,000 p.m.

ILLUSTRATION 15

Mr. Ganesh, a businessman, whose total income (before allowing deduction under section 80GG) for A.Y.2020-21 is ₹ 4,60,000, paid house rent at ₹ 12,000 p.m. in respect of residential accommodation occupied by him at Mumbai. Compute the deduction allowable to him under section 80GG for A.Y.2020-21.

SOLUTION

The deduction under section 80GG will be computed as follows:

(i) Actual rent paid *less* 10% of total income

$$₹\ 1{,}44{,}000\ (-)\ \frac{(10 \times 4{,}60{,}000)}{100} = ₹\ 98{,}000\ (A)$$

(ii) 25% of total income

$$\frac{25 \times 4{,}60{,}000}{100} = ₹\ 1{,}15{,}000\ (B)$$

(iii) Amount calculated at ₹ 5,000 p.m. = ₹ 60,000 (C)

Deduction allowable (least of A, B and C) = ₹ 60,000

(14) Deduction in respect of donations for scientific research or rural development [Section 80GGA]

(i) Eligible assessee: Section 80GGA grants deduction in respect of the donations made for scientific research or rural development by any assessee not having income chargeable under the head “Profits and gains of business or profession”.

(ii) Donations qualifying for deduction:

(a) Any sum paid by the assessee in the previous year to a research association which has, as its object, the undertaking of scientific research or to a University, college or other institution to be used for scientific research; and

Such research association, University, college or institution must be approved under section 35(1)(ii).

(b) Any sum paid to a research Association which has as its object the undertaking of research in social science or statistical research, University, College or other institution to be used for research in social science or statistical research.

Such Research Association, University, College or institution must be approved under section 35(1)(iii).

Further, it has been clarified that the deduction to which an assessee (i.e. donor) is entitled on account of payment of any sum to a research association or university or college or other institution for scientific research or research in a social science or statistical research, shall not be denied merely on the ground that subsequent to payment of such sum by the assessee, the approval granted to any of the aforesaid entities is withdrawn

(c) Any sum paid by the assessee in the previous year

- to an association or institution which has as its object the undertaking of any programme of rural development to be used for carrying out any programme of rural development approved by the prescribed authority for purposes of section 35CCA or
- to an institution or association which has as its object the training of persons for implementing programmes of rural development.

It is, however, essential that assessee furnishes the certificate from such institution or association as referred to in section 35CCA(2) & (2A).

Further, it has been clarified that the deduction to which an assessee (i.e. donor) is entitled on account of payment of any sum to an association or institution for carrying out the programme of rural development shall not be denied merely on the ground that subsequent to payment of such sum by the assessee, the approval granted to such programme is withdrawn

(d) Any sum paid to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme.

(e) Any sum paid to a rural development fund set up and notified under section 35CCA.

(f) Any sum paid by the assessee in the previous year to National Urban Poverty Eradication Fund (NUPEF).

(iii) Restrictions on deduction:

(a) Where a deduction under this section is claimed and allowed for any assessment year, deduction shall not be allowed in respect of such payment under any provision of this Act for the same or any other assessment year.

(b) No deduction shall be allowed in respect of donation of any sum exceeding ₹ 10,000 unless such sum is paid by any mode other than cash.

(15) Deduction in respect of contributions given by companies to political parties [Section 80GGB]

(i) Deduction & Conditions: This section provides for deduction of any sum contributed in the previous year by an Indian company to any political party or an electoral trust. However, no deduction shall be allowed in respect of any sum contributed by way of cash.

(ii) Meaning of "contribute": For the purposes of this section, the word "contribute" has the same meaning assigned to it under section 293A of the Companies Act, 1956[3], which provides that -

(a) a donation or subscription or payment given by a company to a person for carrying on any activity which is likely to effect public support for a political party shall also be deemed to be contribution for a political purpose;

(b) the expenditure incurred, directly or indirectly, by a company on advertisement in any publication (being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like) by or on behalf of a political party or for its advantage shall also be deemed to be a contribution to such political party or a contribution for a political purpose to the person publishing it.

(iii) Meaning of "Political party": It means a political party registered under section 29A of the Representation of the People Act, 1951.

ILLUSTRATION 16

During the P.Y.2019-20, ABC Ltd., an Indian company,

(1) contributed a sum of ₹ 2 lakh to an electoral trust; and

(2) incurred expenditure of ₹ 25,000 on advertisement in a brochure of a political party.

Is the company eligible for deduction in respect of such contribution/expenditure, assuming that the contribution was made by cheque? If so, what is the quantum of deduction?

SOLUTION

An Indian company is eligible for deduction under section 80GGB in respect of any sum contributed by it in the previous year to any political party or an electoral trust. Further, the word "contribute" in section 80GGB has the meaning assigned to it in section 293A of the Companies

[3] Now section 182 of the Companies Act, 2013

Act, 1956, and accordingly, it includes the amount of expenditure incurred on advertisement in a brochure of a political party.

Therefore, ABC Ltd. is eligible for a deduction of ₹ 2,25,000 under section 80GGB in respect of sum of ₹ 2 lakh contributed to an electoral trust and ₹ 25,000 incurred by it on advertisement in a brochure of a political party.

It may be noted that there is a specific disallowance under section 37(2B) in respect of expenditure incurred on advertisement in a brochure of a political party. Therefore, the expenditure of ₹ 25,000 would be disallowed while computing business income/ gross total income. However, the said expenditure incurred by an Indian company is allowable as a deduction from gross total income under section 80GGB.

(16) Deduction in respect of contributions given by any person to political parties [Section 80GGC]

(i) **Deduction & Conditions:** This section provides for deduction of any sum contributed in the previous year by any person to a political party or an electoral trust. However, no deduction shall be allowed in respect of any sum contributed by way of cash.

(ii) **Persons not eligible for deduction:** This deduction will, however, not be available to a local authority and an artificial juridical person, wholly or partly funded by the Government.

(iii) **Meaning of "Political party":** It means a political party registered under section 29A of the Representation of the People Act, 1951.

11.3 DEDUCTIONS IN RESPECT OF CERTAIN INCOMES

(1) Deductions in respect of profits and gains from undertakings or enterprises engaged in infrastructure development, etc. [Section 80-IA]

Applicability

Section 80-IA(1) provides a 10 year tax holiday to an assessee, whose gross total income includes any profits and gains derived by an undertaking or enterprise from an eligible business i.e., business referred to in sub-section (4), namely :

(i) **Infrastructure facility** - Any enterprise carrying on the business of:

(a) developing; or

(b) operating and maintaining; or

(c) developing, operating and maintaining

any infrastructure facility.

Conditions: However, such enterprise must fulfill the following conditions:

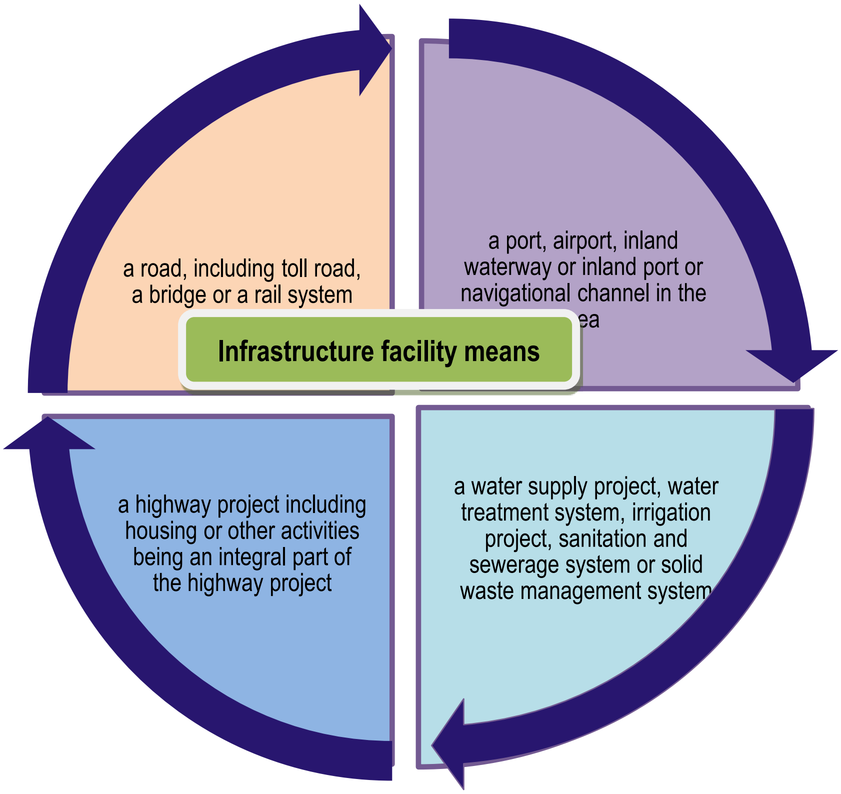
(1) It must be owned by a company registered in India or by a consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act.

(2) It has entered into an agreement with the Central or a State Government or a local authority or statutory body for (i) developing or (ii) operating and maintaining, or (iii) developing, operating and maintaining a new infrastructure facility.

(3) It starts operating and maintaining such infrastructure facility on or after 1-4-1995.

(4) However, where an enterprise which developed such infrastructure facility transfers it to another enterprise on or after 1-4-1999, and such transferee enterprise operates and maintains it according to the agreement drawn up with the Government, etc., this section will apply to the transferee enterprise for the unexpired period of deduction (which was available to the first enterprise).

Meaning of "infrastructure facility":



Infrastructure facility means

a road, including toll road, a bridge or a rail system

a port, airport, inland waterway or inland port or navigational channel in the ea

a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system

a highway project including housing or other activities being an integral part of the highway project

Note:

1. Structures at the ports for storage, loading and unloading etc. will be included in the definition of port for the purpose of section 80-IA, if the concerned port authority has issued a certificate that the said structures form part of the port.

2. Effluent treatment and conveyance system is a part of water treatment system and would accordingly, qualify as an infrastructure facility for the purpose of section 80-IA.

3. The CBDT has, vide *Circular No. 4/2010 dated 18.5.2010*, clarified that widening of an existing road by constructing additional lanes as a part of a highway project by an undertaking would be regarded as a new infrastructure facility for the purpose of section 80-IA(4)(i). However, simply relaying of an existing road would not be classifiable as a new infrastructure facility for this purpose.

***Note** – Any enterprise which starts the development or operation and maintenance of the infrastructure facility on or after 1.4.2017 will not be eligible for deduction under section 80-IA. Instead they would be eligible for investment-linked tax deduction under section 35AD.*

(ii) Industrial parks : Any undertaking which

- develops,
- develops and operates, or
- maintains and operates

an industrial park.

Conditions:

(1) The undertaking begins to operate an industrial park in accordance with the scheme framed and notified by the Central Government.

(2) The scheme is notified by the Government for the period beginning on 1-4-1997 and ending on 31-3-2011 for industrial parks

(3) However, where an undertaking develops an industrial park on or after 1.4.1999 and transfers the operation and maintenance to another undertaking (transferee undertaking), the deduction to the transferee undertaking shall be available for the remaining period in the ten consecutive assessment years, in such a manner as would have been available to the transferor undertaking, as if the operation and maintenance were not so transferred to the transferee undertaking.

Rule 18C lays down the following eligibility criteria for Industrial Parks to claim benefit under section 80-IA (4)(iii) -

(1) The undertaking should begin to develop, develop and operate or maintain and operate an industrial park any time during the period from 1.4.2006 to 31.3.2011.

(2) The undertaking and the Industrial Park should be notified by the Central Government under the Industrial Park Scheme, 2008.

(3) The undertaking should continue to fulfill the conditions envisaged in the Industrial Park Scheme, 2008.

(iii) Power undertakings: Any undertaking which

is set up in any part of India for the generation or generation and distribution of power. However, such undertaking must begin to generate power at any time during the period between 1.4.1993 and 31.3.2017

starts transmission or distribution by laying a network of new transmission or distribution lines at any time during the period from 1.4.1999 and 31.3.2017. However, the deduction shall be allowed only in respect of profits derived from the laying of such network of new lines for transmission or distribution

undertakes substantial renovation and modernisation of the existing network of transmission or distribution lines at any time during the period beginning on 1.4.2004 and ending on 31.3.2017

Meaning of "Substantial renovation and modernisation":

'Substantial renovation and modernisation' means an increase in the plant and machinery in the network of transmission or distribution lines by at least fifty per cent of the book value of such plant and machinery as on 1st April, 2004.

(iv) Undertakings owned by an Indian company and set up for reconstruction or revival of a power generating plant:

An undertaking owned by an Indian company and set up for reconstruction or revival of a power generating plant

Such Indian company should be formed before 30.11.2005 with majority equity participation by public sector companies for the purposes of enforcing the security interest of the lenders to the company owning the power generating plant

Such Indian company should have been notified before 31.12.2005 by the Central Government for the purposes of this clause

Such undertaking should begin to generate or transmit or distribute power before 31.3.2011

Rate of Deduction

The amount of deduction available will be 100% of the profits and gains derived from such business for ten consecutive assessment years commencing at any time during the periods specified in period of tax holiday/concession below.

Period of tax holiday/concession

	Eligible business	Period of tax holiday
1.	For all eligible business except business mentioned in point 2.	Assessee has the option to claim deduction for 10 consecutive assessment years out of 15 years beginning from the year in which the undertaking or the enterprise develops or begins to operate the infrastructure facility or develops industrial park or generates power or commences transmission or distribution of power or undertakes substantial renovation and modernization of the existing transmission or distribution lines.
2.	In case of an infrastructure facility being a public facility like – (i) a road, including a toll road, bridge or rail system; or (ii) a highway project including housing or other activities which are an integral part of the highway project; or (iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system	Assessee has the option to claim deduction for 10 consecutive assessment years out of 20 years beginning from the year in which the undertaking or the enterprise develops or begins to operate the eligible business

Other provisions

(1) **Eligible business to be considered as the only source of income:** For the purpose of computing deduction under this section, the profits and gains of the eligible business shall be computed as if such eligible business were the only source of income of the assessee during the relevant previous years [Sub-section (5)].

(2) **Conditions to exempt profit from housing or other activities, being integral part of highway project:** Where housing or other activities are an integral part of a highway project and the profits and gains have been calculated in accordance with the section, the profits shall not be liable to tax if the following conditions have been fulfilled:

(a) The profit has been transferred to a special reserve account; and

(b) the same is actually utilised for the highway project excluding housing and other activities before the expiry of 3 years following the year of transfer to the reserve account;

(c) The amount remaining unutilised shall be chargeable to tax as income of the year in which the transfer to the reserve account took place [Sub-section (6)].

(3) **Audit of accounts:** The deduction shall be allowed to the undertaking only if the accounts of the undertaking for the relevant previous year have been audited by a chartered accountant and the assessee furnishes the audit report in the prescribed form, duly signed and verified by such accountant along with his return of income [Sub-section (7)].

(4) **Transfer of goods/services between eligible business and other business of the assessee:** Where any goods or services held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or vice versa, and if the consideration for such transfer does not correspond with the market value of the goods or services then the profits and gains of the eligible business shall be computed as if the transfer was made at market value.

However, if, in the opinion of the Assessing Officer, such computation presents exceptional difficulties, the Assessing Officer may compute the profits on such reasonable basis as he may deem fit [Sub-section (8)].

For this purpose, the market value, in relation to any goods or services transferred between the eligible business and any other business carried on by the assessee, shall mean –

(i) the price that such goods or services would ordinarily fetch in the open market; or

(ii) the arm's length price as defined under section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA.

(5) **Deduction not to exceed profits of eligible business:** The deductions claimed and allowed under this section shall not exceed the profits and gains of the eligible business. Further, where deduction is claimed and allowed under this section for any assessment year no deduction in respect of such profits will be allowed under any other section under this chapter under the heading "Deductions in respect of certain incomes". [Sub-section (9)].

(6) **Assessing Officer empowered to make adjustment in case any transaction produces excessive profits to eligible business:** The Assessing Officer is empowered to make an adjustment while computing the profit and gains of the eligible business on the basis of the reasonable profit that can be derived from the transaction, in case due to close connection or for any other reason the transaction between the assessee carrying on the eligible business under section 80-IA and any other person is so arranged that the transaction produces excessive profits to the eligible business [Sub-section (10)].

If the aforesaid arrangement between the assessee carrying on the eligible business and any other person is a specified domestic transaction referred to in section 92BA, then, the amount of profit of such transaction shall be determined having regard to arm's length price as defined under section 92F and not as per the reasonable profit from such transaction.

(7) **Central Government empowered to deny deduction to any class of eligible undertaking or enterprise:** The section empowers the Central Government to declare any class of industrial undertaking or enterprise as not being entitled to deduction under this section. The denial of exemption shall be with effect from such date as may be specified in the notification issued in the Official Gazette [Sub-section (11)].

(8) **Deduction in case of amalgamation or demerger:** In the case of any amalgamation or demerger, by virtue of which the Indian company carrying on the eligible business is transferred to another Indian company, deduction under this section will be available as follows:

(a) No deduction will be available to the amalgamating company or the demerged company, as the case may be, in the year of amalgamation/ demerger.

(b) The provisions of this section will apply to the amalgamated/ resulting company as they would have applied to the amalgamating/ demerged company if the amalgamation/ demerger had not taken place [Sub-section (12)].

However, such transfer of benefit of deduction to the amalgamated/ resulting company would not be available in respect of any enterprise or undertaking which is transferred in a scheme of amalgamation or demerger effected on or after 1.4.2007 [Sub-section (12A)].

(9) **No deduction to any business carrying on specified activities in the nature of a work contract:** The tax holiday under section 80-IA would not be available in relation to a business referred to in sub-section (4) which is in the nature of a works contract awarded by any person (including the Central or State Government) and executed by the undertaking or enterprise referred to in section 80-IA(1).

(2) Deduction in respect of profits and gains by an undertaking or enterprise engaged in development of SEZ [Section 80-IAB]

(i) Quantum of deduction:

Sub-section (1) provides for a deduction of 100% of profits and gains derived by an undertaking or an enterprise from any business of developing a SEZ for 10 consecutive assessment years.

(ii) Eligible assessee:

The deduction is available to an assessee, being a Developer, whose gross total income includes any profits and gains derived by an undertaking or an enterprise from any business of developing a SEZ, notified on or after 1st April, 2005 under the SEZ Act, 2005.

***Note** - No deduction would be available to an assessee, being a developer, where the development of SEZ begins on or after 1st April, 2017.*

(iii) **Meaning of Developer:**

(a) a person who, or

(b) a State Government which

has been granted a letter of approval by the Central Government under section 3(10) of the SEZ Act, 2005.

A developer includes –

(a) an authority and

(b) a Co-developer.

Co-developer means -

(a) a person who, or

(b) a State Government which

has been granted a letter of approval by the Central Government under section 3(12) of the SEZ Act, 2005.

(iv) **Option to choose 10 consecutive A.Y.s out of 15 years to claim deduction:**

The assessee has the option of claiming the said deduction for any ten consecutive assessment years out of fifteen years beginning from the year in which a SEZ has been notified by the Central Government.

(v) **Deduction to transferee in case of transfer of operation and maintenance of such SEZ:**

In a case where an undertaking, being a Developer, who develops a SEZ on or after 1.4.2005 and transfers the operation and maintenance of such SEZ to another Developer, the deduction under sub-section (1) shall be allowed to such transferee Developer for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee Developer.

(vi) The provisions of sub-section (5) and sub-section (7) to (12) of section 80-IA shall apply to the Special Economic Zone for the purpose of allowing deductions under 80-IAB(1).

Lease rent from letting out buildings/developed space along with other amenities in an Industrial Park /SEZ - to be treated as business income [Circular No. 16/2017, dated 25.04.2017]

The issue whether income arising from letting out of premises/developed space along with other amenities in an Industrial Park/SEZ is to be charged under head 'Profits and Gains of Business' or under the head 'Income from House Property' has been subject matter of litigation in recent years. Assessees claim the letting out as business activity, the income arising from which to be charged to tax under the head 'Profits and Gains of Business', whereas the Assessing Officers hold it to be chargeable under the head 'Income from House Property'.

In the case of Velankani Information Systems Pvt Ltd (NJRS Citation [2013-LL-0402-44]), the Karnataka High Court observed that any other interpretation would defeat the object of section 80-IA and Government schemes for development of Industrial Parks in the country. SLPs filed in this case by the Department have been dismissed by the Supreme Court.

In a subsequent judgment dated 30.04.2014 in ITA No. 76 & 78/2012 in the case of CIT v. Information Technology Park Ltd. (NJRS Citation [2014-LL-0430-141], the Karnataka High Court has reaffirmed its earlier views. It has held that, since the assessee-company was engaged in the business of developing, operating and maintaining an Industrial Park and providing infrastructure facilities to different companies as its business, the lease rent received by the assessee from letting out buildings along with other amenities in a software technology park would be chargeable to tax under the head "Profits and gains of business or profession" and not under the head "Income from house property". The judgment has been accepted by the CBDT.

In view of the above, it is now a settled position that in the case of an undertaking which develops, develops and operates or maintains and operates an industrial park/SEZ notified in accordance with the scheme framed and notified by the Government, the income from letting out of premises/developed space along with other facilities in an industrial park/SEZ is to be charged to tax under the head 'Profits and Gains of Business'.

(3) Tax incentives for new start-ups [Section 80-IAC]

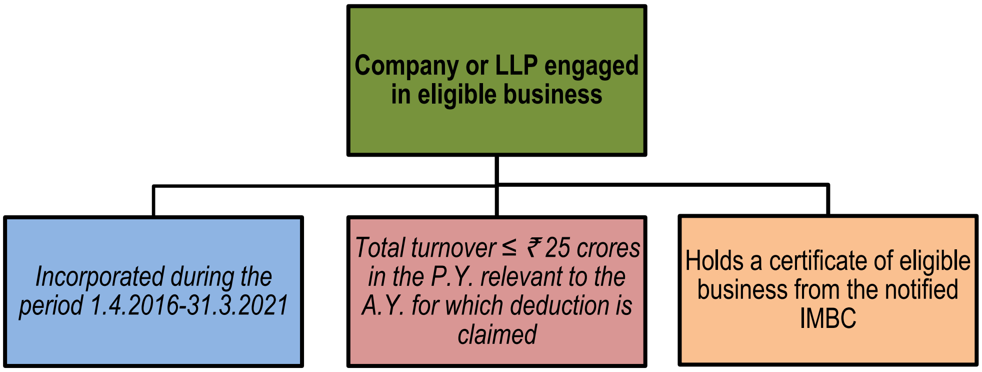
(i) Objective:

Section 80-IAC provides an incentive to start-ups in order to aid their growth in the early phase of their business.

(ii) Quantum of deduction:

Accordingly, a deduction of **100%** of the profits and gains derived by an eligible start-up from an eligible business is allowed for any **three consecutive assessment years out of seven** years beginning from the year in which the eligible start up is incorporated.

(iii) Meaning of eligible start-up:


Company or LLP engaged in eligible business
Incorporated during the period 1.4.2016-31.3.2021
Total turnover ≤ ₹ 25 crores in the P.Y. relevant to the A.Y. for which deduction is claimed
Holds a certificate of eligible business from the notified IMBC

(iv) Meaning of eligible business:

A business carried out by an eligible start-up engaged in –

- *Innovation, development or improvement of products or processes or services or*
- *a scalable business model with a high potential of employment generation or wealth creation*

(v) Conditions to be fulfilled:

This incentive is available to an eligible start-up which fulfils the following conditions:

(1) It is not formed by splitting up, or the reconstruction, of a business already in existence.

Exception: However, this condition shall not apply in the case of an undertaking which is formed as a result of reconstruction, re-establishment or revival of the business of any undertaking which has been discontinued in any previous year due to extensive damage or destruction of any building, machinery, plant or furniture owned by the assessee and used for the purposes of such business. Further, the reason for damage or destruction is due to any natural calamity or other unforeseen circumstances such as the following:

(i) Flood, typhoon, hurricane, cyclone, earthquake or other natural calamity, or

(ii) riot or civil disturbance, or

(iii) accidental fire or explosion, or

(iv) enemy action or action taken in combat,

and such business is re-established or revived within 3 years from the end of such previous year.

(2) It is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

Exceptions: However, any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if all the following conditions are fulfilled, namely:—

(a) such machinery or plant was not, at any time previous to the date of the installation by the assessee, used in India;

(b) such machinery or plant is imported into India;

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of the Income-tax Act, 1961 in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee.

Further, where in the case of a start-up, any machinery or plant or any part thereof previously used for any purpose is transferred to a new business and the total value of the machinery or plant or part so transferred does not exceed 20% of the total value of the machinery or plant used in the business, then, the condition specified that it should not be formed by transfer to a new business of plant and machinery used for any purpose shall be deemed to have been complied with.

(vi) The provisions of sub-section (5) and sub-section (7) to (11) of section 80-IA shall apply to the start-ups for the purpose of allowing deductions under 80-IAC(1).

ILLUSTRATION 17

A (P) Ltd. was incorporated on 1.4.2017 and it holds a certificate of eligible business from the notified IMBC[4]. It is engaged in innovation of new products.

Its total turnover and profits and gains from such business for the P.Y.2017-18 to P.Y.2023-24 are as follows:

Particulars	*P.Y. 2017-18*	*P.Y. 2018-19*	*P.Y. 2019-20*	*P.Y. 2020-21*	*P.Y. 2021-22*	*P.Y. 2022-23*	*P.Y. 2023-24*
	(₹ in crores)						
Total turnover	*15.42*	*18.36*	*20.21*	*22.72*	*24.95*	*23.52*	*24.68*
Profits/Losses	*(2.52)*	*(1.37)*	*6.52*	*8.13*	*9.87*	*7.59*	*9.42*

Is A (P) Ltd. eligible for any tax benefit under the provisions of the Income-tax Act, 1961 for A.Y. 2020-21? If yes, what is the benefit available?

[4] Inter-Ministerial Board of Certification

SOLUTION

A (P) Ltd. is an eligible start-up, since –

(1) it is a company engaged in eligible business of innovation of new products.

(2) it is incorporated during the period 1.4.2016 to 31.3.2021.

(3) its total turnover does not exceed ₹ 25 crores in the relevant previous years for which deduction is claimed (i.e., P.Y.2019-20 to P.Y.2021-22 (or) P.Y.2020-21 to P.Y.2022-23 (or) P.Y.2021-22 to P.Y.2023-24)

(4) it holds a certificate of eligible business from the notified IMBC

Therefore, A (P) Ltd., being an eligible start-up, is eligible for deduction under section 80-IAC of 100% of the profits and gains derived by it from an eligible business for any three consecutive assessment years out of seven years beginning from the year in which the eligible start up is incorporated i.e., P.Y.2017-18.

In the first and second year i.e., P.Y.2017-18 and P.Y.2018-19, A (P) Ltd. has incurred a loss. In the current previous year i.e., P.Y.2019-20, A (P) Ltd. has earned profits from eligible business and can hence, claim 100% of its profits as deduction for any three consecutive assessment years under section 80-IAC from the P.Y.2019-20 to P.Y.2023-24. However, for P.Y.2019-20, the profits eligible for deduction would be the profits after set-off of brought forward losses of P.Y.2017-18 and P.Y. 2018-19.

(4) Deductions in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings, etc. [Section 80-IB]

Applicability

This section will be applicable to assessees, whose gross total income includes any profits and gains derived from any of the following business activities -

(1) An industrial undertaking including a small scale industrial undertaking (SSI) in Jammu and Kashmir

(2) An undertaking which begins commercial production of mineral oil or commercial production of natural gas in licensed blocks.

(3) An undertaking deriving profits from the business of processing, preservation and packaging of fruits or vegetables or meat and meat products or poultry or marine or dairy products or from the integrated business of handling, storage and transportation of foodgrains.

Conditions to be fulfilled, amount of deduction and period of deduction

The rate and period of deduction and the conditions required to be satisfied by the different categories of businesses are given below:

(1) An industrial undertaking including a small scale industrial undertaking (SSI) in Jammu and Kashmir [Sub-sections (2) and (4)]

Conditions: In order to be eligible to claim deduction under section 80-IB, an industrial undertaking must fulfill the following conditions:

(i) It manufactures or produces any article or thing or operates a cold storage plant.

(ii) In case of a manufacturing industrial unit, it should employ 10 or more workers (if manufacture is carried on with the aid of power), or 20 or more workers (if manufacture is carried on without the aid of power).

Quantum and period of deduction: The amount of deduction for an industrial undertaking in Jammu and Kashmir will be 100% of the profits and gains derived from such industrial undertaking for the initial 5 years and thereafter 25% of such profits and gains (in case of a company, the rate is 30%)

The total period of deduction should not exceed 10 consecutive assessment years provided the industrial undertaking begins manufacture or production of articles or things or operation of cold storage plant between 1-4-1993 and 31-3-2012. Where the industrial undertaking is a co-operative society, the deduction will be available for 12 assessment years (instead of 10), including the initial assessment year.

A negative list has also been provided in Part C of the Thirteenth Schedule to specify the commodities which should not be manufactured or produced by such undertakings. The list includes Cigarettes/cigars of tobacco, manufactured tobacco and substitutes, distilled/brewed alcoholic drinks and aerated branded beverages and their concentrates.

(2) An undertaking which begins commercial production of mineral oil or commercial production of natural gas in licensed blocks [Sub-section (9)]

Conditions: In order to claim deduction under the section, the undertaking should be engaged in commercial production of mineral oil or commercial production of natural gas in licensed blocks.

The following further conditions should be fulfilled –

(i) In case of an undertaking engaged in commercial production of mineral oil where such operations are carried out in any part of India, it begins commercial production on or after 1.4.1997.

> ***Note -*** *Commercial production of mineral oil should have commenced on or before 31.3.2017. No deduction would be available under section 80-IB where the commercial production of mineral oil commences on or after 1.4.2017.*

The above deduction for commercial production of mineral oil will not be available for blocks licensed under a contract awarded after 31.3.2011 under the New Exploration

Licensing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated 10th February, 1999 or in pursuance of any law for the time being in force or by the Central or a State Government in any other manner.

(ii) In case of an undertaking engaged in commercial production of natural gas in licensed blocks–

(a) the blocks are licensed under the VIII Round of bidding for award of exploration contracts ("NELP-VIII") under the New Exploration Licensing Policy announced by the Government of India vide Resolution No.O-19018/22/95-ONG.DO.VL, dated 10th February, 1999; or

(b) the blocks are licensed under the IV Round of bidding for award of exploration contracts for Coal Bed Methane blocks

and begins commercial production of natural gas on or after 1st April, 2009.

> ***Note -*** *Commercial production of natural gas in licensed blocks should have commenced on or before 31.3.2017. No deduction would be available under section 80-IB where the commercial production of natural gas commence on or after 1.4.2017.*

Note – All blocks licensed under a single contract, which has been awarded –

(1) under the New Exploration Licencing Policy announced by the Government of India vide Resolution No.O-19018/22/95-ONG.DO.VL, dated 10.2.1999 or

(2) in pursuance of any law for the time being in force or

(3) by Central or a State Government in any other manner

to be treated as a single "undertaking"

Quantum and period of deduction: The deduction will be allowed at 100% of the profits and gains from such business for 7 consecutive assessment years including the initial assessment year i.e. the assessment year relevant to the previous year in which the undertaking commences the commercial production of mineral oil.

(3) An undertaking deriving profits from the business of processing, preservation and packaging of fruits or vegetables or meat and meat products or poultry or marine or dairy products or from the integrated business of handling, storage and transportation of foodgrains [Sub-section (11A)]

Conditions: In order to claim deduction, the undertaking should fulfill the following conditions:

(i) It should be deriving profits from the business of processing, preservation and packaging of fruits or vegetables or meat or meat products or poultry or marine or dairy products or from the integrated business of handling, storage and transportation of foodgrains.

(ii) It should begin to operate such business on or after 1.4.2001.

(iii) It should begin operates such business on or after 1.4.2009 in case of an undertaking deriving profit from the business of processing, preservation and packaging of meat or meat products or poultry or marine or dairy products.

Quantum and period of deduction: The amount of deduction shall be 100% of the profits and gains derived from such business for 5 assessment years beginning with the initial assessment year i.e. the assessment year relevant to the previous year in which the undertaking begins such business. Thereafter, the deduction allowable is 25%. In the case of a company, the rate of 25% shall be substituted by 30%. The total period of deduction should not exceed 10 consecutive assessment years.

The provisions of sub-section (5) and sub-section (7) to (12) of section 80-IA shall apply to the eligible business under section 80-IB.

Admissibility of deduction under Chapter VI-A on the profits enhanced due to disallowance of expenditure related to business activity [Circular No.37/2016, Dated 02.11.2016]

Chapter VI-A of the Income-tax Act, 1961, provides for deductions in respect of certain incomes. In computing the profits and gains of a business activity, the Assessing Officer may make certain disallowances, such as disallowances pertaining to sections 32, 40(a)(ia), 40A(3), 43B etc., of the Act. At times, disallowance out of specific expenditure claimed may also be made. The effect of such disallowances is an increase in the profits.

The issue is whether such higher profits would also result in claim for a higher profit-linked deduction under Chapter VI-A.

The courts have generally held that if the expenditure disallowed is related to the business activity against which the Chapter VI-A deduction has been claimed, the deduction needs to be allowed on the enhanced profits. Some illustrative cases upholding this view are as follows:

(i) If an expenditure incurred by assessee for the purpose of developing a housing project was not allowable on account of non-deduction of TDS under law, such disallowance would ultimately increase assessee's profits from business of developing housing project. The ultimate profits of assessee after adjusting disallowance under section 40(a)(ia) would qualify for deduction under section 80-IB.

(ii) If deduction under section 40A(3) is not allowed, the same would have to be added to the profits of the undertaking on which the assessee would be entitled for deduction under section 80-IB.

In view of the aforesaid judgements, the CBDT has accepted the settled position that the disallowances made under sections 32, 40(a)(ia), 40A(3), 43B, etc. and other specific disallowances, related to the business activity against which the Chapter VI-A deduction has been *claimed, result in enhancement of the profits of the eligible business, and that deduction under Chapter VI-A is admissible on the profits so enhanced by the disallowance.*

Transport, Power and Interest subsidies received by an Industrial Undertaking - Eligibility for deduction under sections 80-IB, 80-IC etc., [Circular No. 39/2016, dated 29.11.2016]

The issue of whether revenue receipts such as transport, power and interest subsidies received by an Industrial Undertaking/ eligible business are part of profits and gains of business derived from its business activities within the meaning of sections 80-IB/ 80-IC of the Income-tax Act, 1961 and, thus, eligible for claim of corresponding deduction under Chapter VI-A of the Act has been a contentious one. Such receipts are often treated as 'Income from other sources' by the Assessing Officers.

The Hon'ble Supreme Court in its judgment dated 9.3.2016 in the case of Meghalaya Steels Ltd and other cases has held that the subsidies of transport, power and interest given by the Government to the Industrial Undertaking are receipts which have been reimbursed for elements of cost relating to manufacture/sale of the products. Thus, there is a direct nexus between profit and gains of the industrial undertaking/business and reimbursement of such business subsidies. Accordingly, such subsidies are part of profits and gains of business derived from the Industrial Undertaking and are not to be included under the head 'Income from other sources'. Therefore, deduction is admissible under section 80-1B/ 80-IC of the Act on such revenue receipts derived from the Industrial Undertaking.

In view of the above, the CBDT has clarified that revenue subsidies received from the Government towards reimbursement of cost of production/ manufacture or for sale of the manufactured goods are part of profits and gains of business derived from the Industrial Undertaking/ eligible business, and are thus, admissible for applicable deduction under Chapter VI-A of the Income-tax Act, 1961.

(5) Deductions in respect of profits and gains from housing projects [Section 80-IBA]

(i) Objective:

In order to provide impetus to affordable housing sector to achieve the larger objective of 'Housing for All', section 80-IBA has been inserted.

(ii) Quantum of deduction:

Where the gross total income of an assessee includes any profits and gains derived from the business of developing and building housing projects, an amount equal to 100% of the profits and gains derived from such business is allowable as deduction under section 80-IBA, subject to fulfilment of certain conditions.

(iii) Conditions to be fulfilled for claim of deduction:

(a) the project is approved by the competent authority after 1st June, 2016 but on or before ***31st March, 2020***;

(b) the project is completed within a period of five years from the date of approval by the competent authority:

However, in a case where the approval in respect of a housing project is obtained more than once, the project shall be deemed to have been approved on the date on which the building plant of such housing project was first approved by the competent authority and the project shall be deemed to have been completed when a certificate of completion of project as a whole is obtained in writing from the competent authority.

(c) the carpet area of the shops and other commercial establishments included in the housing project does not exceed 3% of the aggregate carpet area;

Additional conditions to be fulfilled if the project is approved by the competent authority before 1st September, 2019

(a) where a residential unit in the housing project is allotted to an individual, no other residential unit in the housing project shall be allotted to the individual or the spouse or the minor children of such individual;

(b) Conditions relating to size of plot of land, residential units etc.

	Location of the housing project	Size on plot of land on which the project is located	Carpet area of the residential unit comprised in the housing project	Percentage of floor area ratio to be utilised by the project
(1)	(2)	(3)	(4)	(5)
(i)	Within the cities of Chennai, Delhi, Kolkata or Mumbai	Not less than 1,000 sq. m.	Not more than 30 sq. m.	Not less than 90% of the floor area ratio permissible in respect of the plot of land under the rules to be made by the Central Government or the State Government or the local authority, as the case may be.
(ii)	In any other place	Not less than 2,000 sq. m.	Not more than 60 sq. m.	not less than 80% of such floor area ratio

(c) The project is the only housing project on the plot of land [referred to in column (3)].

(d) the assessee maintains separate books of account in respect of the housing project.

Additional conditions to be fulfilled if the project is approved by the competent authority on or after 1st September, 2019

(a) *where a residential unit in the housing project is allotted to an individual, no other residential unit in the housing project shall be allotted to the individual or the spouse or the minor children of such individual;*

(b) ***Conditions relating to size of plot of land, residential units etc.***

	Location of the housing project	***Size on plot of land on which the project is located***	***Carpet area of the residential unit comprised in the housing project***	***Percentage of floor area ratio to be utilised by the project***
(1)	***(2)***	***(3)***	***(4)***	***(5)***
(i)	*Within the metropolitan cities of Bengaluru, Chennai, Delhi National Capital Region (limited to Delhi, Noida, Greater Noida, Ghaziabad, Gurugram, Faridabad), Hyderabad, Kolkata and Mumbai (whole of Mumbai Metropolitan Region)*	*Not less than 1,000 sq. m.*	*Not more than 60 sq. m.*	*Not less than 90% of the floor area ratio permissible in respect of the plot of land under the rules to be made by the Central Government or the State Government or the local authority, as the case may be.*
(ii)	*In any other place*	*Not less than 2,000 sq. m.*	*Not more than 90 sq. m.*	*Not less than 80% of such floor area ratio*

(c) *The project is the only housing project on the plot of land [referred to in column (3) above].*

(d) *the assessee maintains separate books of account in respect of the housing project.*

(e) *the stamp duty value of a residential unit in the housing project does not exceed ₹ 45 lakhs.*

(iv) **No deduction for person executing the housing project as a works contract:**

An assessee who merely executes the housing project as a works-contract awarded by any person (including the Central Government or the State Government) would not be eligible for deduction under this section.

(v) **Consequence of non-completion of housing project within 5 years:**

In a case where the housing project is not completed within the period of five years from the date of approval by the competent authority and in respect of which a deduction has been claimed and allowed under this section, the total amount of deduction so claimed and allowed in one or more previous years, shall be deemed to be the income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which the period for completion so expires.

(vi) **No deduction under any other provision of the Act in respect of such profits:**

Where any amount of profits and gains derived from the business of developing and building housing projects is claimed and allowed under this section for any assessment year, deduction to the extent of such profit and gains shall not be allowed under any other provision of this Act.

(vii) **Meaning of certain terms:**

	Term	Meaning
(a)	Carpet area	Net usable floor area of an apartment Excluding – • The area covered by the external walls, • areas under service shafts • exclusive balcony or verandah area and • exclusive open terrace area **However, carpet area includes** the area covered by the internal partition walls of the apartment. Exclusive balcony or verandah and exclusive open terrace area means the area of the balcony or verandah and the area of open terrace respectively, which is appurtenant to the net usable floor area of an apartment, meant for the exclusive use of the allottee.
(b)	Competent authority	The authority empowered by the Central Government to approve the building plan by or under any law for the time being in force.
(c)	Floor area ratio	The quotient obtained by dividing the total covered area of plinth area on all the floors by the area of the plot of land
(d)	Housing project	A project consisting predominantly of residential units with such other facilities and amenities as the competent authority may approve subject to the provisions of this section
(e)	Residential unit	An independent housing unit with separate facilities for living, cooking and sanitary requirements, distinctly separated from other residential units within the building, which is directly accessible from an outer door or through an interior door in a shared hallway and not by walking through the living space of another household.

(f)	*Stamp duty value*	*Value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of payment of stamp duty in respect of an immovable property.*

(6) Special provisions in respect of certain undertakings or enterprises in certain special category States [Section 80-IC]

(i) Applicability:

This section allows tax holiday to the undertakings which manufacture or produce specified article or thing or existing undertakings on their substantial expansion in the states of Himachal Pradesh and Uttaranchal.

(ii) Meaning of "substantial expansion":

It means increase in the investment in plant and machinery by at least 50% of the book value of the plant and machinery (before taking depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken.

(iii) Rate of deduction:

The tax holiday in the states of Himachal Pradesh and Uttaranchal will be 100% for the first five assessment years and 25% (30% in the case of a company) for the next five assessment years.

(iv) Eligible business:

Undertakings or enterprises which manufacture or produce from 7.1.03 and ending before 1.4.2012 in the state of Himachal Pradesh or Uttaranchal –

- any article or thing, not being any article or thing specified in the 13th Schedule (namely, tobacco, aerated beverages, pollution causing paper and paper products etc.) in
  - any export processing zone or
  - integrated infrastructure development centre or
  - industrial growth centre or
  - industrial estate or
  - industrial park or
  - software technology park or
  - industrial area or
  - theme park

  as notified by the Board or,
- any article or thing specified in the 14th Schedule

(v) **No deduction under any other section of Chapter VIA of the Act in respect of such profits:**

No benefit to these undertakings will be available under any of the sections in Chapter VIA in relation to the profits and gains of such undertakings.

(vi) **Maximum permissible deduction:**

While computing the total period of 10 years the period for which the benefit under section 80IB has already been availed, if any, shall also be included.

(vii) The provisions of sub-section (5) and sub-section (7) to (12) of section 80-IA shall apply to the eligible undertaking or enterprise under this section.

(7) Tax holiday in respect of profits and gains from eligible business of certain undertakings in North-Eastern States [Section 80-IE]

(i) **Applicability:**

This section provides for an incentive to an undertaking which has during the period between 1st April, 2007 and 1st April, 2017, begun or begins, in any of the North-Eastern States (i.e., the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura) -

(1) to manufacture or produce any eligible article or thing;

(2) to undertake substantial expansion to manufacture or produce any eligible article or thing;

(3) to carry on any eligible business.

(ii) **Meaning of certain terms:**

	Terms	Meaning
(a)	Eligible article or thing	the article or thing other than - goods falling under Chapter 24 of the First Schedule to the Central Excise Tariff Act, 1985 which pertains to tobacco and manufactured tobacco substitutes; - pan masala as covered under Chapter 21 of the First Schedule to the Central Excise Tariff Act, 1985; - plastic carry bags of less than 20 microns; and - goods falling under Chapter 27 of the First Schedule to the Central Excise Tariff Act, 1985 produced by petroleum oil or gas refineries
(b)	Substantial expansion	Increase in the investment in the plant and machinery by at least 25% of the book value of plant and machinery (before taking depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken

(c)	Eligible business	Business of - - hotel (not below two star category); - adventure and leisure sports including ropeways; - providing medical and health services in the nature of nursing home with a minimum capacity of 25 beds; - running an old-age home; - operating vocational training institute for hotel management, catering and food craft, entrepreneurship development, nursing and para-medical, civil aviation related training, fashion designing and industrial training; - running information technology related training centre; - manufacturing of information technology hardware; and - Bio-technology.

(iii) Quantum of deduction and period:

Where the gross total income of an assessee includes any profits and gains derived by such an undertaking, a deduction of 100% of the profits and gains derived from such business for 10 consecutive assessment years commencing with the initial assessment year shall be allowed in computing the total income of the assessee. Initial assessment year means the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things, or completes substantial expansion.

(iv) No deduction under any other section of Chapter VIA or section 10AA of the Act in respect of such profits:

No benefit to these undertakings will be available under any of the sections in Chapter VIA or in section 10AA in relation to the profits and gains of such undertakings.

(v) Maximum permissible deduction:

While computing the total period of 10 years the period for which the benefit under section 80-IC has already been availed, if any, shall also be included.

(vii) The provisions of sub-section (5) and sub-section (7) to (12) of section 80-IA shall apply to the eligible undertaking under this section.

SUMMARY OF DEDUCTIONS IN RESPECT OF CERTAIN INCOMES: SECTIONS 80-IA to 80-IE

Section	Eligible Business		Year of commencement of eligible business	Period of Deduction	Quantum of Deduction
80-IA	**(1)**	**(i) Developing or**	On or after 1.4.1995 but not later than 1.4.2017	**Infrastructure Facility of road, or a bridge or a rail system or a**	100% of the profits and gains derived from such business for 10

		(ii) Operating and maintaining or **(iii) Developing, operating and maintaining any infrastructure facility**		**highway project or a water supply project:** 10 consecutive assessment years out of 20 years beginning from the year in which the enterprise develops or begins to operate the eligible business. **Other eligible businesses:** 10 consecutive assessment years out of 15 years beginning from the year in which the enterprise develops or begins to operate the eligible business.	consecutive assessment years.
	(2)	**Industrial parks**	**Industrial parks:** Notified by the Central Government for the period on or after 1.4.1997 & ending on 31.3.2011.		
	(3)	**Power undertakings**	**Generation or Generation and distribution:** Set up between 1.4.1993 & 31.3.2017. **Transmission or distribution:** Start transmission during the period from 1.4.1999 & 31.3.2017. **Renovation and modernisation of existing network:** Undertakes substantial renovation and modernisation during the period on or after 1.4.2004 & ending on 31.3.2017.		
	(4)	**Undertaking owned by an Indian Company set up for Reconstruction or revival of a power generating plant**	Company formed on or before 30th November, 2005 and begins to generate or transmit or distribute power before 31st March 2011 and notified before 31.12.2005 by Central Government		

80-IAB	**Development of Special Economic Zones(SEZs)**		Develops SEZ, notified on or after 1st April 2005 but before 1st April 2017.	10 consecutive AYs out of 15 years beginning from the year in SEZ has been notified.	100% of the profits and gains derived from such business.
80-IAC	**A business carried out by an eligible start-up engaged in Innovation, Development or Improvement of products or processes or services or a scalable business model with a high potential of employment generation or wealth creation**		The company or LLP is incorporated during the period 1.4.2016 - 31.3.2021	3 consecutive AYs out of 7 years beginning from the year in which company or LLP, incorporated.	100% of the profits and gains derived from such business.
80-IB	**(1)**	**An industrial undertaking including a small scale industrial undertaking (SSI) in Jammu and Kashmir**	Begins to manufacture or production of any article or thing or operate cold storage plant during the period 1-4-1993 and 31-3-2012.	Not exceeding 10 consecutive AYs (12 AYs in case of co-operative society)	100% of the profits and gains derived from such industrial undertaking for the initial 5 AYs and thereafter 25% (30% in case of company) of such profits and gains
	(2)	**Commercial production of mineral oil or commercial production of natural gas in licensed blocks**	**Commercial production of mineral oil:** On or after 1st April, 1997 but not later than 31.3.2017 **Commercial production of natural gas:** On or after 1st April, 2009 but not later than 31.3.2017	7 consecutive AYs including the initial AY	100% of the profits and gains from such business
	(3)	**Processing, preservation and packaging of**	**Processing, preservation and packaging of meat**	10 consecutive AYs beginning with the initial AY	100% of the profits and gains derived from such

	fruits or vegetables or meat and meat products or poultry or marine or dairy products or from the integrated business of handling, storage and transportation of foodgrains	**or meat products or poultry or marine or dairy products:** On or after 1.4.2009 **Other eligible businesses:** On or after 1.4.2001		business for 5 AYs beginning with the initial AY 25% (30% in case of company) for remaining 5 years
80-IBA	**Developing and building housing projects**	Project is approved after 1st June 2016 but on or before ***31st March 2020***	----	100% of the profits and gains derived from such housing project.
80-IC	Undertakings which manufacture or produce specified article or thing or existing undertakings on their substantial expansion **in the states of Himachal Pradesh and Uttaranchal**	Manufacture or produce article or thing from 7.1.03 and ending before 1.4.2012	10 AYs commencing with the initial AY.	100% for the first five AYs and 25% (30% in the case of a company) for the next five AYs.
80-IE	**Undertaking begun or begins, in any of the North-Eastern States** (i.e., the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura) - (1) to manufacture or produce any eligible article or thing; (2) to undertake substantial expansion to manufacture or produce any eligible article or thing; (3) to carry on any eligible business.	between 1st April, 2007 and ending before 1st April, 2017	10 consecutive AYs commencing with the initial AY	100% of the profits and gains derived from such business

(8) Deduction in respect of profits and gains from business of collecting and processing of bio-degradable waste [Section 80JJA]

(i) **Eligible business:** The deduction is allowable where the gross total income of an assessee includes any profits and gains derived from the business of collecting and processing or treating of bio-degradable waste -

(1) for generating power, or

(2) producing bio-fertilizers, bio-pesticides or other biological agents, or

(3) for producing bio-gas, or

(4) making pellets or briquettes for fuel or organic manure.

(ii) **Quantum of deduction and period:** The deduction allowable under this section is an amount equal to the whole of such profits and gains for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the business commences.

(9) Deduction in respect of employment of new employees [Section 80JJAA]

(i) **Quantum and period of deduction:**

Where the gross total income of an assessee to whom section 44AB applies, includes any profits and gains derived from business, a deduction of an amount equal to 30% of additional employee cost incurred in the course of such business in the previous year, would be allowed for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

(ii) **Conditions to be fulfilled:**

The deduction would be allowed only subject to fulfilment of the following conditions:

- The business should not be formed by splitting up, or the reconstruction, of an existing business
- The business is not acquired by the assessee by way of transfer from any other person or as a result of any business reorganisation
- The report of the accountant, giving the prescribed particulars, has to be furnished along with ROI

(iii) Meaning of certain terms:

<table>
<tr><th></th><th>Term</th><th colspan="2">Meaning</th></tr>
<tr><td rowspan="2">(a)</td><td rowspan="2">Additional employee cost</td><td colspan="2">Total emoluments paid or payable to additional employees employed during the previous year.</td></tr>
<tr><td>In the case of an existing business</td><td>The additional employee cost shall be Nil, if—
(a) there is no increase in the number of employees from the total number of employees employed as on the last day of the preceding year;
(b) emoluments are paid otherwise than by an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account <i>or through any other prescribed electronic mode.</i></td></tr>
<tr><td></td><td></td><td>In the first year of a new business</td><td>The emoluments paid or payable to employees employed during that previous year shall be deemed to be the additional employee cost.</td></tr>
<tr><td>(b)</td><td>Additional employee</td><td colspan="2">An employee who has been employed during the previous year and whose employment has the effect of increasing the total number of employees employed by the employer as on the last day of the preceding year.
<u>Exclusions from the definition</u>:
(a) an employee whose total emoluments are more than ₹ 25,000 per month; or
(b) an employee for whom the entire contribution is paid by the Government under the Employees’ Pension Scheme notified in accordance with the provisions of the Employees’ Provident Funds and Miscellaneous Provisions Act, 1952; or
(c) an employee employed for a period of less than 240 days during the previous year. In case of an assessee engaged in the business of manufacturing of apparel or footwear or leather products, an employee employed for a period of less than 150 days during the previous year; or</td></tr>
</table>

		(e) an employee who does not participate in the recognised provident fund. ***Note –*** *If an employee is employed during the previous year for less than 240 days or 150 days, as the case may be, but is employed for a period of 240 days or 150 days, as the case may be, in the immediately succeeding year, he shall be deemed to have been employed in the succeeding year.* *Accordingly, the employer would be entitled to deduction of 30% of additional employee cost of such employees in the succeeding year.*
(c)	Emoluments	any sum paid or payable to an employee in lieu of his employment by whatever name called. **Exclusions from the definition**: (a) any contribution paid or payable by the employer to any pension fund or provident fund or any other fund for the benefit of the employee under any law for the time being in force; and (b) any lump-sum payment paid or payable to an employee at the time of termination of his service or superannuation or voluntary retirement, such as gratuity, severance pay, leave encashment, voluntary retrenchment benefits, commutation of pension and the like.

ILLUSTRATION 18

Mr. A has commenced the business of manufacture of computers on 1.4.2019. He employed 350 new employees during the P.Y.2019-20, the details of whom are as follows –

	No. of employees	***Date of employment***	***Regular/Casual***	***Total monthly emoluments per employee (₹)***
(i)	*75*	*1.4.2019*	*Regular*	*24,000*
(ii)	*125*	*1.5.2019*	*Regular*	*26,000*
(iii)	*50*	*1.8.2019*	*Casual*	*25,500*
(iv)	*100*	*1.9.2019*	*Regular*	*24,000*

The regular employees participate in recognized provident fund while the casual employees do not. Compute the deduction, if any, available to Mr. A for A.Y.2020-21, if the profits and gains derived from manufacture of computers that year is ₹ 75 lakhs and his total turnover is ₹ 2.16 crores.

What would be your answer if Mr. A has commenced the business of manufacture of footwear on 1.4.2019?

SOLUTION

Mr. A is eligible for deduction under section 80JJAA since he is subject to tax audit under section 44AB for A.Y.2020-21, as his total turnover from business exceeds ₹ 1 crore and he has employed “additional employees” during the P.Y.2019-20.

I **If Mr. A is engaged in the business of manufacture of computers**

Additional employee cost = ₹ 24,000 × 12 × 75 **[See Working Note below]** = ₹ 2,16,00,000

Deduction under section 80JJAA = 30% of ₹ 2,16,00,000 = ₹ 64,80,000.

Working Note:

Number of additional employees

Particulars	No. of workmen	
Total number of employees employed during the year		350
Less: Casual employees employed on 1.8.2019 who do not participate in recognized provident fund	50	
Regular employees employed on 1.5.2019, since their total monthly emoluments exceed ₹ 25,000	125	
Regular employees employed on 1.9.2019 since they have been employed for less than 240 days in the P.Y.2019-20.	100	275
Number of “additional employees”		**75**

Notes –

(i) *Since casual employees do not participate in recognized provident fund, they do not qualify as additional employees. Further, 125 regular employees employed on 1.5.2019 also do not qualify as additional employees since their monthly emoluments exceed ₹ 25,000. Also, 100 regular employees employed on 1.9.2019 do not qualify as additional employees for the P.Y.2019-20, since they are employed for less than 240 days in that year.*

Therefore, only 75 employees employed on 1.4.2019 qualify as additional employees, and the total emoluments paid or payable to them during the P.Y.2019-20 is deemed to be the additional employee cost.

(ii) *As regards 100 regular employees employed on 1.9.2019, they would be treated as additional employees for previous year 2020-21, if they continue to be employees in that year for a minimum period of 240 days. Accordingly, 30% of additional employee cost in respect of such employees would be allowable as deduction under section 80JJAA in the hands of Mr. A for the A.Y. 2021-22.*

II **If Mr. A is engaged in the business of manufacture of footwear**

If Mr. A is engaged in the business of manufacture of footwear, then, he would be entitled to deduction under section 80JJAA in respect of employee cost of regular employees employed on 1.9.2019, since they have been employed for more than 150 days in the previous year 2019-20.

Additional employee cost = ₹ 2,16,00,000 + ₹ 24,000 × 7 × 100 = ₹ 3,84,00,000

Deduction under section 80JJAA = 30% of ₹ 3,84,00,000 = ₹ 1,15,20,000

(10) Deduction in respect of certain income of Offshore Banking Units and International Financial Services Centre [Section 80LA]

(i) Eligible assessee:

This section is applicable to the following assessees -

(a) a scheduled bank having an Offshore Banking Unit in a SEZ; or

(b) any bank, incorporated by or under the laws of a country outside India, and having an Offshore Banking Unit in a SEZ; or

(c) a Unit of an International Financial Services Centre (IFSC).

(ii) Eligible income qualifying for deduction:

The deduction will be allowed on account of the following income included in the gross total income of such assessees -

(a) income from an Offshore Banking Unit in a SEZ; or

(b) income from the business referred to in section 6(1) of the Banking Regulation Act, 1949, with -

(1) an undertaking located in a SEZ or

(2) any other undertaking which develops, develops and operates or develops, operates and maintains a SEZ; or

(c) income from any Unit of the IFSC from its business for which it has been approved for setting up in such a Centre in a SEZ.

(iii) Quantum and period of deduction:

S. No.	*Eligible assessee*	*Quantum and period of deduction*	*Relevant previous year from which deduction is allowed*
(a)	*a scheduled bank having an Offshore Banking Unit in a SEZ, whose GTI includes*	*100% of such income for 5 consecutive AYs. Thereafter, 50% of such*	*Beginning with the assessment year relevant to the previous*

	any income referred to in (ii) above	*income for the next 5 consecutive AYs.*	*year in which* *(1) the permission under section 23(1)(a) of the Banking Regulation Act, 1949 was obtained; or* *(2) the permission or registration under the SEBI Act, 1992 was obtained; or* *(3) the permission or registration under any other relevant law was obtained.*
(b)	*any bank, incorporated by or under the laws of a country outside India, and having an Offshore Banking Unit in a SEZ, whose GTI includes any income referred to in (ii) above*		
(c)	*Unit of an International Financial Services Centre (IFSC), whose GTI includes any income referred to in (ii) above*	*100% of such income for any 10 consecutive AYs at the option of the assessee, out of 15 years.*	

(iv) Conditions:

The following conditions have to be fulfilled for claiming deduction under this section-

(a) The report of a Chartered Accountant in the prescribed form certifying that the deduction has been correctly claimed in accordance with the provisions of this section, should be submitted along with the return of income.

(b) A copy of the permission obtained under section 23(1)(a) of the Banking Regulation Act, 1949 should also be furnished along with the return of income.

(11) Deduction in respect of income of co-operative societies [Section 80P]

(i) Applicability:

Under this section, certain specified income of a co-operative society would be allowed as a deduction, provided such income is included in the gross total income of the society.

(ii) Eligible income for deduction and quantum of deduction:

Deduction in respect of profit attributable to certain specified activities

100% deduction shall be allowed in respect of profits and gains attributable to any one or more of the following activities to a co-operative society engaged in -

(1) carrying on the business of banking or providing credit facilities to its members; or

(2) a cottage industry; or

(3) the marketing of the agricultural produce grown by its members; or

(4) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture or for the purpose of supplying them to its members; or

(5) the processing without the aid of power, of the agricultural produce of its members; or

(6) the collective disposal of the labour to its member; or

(7) fishing and other allied pursuits, such as catching, curing, processing, preserving, storing and marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to their members.

However, the exemption in respect of income referred to in (6) or (7) will be available only in the case of those co-operative societies which, under their rules and by-laws, restrict the voting rights to

(i) members who contribute their labour force or who actually carry on the fishing or other allied activities,

(ii) the co-operative credit societies which provide financial assistance to the society and

(iii) the State Government.

Deduction in respect of profit of primary co-operative societies

100% of the profits and gains of the business would be allowed as deduction from the gross total income of the co-operative society in case of a primary co-operative society engaged in supplying milk, oilseeds, fruits or vegetables raised or grown by its members to –

- a federal co-operative society engaged in supplying milk, oilseeds, fruits or vegetables, as the case may be, or
- the Government or a local authority or
- a Government company as defined in section 617[5] of the Companies Act, 1956 or a corporation established by or under a Central, State or Provincial Act (engaged in supplying milk, oilseeds, fruits or vegetables, as the case may be, to the public),

Deduction in respect of other activities

A co-operative society which is engaged in activities other than to those mentioned above either independently of, or in addition to, all or any of the activities so specified, is eligible for deduction upto ₹ 50,000 to the extent of its business income arising from other activities. The limit is ₹ 1,00,000 in the case of consumer co-operative societies.

[5] As defined in section 2(45) of the Companies Act, 2013

For this purpose, consumer co-operative society means a society for the benefit of the consumers.

Deduction in respect of Interest or dividend income

Any income arising to a co-operative society by way of any interest and dividends derived from its investments with any other co-operative society is deductible in full under this section.

Deduction in respect of letting-out income for certain purpose

The income derived by a co-operative society from the letting out of godowns or warehouses for storage, processing or facilitating the marketing of commodities is fully allowable as deduction.

Deduction in respect of interest on securities and income from house property to certain co-operative societies

Any income arising to a co-operative society by way of 'Interest on securities' or 'Income from house property' (chargeable under section 22) is fully deductible under this section where the gross total income of the co-operative society does not exceed ₹ 20,000 and it is not a housing society or an urban consumer's society or a society carrying on transport business or a society engaged in the performance of any manufacturing operations with the aid of power. Thus, a majority of small co-operative societies would not have to pay any income-tax.

(iii) **Meaning of urban consumers' co-operative society:**

It means a society for the benefit of the consumers within the limits of a municipal corporation, municipality, municipal committee, notified area committee, town area or cantonment.

(iv) **Deduction under other section of Chapter VI-A of the Act:**

Where the co-operative society is also entitled to the deduction available under section 80-IA, the deduction under this section shall be allowed with reference to the gross total income as reduced by the deduction allowable under section 80-IA.

(v) **Non-eligible co-operative societies:**

The benefit under section 80P has been withdrawn in respect of all co-operative banks, other than primary agricultural credit societies (i.e. as defined in Part V of the Banking Regulation Act, 1949) and primary co-operative agricultural and rural development banks (i.e. societies having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities). This is for the purpose of treating co-operative banks at par with other commercial banks, which do not enjoy similar tax benefits.

(vi) Regional Rural Banks not eligible for deduction under section 80P:

The CBDT has, through *Circular No. 6/2010 dated 20.9.2010*, reiterated that Regional Rural Banks are not eligible for deduction under section 80P of the Income-tax Act, 1961 from the assessment year 2007-08 onwards. It has also been clarified that the *Circular No. 319 dated 11-1-1982* deeming any Regional Rural Bank to be cooperative society stands withdrawn for application with effect from A.Y.2007-08.

This is consequent to the amendment in section 80P by the Finance Act, 2006, providing specifically that w.e.f. 1-4-2007, the provisions of section 80P will not apply to any co-operative bank other than a Primary Agricultural Credit Society or a Primary Cooperative Agricultural and Rural Development Bank. The same has been further clarified by this circular.

(12) Deduction in respect of certain income of Producer Companies [Section 80PA]

(i) Applicability:

Under section 80P, 100% deduction is available in respect of profits of co-operative society which provide assistance to its members engaged in primary agricultural activities.

A similar benefit has been extended, by insertion of new section 80PA, to Farm Producer Companies (FPC), having a total turnover of less than ₹ 100 crore in any previous year, whose gross total income includes any profits and gains derived from eligible business.

(ii) Meaning of Eligible Business:

Eligible business means -

(a) the marketing of agricultural produce grown by its members, or

(b) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purpose of supplying them to its members, or

(c) the processing of the agricultural produce of its members

(iii) Quantum of deduction:

100% of profits and gains attributable to eligible business for the previous year relevant to A.Y.2019-20 to A.Y.2024-25

In a case where the assessee is entitled also to deduction under any other provision of Chapter VI-A, the deduction under this section shall be allowed with reference to the income, if any, as referred to in this section included in the gross total income as reduced by the deductions under such other provision of this Chapter.

(iv) Meaning of certain terms:

	Term	Meaning [Section 581A of the Companies Act, 1956]
(i)	Member	A person or Producer institution (whether incorporated or not) admitted as a Member of a Producer Company and who retains the qualifications necessary for continuance as such.

(ii)	Producer Company	A body corporate having objects or activities specified in section 581B of the Companies Act, 1956 and registered as Producer Company under that Act. As per section 581B of the Companies Act, 1956, the objects of the Producer Company shall relate to all or any of the following matters, namely:-- (a) production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce of the Members or import of goods or services for their benefit: However, the Producer Company may carry on any of the activities specified in this clause either by itself or through other institution; (b) processing including preserving, drying, distilling, brewing, vinting, canning and packaging of produce of its Members; (c) manufacture, sale or supply of machinery, equipment or consumables mainly to its Members; (d) providing education on the mutual assistance principles to its Members and others; (e) rendering technical services, consultancy services, training, research and development and all other activities for the promotion of the interests of its Members; (f) generation, transmission and distribution of power, revitalisation of land and water resources, their use, conservation and communications relatable to primary produce; (g) insurance of producers or their primary produce; (h) promoting techniques of mutuality and mutual assistance; (i) welfare measures or facilities for the benefit of Members as may be decided by the Board; (j) any other activity, ancillary or incidental to any of the activities referred to in clauses (a) to (i) or other activities which may promote the principles of mutuality and mutual assistance amongst the Members in any other manner; (k) financing of procurement, processing, marketing or other activities specified in clauses (a) to (j) which include extending of credit facilities or any other financial services to its Members. Section 581B(2) provides that every Producer Company shall deal primarily with the produce of its active Members for carrying out any of its objects specified in this section. "Active Member" means a member who fulfils the quantum and period of patronage of the Producer Company as may be required by the articles.

(13) Deduction in respect of royalty income, etc., of authors of certain books other than text books [Section 80QQB]

(i) **Eligible assessee and Quantum of deduction:** Under section 80QQB, deduction of up to a maximum ₹ 3,00,000 is allowed to an individual resident in India, being an author including a joint author in respect of income derived by him in the exercise of his profession i.e., the deduction shall be the income derived as author or **₹ 3,00,000**, whichever is less.

(ii) **Eligible income:**

(a) This income may be received either by way of a lumpsum consideration for the assignment or grant of any of his interests in the copyright of any book.

(b) Such book should be a work of literary, artistic or scientific nature, or of royalties or copyright fees (whether receivable in lump sum or otherwise) in respect of such book.

(c) This deduction shall not, however, be available in respect of royalty income from brochures, commentaries, diaries, guides, journals, magazines, newspapers, pamphlets, textbook for schools, tracts and other publications of similar nature.

Note - Where an assessee claims deduction under this section, no deduction in respect of the same income may be claimed under any other provision of the Income-tax Act, 1961.

(iii) **Manner of computation of deduction:** For the purpose of calculating the deduction under this section, the amount of eligible income (royalty or copyright fee received otherwise than by way of lumpsum) before allowing expenses attributable to such income, shall not exceed 15% of the value of the books sold during the relevant previous year.

However, this condition is not applicable where the royalty or copyright fees is receivable in lump sum in lieu of all rights of the author in the book.

(iv) **Conditions:**

(a) **Furnishing of certificate in prescribed form**: For claiming the deduction, the assessee shall have to furnish a certificate in the prescribed manner in the prescribed format, duly verified by the person responsible for making such payment, setting forth such particulars as may be prescribed.

(b) **Period for repatriation of income earned outside India:** Where the assessee earns any income from any source outside India, he should bring such income into India in convertible foreign exchange within a period of six months from the end of the previous year in which such income is earned or within such further period as the competent authority may allow in this behalf for the purpose of claiming deduction under this section.

The competent authority shall mean the Reserve Bank of India or such other authority as is authorised under any law for the time being in force for regulating payments and dealings in foreign exchange.

(14) Deduction in respect of royalty on patents [Section 80RRB]

(i) **Eligible assessee:** This deduction shall be available only to a resident individual who is registered as the true and first inventor in respect of an invention under the Patents Act, 1970, including the co-owner of the patent and earning income by way of royalty of a patent registered on or after 1.4.2003.

(ii) **Quantum of deduction:** This section allows deduction to a resident individual in respect of income by way of royalty of a patent registered on or after 1.4.03 up to an amount of **₹ 3 lakhs**.

> **Note -** No deduction in respect of such income will be allowed under any other provision of the Income-tax Act, 1961

(iii) **Eligible income:** This deduction shall be restricted to the royalty income including consideration for transfer of rights in the patent or for providing information for working or use of a patent, use of a patent or the rendering of any services in connection with these activities.

The deduction shall not be available on any consideration for sale of product manufactured with the use of the patented process or patented article for commercial use.

(iv) **Conditions:**

(a) In respect of any such income which is earned from sources outside India, the deduction shall be restricted to such sum as is brought to India in convertible foreign exchange within a period of 6 months or extended period as is allowed by the competent authority (Reserve Bank of India).

(b) For claiming this deduction the assessee shall be required to furnish a certificate in the prescribed form signed by the prescribed authority, alongwith the return of income.

(v) **Rectification of assessment where patent is revoked subsequently:** Where the patent is subsequently revoked or the name of the assessee was excluded from the patents register as patentee in respect of that patent, the deduction allowed during the period shall be deemed to have been wrongly allowed and the assessment shall be rectified under the provisions of section 155.

The period of 4 years for rectification shall be reckoned from the end of the previous year in which the order of the revocation of the patent is passed.

11.4 DEDUCTIONS IN RESPECT OF OTHER INCOME

(1) Deduction in respect of interest on deposits in savings accounts [Section 80TTA]

(i) **Eligible assessee and Quantum of deduction:** Section 80TTA provides that in case the gross total income of an assessee, being an individual or a Hindu Undivided Family, includes any income by way of an interest on deposits in a saving account (not being time deposits, which are deposits repayable on expiry of fixed periods), deduction up to **₹ 10,000** in aggregate shall be allowed while computing the total income of such assessee. Such deduction shall be allowed in case the saving account is maintained with:

(a) a banking company to which the Banking Regulation Act, 1949, applies (including any bank or banking institution referred to in section 51 of that Act);

(b) a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank); or

(c) a post office.

Note - Deduction under this section would, however, not be available to a resident senior citizen eligible for deduction under section 80TTB.

(ii) **Restriction:** If the aforesaid income is derived from any deposit in a savings account held by, or on behalf of, a firm, an AOP/BOI, no deduction shall be allowed in respect of such income in computing the total income of any partner of the firm or any member of the AOP or any individual of the BOI.

In effect, the deduction under this section shall be allowed only in respect of the income derived in form of the interest on the saving bank deposit (other than time deposits) made by the individual or Hindu Undivided Family directly.

(2) Deduction in respect of interest on deposits in case of senior citizens [Section 80TTB]

(i) **Eligible assessee:** A senior citizen (a resident individual who is of the age of 60 years or more at any time during the relevant previous year), whose gross total income includes income by way of interest on deposits with –

(a) a banking company to which Banking Regulation Act, 1949 applies

(b) a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank)

(c) a Post Office.

(ii) **Quantum of deduction:** Actual amount of interest on deposits or **₹ 50,000**, whichever is lower.

(iii) **Non-availability of deduction to partner/member, where deposit held by firm/AOP/BOI:** Where interest income is derived from any deposit held by, or on behalf of, a firm, an AOP or a BOI, the partner of the firm or member of AOP/BOI would not be allowed deduction in respect of such income while computing their total income.

ILLUSTRATION 19

Mr. A, a resident individual aged about 61 years, has earned business income (computed) of ₹ 1,35,000, lottery income of ₹ 1,20,000 (gross) during the P.Y. 2019-20. He also has interest on Fixed Deposit of ₹ 30,000 with banks. He invested an amount of ₹ 1,50,000 in Public Provident Fund account. What is the total income of Mr. A for the A.Y.2020-21?

SOLUTION

Computation of total income of Mr. A for A.Y.2020-21

Particulars	₹	₹
Profits and gains of business or profession		1,35,000
Income from other sources		
- Interest on Fixed Deposit with banks		30,000
- lottery income		1,20,000
Gross Total Income		**2,85,000**
Less: Deductions under Chapter VIA **[See Note below]**		
Under section 80C		
- Deposit in Public Provident Fund	1,50,000	
Under section 80TTB		
- Interest on fixed deposits with banks	30,000	
	1,80,000	
Restricted to		1,65,000
Total Income		**1,20,000**

Note: *In case of resident individuals of the age of 60 years or more, interest on bank fixed deposits qualifies for deduction upto ₹ 50,000 under section 80TTB.*

Though the value of eligible deductions is ₹ 1,80,000, however, deduction under Chapter VI-A cannot exceed the gross total income exclusive of long term capital gains taxable under section 112 and section 112A, short-term capital gains covered under section 111A and winnings of lotteries of the assessee.

Therefore, the maximum permissible deduction under Chapter VI-A = ₹ 2,85,000 – ₹ 1,20,000 = ₹ 1,65,000.

ILLUSTRATION 20

Mr. Gurnam, aged 42 years, has salary income (computed) of ₹ 5,50,000 for the previous year ended 31.03.2020. He has earned interest of ₹ 14,500 on the saving bank account with State Bank of India during the year. Compute the total income of Mr. Gurnam for the assessment year 2020-21 from the following particulars:

(i) Life insurance premium paid to Birla Sunlife Insurance in cash amounting to ₹ 25,000 for insurance of life of his dependant parents. The insurance policy was taken on 15.07.2017 and the sum assured on life of his dependant parents is ₹ 2,00,000.

(ii) Life insurance premium of ₹ 25,500 paid for the insurance of life of his major son who is not dependant on him. The sum assured on life of his son is ₹ 2,50,000 and the life insurance policy was taken on 30.3.2012.

(iii) Life insurance premium paid by cheque of ₹ 22,500 for insurance of his life. The insurance policy was taken on 08.09.2016 and the sum assured is ₹ 2,00,000.

(iv) Premium of ₹ 26,000 paid by cheque for health insurance of self and his wife.

(v) ₹ 1,500 paid in cash for his health check-up and ₹ 4,500 paid in cheque for health check-up for his parents, who are senior citizens.

(vi) Paid interest of ₹ 6,500 on loan taken from bank for MBA course pursued by his daughter.

(vii) A sum of ₹ 15,000 donated in cash to an institution approved for purpose of section 80G for promoting family planning.

SOLUTION

Computation of total income of Mr. Gurnam for the Assessment Year 2020-21

Particulars	₹	₹	₹
Income from salary			5,50,000
Interest on saving bank deposit			14,500
Gross Total Income			**5,64,500**
Less: **Deduction under Chapter VI-A**			
Under section 80C (See Note 1)			
Life insurance premium paid for life insurance of:			
- major son	25,500		
- self ₹ 22,500 restricted to 10% of ₹ 2,00,000	20,000	45,500	
Under section 80D (See Note 2)			
Premium paid for ₹ 26,000 health insurance of self and wife by cheque, restricted to	25,000		
Payment made for health check-up for parents:	4,500	29,500	

Under section 80E			
For payment of interest on loan taken from bank for MBA course of his daughter		6,500	
Under section 80TTA (See Note 4)			
Interest on savings bank account ₹ 14,500 restricted to		10,000	91,500
Total Income			**4,73,000**

Notes:

(1) As per section 80C, no deduction is allowed in respect of premium paid for life insurance of parents whether they are dependant or not. Therefore, no deduction is allowable in respect of ₹ 25,000 paid as premium for life insurance of dependant parents of Mr. Gurnam.

In respect of insurance policy issued on or after 01.04.2012, deduction shall be allowed for life insurance premium paid only to the extent of 10% of sum assured. In case the insurance policy is issued before 01.04.2012, deduction of premium paid on life insurance policy shall be allowed up to 20% of sum assured.

Therefore, in the present case, deduction of ₹ 25,500 is allowable in respect of life insurance of Mr. Gurnam's son since the insurance policy was issued before 01.04.2012 and the premium amount is less than 20% of ₹ 2,50,000. However, in respect of premium paid for life insurance policy of Mr. Gurnam himself, deduction is allowable only up to 10% of ₹ 2,00,000 since the policy was issued after 01.04.2012 and the premium amount exceeds 10% of sum assured.

(2) As per section 80D, in case the premium is paid in respect of health of a person specified therein and for health check-up of such person, deduction shall be allowed up to ₹ 25,000. Further, deduction up to ₹ 5,000 in aggregate shall be allowed in respect of health check-up of self, spouse, children and parents. In order to claim deduction under section 80D, the payment for health-checkup can be made in any mode including cash. However, the payment for health insurance premium has to be paid in any mode other than cash.

Therefore, in the present case, in respect of premium of ₹ 26,000 paid for health insurance of self and wife, deduction would be restricted to ₹ 25,000. Since the limit of ₹ 25,000 has been exhausted against medical insurance premium, no deduction is allowable for preventive health check-up for self and wife. However, deduction of ₹ 4,500 is allowable in respect of health check-up of his parents, since it falls within the limit of ₹ 5,000.

(3) No deduction shall be allowed under section 80G in case the donation is made in cash of a sum exceeding ₹ 2,000. Therefore, deduction under section 80G is not allowable in respect

of **cash donation** of ₹ 15,000 made to an institution approved for the purpose of section 80G for promotion of family planning.

(4) As per section 80TTA, deduction shall be allowed from the gross total income of an individual or Hindu Undivided Family in respect of income by way of interest on deposit in the savings account included in the assessee's gross total income, subject to a maximum of ₹ 10,000. Therefore, a deduction of ₹ 10,000 is allowable from the gross total income of Mr. Gurnam, though the interest from savings bank account is ₹ 14,500.

11.5 OTHER DEDUCTIONS

Deduction in the case of a person with disability [Section 80U]

(1) Section 80U harmonizes the criteria for defining disability as existing under the Income-tax Rules with the criteria prescribed under the Persons with Disability (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995.

(2) **Eligible assessee:** This section is applicable to a resident individual, who, at any time during the previous year, is certified by the medical authority to be a person with disability.

The benefit of deduction under this section has also been extended to persons suffering from autism, cerebral palsy and multiple disabilities.

(3) **Quantum of deduction** A deduction of **₹ 75,000** in respect of a person with disability and **₹ 1,25,000** in respect of a person with severe disability (having disability over 80%) is allowable under this section.

(4) **Conditions:**

(a) The assessee claiming a deduction under this section shall furnish a copy of the certificate issued by the medical authority in the form and manner, as may be prescribed, along with the return of income under section 139, in respect of the assessment year for which the deduction is claimed.

(b) Where the condition of disability requires reassessment, a fresh certificate from the medical authority shall have to be obtained after the expiry of the period mentioned on the original certificate in order to continue to claim the deduction.

EXERCISE

Question 1

Mr. Srinivasan, aged 61 years, furnishes the following particulars for the year ending 31.03.2020:

(a) Life Insurance Premium paid – ₹ 15,000, actual capital sum of the policy assured for ₹ 1,40,000. The insurance policy was taken on 31.03.2012;

(b) Contribution to Public Provident Fund – ₹ 40,000 in the name of father;

(c) Tuition fee payment – ₹ 8,000 each for 2 sons pursuing full time graduation course in Calcutta; Tuition fee for daughter pursuing PHD in Kellogg University, USA – ₹ 2.50 Lacs;

(d) Housing loan principal repayment – ₹ 32,000 to Axis Bank. This property is under construction at Calcutta as on 31.03.2020;

(e) Principal repayment of housing loan taken from a relative – ₹ 70,000. The property is self-occupied situated at Pune;

(f) Deposit under Senior Citizens Savings Scheme – ₹ 15,000;

(g) Five-year deposits in an account under Post Office Time Deposit Scheme – ₹ 50,000;

(h) Investment in National Savings Certificate – ₹ 70,000;

Compute the deduction eligible under appropriate provisions of section 80C for A.Y. 2020-21.

Answer

Computation of eligible deduction under section 80C for A.Y.2020-21

Particulars	₹
Life Insurance Premium **(See Note 1)**	15,000
Contribution to Public Provident fund **(See Note 2)**	Nil
Tuition fee of 2 sons for graduation course **(See Note 3)**	16,000
Housing loan principal repayment **(See Notes 4 & 5)**	Nil
Senior Citizen Savings Scheme deposit **(See Note 6)**	15,000
Post Office Time Deposit Scheme **(See Note 6)**	50,000
Investment in National Savings Certificate	70,000
Total Investment	**1,66,000**
Eligible deduction under section 80C restricted to	1,50,000

Notes:

1. Any amount of life insurance premium paid in excess of the specified percentage of actual capital sum assured shall be ignored for the purpose of deduction under section 80C. In the given case, since the insurance policy has been issued before 1.04.2012, therefore, premium paid upto 20% of actual capital sum assured i.e., ₹ 28,000 shall be allowed as deduction. Hence, the premium of ₹ 15,000 paid during the year is allowable as deduction under section 80C.

2. In the case of an individual, contribution to PPF can be made in his name or in the name of his spouse or children to qualify for deduction under section 80C. **As the contribution was made in the name of his father, deduction is not allowable.**

3. Tuition fee paid is eligible for deduction under section 80C for a maximum of two children. Therefore, ₹ 16,000 shall be allowed as deduction. **Tuition fee paid to an educational institution situated outside India is not eligible for deduction.**

4. In order to claim the principal repayment on loan borrowed for house property as deduction, the construction of such property should have been completed and should be chargeable to tax under the head "Income from house property". In the given case, since the property is under construction, principal repayment does not qualify for deduction.

5. Repayment of principal on housing loan is not allowed as deduction in case the loan is borrowed from friends, relatives etc. In order to qualify for deduction, the loan should have been obtained from Central Government / State Government / bank / specified employer / institution.

6. The following investments are also eligible for deduction under section 80C:-

   (1) five year time deposit in an account under Post Office Time Deposit Rules, 1981; and

   (2) deposit in an account under the Senior Citizens Savings Scheme Rules, 2004.

Question 2

X Ltd. has two units, unit 'N' and unit 'Y'. Unit 'N' engaged in the business of power generation installed a windmill in March, 2018 and had a profit of ₹ 100 lakhs in Assessment Year 2020-21. X Ltd. claimed depreciation of ₹ 120 lakhs on windmill against the profit of ₹ 100 lakhs from power generation business which was eligible for deduction under section 80-IA. Unit 'Y', engaged in manufacturing of wires, non-eligible business, had a profit of ₹ 70 lakhs for Assessment Year 2020-21.

The loss of ₹ 20 lakhs, i.e., balance depreciation not set off pertaining to unit 'N' was set-off against the profits of unit 'Y' carrying on non-eligible business, by the assessee, X Ltd. The Assessing Officer was of the view that depreciation relating to a business eligible for deduction under section 80-IA cannot be set-off against non-eligible business income. Hence, unabsorbed *depreciation should be carried forward to the subsequent year to be set off against eligible business income of the assessee of that year.*

Examine the correctness of the action of the Assessing Officer.

Answer

In *CIT v. Swarnagiri Wire Insulations Pvt. Ltd. (2012) 349 ITR 245*, the Karnataka High Court observed that it is a generally accepted principle that the deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in section 80-IA(5) cannot override the provisions of section 70(1).

In this case, X Ltd. had incurred loss in eligible business (power generation) on account of claiming depreciation of ₹ 120 lakhs. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed.

It is, thereafter, that section 70(1) comes into play, whereby an assessee is entitled to set off the losses from one source against income from another source under the same head of income. Accordingly, X Ltd. is entitled to the benefit of set off of loss of ₹ 20 lakhs (representing balance depreciation not set-off) pertaining to Unit N engaged in eligible business of power generation against profit of ₹ 70 lakhs of Unit Y carrying on non-eligible business. Therefore, the net profit of ₹ 50 lakhs would be taxable in the A.Y.2020-21.

However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year i.e., the loss (arising on account of balance depreciation of eligible business) so set-off under section 70(1) has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent year. Accordingly, in the A.Y.2021-22, the net profits of Unit N has to be reduced by ₹ 20 lacs for computing the profits eligible for deduction under section 80-IA in that year.

The action of the Assessing Officer in not permitting set-off of loss of eligible business against profits of non-eligible business in this case is, therefore, not correct.

Question 3

From the following details, compute the total income of Mr. A, Mr. B and Mr. C for A.Y.2020-21 –

Particulars		*Mr. A*	*Mr. B*	*Mr. C*
		₹	₹	₹
(i)	*Salary (computed)*	*9,25,000*	*10,45,000*	*11,15,000*
(ii)	*Interest income (on fixed deposits)*	*75,000*	*85,000*	*95,000*

The particulars of their other investments/ payments made during the P.Y.2019-20 are given hereunder –

	Particulars	₹
(1)	*Deposit in Public Provident Fund (PPF) by Mr. A*	*1,50,000*
(2)	*Life insurance premium paid by Mr. C, the details of which are as follows –*	

Date of issue of policy	Person insured	Actual capital sum assured (₹)	Insurance premium paid during 2019-20 (₹)
31/3/2012	Self	1,48,000	15,000
11/6/2016	Spouse	1,25,000	15,000
31/7/2017	Handicapped son (Section 80U disability)	2,00,000	32,000

(3)	***Payment of medical insurance premium by the following persons to insure their health:***	

Payer	Amount in ₹	Mode of payment
Mr. A (aged 55 years)	30,000	Account payee cheque
Mr. B (aged 52 years)	15,000	Cash
Mr. C (aged 48 years)	20,000	Crossed cheque

(4)	*Mr. B paid interest on loan taken for the purchase of house in which he currently resides. He is claiming benefit of self-occupation under section 23(2) in respect of this house. He does not own any other house.*	*2,20,000*
	Repayment of principal amount of loan taken for purchase of the said house	*1,70,000*
(5)	*Contribution by Mr. A by cheque to National Children's Fund during the year.*	*30,000*
(6)	*Mr. B makes the following donations during the P.Y.2019-20 -*	
	Donation to BJP by crossed cheque	*50,000*
	Donation to Electoral trust by cash	*50,000*

Answer

Computation of total income for A.Y.2020-21

	Particulars	Mr. A	Mr. B	Mr. C
		₹	₹	₹
	Salary	9,25,000	10,45,000	11,15,000
	Income from house property ***[See Note 4]***		(2,00,000)	

	Income from other sources (Interest)	75,000	85,000	95,000
(A)	**Gross total income**	**10,00,000**	**9,30,000**	**12,10,000**
	***Less:* Deductions under Chapter VIA**			
	Under section 80C			
	Deposit in PPF ***[See Note 3]***	1,50,000		
	LIC premium paid ***[See Note 1]***			57,500
	Principal repayment of housing loan (restricted to ₹ 1,50,000) ***[See Note 4]***		1,50,000	
	Under section 80D			
	Medical insurance premium ***[See Note 2]***	25,000	Nil	20,000
	Under section 80G			
	Contribution to National Children's Fund ***[See Note 5]***	30,000		
	Under section 80GGC ***[See Note 6]***			
	Donation to BJP by crossed cheque		50,000	
	Cash donation to Electoral Trust		Nil	
(B)	**Total deduction under Chapter VIA**	**2,05,000**	**2,00,000**	**77,500**
(C)	**Total Income (A) – (B)**	**7,95,000**	**7,30,000**	**11,32,500**

Notes:

(1) Deduction u/s 80C in respect of life insurance premium paid by Mr. C

Date of issue of policy	Person insured	Actual capital sum assured	Insurance premium paid during 2019-20	Restricted to % of sum assured	Deduction u/s 80C
31/3/2012	Self	1,48,000	15,000	20%	15,000
11/6/2016	Spouse	1,25,000	15,000	10%	12,500
31/7/2017	Handicapped Son (section 80U disability)	2,00,000	32,000	15%	30,000
				Total	**57,500**

(2)	**Medical Insurance Premium** (i) Medical insurance premium of ₹ 30,000 paid by account payee cheque by Mr. A is allowed as a deduction under section 80D, subject to a maximum of ₹ 25,000. (ii) Medical insurance premium paid by cash is not allowable as deduction. Hence, Mr. B is not eligible for deduction under section 80D in respect of medical insurance premium of ₹ 15,000 paid in cash. (iii) Mr. C is eligible for deduction of ₹ 20,000 under section 80D in respect of medical insurance premium paid by crossed cheque.
(3)	The maximum amount eligible for deduction under section 80C shall not exceed ₹ 1,50,000. Mr. A would be eligible for deduction of ₹ 1,50,000 in respect of PPF under section 80C.
(4)	**Deduction in respect of interest and principal repayment of housing loan** Mr. B is eligible for a maximum deduction of ₹ 2,00,000 under section 24 in respect of interest on housing loan taken in respect of a self-occupied property, for which he is claiming benefit of “Nil” annual value. Therefore, ₹ 2,00,000 would represent his loss from house property. Further, the maximum amount eligible for deduction under section 80C should not exceed ₹ 1,50,000. Since, Mr. B has no other investment under section 80C during the previous year 2019-20, he would be eligible for deduction of ₹ 1,50,000 in respect of principal repayment of housing loan.
(5)	Contribution to National Children’s Fund qualifies for 100% deduction under section 80G. Therefore, Mr. A is entitled to 100% deduction of the sum of ₹ 30,000 contributed by him by way of cheque to National Children’s Fund.
(6)	Mr. B is eligible for deduction under section 80GGC in respect of donation to a political party made otherwise than by way of cash. However, cash donations to electoral trust do not qualify for deduction under section 80GGC.

Question 4

Following issues have been raised by Navi Limited in connection with its eligibility for claiming deduction under section 80-IB for your consideration and advice for the assessment year 2020-21:

(i) It operates two separate industrial units. One unit is eligible for deduction under section 80-IB, while the other unit is not eligible for such deduction. If the eligible unit has profit and the other unit has loss, should it claim deduction after setting off the loss of the other unit against profit of the eligible unit?

(ii) Its profit from one unit includes sale of import entitlement, duty drawback and interest from customers for delayed payment. Is it permissible to claim deduction on these items of income?

Answer

(i) Section 80-IB(13) provides that the provisions contained in section 80-IA(5) shall, so far as may be, apply to the eligible business under section 80-IB. Accordingly, for the purpose of computing the deduction under section 80-IB, the profits and gains of an eligible business shall be computed as if such eligible business was the only source of income of the assessee.

Therefore, Navi Limited should claim deduction under section 80-IB on profit from the eligible unit without setting off loss suffered in the other unit. It may be noted that the aggregate deduction under Chapter VI-A, however, cannot exceed the gross total income of the assessee.

(ii) Under section 80-IB, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking referred to in the section, there shall be allowed, in computing the total income of the assessee, a deduction from such profits and gains at the specified percentage and for such number of years as specified in the section. In *CIT vs. Sterling Foods (1999) 237 ITR 579 (SC)* and *Liberty India vs. CIT (2009) 317 ITR 218 (SC),* it was held that sale of import entitlement and duty drawback cannot be construed as income derived from industrial undertaking. Therefore, such income cannot be included in computing income for the purpose of deduction under section 80-IB.

Interest income derived by an undertaking on delayed collection of sale proceeds shall be treated as income derived from the industrial undertaking, and therefore, the same would be eligible for deduction under section 80-IB. [*Phatela Cotgin Industries Private Limited vs CIT (2008) 303 ITR 411 (P & H)].*

Question 5

PQR Co-operative Bank, a co-operative society, having its area of operation confined to Gubbi Taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities, has received the following amounts during the year ending 31.3.2020:

(i) Interest amounting to ₹ 1,00,000 from its members on loans advanced to them.

(ii) Interest amounting to ₹ 1,50,000 on deposits with other co-operative societies.

(iii) Rent amounting to ₹ 2,00,000 from letting out its godowns for storage of commodities.

PQR Co-operative Bank seeks your advice in the matter of taxability of the above amounts and the eligibility for deduction, if any, in respect thereof for the assessment year 2020-21.

Answer

Sub-clause (viia) to section 2(24) includes within the scope of definition of income, the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members. Hence, the interest of ₹ 1,00,000 received by PQR Co-operative Bank on loans advanced to its members constitutes its income.

Further, interest received amounting to ₹ 1,50,000 on deposits with other co-operative societies and rent amounting to ₹ 2,00,000 received from letting out its godowns for storage of commodities also constitute the income of the co-operative bank.

Sub-section (4) of section 80P provides that section 80P shall not apply to any co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

Explanation to section 80P(4) defines a primary co-operative agricultural and rural development bank to mean a society having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities.

PQR Co-operative Bank is a primary co-operative agricultural and rural development bank as defined in the said *Explanation* since it is a co-operative society having its area of operation confined to Gubbi Taluk and its principal object is to provide long-term credit for agricultural and rural development activities. Therefore, it is eligible for deduction under section 80P.

Interest of ₹ 1,00,000 received by the bank on loans advanced to its members is eligible for deduction in full under section 80P(2)(a)(i).

Interest of ₹ 1,50,000 received by the bank from deposits with other co-operative societies qualifies for deduction in full under section 80P(2)(d).

Rent of ₹ 2,00,000 received by the bank from letting out its godowns for storage of commodities is eligible for deduction in full under section 80P(2)(e).

SIGNIFICANT SELECT CASES

1. Can the Commissioner reject an application for grant of approval under section 80G(5) on the ground that the trust has failed to apply 85% of its income for charitable purposes?

CIT v. Shree Govindbhai Jethalal Nathavani Charitable Trust (2015) 373 ITR 619 (Guj)

Facts of the case: The assessee trust filed an application in Form 10G for grant of approval under section 80G(5)[6]. It also filed copies of trust deed and registration certificate dated 18th August, 2011 with the approving authority. As per the trust deed, the main objects of the trust are educational, social activities, etc. In order to verify the facts stated in the application, the trust was asked to produce books of account, relevant vouchers, donation book and minutes in original. On perusal of the books for financial year 2011-12, it was found that the trust had not applied 85% of its income and therefore, the Commissioner rejected the application of the assessee seeking approval under section 80G(5) and Rule 11AA of the Income-tax Rules, 1962.

Tribunal's view: On appeal, the Tribunal noted the decision of Punjab and Haryana High Court in the case of *CIT v. O.P. Jindal Global University (2013) 38 Taxmann 366*, in which it was held that at the time of granting approval of exemption under section 80G, only the objects of the trust are required to be examined and the aspect of application of funds can be examined by the Assessing Officer at the time of framing the assessment. Consequently, the Tribunal held that the Commissioner has erred in refusing to grant recognition to the trust under section 80G(5).

High Court's Observations: The High Court was of the view that the issue in the present case is now not *res integra* in view of the decision of the Division Bench of this Court in the case of *N.N. Desai Charitable Trust v. CIT (2000) 246 ITR 452 (Guj).* In that case, the Division Bench observed that, while considering the application for the purpose of section 80G, the authority cannot act as an assessing authority and the enquiry should be confined to finding out if the institution satisfies the prescribed conditions. The Division Bench also made the following observations:

(i) Section 80G does not relate to assessment of the trust or the institution whose income is not liable to be included in the computation of taxable income under various provisions of the Act. Primarily, section 80G is related to giving deduction in respect of donations made by a person to such trusts and institutions.

[6] Section 80G(5)(i) provides that donation to any institution or fund would qualify for deduction thereunder only if it is established in India for a charitable purpose and derives such income which would not be liable to inclusion in its total income under the provisions of sections 11 and 12 or section 10(23AA)/(23C).

(ii) There are two distinct concepts. The first is whether an institution or fund is such whose income is not liable to be included in the computation of total income, has to be determined on the basis of its status or character. The second is the actual assessment of income, which necessarily takes place in future after donation is received by the donee, on fulfilment of other conditions about application of income by the eligible trusts, which in the very nature of things can operate only after receipt of income. The two are different concepts.

(iii) The liability to assessment is neither affected on account of grant of recognition under section 80G nor on whether the donor ultimately gets deduction in respect of such donation. Once a trust is registered under section 12AA, its income from property includes donation which is covered by section 11(1)(d) or under section 12. Such donations are deemed to be income from property, which are not to be included in the total income under section 11 or section 12. The enquiry under section 80G, hence, cannot go beyond that.

(iv) The scope of enquiry cannot include an enquiry as to whether, at the close of the previous year, the donee-trust will actually be able to apply 85% of its income because non-fulfillment of some conditions by the donee-trust as regards application or accumulation cannot be ascertained *in praesenti*, when the donation is made. The question of whether the trust will be able to apply 85% of its income can be determined only from the facts existing at the close of the assessment year.

The High Court also noted that similar views were expressed by the Punjab and Haryana High Court in the case of *CIT v. O. P. Jindal Global University (2013) 38 Taxmann.com 366.*

High Court's Decision: The High Court, thus, concurred with the decision of the Tribunal setting aside the order passed by the Commissioner refusing to grant registration under section 80G(5) to the assessee-trust due to the reason that it has not applied 85% of its income for charitable purposes.

2. Can Inland Container Depots (ICDs) be treated as infrastructure facility, for profits derived therefrom to be eligible for deduction under section 80-IA?

CIT v. Container Corporation of India Limited [2018] 404 ITR 397 (SC)

Facts of the case: M/s. Container Corporation of India Ltd. (CONCOR) is a Government company engaged in the business of handling and transportation of containerized cargo. Its operating activities are mainly carried out at its Inland Container Depots, Container Freight Stations and Port Side Container Terminals. CONCOR filed its income-tax returns for the relevant assessment years and claimed deduction under various heads including deduction under section 80-IA for profits derived from inland container depots. The claim for deduction on the profits earned from inland container depots was, however, rejected by the Assessing Officer.

Issue: The issue under consideration is whether profits derived from inland container depots can be treated as an infrastructure facility eligible for deduction under section 80-IA.

Supreme Court's Observations: Inland Container Depots function for the benefit of exporters and importers located in industrial centres which are situated at distance from sea ports. The purpose of establishing them was to promote the export and import in the country as these depots acts as a facilitator and reduce inconvenience to the exporter or importer.

Section 80-IA provides for a deduction of profits derived from operation of an infrastructure facility. The Finance Act, 2001 substituted section 80-IA(4), consequent to which the definition of "infrastructure facility" in *Explanation* to section 80-IA(4)(i) included an inland port. The Supreme Court observed that, considering the nature of work such as custom clearance carried out at inland container depots, it can be considered as an inland port within the meaning of section 80-IA(4). Thus, deduction under section 80-IA can be claimed in respect of income earned therefrom.

Supreme Court's Decision: The Supreme Court, accordingly, upheld the decision of the division bench of the High Court and held that CONCOR can claim for deduction under Section 80-IA in respect of profits derived from Inland Container Depots.

3. **Would an assessee who enters into an agreement with the Gujarat State Road Development Corporation for an infrastructure development project be entitled to deduction under section 80-IA(4), even though as per the requirement contained therein, the agreement has to be entered into with the Central Government or State Government or a local authority or any other statutory body?**

CIT v. Ranjit Projects Private Limited [2018] 408 ITR 274 (Guj)

Facts of the Case: The assessee is a private limited company engaged in implementing infrastructure development projects. For the relevant assessment year, it claimed deduction of Rs. 4.97 crores under section 80-IA(4). The assessee contended that it had undertaken a road development project, for which, it had entered into an agreement with the Gujarat State Road Development Corporation (GSRDC) which was set up by the Government for the special purpose.

The Assessing Officer doubted whether such agreement would satisfy the requirements of section 80-IA(4). The assessee, however, contended that the GSRDC was performing all the functions of the State Government and therefore, the concession agreement executed by GSRDC should be treated to have been entered into by the State Government. The Assessing Officer, however, did not accept the assessee's contention and rejected the assessee's claim of deduction under section 80-IA(4). However, the Commissioner (Appeals) and the Tribunal allowed the assessee's claim for deduction under section 80-IA(4).

Relevant provision of the Income-tax Act, 1961: Section 80-IA provides for a certain deduction in respect of profits and gains from undertakings or enterprises engaged in infrastructure development. Section 80-IA(4) provides that such section would, *inter alia*, apply to any enterprise carrying on the business of developing or operating and maintaining or developing, operating and maintaining any infrastructure facility. One of the conditions to be fulfilled for claiming deduction is that the assessee should have entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for developing or operating and maintaining or developing, operating and maintaining a new infrastructure facility.

Issue: The issue under consideration is whether an assessee who enters into an agreement with Gujarat State Road Development Corporation for an infrastructure development project would be entitled to deduction under section 80-IA(4), even though as per the requirement contained therein, the agreement has to be entered into with the Central Government or State Government or a local authority or any other statutory body.

High Court's Observations: The High Court observed that GSRDC is a wholly Government owned company incorporated pursuant to the State Government's resolution dated February 28, 1999. The memorandum of association shows that the Government enjoys total control over GSRDC. GSRDC was constituted by the State Government as a nodal agency for the purpose of executing road development projects through private participation. Hence, GSRDC is a Government agency as defined in section 2(e) of the Gujarat Infrastructure Development Act, 1999.

High Court's Decision: The High Court held that since the assessee has entered into an agreement with GSRDC, a government agency constituted by the State Government for the purposes of executing road development projects, it is entitled to deduction under Section 80-IA.

Note –** The SLP filed by the Department against the judgement was dismissed.**

4. Can unabsorbed depreciation of a business of an industrial undertaking eligible for deduction under section 80-IA be set off against income of another non-eligible business of the assessee?

CIT v. Swarnagiri Wire Insulations Pvt. Ltd. (2012) 349 ITR 245 (Kar.)

Facts of the case: The assessee was in the business of manufacture of wires. It installed a windmill for power generation. The assessee claimed depreciation on windmill against income from power generation, which was eligible for deduction under section 80-IA. The balance depreciation was set off against the profits from manufacturing of wires, being a non-eligible business.

Assessing Officer's contention: The Assessing Officer contended that depreciation relating to a business eligible for deduction under section 80-IA cannot be set off against non-eligible business income. Therefore, unabsorbed depreciation was to be carried forward to the subsequent year to be set off against the eligible business income of the assessee of that year.

Tribunal's Observations: The Tribunal observed that the balance depreciation of the eligible business is required to be carried forward for set-off against eligible business income of the next year while determining the profits eligible for deduction under section 80-IA in that year. However, the Tribunal noted that section 80-IA is a beneficial section permitting certain deduction in respect of certain income under Chapter VI-A. A provision granting tax incentive for economic growth should be construed liberally and any restriction placed should also be construed in a reasonable and purposive manner to advance the objects of the provision.

High Court's Observations and Decision: The High Court observed that it is a generally accepted principle that deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in section 80-IA(5) cannot override the provisions of section 70(1). The assessee had incurred loss in eligible business after claiming depreciation. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed. It is thereafter that section 70(1) comes into play, whereby the assessee is entitled to set off the losses from one source against income from another source under the same head of income. The Court, therefore, held that the assessee was entitled to the benefit of set off of loss of eligible business against the profits of non-eligible business. However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year i.e., the loss (arising on account of balance depreciation of eligible business) so set-off under section 70(1) has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent year.

***Note** – The crux of the above decision can be explained with a simple example. Let us consider a company, X Ltd., having two units, Unit A and Unit B. If Unit A engaged in eligible business (say, power generation) has a profit of ₹ 100 lacs in A.Y.2019-20, before claiming depreciation of ₹ 120 lacs and Unit B engaged in non-eligible business (say, manufacture of wires) has a profit of ₹ 70 lacs, then, as per the above decision, the loss of ₹ 20 lacs (representing balance depreciation not set-off) pertaining to Unit A can be set-off against profit of ₹ 70 lacs of Unit B carrying on non-eligible business. Therefore, the net profit of ₹ 50 lacs would be taxable in the A.Y.2019-20. If in the next year, i.e. A.Y.2020-21, the net profits of Unit A and Unit B are ₹ 200 lacs and ₹ 80 lacs, respectively, then the eligible deduction under section 80-IA for that year would be ₹ 180 lacs (i.e., ₹ 200 lacs minus ₹ 20 lacs, being loss (representing balance depreciation) set-off in the A.Y.2019-20 against other income).*

5. Is the increase in gross total income consequent to disallowance under section 40(a)(ia) eligible for profit-linked deduction under Chapter VI-A?

CIT v. Sunil Vishwambharnath Tiwari (2016) 388 ITR 630 (Bom)

Facts of the case: The assessee engaged in development of housing projects filed his return of income for the relevant assessment year after claiming deduction of Rs.16.82 lakhs under section 80-IB(10) [now, section 80-IBA]. The return was selected for scrutiny. In the assessment, a sum of Rs.83 lakhs towards sub-contract payment; Rs.1.75 lakh as commission payment and Rs.7.96 lakhs towards advertisement expenses were disallowed for non-deduction of tax at source by invoking section 40(a)(ia). While based on the assessment, the total income was fixed at Rs.92.71 lakhs, the Revenue authority limited the deduction under section 80-IB(10) to the original amount claimed by the assessee.

Appellate Authorities' Views: The CIT (Appeals) held in favour of the assessee by stating that there cannot be a separate treatment for addition to income and deductions from gross total income i.e., the amount which is added to gross total income would be eligible for corresponding deduction from gross total income. The Tribunal affirmed the view of CIT (Appeals).

Issue: Whether the increase in gross total income on account of disallowance of expenditure under section 40(a)(ia) must be considered for the purpose of deduction under section 80-IB in the absence of any explicit restriction therein?

High Court's Observations: The High Court observed that the fact that the assessee had not deducted tax at source was undisputed. On account of such non-deduction, expenses had been disallowed under section 40(a)(ia) which goes on to increase the income chargeable under the head 'Profits and gains of business or profession'. As deduction under section 80-IB(10) is with reference to the assessee's gross total income, such enhanced income becomes eligible for deduction. Disallowance under section 40(a)(ia) would, thus, be tax neutral for the assessee, on account of the enhanced profit-linked deduction available to him.

High Court's Decision: Affirming the Tribunal's order, the High Court held that the assessee is entitled to claim deduction under section 80-IB(10) in respect of the enhanced gross total income as a consequence of disallowance of expenditure under section 40(a)(ia).

Notes:

(1) Section 80-IB(10) allows deduction at 100% of the profits in respect of housing projects approved before 31.03.2008. Students may note that, presently, section 80-IBA provides for such deduction @100% of the profits and gains from housing project subject to satisfaction of the conditions mentioned therein.

(2) The CBDT has, in its Circular No.37/2016 dated 2.11.2016, mentioned that the courts have generally held that if the expenditure disallowed is related to the business activity against which the Chapter VI-A deduction has been claimed, the

deduction needs to be allowed on the enhanced profits. Thus, the settled position is that the disallowances made under sections 32, 40(a)(ia), 40A(3), 43B, etc. and other specific disallowances, relating to the business activity against which the Chapter VI-A deduction has been claimed, result in enhancement of the profits of the eligible business, and that deduction under Chapter VI-A is admissible on the profits so enhanced on account of such disallowance.

6. Can transport subsidy, interest subsidy and power subsidy received from the Government be treated as profits "derived from" business or undertaking to qualify for deduction under section 80-IB?

CIT v. Meghalaya Steels Ltd (2016) 383 ITR 217 (SC)

Facts of the case: The assessee-company, engaged in the business of manufacture of steel and ferro silicon, claimed deduction under section 80-IB on the profits and gains of the business/undertaking which included transport subsidy, interest subsidy and power subsidy received from Government.

Revenue's Contentions: The Assessing Officer was of the view that these subsidies were not eligible for deduction under section 80-IB(4) and hence, disallowed the same, contending that the source of the subsidies was the Government and not the business of the assessee, these subsidies have a close and direct nexus with the grants of the Government and not the business of the assessee. Hence, these subsidies, included in the profits, were "attributable to the business" but not "derived from" business to qualify for deduction under section 80-IB. The Commissioner (Appeals) upheld the view of the Assessing Officer. However, the Appellate Tribunal and High Court allowed the deduction in respect of such subsidies.

Supreme Court's Observations: The Supreme Court observed that an important test to determine whether the profits and gains are "derived from" business or an undertaking is that there should be a direct nexus between such profits and gains and the undertaking or business. Such nexus should not be only incidental. As long as profits and gains emanate directly from the business itself, the fact that the immediate source of the subsidies is the Government would make no difference. The profits and gains referred to in section 80-IB has reference to net profit, which can be calculated by deducting from the sale price of an article, all elements of cost which go into manufacturing or selling it. Thus, the profits arrived at after deducting manufacturing costs and selling costs reimbursed to the assessee by the Government, is the profits and gains "derived from" the business of the assessee.

The Supreme Court observed that section 28(iii)(b) specifically states that income from cash assistance, by whatever name called, received or receivable by any person against exports under any scheme of the Government of India, will be income chargeable to income-tax under the head "Profits and gains of business or profession". The Apex Court further observed that if cash assistance received or receivable against exports schemes are being included as income under the head “Profits and gains of business or profession”, subsidies which go towards reimbursement of cost of production of goods of a particular business would also have to be included under the head “Profits and gains of business or profession”, and not under the head “Income from other sources”.

Supreme Court’s Decision: The Supreme Court, accordingly, held that transport subsidy, interest subsidy and power subsidy from Government were revenue receipts which were reimbursed to the assessee for elements of cost relating to manufacture or sale of their products.

Therefore, there is a direct nexus between profits and gains of the undertaking or business, and reimbursement of such subsidies. The subsidies were only in order to reimburse, wholly or partially, costs actually incurred by the assessee in the manufacturing and selling of its products. Accordingly, these subsidies qualify for deduction under section 80-IB.

7. **Can Duty Drawback be treated as profit derived from the business of the industrial undertaking to be eligible for deduction under section 80-IB?**

CIT v. Orchev Pharma P. Ltd. (2013) 354 ITR 227 (SC)

Supreme Court’s Decision: On this issue, the Supreme Court, following the decision in case of *Liberty India v. CIT (2009) 317 ITR 218 (SC)* held that Duty Drawback receipts cannot be said to be profits derived from the business of industrial undertaking for the purpose of computation of deduction under section 80-IB.

Note - *In the case of Liberty India v. CIT (2009) 317 ITR 218 (SC), the Supreme Court observed that DEPB / Duty drawback are incentives which flow from the schemes framed by the Central Government or from section 75 of the Customs Act, 1962. Section 80-IB provides for the allowing of deduction in respect of profits and gains derived from eligible business.* ***However, incentive profits are not profits derived from eligible business under section 80-IB. They belong to the category of ancillary profits of such undertaking.*** *Profits derived by way of incentives such as DEPB/Duty drawback cannot be credited against the cost of manufacture of goods debited in the profit and loss account and they do not fall within the expression "profits derived from industrial undertaking" under section 80-IB. Hence, Duty drawback receipts and DEPB benefits do not form part of the profits derived from the eligible business for the purpose of the deduction under section 80-IB.*

8. **Does the period of exemption under section 80-IB commence from the year of trial production or year of commercial production? Would it make a difference if sale was effected from out of the trial production?**

CIT v. Nestor Pharmaceuticals Ltd. / Sidwal Refrigerations Ind Ltd. v. DCIT (2010) 322 ITR 631 (Delhi)

Facts of the case: In this case, the assessee had started trial production in March 1998 whereas commercial production started only in April, 1998. Therefore, the assessee claimed deduction under section 80-IB for the assessment years 1999-2000 to 2003-04, whereas the Assessing Officer denied deduction for A.Y.2003-04 on the ground that the five year period would be reckoned from A.Y.1998-99, since the trial production began in March, 1998.

Tribunal's Observations: The Tribunal observed that not only the trial production had started in March 1998 but there was in fact sale of one water cooler and air-conditioner in the month of March 1998. The explanation of the assessee was that this was done to file the registration under the Excise Act and Sales-tax Act.

High Court's Observations & Decision: The High Court observed that with mere trial production, the manufacture for the purpose of marketing the goods had not started which starts only with commercial production, namely, when the final product to the satisfaction of the manufacturer has been brought into existence and is fit for marketing. However, in this case, since the assessee had effected sale in March 1998, it had crossed the stage of trial production and the final saleable product had been manufactured and sold. The quantum of commercial sale and the purpose of sale (namely, to obtain registration of excise / sales-tax) is not material. With the sale of those articles, marketable quality was established. Therefore, the conditions stipulated in section 80-IB were fulfilled with the commercial sale of the two items in that assessment year, and hence the five year period has to be reckoned from A.Y.1998-99.

***Note** – Though this decision was in relation to deduction under section 80-IA, as it stood prior to its substitution by the Finance Act, 1999 w.e.f. 1.4.2000, presently, it is relevant in the context of section 80-IB.*

9. Can an assessee who has not claimed deduction under section 80-IB in the initial years, start claiming deduction thereunder for the remaining years during the period of eligibility, if the conditions are satisfied?

Praveen Soni v. CIT (2011) 333 ITR 324 (Delhi)

High Court's Decision: On the above issue, the Delhi High Court held that the provisions of section 80-IB nowhere stipulated a condition that the claim for deduction under this section had to be made from the first year of qualification of deduction failing which the claim will not be allowed in the remaining years of eligibility. Therefore, the deduction under section 80-IB should be allowed to the assessee for the remaining years up to the period for which his entitlement would accrue, provided the conditions mentioned under section 80-IB are fulfilled.

10. Can an assessee who has set up a new industrial undertaking and availed deduction @100% of profits under section 80-IC(3) for the five years, once again claim deduction@100% of profits on the basis of having undertaken substantial expansion thereafter?

CIT v. Classic Binding Industries [2018] 407 ITR 429 (SC)

Facts of the case: The assessee-firm started its business on July 11, 2005 and its initial assessment year for the purpose of deduction under section 80-IC was A.Y. 2006-07. The assessee claimed deduction under section 80-IC to the extent of 100 % of eligible profits for five assessment years from A.Y.2006-07 to A.Y.2010-11. Thereafter, the assessee once again claimed 100% deduction against eligible profits in the A.Y.2012-13 on the ground that it had carried out substantial expansion in the F.Y.2011-12.

The Assessing Officer restricted the deduction to 25% of the eligible profits for the assessment year under consideration, namely, A.Y.2012-13 (i.e., the seventh assessment year) on the ground that the assessee had already claimed deduction@100% of the eligible profits under section 80-IC for assessment years 2006-07 to 2010-11. The finding of the Assessing Officer was affirmed by the Commissioner (Appeals) and the Tribunal, but reversed by the High Court. Hence, the Department filed an appeal to the Supreme Court.

Relevant provision of the Income-tax Act, 1961: Section 80-IC applies to an undertaking or enterpirse which has begun or begins to manufacture any specified article or thing therein by setting up a new factory, *inter alia,* in the State of Himachal Pradesh. As per section 80-IC(3), the category of undertakings or enterprises to which the assessee belongs, is entitled to deduction@100% of profits and gains for five assessment years commencing from the initial assessment year and, thereafter, deduction@25% of profits and gains for the next five years. The period of deduction is, thus, 10 years, namely, deduction@100% for the first five years and @25% for the remaining five years.

Issue: The issue under consideration is whether an assessee who has set up a new industrial undertaking and availed deduction@100% of profits under section 80-IC(3) for the first five years, can once again claim deduction@100% of profits on the basis of having undertaken substantial expansion thereafter in a subsequent year.

Supreme Court's Observations: The Supreme Court observed that upon a pragmatic and reasonable interpretation, once the assessee satisfies the eligibility conditions under section 80-IC and the initial assessment year commences from a certain assessment year for claim of deduction@100% of profits for a certain period, five years in this case, there cannot be another "initial assessment year", commencing after the expiry of the said period on the basis of substantial expansion.

Supreme Court's Decision: The Supreme Court held that within the period of ten years, having claimed deduction@100% of profits for the first five years, the assessee cannot once again claim deduction@100% of profits for a fresh period of five years thereafter on the basis of substantial expansion as section 80-IC (3), in no uncertain terms, provides for deduction only at 25% of profits in respect of the next five year period.

CHAPTER 12

ASSESSMENT OF VARIOUS ENTITIES

LEARNING OUTCOMES

After studying this chapter, you would be able to:

- ❑ **compute** the book profit of a company and Minimum Alternate Tax (MAT) payable;
- ❑ **determine** the MAT credit to be carried forward;
- ❑ **examine** the applicability of MAT provisions in the case of a foreign company;
- ❑ **compute** the tax payable by a company and mutual fund on dividend/income distributed;
- ❑ **examine** the special provisions relating to taxation of business trusts, securitisation trusts and investment fund and **compute** the tax liability in the hands of such trusts/fund and the unit holders;
- ❑ **examine** whether alternate minimum tax (AMT) would be applied in the case of persons other than companies;
- ❑ **compute** AMT and determine AMT credit to be carried forward;
- ❑ **compute** the total income of a firm, AOPs/BoIs and its partners/members applying the general and special provisions under the Act;
- ❑ **identify and address** the issues arising in respect of transactions relating to determination of total income of a HUF, firm, AOPs and company;
- ❑ **determine** the liability of partners of a firm and LLP on dissolution;
- ❑ **examine** the incidence of taxation on mutual concerns.

12.1 ASSESSMENT OF COMPANIES

(1) Meaning of 'Company' for purposes of income-tax

Under the Income-tax Act, 1961, the term "company" has a much wider meaning than what has been given to it under the Companies Act. The company is considered as a 'person' for all purposes of assessment proceedings [Section 2(31)(iii)].

Section 2(17) of the Income-tax Act, 1961 defines a company for income-tax purposes. Accordingly, 'company' means –

(i) any Indian company as defined in section 2(26); or

(ii) anybody corporate incorporated by or under the laws of a country outside India, i.e., any foreign company; or

(iii) any institution, association or body which is assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922 or for any assessment year commencing on or before 1.4.1970 under the present Act; or

(iv) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of the CBDT to be a company.

Such institution, association etc. shall be deemed to be a company for such assessment years as may be specified in the CBDT's order.

(2) Classes of Companies

♦ **Domestic and Foreign Company:** Companies can be classified into two groups, viz.(i) Domestic company and (ii) Foreign company.

(i) **Domestic company** means an Indian company or any other company, which, in respect of its income liable to tax, has made the prescribed arrangements for the declaration and payment of the dividends (including dividends on preferential shares) within India, payable out of such income [Section 2(22A)].

Indian Company [Section 2(26)] - A company has to satisfy the following two conditions so that it can be regarded as an Indian company –

(a) the company should have been formed and registered under Companies Act, 1956[1]

(b) the registered office or the principal office of the company should be in India.

The expression 'Indian Company' also includes the following provided their registered or principal office is in India:

(i) a company formed and registered under any law relating to companies which was or is in force in any part of India;

[1] The Companies Act, 2013

(ii) a corporation established by or under a Central, State or Provincial Act (like Financial Corporation or a State Road Transport Corporation);

(iii) an institution or association or body which is declared by the Board to be a company under section 2(17)(iv);

(iv) in the case of any of the Union territories of Dadra and Nagar Haveli, Goa, Daman and Diu, and Pondicherry, a company formed and registered under any law for the time being in force in that Union territory.

Prescribed arrangements for the declaration and payment of dividends within India [Rule 27]: The arrangements referred to in sections 194 and 236 to be made by a company for declaration and payment of dividends (including dividends on preference shares) within India are as follows:

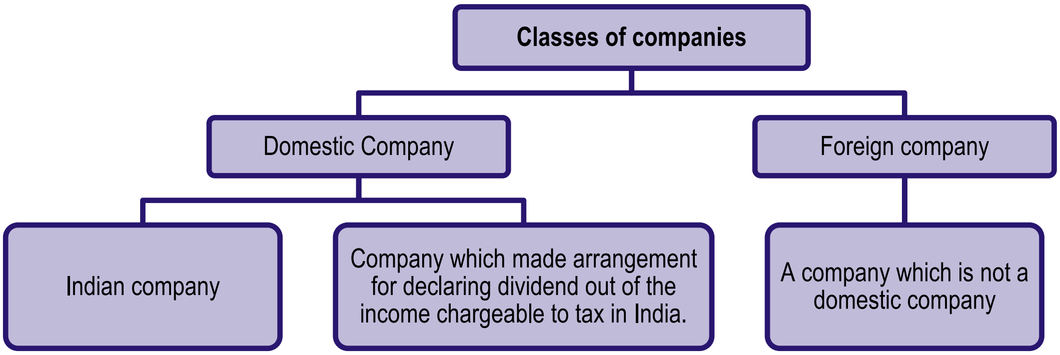
(i) The share register of the company concerned for all its shareholders shall be maintained regularly at its principal place of business within India in respect of any assessment year from a date not later than 1st April of such year.

(ii) The general meeting for passing the accounts of the previous year relevant to the assessment year and for declaring any dividends in respect thereof shall be held only at a place within India.

(iii) The dividends declared, if any, shall be made payable only within India to all the shareholders.

It is obligatory for Indian companies to make the prescribed arrangements stated above; non-Indian companies will be treated as domestic companies only if they make the prescribed arrangements for the declaration and payment of dividends in India.

(ii) **Foreign Company:** A company that is not a domestic company is a foreign company [Section 2(23A)].


Classes of companies
Domestic Company
Foreign company
Indian company
Company which made arrangement for declaring dividend out of the income chargeable to tax in India.
A company which is not a domestic company

- **Closely-held and widely-held Company:** Domestic companies are again divided into broad groups, viz

  (1) companies in which public are substantially interested and

  (2) companies in which public are not substantially interested.

  The former types of companies are also referred to as 'widely-held companies' while the latter are also referred to as 'closely-held companies'.

  To determine whether a company is one in which the public are substantially interested, one has to apply the tests laid down in section 2(18). Briefly, the following companies fall under this category:

  (i) A company owned by the Government (either Central or State but not Foreign) or the Reserve Bank of India (RBI) or in which not less than 40% of the shares are held by the Government or the RBI or corporation owned by that bank.

  (ii) A company which is registered under section 25 of the Companies Act, 1956[2] (formed for promoting commerce, arts, science, religion, charity or any other useful object and which prohibits payment of dividends to its members).

  (iii) A company having no share capital which is declared by the Board for the specified assessment years to be a company in which the public are substantially interested.

  (iv) A mutual benefit finance company which carries on its principal business of accepting deposits from its members and which is declared by the Central Government under section 620A of the Companies Act, 1956[3] to be Nidhi or a Mutual Benefit Society.

  (v) A company whose equity shares (not being shares entitled to a fixed rate of dividend) carrying at least 50% of the voting power have been allotted unconditionally to or acquired unconditionally by and were beneficially held throughout the relevant previous year by one or more co-operative societies.

  (vi) A company which is not a private company as defined in the Companies Act, 1956[4] and which fulfills any of the following conditions:

  - its equity shares should have, as on the last day of the relevant previous year, been listed in a recognized stock exchange in India; or

[2] Section 8 of Companies Act, 2013

[3] Section 406 of Companies Act, 2013

[4] Section 2(68) of Companies Act, 2013

- its equity shares carrying at least 50% (40% in case of an Indian company in ship construction business or in the manufacture or processing of goods or in mining or in generation or distribution of electricity or any other form of power) voting power should have been unconditionally allotted to or acquired by and should have been beneficially held throughout the relevant previous year by

  (a) Government or

  (b) a Statutory Corporation or

  (c) a company in which public are substantially interested or

  (d) any wholly owned subsidiary of company mentioned in (c).

  Thus, it should be noted that all public limited companies must automatically be treated as companies in which public are substantially interested, whereas all private limited companies will be treated as companies in which public are not substantially interested.

♦ **Relevance of the above classification:**

(1) The distinction between domestic and foreign companies is significant for the purpose of rates of tax prescribed.

Domestic companies are taxed at 30% ***but where the total turnover or gross receipt in the previous year 2017-18 does not exceed ₹ 400 crore,*** it shall be taxed at 25% of the total income. However, a foreign company will be taxed at 40%. In respect of specified royalties and fees for technical services received from Government or an Indian concern in pursuance of an agreement, approved by the Central Government, made by the foreign company with the Government or Indian concern between 1.4.1961 and 31.3.1976 (in case of royalties) and between 1.3.1964 and 31.3.1976 (in case of FTS), the rate of tax is 50%. A surcharge @ 7% of the tax payable is leviable in the case of domestic companies and @2% of tax payable in the case of foreign companies, if the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore. Surcharge@12% of the tax payable is leviable in the case of domestic companies and @5% of tax payable in the case of foreign companies, if the total income exceeds ₹ 10 crore.

Note *– The Taxation Laws (Amendment) Ordinance, 2019 was promulgated by the President of India on 20.9.2019 to amend the Income-tax Act, 1961 and the Finance (No.2) Act, 2019 and is in force[5]. This Ordinance has inserted two new sections, section 115BAA and 115BAB, in the Income-tax Act, 1961 to be applicable from A.Y.2020-21.*

[5] At the time of publication of the Study Material

Section 115BAA provides for concessional rate of tax@22% (plus surcharge@10% and HEC@4%) for domestic companies, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction (weighted or otherwise) for contribution to research and development, additional depreciation etc.

Section 115BAB provides for concessional rate of tax@15% (plus surcharge@10% plus HEC@4%) to new manufacturing domestic companies set up and registered on or after 1.10.2019, and commences manufacturing on or before 31.3.2023, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction (weighted or otherwise) for contribution to research and development, additional depreciation etc.

Domestic Companies have to exercise the option to be governed by these special provisions of the Act. The option for section 115BAB has to be exercised in the very first year in which the eligible company is set up, failing which it cannot exercise such option in the future years. However, a company eligible to exercise option u/s 115BAA can defer exercise of such option to a future year, if it is availing sizable profit-linked or investment-linked deductions or additional depreciation in the P.Y.2019-20. However, once the company exercises such option under section 115BAA or 115BAB, as the case may be, in a year, it would continue to be governed by the special provisions u/s 115BAA or 115BAB, as the case may be, thereafter and cannot opt for regular provisions in any subsequent year.

It may be noted that companies exercising option under section 115BAA or section 115BAB are not liable to minimum alternate tax under section 115JB.

These two sections, namely sections 115BAA and 115BAB have been detailed in Annexure – 1 at the end of this chapter. These sections would come into effect from A.Y.2020-21 after passing of the Taxation Laws (Amendment) Ordinance, 2019 by the Parliament.

(2) The question as to whether a company is one in which public are substantially interested or not is relevant for application of certain provisions which are applicable only to closely held company.

There are certain special provisions which are applicable only to companies in which public are not substantially interested. The list of such special provisions is as follow:

S. No.	Section	Provision
1	2(22)(e)	Advance or loan by a closely held company - deemed dividend

2	56(2)(viib)	Consideration received in excess of FMV of shares issued by a closely held company to be treated as income of such company, where shares are issued at a premium
3	68	Taxation of sum received by closely held company as share application money, share capital, share premium and the explanation offered by company is not satisfactory
4	79	Carry forward and set-off of losses in case of closely held companies
5	179	Liability of directors of private company in liquidation

(3) Concessional rate of tax on dividends received by Indian companies from specified foreign companies [Section 115BBD]

(i) **Concessional rate -** Dividends received by Indian companies from specified foreign companies to be subject to a concessional rate of 15% (as against the general rate of 30% applicable to Indian companies).

(ii) **No expenditure is allowed -** This rate of 15% would be applied on gross dividend, in the sense, that no expenditure would be allowable in respect of such dividend.

(iii) **Meaning of specified foreign company -** Specified foreign company means a foreign company in which the Indian company holds 26% or more in nominal value of the equity share capital of the company. Therefore, this concessional rate would not be applicable in respect of dividend received from a foreign company in which the holding of the Indian company is less than 26% of the nominal value of the equity share capital.

(4) Minimum Alternate Tax on companies [Section 115JB]

(i) Applicability of MAT

As per section 115JB(1), in case of company (domestic or foreign), if the income-tax payable on the total income computed under the Income-tax Act, 1961 is *less* than, ***15%*** of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of ***15%*** (add surcharge, if applicable, i.e., 7% for domestic companies and 2% for foreign companies, where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, and 12% for domestic companies and 5% for foreign companies where the total income exceeds ₹ 10 crore). Further, health and education cess @ 4% shall be added on the aggregate of income-tax and surcharge.

(ii) Maintenance of statement of profit and loss [Section 115JB(2)]

(a) Every company other than a company referred to in clause (b) of section 115JB(2) shall for the purpose of this section, prepare its statement of profit and loss for the relevant previous year in accordance with the provisions of Schedule III to the Companies Act, 2013 **[Clause (a) of section 115JB(2)].**

(b) Insurance companies, banking companies, companies engaged in generation or supply of electricity or any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company, shall for the purposes of this section, prepare its statement of profit and loss for the relevant previous year in accordance with the provisions of the Act governing such company **[Clause (b) of section 115JB(2)].**

(c) The section also specifies that the statement of profit and loss for the relevant previous year has to be drawn in accordance with Schedule III to the Companies Act, 2013. Further, while preparing the annual accounts,-

(i) the accounting policies,

(ii) the accounting standards followed for preparing such accounts, including statement of profit and loss

(iii) the method and rates for calculating depreciation

shall be the same as have been adopted for the purpose of preparing such accounts including statement of profit and loss and laid before the company at its annual general meeting.

(d) Where the financial year adopted by the company under the Companies Act, 2013[6] is different from the previous year under the Income-tax Act, 1961, the accounting policies, accounting standards and methods and rates adopted for calculating depreciation shall correspond to the accounting policies followed for preparing such accounts including statement of profit and loss for the financial year.

(iii) Computation of book profit [*Explanation 1* below section 115JB(2)]

For computing the book profit, the profit shall be increased by the following amounts, if the amount referred in (a) to (i) is debited to the statement of profit and loss

(a) **Income-tax:** Income-tax paid or payable, and the provision therefor;

[It may be noted that income-tax includes –

(1) dividend distribution tax under section 115-O/ tax on distributed income under section 115R;

(2) interest;

(3) surcharge;

(4) health and education cess (*Explanation 2* to section 115JB)].

[6] As per section 2(41) of the Companies Act, 2013, the financial year of a company shall be the period ending 31st March of every year. If a company is incorporated on or after 1st January of a year, then the financial year shall be the period ending 31st March of the following year.

(b) **Amount carried to Reserves:** Amount carried to any reserves, by whatever name called;

(c) **Provisions:** Amounts set aside to provisions for meeting liabilities other than ascertained liabilities;

(d) **Provisions for losses of subsidiary companies:** Amount of provision for losses of subsidiary companies;

(e) **Dividends:** Amount of dividends paid or proposed; or

(f) **Expenditure relatable to exempt income:** Amount of expenditure relatable to any income to which section 10 or sections 11 or 12 apply;

(fa) **Expenditure relatable to share of an assessee in the income of an AOP or BOI:** Amount of expenditure relatable to income, being share of the assessee in the income of an AOPs or BOIs, on which no income-tax is payable in accordance with the provisions of section 86;

(fb) **Expenditure relatable to income accruing to foreign company:** The amount or amounts of expenditure relatable to income accruing or arising to an assessee, being a foreign company, from –

(A) the capital gains arising on transactions in securities; or

(B) the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII i.e., section 115A

if the income-tax payable thereon in accordance with the provisions of the Act, other than the provisions of this Chapter, is at a rate less than ***15%***;

(fc) **Notional loss on the units of business trust:** The amount representing-

- notional loss on transfer of a capital asset, being share or a special purpose vehicle to a business trust in exchange of units allotted by that trust; or
- notional loss resulting from any change in carrying amount of said units or
- loss on transfer of such units

(fd) **Amount of expenditure relatable to income referred under section 115BBF:** The amount or amounts of expenditure relatable to income by way of royalty in respect of patent chargeable to tax under section 115BBF;

(g) **Depreciation:** The amount of depreciation;

(h) **Deferred tax:** The amount of deferred tax and provision therefor;

(i) **Provision for diminution in the value of any asset:** The amount set aside as provision for diminution in the value of any asset.

(j) **Amount standing in the revaluation reserve:** The profit shall also be increased by the amount standing in revaluation reserve relating to the revalued asset on the retirement or disposal of such asset, in case the same is not credited to the profit and loss account.

(k) **Amount of gain arise on transfer units of business trust:** When units of business trust are actually transferred, the amount of gain on such transfer has to be added to compute the book profit, since notional gains on transfer of share of a special purpose vehicle to a business trust in exchange for the units of the business trust and notional gains resulting from change in carrying amount of such units have been deducted to compute book profit.

In a case where the shares are carried at cost: The amount of gain has to be computed by taking into consideration the cost of shares exchanged with the units of the business trust.

In a case where the shares are carried at a value other than the cost through statement of profit and loss: The carrying amount of shares at the time of exchange would be taken into consideration for computing the amount of gain. The amount of gain on such transfer, if any, credited to statement of profit and loss will be reduced.

The profit shall be reduced by the following amounts:

(i) **Amount withdrawn from any reserve:** The amount withdrawn from any reserve or provision, if any such amount is credited to the statement of profit and loss.

However, the amount withdrawn from reserves/ provisions shall not be reduced from the book profit unless the book profit of that year has been increased by those reserves/ provisions;

(ii) **Exempt income:** Amount of income to which section 10 or sections 11 or 12 apply, if such amount is credited to the statement of profit and loss;

(iia) **Depreciation:** The amount of depreciation debited to the statement of profit and loss (excluding the claim of depreciation on account of revaluation of assets);

(iib) **Amount withdrawn from the revaluation reserve:** The amount withdrawn from the revaluation reserve and credited to the statement of profit and loss, to the extent it does not exceed the amount of depreciation on revaluation of assets;

(iic) **Share of the assessee in the income of an AOPs or BOIs:** The amount of income, being the share of the assessee in the income of an AOPs or BOIs, on which no income-tax is payable in accordance with the provisions of section 86, if any such amount is credited to the statement of profit and loss;

(iid) **Income accruing to foreign company:** The amount of income accruing or arising to an assessee, being a foreign company, from, -

(A) the capital gains arising on transactions in securities; or

(B) the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII i.e., section 115A,

if such income is credited to the statement of profit and loss and the income-tax payable thereon in accordance with the provisions of the Income-tax Act, 1961, other than the provisions of Chapter XII-B, is at a rate less than ***15%***;

(iie) **Notional gain on the units of business trust:** The amount representing –

(A) the notional gain on transfer of a capital asset, being a share of a SPV to a business trust in exchange of units allotted by the business trust;

(B) notional gain resulting from any change in carrying amount of said units;

(C) gain on transfer of such units,

if any, credited to statement of profit and loss;

(iif) **Loss on transfer of units:** The amount of loss on transfer of units acquired in exchange of shares of SPV computed by taking into account the cost of the shares exchanged with the units, where the shares are carried at cost. In case shares are carried at a value other than cost through statement of profit and loss, the amount of loss on transfer of such units has to be computed by taking into account the carrying amount of the shares at the time of exchange;

(iig) **Income by way of royalty taxable under section 115BBF:** The amount of income by way of royalty in respect of patent chargeable to tax under section 115BBF;

(iih) **Brought forward loss and unabsorbed depreciation: Aggregate amount of unabsorbed depreciation and loss brought forward in case of a –**

(A) company, and its subsidiary and the subsidiary of such subsidiary, where, the Tribunal, on an application moved by the Central Government under section 241 of the Companies Act, 2013 has suspended the Board of Directors of such company and has appointed new directors who are nominated by the Central Government under section 242 of the said Act;

(B) company against whom an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under section 7 or section 9 or section 10 of the Insolvency and Bankruptcy Code, 2016.

It may be noted that loss does not include depreciation.

A company would be a subsidiary of another company if such other company holds more than half in the nominal value of equity share capital of the company.

(iii) **Brought forward loss or unabsorbed depreciation in case of other companies:** Amount of brought forward loss or unabsorbed depreciation, whichever is less, in case of other companies as per books of account.

The loss shall not include depreciation; If either the figure of brought forward loss or unabsorbed depreciation is "NIL", no deduction will be allowed from the book profit of the relevant year;

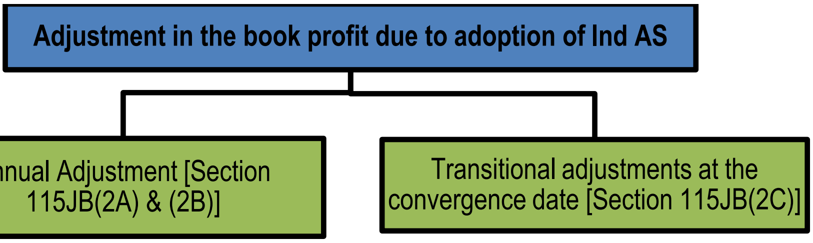
(vii) **Profits of sick industrial company:** The amount of profits of a sick industrial company (BIFR company) commencing from the previous year in which the company became sick and ending with the assessment year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses. For this purpose, "net worth" shall have the same meaning as assigned under section 3(1)(ga) of the Sick Industrial Companies (Special Provisions) Act, 1985.

(viii) **Deferred tax:** The amount of deferred tax, if any such amount is credited to the statement of profit and loss.

(iv) Computation of Book Profit for Ind AS compliant companies:

The Central Government has notified the Indian Accounting Standards (Ind AS) which are converged with International Financial Reporting Standards (IFRS) and prescribed the Companies (Indian Accounting Standards) Rules, 2015 which lay down the roadmap for implementation of these Ind AS.

As the book profit based on Ind AS compliant financial statements is likely to be different from the book profit based on existing Indian GAAP, sub-sections (2A), (2B) and (2C) of section 115JB provides the framework for computation of book profit for Ind AS compliant companies in the year of adoption and thereafter.



Adjustment in the book profit due to adoption of Ind AS

Annual Adjustment [Section 115JB(2A) & (2B)]

Transitional adjustments at the convergence date [Section 115JB(2C)]

I MAT on Ind AS compliant financial statement [Section 115JB(2A)]

In case of a company whose financial statements are drawn up in compliance with the Indian Accounting Standards (Ind ASs) specified in Annexure to the Companies (Indian Accounting Standards) Rules, 2015, the following additional adjustments shall be done to the book profit as computed above in point no. (iii) as per section 115JB(2) read with *Explanation 1*-

(a) increased by all amounts credited to other comprehensive income in the statement of profit and loss under the head "Items that will not be re-classified to profit or loss";

(b) decreased by all amounts debited to other comprehensive income in the statement of profit and loss under the head "Items that will not be re-classified to profit or loss";

However, no adjustment shall be made where the amount credited or debited to other comprehensive income under the head "Items that will not be re-classified to profit or loss", in respect of —

(i) Revaluation surplus for assets in accordance with the Indian Accounting Standards 16 and Indian Accounting Standards 38; or

(ii) Gains or losses from investments in equity instruments designated at fair value through other comprehensive income in accordance with the Indian Accounting Standards 109. **[First proviso to section 115JB(2A)]**

However, the book profit of the previous year, in which such asset or investment is retired, disposed, realised or otherwise transferred, shall be increased or decreased, as the case may be, by the amount or the aggregate of the amounts as referred to in the first proviso for the previous year or any of the preceding previous years and relatable to such asset or investment **[Second proviso to section 115JB(2A)]**

The other comprehensive income (OCI) includes certain items that will permanently be recorded in reserves and hence, never be reclassified to the statement of profit and loss included in the computation of book profits. These items shall be included in book profit for MAT purposes at the point of time as specified below-

Sl.No	Items	Point of time
1	Changes in revaluation surplus of Property, Plant or Equipment (PPE) and Intangible assets (Ind AS 16 and Ind AS 38)	To be included in book profits at the time of realisation/ disposal/ retirement or otherwise transferred
2	Gains and losses from investments in equity instruments designated at fair value through other comprehensive income (Ind AS 109)	To be included in book profits at the time of realisation/ disposal/ retirement or otherwise transferred
3	Remeasurements of defined	To be included in book profits every year as the re-measurements gains

	benefit plans (Ind AS 19)	and losses arise
4	Any other item	To be included in book profits every year as the gains and losses arise

(c) Increased by amounts or aggregate of the amounts debited to the statement of profit and loss on distribution of non-cash assets to shareholders in a demerger in accordance with Appendix A of the Indian Accounting Standards 10;

(d) Decreased by all amounts or aggregate of the amounts credited to the statement of profit and loss on distribution of non-cash assets to shareholders in a demerger in accordance with Appendix A of the Indian Accounting Standards 10;

Appendix A of Ind AS 10 provides that any distributions of non-cash assets to shareholders in a demerger shall be accounted for at fair value. The difference between the carrying value of the assets and the fair value is recorded in the statement of profit and loss.

Correspondingly, the reserves are debited at fair value to record the distribution as a 'deemed dividend' to the shareholders. As there is a corresponding adjustment in retained earnings, this difference arising on demerger shall be excluded from the book profits.

II **Sub-section (2B)** states that in demerger, in the case of a resulting company, the property and the liabilities of the undertaking or undertakings being received by it are recorded at values different from values appearing in the books of account of the demerged company immediately before the demerger, any change in such value shall be ignored for the purpose of computation of book profit of the resulting company under this section.

III **MAT on first time adoption [Section 115JB(2C)]:**

In case of Ind AS compliant company, the book profit of the year of convergence and each of the following four previous years, shall be further increased or decreased, as the case may be, by one fifth of the **transition amount**.

In the first year of adoption of Ind AS, the companies would prepare Ind AS financial statement for reporting year with a comparative financial statement for immediately preceding year. As per Ind AS 101, a company would make all Ind AS adjustments on the opening date of the comparative financial year. The entity is also required to present an equity reconciliation between previous Indian GAAP and Ind AS amounts, both on the opening date of preceding year as well as on the closing date of the preceding year.

For the purposes of computation of book profits of the year of adoption and for adjustments, the amounts adjusted as on the opening date of the first year of adoption shall be considered.

For example, companies which adopt Ind AS with effect from 1 April 2016 are required to prepare their financial statements for the year 2016-17 as per the requirements of Ind AS. Such companies are also required to prepare an opening balance sheet as of 1st April 2015 and restate the financial statements for the comparative period 2015-16.

In such a case, the first time adoption adjustments as of 31 March 2016 shall be considered for computation of MAT liability for previous year 2016-17 (Assessment year 2017-18) and thereafter.

Further, in this case, the five years period shall be previous years 2016-17, 2017-18, 2018-19, 2019-20 and 2020-21.

However, the book profit of the previous year in which the asset or investment referred to in sub clauses (B) to (E) of clause (iii) of the *Explanation* is retired, disposed, realised or otherwise transferred shall be increased or decreased, as the case may be, by the amount of the aggregate of the amounts referred to in the said sub-clause relatable to such asset or investment: **[First proviso to section 115JB(2C)]**

Further, the book profit of the previous year in which the foreign operation referred to in sub clause (F) of clause (iii) of the *Explanation* is disposed or otherwise transferred, shall be increased or decreased, as the case may be, by the amount of the aggregate of the amounts referred to in the said sub-clause relatable to such foreign operations. **[Second proviso to sub-section (2C)]**

Meaning of certain terms [*Explanation* to Section 115JB(2C)]

Clause	Term	Meaning
(i)	**Year of convergence**	the previous year within which the convergence date falls**.**
(ii)	**Convergence date**	the first day of the first Indian Accounting Standards reporting period as defined in the Ind AS 101**.**
(iii)	**Transition amount**	the amount or aggregate of the amounts adjusted in other equity (excluding capital reserve and securities premium reserve) on convergence date but not including the following: (A) Amount or aggregate of the amounts adjusted in the other comprehensive income on the convergence date which shall be subsequently re-classified to the profit and loss; (B) Revaluation surplus for assets in accordance with the Indian Accounting Standards 16 and

		Indian Accounting Standards 38 adjusted on the convergence date; (C) Gains or losses from investments in equity instruments designated at fair value through other comprehensive income in accordance with the Indian Accounting Standards 109 adjusted on the convergence date; (D) Adjustments relating to items of property, plant and equipment and intangible assets recorded at fair value as deemed cost in accordance with paragraphs D5 and D7 of the Indian Accounting Standards 101 on the convergence date; (E) Adjustments relating to investments in subsidiaries, joint ventures and associates recorded at fair value as deemed cost in accordance with paragraph D15 of the Indian Accounting Standards 101 on the convergence date; and (F) Adjustments relating to cumulative translation differences of a foreign operation in accordance with paragraph D13 of the Indian Accounting Standards 101 on the convergence date. **[clause (iii)]**

Transitional adjustments: Analysis		
(i)	The adjustments arising on account of transition to Ind AS from existing Indian GAAP is required to be recorded directly in Other Equity at the date of transition to Ind AS. These adjustments has to be made in the following manner:	
	(a)	The book profit of the year of convergence and the following four previous years shall be increased or decreased with the transitional adjustments recorded directly in Other Equity excluding capital reserve and securities premium reserve and excluding the amounts referred in (A) to (F) (in the definition of Transition Amount), on the convergence date.
	(b)	Those adjustments recorded in other comprehensive income referred in (A) above (in the definition of Transition Amount) and which would subsequently be reclassified to the profit and loss, shall be included in book profits in the year in which these are reclassified to the profit and loss, therefore these amounts are excluded from the transition amount.
	(c)	Those adjustments recorded in other comprehensive income referred in (B) and (C) (in the definition of Transition Amount) above and which

would never be subsequently reclassified to the profit and loss shall be included in book profits as specified hereunder:

Sl. No	Items	Point of time
1	Changes in revaluation surplus of Property, Plant or Equipment (PPE) and Intangible assets (Ind AS 16 and Ind AS 38)	To be included in book profits at the time of realisation/ disposal/ retirement or otherwise transferred
2	Gains and losses from investments in equity instruments designated at fair value through other comprehensive income (Ind AS 109)	To be included in book profits at the time of realisation/ disposal/ retirement or otherwise transferred
3	Remeasurements of defined benefit plans (Ind AS 19)	To be included in book profits every year as the re-measurements gains and losses arise
4	Any other item	To be included in book profits every year as the gains and losses arise

(d) The other adjustments referred in (D), (E) and (F) (in the definition of Transition Amount) above shall be made in the following manner:

(I) **Property, Plant and Equipment (PPE) and intangible assets at fair value as deemed cost [referred in (D) (in the definition of Transition Amount) above]**

An entity may use fair value in its opening Ind AS Balance Sheet as deemed cost for an item of PPE or an intangible asset as mentioned in paragraphs D5 and D7 of Ind AS 101. In such cases the treatment shall be as under—

- The existing provisions for computation of book profits under section 115JB of the Act provide that in case of revaluation of assets, any impact on account of such revaluation shall be ignored for the purposes of computation of book profits. Further, the adjustments in retained earnings on first time adoption with respect to items of PPE and Intangible assets shall be ignored for the purposes of computation of book profits.
- Depreciation shall be computed ignoring the amount of aforesaid retained earnings adjustment.

Similarly, gain/loss on realization/ disposal/ retirement of such assets shall be computed ignoring the aforesaid retained earnings adjustment.

		II.	**Investments in subsidiaries, joint ventures and associates at fair value as deemed cost [referred in (E) (in the definition of Transition Amount) above]** An entity may use fair value in its opening Ind AS Balance Sheet as deemed cost for investment in a subsidiary, joint venture or associate in its separate financial statements as mentioned in paragraph D15 of Ind AS 101. In such cases retained earnings adjustment shall be included in the book profit at the time of realisation of such investment.
		III.	**Cumulative translation differences [referred in (F) (in the definition of Transition Amount) above]** • An entity may elect a choice whereby the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to Ind AS. Further, the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to Ind AS and shall include only the translation differences after the date of transition. • In such cases, to ensure that such Cumulative translation differences on the date of transition which have been transferred to retained earnings, are taken into account, these shall be included in the book profits at the time of disposal of foreign operations as mentioned in paragraph 48 of Ind AS 21.
(ii)	All other adjustments to retained earnings (recorded as other equity) at the time of transition (including for example, Decommissioning Liability, Asset retirement obligations, Foreign exchange capitalisation/ decapitalization, Borrowing costs adjustments etc.) shall be included in book profits, equally over a period of five years starting from the year of first time adoption of Ind AS.		
(iii)	Section 115JB of the Act already provides for adjustments on account of deferred tax and its provision. Any deferred tax adjustments recorded in Reserves and Surplus on account of transition to Ind AS shall also be ignored.		

(v) Clarifications on computation of book profit for the purposes of levy of Minimum Alternate Tax (MAT) under section 115JB of the Income-tax Act, 1961 for Ind AS compliant companies [Circular No. 24/2017 dated 25.07.2017]

After amendment in section 115JB for computation of book profit for the purposes of levy of Minimum Alternate Tax (MAT) for Indian Accounting Standards (Ind AS) compliant companies, CBDT received representations from various stakeholders seeking clarifications on certain issues arising therefrom.

Accordingly, the CBDT has vide this circular, clarified these issues by way of the following FAQs:

Question 1: *The profit for the period may include Marked to market (MTM) gains/ losses on account of fair value adjustments on various financial instruments recognised through profit or loss (FVTPL). A situation may arise where the losses on account of fair value adjustments could be added back in view of clause (i) of Explanation 1 to section 115JB(2) of the Act. Whether the losses on such instruments require any adjustment for computing book profits for the purposes of MAT?*

Answer: Since MTM gains recognised through profit or loss on FVTPL classified financial instruments are included in book profits for MAT computation, it is clarified that MTM losses on such instruments recognised through profit or loss shall not require any adjustments as provided under clause (i) of *Explanation 1* to section 115JB(2) of the Act. However, in case of provision for diminution/ impairment in value of assets other than FVTPL financial instruments, the existing adjustment of clause (i) of *Explanation 1* to section 115JB (2) of the Act shall apply.

It is further clarified that for financial instruments where gains and losses are recognised through Other Comprehensive income (OCI), the amended provisions of MAT shall continue to apply.

Question 2: *For the purposes of section 115JB of the Act, what shall be the starting point for computing Book profits for Ind AS compliant companies? Whether Profit before other comprehensive income [Item number XIII in Part 2 (Statement of Profit and Loss) of Division II of Schedule III to the Companies Act 2013] or Total Comprehensive Income (including other comprehensive income) [Item number XV in Part 2 (Statement of Profit and Loss) of Division II of Schedule III to the Companies Act 2013] shall be the starting point?*

Answer: Starting point for computing Book profits for Ind AS compliant companies shall be Profit before other comprehensive income [Item number XIII in Part 2 (Statement of Profit and Loss) of Division II of Schedule III to the Companies Act 2013].

Question 3: *As per Explanation to Section 115JB(2C) of the Act, the convergence date is defined as the first day of the first Indian Accounting standards reporting period as defined in Ind AS 101. The Memorandum explaining the provisions of the Finance Bill 2017 mentions that the adjustment as on the last day of the comparative period is to be considered. It may be clarified as to what would be the appropriate manner for computation of transition amount on convergence date, 1st April i.e. at the start of the day or at the end of the day?*

Answer: In the first year of adoption of Ind AS, the companies would prepare Ind AS financial statement for reporting year with a comparative financial statement for immediately preceding year. As per Ind AS 101, a company would make all Ind AS adjustments on the opening date of the comparative financial year. The entity is also required to present an equity reconciliation between previous Indian GAAP and Ind AS amounts, both on the opening date of preceding year as well as on the closing date of the preceding year. The amounts as on start of the opening date of the first year of adoption should be considered for the purposes of computation of transition amount.

For example, companies which adopt Ind AS with effect from 1st day of April 2016 are required to prepare their financial statements for the year 2016-17 as per requirements of Ind AS. Such companies are also required to prepare an opening balance sheet as of 1st day of April 2015 and restate the financial statements for the comparative period 2015-16. In such a case, the first time adoption adjustments as of 31st day of March 2016 should be considered [i.e. the start of business on 1st day of April 2016 (or, equivalently, close of business on 31st day of March 2016)] for computation of MAT liability for previous year 2016-17 (Assessment year 2017-18) and thereafter.

Question 4: As per Indian GAAP, proposed dividend was required to be recognized in the financial statements for the year for which it pertained to even though these were declared in the subsequent year. Section 115JB of the Act already provides for adjustments for dividend for computation of book profit. As per Ind AS, the amount of proposed dividend (including dividend distribution taxes) is required to be recognized in the year in which it has been declared rather than the year for which it pertains to. Accordingly, on transition to Ind AS, the amount of proposed dividend for FY 2015-16 which was recognized in profit and loss account in FY 2015-16 is required to be reversed and credited to Retained Earnings. For the computation of MAT, whether these balances would form part of the transition amount and thus be adjusted over a period of 5 years?

Answer: Adjustment of proposed dividend (including dividend distribution taxes) shall not form part of the transition amount.

Question 5: *Under Ind AS, adjustments on the transition date may have a corresponding impact on deferred taxes. Should the deferred taxes on such amounts be considered for the purpose of transition amount?*

Answer: Any deferred taxes adjustments recorded on the transition date shall be ignored for the purpose of computing Transition Amount.

Question 6: *As mentioned in Question No.1, clause (i) of Explanation 1 to Section 115JB(2) of the Act provides for adjustments for computation of book profit for the amount or amounts set aside as provision for diminution in the value of any asset. Convergence date adjustments may include adjustment for Provision for Bad and Doubtful Debts (Expected Credit Loss adjustment) at the time of transition. Whether these adjustments would form part of the transition amount referred to in section 115JB(2C) of the Act?*

Answer: Adjustments relating to provision for diminution in the value of any assets other than the ones mentioned in Question Number 1 above, shall not be considered for the purpose of computation of the Transition Amount. Therefore, adjustments relating to provision for doubtful debts shall not be considered for the purpose of computation of the transition amount.

Question 7: *Under Section 115JB of the Act, transition amount has been defined as the amount or the aggregate of the amounts adjusted in the 'Other Equity' (excluding capital reserve and securities premium reserve) on the convergence date. Whether changes in share application money on reclassification to 'Other Equity' would form part of the Transition Amount?*

Answer: Share application money pending allotment which is reclassified to Other Equity on transition date shall not be considered for the purpose of computing Transition Amount.

Question 8: *Under Ind AS, Investments in preference share is considered to be a liability and the corresponding dividend expense is debited to Profit and loss account as interest cost. Should such interest expenses on preference shares be deducted for the purpose of MAT computation?*

Answer: For the purpose of computation of MAT, profit/Transition Amount shall be increased by dividend/interest on preference share (including dividend distribution taxes) whether presented as dividend or interest.

Question 9: *How do we account for items such as equity component, if any, of financial instruments like Non-Convertible debentures (NCDs), Interest free loan etc. included in other equity as per Ind AS for the computation of transition amount under MAT?*

Answer: Items such as equity component of financial instruments like NCD's, Interest free loan etc. would be included in the Transition Amount.

Question 10: *Where revaluation/fair value adjustments have been made to items of Property, Plant & Equipment (PPE) under Ind AS, as per section 115JB of the Act, the book profit of the previous year in which the items of PPE are retired, disposed or realised shall be increased or decreased, as the case may be, by the revaluation amount relatable to such items of PPE. Whether the revaluation amount to be considered for adjustment should be the gross amount of the revaluation or the amount after adjustment of the depreciation on the revaluation amount?*

Answer: The book profit of the previous year in which the items of PPE are retired, disposed, realised or otherwise transferred shall be increased or decreased, as the case may be, by the revaluation amount after adjustment of the depreciation on the revaluation amount relatable to such asset. This has been explained by an illustration as under:

Particulars	*Erstwhile Indian GAAP*	*Ind-AS (considering fair value/revaluation adjustment on PPE)*	*Fair Value/ Revaluation Adjustments and corresponding depreciation*
WDV/Deemed Cost as on 1 April 2015	*100*	*1000*	*900*
Depreciation @ 10% for F.Y. 2015-16	*10*	*100*	*90*
WDV as on 1 April 2016	*90*	*900*	*810*
Depreciation @ 10% for F.Y. 2016-17	*9*	*90*	*81*
WDV as on 1 April 2017	*81*	*810*	*729**
Sale value as on 1 April 2017	*900*	*900*	
Profit on sale credited to P & L	*819*	*90*	
Adjustment for MAT - revaluation amount after adjustment of the depreciation	*0*	*729**	
Profit on sale to be considered for MAT	***819***	***819***	

Question 11: *How should adjustments for service concession arrangements be treated for the purpose of computation of book profit under MAT?*

Answer: Adjustments on account of Service Concession arrangements would be included in the Transition Amount and also on an ongoing basis.

Question 12: *Existing clause (iii) of explanation to section 115JB(2) of the Act provides for deduction of lower of the amount of loss brought forward or unabsorbed depreciation as per books of account for computation of book profits. In case where, on adjustment of transition amount, the losses as per books of account gets wiped off, whether deduction for the said amount would be available for assessment year 2017-2018 onwards?*

Answer: For assessment year 2017-2018, the deduction of lower of depreciation or losses shall be allowed based on the position as on 31 March 2016. For the subsequent periods, the position as per books of account drawn as per Ind AS shall be considered for computing lower of loss brought forward or unabsorbed depreciation.

Question 13: *How Capital Reserves or Securities Premium existing as per old Indian GAAP reclassified to Retained Earnings/ Other Reserves on Convergence date be treated for MAT purpose.*

Answer: The Capital Reserves or Securities Premium existing as on the convergence date as per the erstwhile Indian GAAP which are reclassified to Retained Earnings/ Other

Reserves under Ind AS and vice versa, shall not be considered for the purposes of Transition Amount.

It is further clarified, that even after such reclassifications, the amount of revaluation reserve shall continue to be considered as revaluation reserve for the purposes of computation of book profit and shall also include transfer to any other reserves by whatever name called or capitalised.

Question 14: *Companies which follow accounting year other than March, 2017 ending for Companies Act purposes and are required to transition to Ind AS will have to prepare financial statements for MAT purposes for FY 2016-17 partly under Indian GAAP and partly under Ind AS. How should such companies compute MAT on transition to Ind AS?*

Answer: In view of second proviso to section 115JB(2) of the Act, companies will be required to follow Indian GAAP for the pre-convergence period and Ind AS for the balance period.

For example, a Company following December ending will be required to prepare, accounts for MAT purposes under Indian GAAP for 9 months upto December 2016 and under Ind AS for 3 months thereafter. The transition amount will be calculated with reference to 1st January, 2017.

(vi) Compulsory filing of return of income and furnishing of report from Chartered Accountant

The section also provides that every company to which this section applies shall furnish, along with the return of income filed under section 139(1) or in response to a notice under section 142(1)(i), a report from a chartered accountant certifying that the book profit has been computed in accordance with the provisions of this section [Section 115JB(4)].

(vii) Allowability of carry forward of losses

In respect of the relevant previous year, the amounts determined under the provisions of section 32(2) or section 72(1)(ii) or section 73 or section 74 or section 74A(3), shall be allowed to be carried forward [Section 115JB(3)].

(viii) Applicability of other provisions of the Act

All other provisions of the Act shall apply to every assessee, being a company mentioned in this section [Section 115JB(5)]**.**

(ix) Non-applicability of MAT [Section 115JB(5A)].

The provisions of MAT u/s 115JB shall not apply to any income accruing or arising to a company from life insurance business referred to in section 115B

(x) Non-applicability of MAT in respect of certain foreign companies

Explanation 4 to section 115JB with retrospective effect from 01.04.2001 provides for non-applicability of levy of MAT under section 115JB in the following cases:

	Existence of DTAA with the country of residence of the foreign company	**Additional condition to be satisfied for non-applicability of MAT**
(i)	The foreign company is a resident of a country or a specified territory with which India has a DTAA under section 90(1) or the Central Government has adopted any agreement between specified associations for double taxation relief under section 90A(1)	It should not have a permanent establishment in India in accordance with the provisions of such Agreement
(ii)	The foreign company is a resident of a country with which India does not have an agreement of the nature referred to in clause (i) above	It is not required to seek registration under any law for the time being in force relating to companies.

Explanation 4A to section 115JB has been inserted with retrospective effect from 01.04.2001 to clarify that MAT provisions shall not be applicable to an assessee, being a foreign company, where its total income comprises solely of profits and gains from business referred to in section 44B or section 44BB or section 44BBA and such income has been offered to tax at the presumptive rates specified in these sections.

(xi) Concessional rate of MAT for unit located in IFSC

In case of a company, being a unit located in International Financial Services Centre and deriving its income solely in convertible foreign exchange, the minimum alternate tax shall be chargeable at the rate of 9% instead of 15%. [Section 115JB(7)]

ILLUSTRATION 1

A domestic company, ABC Ltd., furnishes the following particulars in respect of Assessment Year 2020-21 and seeks your opinion on the application of section 115JB. You are also required to compute the total income and tax payable.

(1)	*Profits as per Statement of profit and loss as per the Companies Act, 2013*		*₹ 215 Lacs*
(2)	*Statement of Profit and Loss includes:*		
	(a) Credits:	*Dividend income from Indian companies*	*₹ 20 Lacs*
		Excess realized on sale of land held as investment	*₹ 30 Lacs*
	(b) Debits:	*Depreciation on straight line method basis*	*₹ 100 Lacs*
		Provision for loss of subsidiary company	*₹ 60 Lacs*
(3)	*Depreciation allowable as per the Income-tax Rules, 1962*		*₹ 150 Lacs*

(4)	*Short term Capital gains on sale of land mentioned above as computed under Income-tax Act, 1961*	*₹ 40 Lacs*
(5)	*Losses brought forward as per books of account and as per Income-tax Act, 1961:*	
	Business loss	*₹ 50 Lacs*
	Unabsorbed depreciation	*₹ 60 Lacs*

The company has represented to you that the excess realized on sale of land cannot form part of the book profit for purposes of section 115JB. You will have to deal with this issue assuming that ABC Ltd. is not required to comply with the Indian Accounting Standards. Ignore the provisions of section 115BAA.

Note - *The turnover of ABC Ltd. for the P.Y.2017-18 was ₹ 390 crore.*

SOLUTION

In the case of a company, it has been provided that where tax on ***15%*** of book profit exceeds tax on total income computed as per normal provisions, the book profit shall be deemed to be the total income for tax purposes.

It is therefore necessary to compute total income as per Income-tax Act, 1961 as well as book profits.

I. Computation of Total income as per the Income-tax Act, 1961

Particulars	₹ (in Lacs)	
Net profit as per statement of profit and loss		215
Add: Depreciation debited to statement of profit and loss	100	
Provision for losses of subsidiary company	60	160
		375
Less: Dividend income – exempt under section 10(34)	20	
Excess realized on sale of land (considered separately)	30	
Depreciation allowable as per Income-tax Rules, 1962	150	200
Business Income		175
Less: Set-off of brought forward business loss		50
		125
Capital gains (Short term capital gains)		40
		165
Less: Set-off of unabsorbed depreciation		60
Total Income as per Income-tax Act, 1961		**105**

II. Computation of book profit under section 115JB

Particulars	(₹ in Lacs)	
Net profit as per statement of profit and loss		215
Add: Provision for loss of subsidiary		60
Depreciation		100
		375
Less: Dividend income exempt under section 10(34)	20	
Depreciation	100	
Business loss which is less than unabsorbed depreciation	50	170
"Book Profit"		**205**

III. Computation of Tax liability under the normal provisions of the Income-tax Act, 1961

Total income as per the Income-tax Act, 1961 is ₹ 105 Lacs,

Particulars	₹
Tax payable ₹ 105 Lacs @ 25%, since the turnover of the company for the previous year 2017-18 does not exceed ₹ 400 crore.	26,25,000
Add: Surcharge @ 7%	1,83,750
	28,08,750
Add: Health and education cess @ 4%	1,12,350
Total Tax payable	**29,21,100**

IV. Computation of Minimum Alternate Tax

Particulars	₹
Tax @ ***15%*** of book profit of ₹ 205 lacs	30,75,000
Add: Surcharge @ 7%	2,15,250
	32,90,250
Add: Health and education cess @ 4%	1,31,610
Minimum Alternate Tax payable	**34,21,860**

Since ***15%*** of book profit exceeds the tax payable as per the Income-tax Act, 1961, the book profit of ₹ 205 lacs would be deemed to be the total income and the tax payable on such total income shall be ***15%*** thereof i.e. ₹ 30,75,000 plus surcharge @ 7% being ₹ 2,15,250 plus health and education cess @ 4% (of tax and surcharge) being ₹ 1,31,610. Total tax liability would be ₹ 34,21,860.

Note: With regard to the company's representation, in respect of capital gain whether liable for book profit tax under section 115JB, it may be noted that since the excess realized on sale of land has been included in net profit computed under Schedule III of the Companies Act, 2013, it will form part of book profit [Bombay High Court judgment in *CIT v. Veekay Lal Investment Co. Pvt. Ltd. (2001) 249 ITR 597*].

ILLUSTRATION 2

Maitri Jeans (P) Ltd. is in the business of manufacturing jeans. For the assessment year 2020-21, it paid tax @ 15% on its book profit computed under section 115JB. The Assessing Officer though satisfied that it is liable to pay book profit tax U/s. 115JB, wants to charge interest under sections 234B and 234C as no advance tax was paid during the financial year 2019-20. The company seeks your opinion on the proposed levy of interest. Advice.

SOLUTION

The issue under consideration is whether interest under sections 234B and 234C can be levied where a company is assessed on the basis of its book profit under section 115JB.

The Supreme Court, in *Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470*, observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted.

According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year.

Under section 115JB(1), where the tax payable on total income is less than ***15%*** of "book profit" of a company, the "book profit" would be deemed to be the total income and tax would be payable at the rate of ***15%***.

Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.

Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C.

Therefore, even though Maitri Jeans (P) Ltd. is assessed on the basis of its book profit under section 115JB for A.Y.2020-21, it is liable to pay advance tax. Since Maitri Jeans (P) Ltd. has not paid any advance tax during the financial year 2019-20, the levy of interest under section 234B and 234C is valid.

ILLUSTRATION 3

Sona Ltd., a resident company, earned a profit of ₹ 15 lakhs after debit/ credit of the following items to its Statement of Profit and Loss for the year ended on 31/03/2020.

(i) Items debited to Statement of Profit and Loss:

No.	Particulars	₹
1.	*Provision for the loss of subsidiary*	*70,000*
2.	*Provision for doubtful debts*	*75,000*
3.	*Provision for income-tax*	*1,05,000*
4.	*Provision for gratuity based on actuarial valuation*	*2,00,000*
5.	*Depreciation*	*3,60,000*
6.	*Interest to financial institution (unpaid before filing of return)*	*1,00,000*
7.	*Penalty for infraction of law*	*50,000*

(ii) Items credited to Statement of Profit and Loss:

No.	Particulars	₹
1.	*Profit from unit established in special economic zone*	*5,00,000*
2.	*Share in income of an AOP as a member*	*1,00,000*
3.	*Income from units of UTI*	*75,000*
4.	*Long term capital gains on sale of building*	*3,00,000*

Other Information:

(i) Depreciation includes ₹ 1,50,000 on account of revaluation of fixed assets.

(ii) Depreciation as per Income-tax Rules is ₹ 2,80,000.

(iii) Brought forward loss of ₹ 10 lakhs which includes unabsorbed depreciation of ₹ 4 lakhs.

(iv) The capital gain has been invested in specified assets under section 54EC.

(v) The AOPs, of which the company is a member, has paid tax at maximum marginal rate.

(vi) Provision for income-tax includes ₹ 45,000 of interest payable on income-tax.

Compute minimum alternate tax under section 115JB of the Income-tax Act, 1961, for A.Y. 2020-21, assuming that Sona Ltd. is not required to comply with the Indian Accounting Standards. Ignore the provisions of section 115BAA.

SOLUTION

Computation of "Book Profit" for levy of MAT under section 115JB for A.Y.2020-21

Particulars	₹	₹
Net Profit as per Statement of Profit and Loss *Add:* Net profit to be increased by the following amounts		15,00,000

as per *Explanation 1* to section 115JB:		
- Provision for the loss of subsidiary	70,000	
- Provision for doubtful debts, being the amount set aside as provision for diminution in the value of any asset	75,000	
- Provision for income-tax	1,05,000	
[As per *Explanation 2* to section 115JB, income-tax shall include, *inter alia*, any interest charged under the Act. Therefore, whole of the amount of provision for income-tax including ₹ 45,000 towards interest payable has to be added]		
- Depreciation	3,60,000	6,10,000
		21,10,000
Less: Net profit to be decreased by the following amounts as per *Explanation 1* to section 115JB:		
- Share in income of an AOP as a member	1,00,000	
[In a case, where AOP has paid tax on its total income at maximum marginal rate, no income-tax is payable by the company, being a member of AOP, in accordance with the provisions of section 86. Therefore, share in income of an AOP on which no income-tax is payable in accordance with the provisions of section 86, would be reduced while computing book profit, since the same has been credited to statement of profit and loss]		
- Income from units in UTI	75,000	
[Income from units in UTI shall be reduced while computing the book profits, since the same is exempt under section 10(35)]		
- Depreciation other than depreciation on revaluation of assets (₹ 3,60,000 – ₹ 1,50,000)	2,10,000	
- Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account.		
[Lower of unabsorbed depreciation ₹ 4,00,000 and brought forward business loss ₹ 6,00,000 as per books of accounts has to be reduced while computing the book profit]	4,00,000	7,85,000
Book Profit		**13,25,000**

Computation of MAT liability under section 115JB

Particulars	₹
15% of book profit	1,98,750
Add: Health and education cess @ 4%	7,950
Minimum Alternate Tax liability	2,06,700

Notes:

(1) It is only the specific items mentioned under *Explanation 1* to section 115JB, which can be adjusted from the net profit as per the Statement of Profit and Loss prepared as per the Companies Act for computing book profit for levy of MAT. Since the following items are not specified thereunder, the same cannot be adjusted for computing book profit:

- Interest to financial institution (unpaid before filing of return) and
- Penalty for infraction of law

(2) Provision for gratuity based on actuarial valuation is an ascertained liability *[CIT v. Echjay Forgings (P) Ltd. (2001) 251 ITR 15 (Bom.)]*. Hence, the same should not be added back to compute book profit.

(3) As per proviso to section 115JB(6), the profits from unit established in special economic zone cannot be excluded while computing the book profit, and hence, such income would be liable for MAT.

(4) Long-term capital gains cannot be deducted while computing book profit even if such amount of capital gains is invested in specified assets under section 54EC, since book profit has to be computed by adding/ deducting the items mentioned under *Explanation 1* to section 115JB alone. Capital Gains reflected in the statement of profit and loss shall be part of book profit under section 115JB. Capital gains exempted under section 54EC cannot also be excluded for computing book profit. *[CIT v. Veekaylal Investment Co. P. Ltd. (2001) 249 ITR 597 (Bom.) & N J Jose and Co. (P) Ltd. v. ACIT (2010) 321 ITR 132 (Ker.)]*

(xii) Set-off of credit of tax paid under section 115JB [Section 115JAA]

(1) This section provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid over and above the tax payable under the other provisions of the Income-tax Act, 1961, will be allowed as tax credit in the subsequent years. However, no interest would be payable on the tax credit allowed.

(2) The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act.

(3) This tax credit is allowed to be carried forward for **15 assessment years** succeeding the assessment year in which the credit became allowable**.**

(4) Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

(5) Where as a result of order passed, the amount of tax payable is reduced or

increased, the amount of tax credit allowed shall also be reduced or increased accordingly.

(6) In case of conversion of a private company or unlisted public company into an LLP, the tax credit under section 115JAA for MAT paid by the company under section 115JB would not be allowed to the successor LLP.

(7) Where the amount of tax credit in respect of any income-tax paid in any country or specified territory outside India, under section 90 or section 90A or section 91, allowed against the tax payable under the provisions of section 115JB(1) exceeds the amount of such tax credit admissible against the tax payable by the assessee on its income in accordance with the other provisions of this Act, then, while computing the amount of credit under this sub-section, such excess amount shall be ignored.

In other words, the amount of tax credit in respect of MAT shall not be allowed to be carried forward to subsequent year to the extent such credit relates to the difference between the amount of foreign tax credit (FTC) allowed against MAT and FTC allowable against the tax computed under regular provisions of Act other than the provisions relating to MAT.

Note *– The Taxation Laws (Amendment) Ordinance, 2019, promulgated by the President of India on 20.9.2019, has reduced the rate of MAT from 18.5% of book profit (upto A.Y.2019-20) to 15% of book profit (from A.Y.2020-21). In this chapter, MAT has been computed applying the rate of 15% of book profit.*

Further, domestic companies eligible to opt for special provisions under section 115BAA and 115BAB from A.Y.2020-21 would not be liable to pay MAT under section 115JB. A company opting for section 115BAA from A.Y.2020-21 or any subsequent year cannot set-off MAT credit available to it under section 115JAA from the year in which it exercises such option. The provisions of section 115BAA and 115BAB are discussed in detail in Annexure - 1 at the end of this chapter.

These amendments by the Taxation Laws (Amendment) Ordinance, 2019 would be effective from A.Y.2020-21, after the same is passed by the Parliament.

(5) Tax on distributed profit of domestic companies: Chapter XII D [Section 115-O]

The amounts declared, distributed or paid on or after 1.4.2003 by a domestic company by way of dividends are charged to additional income-tax at the flat rate of 15%, in addition to normal income-tax chargeable on the income of the company. Dividend received from domestic companies on or after 1.4.03 are exempt in the hands of shareholders subject to the amount of dividend chargeable to tax under section 115BBDA [Section 115-O(1)]

However, in respect of dividend referred to in section 2(22)(e), the rate of dividend distribution tax would be 30%.

(i) Removal of cascading effect of dividend distribution effect:

(a) Section 115-O(1A) seeks to provide relief from double taxation of dividends by removing the cascading effect of dividend distribution tax in a multi-tier corporate structure. A domestic holding company receiving dividend from its subsidiary company can reduce the same from dividends declared, distributed or paid by it.

However, there are certain conditions to be fulfilled to avail this benefit. They are –

Status of subsidiary company	Conditions
Where subsidiary is a domestic company	the subsidiary should have paid the dividend distribution tax, as payable on such dividend
Where subsidiary is a foreign company	the tax is payable by the domestic company under section 115BBD on such dividend

Meaning of holding company - For this purpose, a holding company is one which holds more than 50% of the nominal value of equity shares of the subsidiary.

(b) The NPS [Non-Pension System] Trust is exempted from the applicability of dividend distribution tax in respect of dividend paid to any person for, or on behalf of, the NPS Trust. Hence, the dividend paid to any person for, or on behalf of, the NPS Trust would not be subject to dividend distribution tax. Therefore, for the purpose of calculating dividend distribution tax, a company can reduce such dividend from the dividends declared, distributed or paid by it. [Section 115-O(1A)]

(ii) Grossing up of dividend distributed:

Section 115-O(1B) provides that for the purposes of determining the tax on distributed profits payable in accordance with the section 115-O, any amount by way of dividends referred to in section 115-O(1), as reduced by the amount referred to in section 115-O(1A) [referred to as net distributed profits], shall be increased to such amount as would, after reduction of the tax on such increased amount at the rate specified in section 115-O(1), be equal to the net distributed profits.

However, this provision does not apply in respect of dividend referred to in section 2(22)(e).

ILLUSTRATION 4

X Ltd., a domestic company, has distributed on 1/11/2019, dividend of ₹ 230 lakh to its shareholders. On 1/10/2019, X Ltd. has received dividend of ₹ 60 lakh from its domestic subsidiary company Y Ltd., on which Y Ltd. has paid dividend distribution tax under section 115-O. Compute the additional income-tax payable by X Ltd. under section 115-O.

SOLUTION

Particulars	₹ in lakh
Dividend distributed by X Ltd.	230
Less: Dividend received from subsidiary Y Ltd.	60
Net distributed profits	**170**
Add: Increase for the purpose of grossing up of dividend $\left\{\frac{15}{(100-15)}\times 170\right\}$[7]	30
Gross dividend	**200**
Additional income-tax payable by X Ltd. u/s 115-O [15% of ₹ 200 lakh]	30.00
Add: Surcharge @ 12%	3.60
	33.60
Add: Health and education cess @ 4%	1.34
	34.94

ILLUSTRATION 5

Yaman Limited is a company in which 60% of the shares are held by Piloo Limited. Yaman Limited declared a dividend amounting to ₹ 35 lacs to its shareholders for the financial year 2018-19 in its Annual General Meeting held on 10th July, 2019. Dividend distribution tax was paid by Yaman Limited on 21st July, 2019. Piloo Limited declared an interim dividend amounting to ₹ 50 lacs on 15th October, 2019.

Compute the amount of tax on dividend payable by Piloo Limited.

What would be your answer, if 58% shares of Piloo Limited are held by Kafi Limited, an Indian company?

SOLUTION

As per section 115-O, dividend distribution tax at the rate of 17.472% (i.e., 15% plus surcharge @ 12% and health and education cess @ 4%) is leviable on dividend declared, distributed or paid by a domestic company. As per section 115-O(1A), a holding company receiving dividend from its domestic subsidiary company can reduce the same from dividend declared, distributed or paid by it. The dividend from its domestic subsidiary company should be received in the same financial

[7] As per sub-section (1B) of section 115-O, for the purpose of grossing up, the rate specified in sub-section (1) has to be considered. The rate specified in sub-section (1) is 15%. Further, in the example given in the *Explanatory Memorandum* to the Finance (No.2) Bill, 2014, grossing up has been done at the rate of 15%.

However, it is also possible to take a view that grossing up should be done at the rate of ***17.472%*** (that is, 15% plus surcharge @ ***12%*** plus health and education cess @ 4%), which is the effective rate of dividend distribution tax.

year in which the holding company declares, distributes or pays the dividend. Further, the dividend shall not be considered for reduction more than once.

The conditions to be fulfilled for this purpose are as follows:

(1) The domestic subsidiary company should have paid the dividend distribution tax which is payable on such dividend;

(2) The recipient holding company should be a domestic company;

For this purpose, a holding company is a company which holds more than 50% of the nominal value of equity shares capital of another company.

Section 115-O (1B) provides that for the purposes of determining the tax on distributed profits payable in accordance with section 115-O, any amount by way of dividends referred to in section 115-O(1), as reduced by the amount referred to in section 115-O(1A) [referred to as net distributed profits], shall be increased to such amount as would, after reduction of the tax on such increased amount at the rate specified in section 115-O(1), be equal to the net distributed profits.

On the basis of the aforesaid provision, dividend distribution tax payable by Piloo Limited shall be computed as follows:

Particulars	₹ in lakh
Dividend distributed by Piloo Ltd.	50.00
Less: Dividend received from subsidiary Yaman Ltd. (60% of ₹ 35 lacs)	21.00
Net distributed profits	29.00
Add: Increase for the purpose of grossing up of dividend ₹ 29 x 100 /85 = ₹ 34.12 minus ₹ 29.00	5.12
Gross dividend	34.12
Additional income-tax payable by Piloo Ltd. u/s 115-O [15% of ₹ 34.12 lakh]	5.12
Add: Surcharge @ 12%	0.61
	5.73
Add: Health and education cess @ 4%	0.23
	5.96

In order to remove the cascading effect of DDT in a multi-tier corporate structure, section 115-O provides that, in case any domestic company (Piloo Ltd., in this case) receives any dividend during the year from any subsidiary company (Yaman Ltd., in this case) and such subsidiary company (Yaman Ltd.) has paid the DDT as payable on such dividend, then, dividend distributed by the holding company (Piloo Ltd.,) in the same year to the extent of dividend received from the subsidiary (Yaman Ltd.), shall not be subject to DDT under section 115-O, irrespective of whether the holding company (Piloo Ltd.) is a subsidiary of any other company (Kafi Ltd., in this case).

Therefore, in spite of the fact that Piloo Ltd. is a subsidiary of Kafi Ltd., it can reduce the amount of dividend received from Yaman Ltd. for computation of dividend distribution tax. Therefore, dividend distribution tax payable by Piloo Ltd. shall be 17.472% of ₹ 34.12 lacs (grossed up amount) i.e. ₹ 5.96 lacs.

(iii) Payment of DDT even if no income-tax is payable by the company

Even if no income-tax is payable by a domestic company on its total income computed in accordance with the provisions of Income-tax Act, 1961, the tax on distributed profits shall be payable by such company [Section 115-O(2)].

(iv) Prescribed period for payment of DDT

Additional income-tax must be paid to the credit of the Central Government within fourteen days from the date of

(a) declaration of any dividend or

(b) distribution of any dividend or

(c) payment of any dividend,

whichever is earliest [Section 115-O(3)].

(v) No credit of DDT paid

The tax on distributed profits so paid by the company shall be treated as the final payment of tax in respect of the amount declared, distributed or paid as dividends and no further credit therefore shall be claimed by the company or by any other person in respect of the amount of tax so paid [Section 115-O(4)].

(vi) No deduction under any other provisions

No deduction under any of the provisions of the Income-tax Act, 1961 shall be allowed to the company or shareholder in respect of the dividend income or DDT [Section 115-O(5)].

(vii) Exemption from levy of DDT on distributions by a SPV to a business trust

Non-levy of DDT on distributed profits in respect of any amount declared, distributed or paid by way of dividends (whether interim or otherwise) out of its current income –

(a) By a specified domestic company i.e., by a domestic company in which a business trust has become a holder of the whole of the nominal value of equity share capital of the company (excluding the equity share capital required to be held mandatorily by any other person in accordance with any law for the time being in force or any directions of Government or any regulatory authority or equity share capital held by any Government or Government body).

(b) On or after the specified date i.e., on or after the date of acquisition of such holding referred to in (a) above by the business trust. [Section 115-O(7)].

However, this exemption would not be applicable in respect of any amount declared, distributed or paid at any time by the specified domestic company out of its accumulated profits or current profits upto the date of acquisition by the business trust of the specified holding [as per (a) above] in the SPV.

(viii) Exemption from levy of DDT on distributions by unit located in International Financial Services Centre

No tax on distributed profits shall be chargeable in respect of the total income of a company, being a unit located in International Financial Services Centre, deriving income solely in convertible foreign exchange, for any assessment year on any amount declared, distributed or paid by such company, by way of dividends (whether interim or otherwise) on or after 1st April, 2017 out of its current income**,** either in the hands of the company or the person receiving such dividend.

Further, any dividend paid out of income accumulated as a unit of International Financial Services Centre after 1st April, 2017 shall not be liable for tax on distributed profits either in the hands of the company or the person receiving such dividend [Section 115-O(8)].

(ix) Interest on non-payment or delayed payment of additional income-tax by the company

Section 115P provides that non-payment of dividend distribution tax within the time allowed under section 115-O(3) attracts simple interest @ 1% for every month or part thereof on the amount of such tax for the period beginning from the date following the date on which the tax was payable and ending with the date on which the tax is actually paid. The Principal Officer of a domestic company and the company is liable to pay interest on such non-payment or delayed payment.

(x) Deemed assessee-in-default

Section 115Q provides that the Principal Officer and the company would be deemed to be an assessee-in-default if they fail to pay the tax in accordance with the provisions of section 115-O.

(6) Levy of additional income-tax on distributed income of a domestic company on account of buy-back of shares [Chapter XII-DA]

(i) Under section 115-O, dividend distribution tax (DDT) is levied on a company at the time when it distributes, declares or pays any dividend to its shareholders. Consequently, the amount of dividend received by the shareholders is not included in the total income of the shareholder, by virtue of exemption provided under section 10(34) subject to the amount of dividend chargeable to tax under section 115BBDA.

(ii) So far, the consideration received by a shareholder on buy-back of shares by a company is not treated as dividend but is taxable as capital gains under section 46A.

(iii) While payment of dividend is one option available to a company to distribute its reserves to its shareholders, another option available is to buy-back its own shares at a consideration determined by it. If the company exercises the former option, the payment of dividend would be subject to DDT under section 115-O and income in the hands of shareholders would be exempt as per section 10(34) subject to section 115BBDA. However, if the company prefers the second option, the income would be taxed in the hands of shareholder under section 46A as capital gains.

(iv) In order to discourage the practice of domestic companies resorting to buy back of unlisted shares instead of payment of dividends in order to avoid payment of tax by way of DDT, especially if the capital gains arising to the shareholders are either not chargeable to tax or are taxable at a lower rate, Chapter XII-DA, comprising of sections 115QA, 115QB and 115QC, levies additional income-tax on buy back of such shares by domestic companies. The income arising to the shareholders in respect of such buy back of unlisted shares by the domestic company would be exempt under section 10(34A), where the company is liable to pay the additional income-tax on the buy-back of shares.

(v) Levy of additional income-tax @ 20% on buyback of shares [Section 115QA]

The Finance (No. 2) Act, 2019 has extended the levy of additional income-tax on buy back to all companies including listed companies with effect from 5.7.2019. Thus, hereafter, In case of buyback of shares (whether listed or unlisted) by domestic companies, additional income-tax @20% (plus surcharge@12% and cess@4%) is leviable in the hands of the company.

Consequently, the income arising to the shareholders in respect of such buyback of shares by the domestic company would be exempt under section 10(34A), since the domestic company is liable to pay additional income-tax on the buyback of shares.

It means additional income tax is applicable to all companies, whether listed or unlisted, with effect from 5th July, 2019, However, the provision of this sub-section shall not apply to such buy of shares being the shares listed on recognized stock exchange in respect of which public announcement has been made before 5th July, 2019 in accordance with the provisions of SEBI (Buy Back Of Securities) Regulation 2018 made under the SEBI Act, 1992 as amended from time to time.

Note: *Prior to 5.7.2019, additional income-tax was attracted only in case of buy-back of unlisted shares by domestic companies. Consequently, only holders of unlisted shares were entitled to exemption under section 10(34A).*

Taxation provisions in respect of buyback effected on or after 5.7.2019

(1)	*(2)*	*(3)*	*(4)*
Taxability in the hands of	***Buyback of shares by domestic companies***	***Buyback of shares by a company, other than a domestic company***	***Buyback of specified securities by any company***
Company	*Subject to additional income-tax@23.296%.*	*Not subject to tax in the hands of the company.*	*Not subject to tax in the hands of the company.*
Shareholder/ holder of specified securities	*Income arising to shareholders exempt under section 10(34A)*	*Income arising to shareholder taxable as capital gains u/s 46A.*	*Income arising to holder of specified securities taxable as capital gains u/s 46A.*

Such tax should be paid to the credit of the Central Government within 14 days from the date of payment of any consideration for such buyback to the shareholder.

Meaning of buyback and distributed income	
Buyback	Purchase by a company of its own shares in accordance with the provisions of any law for the time being in force to companies [clause (i) of *Explanation* to section 115QA]
Distributed income	The consideration paid by the company on buy-back of shares as reduced by the amount which was received by the company for issue of such shares, determined in the manner as may be prescribed [clause (ii) of *Explanation* to section 115QA]

Accordingly, the CBDT has, vide notification no. 94/2016 dated 17-10-2016, inserted Rule 40BB to provide the manner of determination of the amount received by the company for issue of shares being bought back in various circumstances including shares being issued under tax neutral reorganisations and in different tranches as follows:

Sub-rule No.	**Circumstance**	**Manner of determination of amount received by the company in respect of issue of shares being bought back**
2	Where shares have been issued by a company to any person way of subscription	Amount actually received by the company in respect of such share **including** any amount actually received by way of **premium**.

3	Where the company had at any time, prior to the buy-back of the share, returned any sum out of the amount received in respect of such share	The amount actually received in respect of such shares as **reduced by the sum so returned** However, if the sum or any part of it so returned was chargeable to additional income-tax under section 115-O and the company has paid such additional income tax, then, such sum or part thereof, as the case may be, shall not be reduced.
4	Where the share has been issued by a company under any plan or scheme under which an employees' stock option has been granted or as part of sweat equity shares	The **fair market value of the share** as computed in accordance of Rule 3(8), **to the extent credited to the share capital and share premium account** by the company shall be deemed to be the amount received by the company for issue of said share. "Sweat equity shares" means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called [Clause (b) of *Explanation* to section 17(2)(vi)].
5	Where the share has been issued by a company being an amalgamated company, under a scheme of amalgamation, in lieu of the share or shares of an amalgamating company	The amount **received by the amalgamating company** in respect of such share or shares determined in accordance with this rule, shall be deemed to be the amount received by the amalgamated company in respect of the share so issued by it.
6	Where the Shares are issued by resulting company under a scheme of demerger	**Amount received by the resulting company in respect of shares issued by it under a scheme of demerger:** $\text{Amount received by the demerged co. in respect of the original shares (determined as per this Rule)} \times \frac{\text{Net book value of assets transferred in a demerger}}{\text{Net worth of the demerged co. immediately before demerger}}$

7		**Amount received in respect of the original shares issued by the demerged company post demerger:** The amount received by the demerged company in respect of the original shares **(-)** the amount as so arrived under sub-rule (6).
8	Where the share has been issued or allotted by the company as part of consideration for acquisition of any asset or settlement of any liability	The amount received by the company for issue of such share shall be determined in accordance with the following formula- Amount received = A/B Where, A = an amount being lower of the following amounts- (a) $\text{The amount received by the demerged company in respect of the original shares} \times \frac{\text{The part of consideration being paid by issue of shares}}{\text{The total consideration}}$ (b) the amount of consideration for acquisition of the asset or settlement of the liability to be paid in the form of shares, to the extent credited to the share capital and share premium account by the company; B = the number of shares issued by the company as part of consideration:
9	Where the shares have been issued or allotted by a company on succession or conversion, as the case may be, of a firm into the company or succession of sole proprietary concern by the company	The amount received by the company for issue of shares shall be determined in accordance with the following formula- Amount received = (A-B)/C A= book value of the assets in the balance-sheet as reduced by any amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act and any amount shown in the balance-sheet as

		asset including the unamortized amount of deferred expenditure which does not represent the value of any asset; For determining book value of the assets, any change in the value of the assets consequent to their revaluation shall be ignored. **B = book value of liabilities shown in the balance-sheet, but does not include the following amounts**, namely:- (a) capital, by whatever name called, of the proprietor or partners of the firm, as the case may be; (b) reserves and surpluses, by whatever name called, including balance in profit and loss account; (c) any amount representing provision for taxation, other than amount of tax paid, as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto; (d) any amount representing provisions made for meeting liabilities, other than ascertained liabilities; and (e) any amount representing contingent liabilities, **C = number of shares issued on conversion or succession**.
10	Where the share has been issued or allotted, without any consideration, on the basis of existing shareholding in the company	The consideration in respect of such share shall be deemed to be "**Nil"**
11	Where the shares have been issued on conversion of preference shares or bond or debenture, debenture-stock or deposit certificate in any form or	The amount received by the company in respect of such instrument as so converted.

	warrants or any other security issued by the company	
12	Where the share being bought back is held in dematerialised form and the same cannot be distinctly identified	The amount received by the company in respect of such share shall be the amount received for the issue of share determined in accordance with this rule on the basis of the first-in-first-out method.
13	In any other case	The face value of the share shall be deemed to be the amount received by the company for issue of the share.

(vi) No credit or deduction under the Act in respect of such income or additional income-tax:

The additional income-tax payable by the company shall be the final payment of tax on such income. No credit or deduction shall be claimed by the company or any other person in respect of such tax paid.

Further, no deduction under any provision of the Income-tax Act, 1961 shall be allowed to the company or the shareholder in respect of income, which has been subject to additional income-tax, or tax thereon.

(vii) Interest payable for non-payment of additional income-tax by the company [Section 115QB]

The principal officer of the domestic company and the company will be liable to pay simple interest on the amount of additional income-tax not paid within the specified time. Such interest is leviable at the rate of 1% for every month or part of the month on the amount of such tax not paid or short paid for the period beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

(viii) Deemed Assessee-in-default [Section 115QC]

The principal officer of the domestic company and the company will be deemed to be an assessee-in-default in respect of amount of tax payable by him or it, in case the additional income-tax is not paid to the credit of Central Government within the specified time. In such a case, all the provisions of the Act for the collection and recovery of income-tax would apply.

ILLUSTRATION 6

XYZ Ltd., a domestic company, purchases its own unlisted shares on 4th July, 2019. The consideration for buyback amounted to ₹ 21 lakh, which was paid on the same day. The amount received by the company two years back for issue of such shares determined in the manner specified in Rule 40BB was ₹ 13 lakh. Compute the additional income-tax payable by XYZ Ltd. Compute the interest, if any, payable if such tax is paid to the credit of the Central Government on 29th September, 2019.

What would be your answer if the shares purchased were listed shares, other facts remaining the same?

SOLUTION

XYZ Ltd is liable to pay ₹ 1,86,368 as additional income-tax, which is the amount calculated @ 23.296% (20% plus surcharge @ 12% plus health and education cess @ 4%) on ₹ 8 lakh, being its distributed income (i.e., ₹ 21 lakh – ₹ 13 lakh).

The additional income-tax was payable on or before 18th July, 2019. However, the same was paid only on 29th September 2019.

Period for which interest @ 1% per month or part of a month is leviable -

Period	No. of months/part of month
19th July – 18th August, 2019 (whole of first month)	1
19th August – 18th September, 2019 (whole of second month)	1
19th September – 29th September, 2019 (part of third month)	1
Total number of months	**3**

Interest under section 115QB is payable @ 1% per month for 3 months on the amount of additional tax payable i.e., ₹ 1,86,300 (rounded off as per Rule 119A). Therefore, interest payable under section 115QB is ₹ 5,589.

If the shares purchased were listed shares, additional income-tax would not be attracted in the hands of XYZ Ltd., since the purchase was made before 5.7.2019.

(7) Special provisions relating to income of shipping companies

To make the Indian shipping industry more competitive, a tonnage tax scheme for taxation of shipping profits has been introduced. Tonnage tax will induce more ships to fly the Indian Flag.

Chapter XII-G, containing sections 115V to 115VZC, provides for special provisions relating to taxation of the income of shipping companies. With the introduction of tonnage tax scheme, the companies have to exercise the option to be assessed under this scheme or under the normal provisions of the Income-tax Act. The salient features of the scheme are as follows:

- A company owning at least one qualifying ship may join.
- A qualifying ship is one with a minimum tonnage of 15 tons and having a valid certificate.
- If a company is incorporated after the initial period or a company which is incorporated before the initial period but becomes a qualifying company for the first time after the initial period, this application is required to be made within three months of the date of incorporation or the date on which it becomes a qualifying company, as the case may be.

(I) Computation of Tonnage Income from Business of Operating Qualifying Ships

Computation of profits and gains from the business of operating qualifying ships [Section 115VA]

(1) A company has the option to compute the income from the business of operating qualifying ships in accordance with the provisions of this Chapter.

(2) Such income is deemed to be the income chargeable to tax under the head "Profits and gains of business or profession" in respect of such business.

Operating ships [Section 115VB]

(1) A company shall be regarded as operating a ship if it operates any ship whether owned or chartered by it.

(2) Even if only a part of the ship has been chartered in by it in an arrangement such as slot charter, space charter or joint charter, the company would be regarded as operating a ship.

(3) However, a company will not be regarded as the operator of a ship which has been chartered out on bareboat charter-cum-demise terms or on bareboat charter terms for a period exceeding three years.

(4) "Bareboat charter" means hiring of a ship for a stipulated period on terms which give the charterer possession and control of the ship, including the right to appoint the master and crew;

(5) "Bareboat charter-cum-demise" means a bareboat charter where the ownership of the ship is intended to be transferred after a specified period to the company to whom it has been chartered;

Meaning of "Qualifying company" [Section 115VC]

(1) A company will be a qualifying company if -

(a) it is an Indian company;

(b) the place of effective management of the company is in India;

(c) it owns at least one qualifying ship; and

(d) the main object of the company is to carry on the business of operating ships.

(2) The expression "place of effective management of the company" has been defined in the *Explanation* to the section to mean –

(a) the place where the board of directors of the company or its executive directors make their decisions; or

(b) in a case where the board of directors routinely approve the commercial and strategic decisions made by the executive directors or officers of the company, the place where such executive directors or officers of the company perform their functions.

Meaning of "Qualifying ship" [Section 115VD]

(1) A ship is a qualifying ship if

(i) it is a seagoing ship or vessel of 15 net tonnage or more;

(ii) it is registered –

(a) under the Merchant Shipping Act, 1958; or

(b) outside India in respect of which a licence has been issued by the Director-General of Shipping under section 406 or 407 of the Merchant Shipping Act, 1958

(iii) there is a valid certificate in force indicating the net tonnage of such a ship;

(2) However, the following ships are not "qualifying ships" –

(i) a seagoing ship or vessel if the main purpose for which it is used is for the provision of goods or services of a kind normally provided on land ("seagoing ship" means a ship which is certified as seagoing by the competent authority of any country);

(ii) fishing vessels;

(iii) factory ships (which includes a vessel providing processing services in respect of processing of the fishing produce);

(iv) pleasure craft (i.e. a ship, whose primary use is for the purposes of sport or recreation);

(v) harbour and river ferries;

(vi) offshore installations;

(vii) a qualifying ship which is used as a fishing vessel for a period of more than thirty days during a previous year.

Manner of computation of income under tonnage tax scheme [Section 115VE]

(1) A tonnage tax company engaged in the business of operating qualifying ships should compute the profits from such business under the tonnage tax scheme;

(2) "Tonnage tax company" means a qualifying company in relation to which tonnage tax option is in force;

(3) "Tonnage tax scheme" means a scheme for computation of profits and gains of business of operating qualifying ships under the provisions of this Chapter.

(4) The business of operating qualifying ships giving rise to "relevant shipping income" (i.e. income referred to in section 115V-I(1)) has to be considered as a separate business, distinct from all other activities or business carried on by the company.

(5) Such profits should be computed separately from the profits and gains from any other business.

(6) The tonnage tax scheme will apply only if an option to that effect is made (in accordance with the provisions of section 115VP).

(7) The profits and gains from the business of operating qualifying ships of a company engaged in such business and –

(a) not covered under the tonnage tax scheme or,

(b) which has not made an option to that effect,

have to be computed in accordance with the other provisions of this Act.

Tonnage income [Section 115VF]

(1) "Tonnage income" means the income of a tonnage tax company computed in accordance with the provisions of this Chapter. The tonnage income has to be computed in accordance with the provisions of section 115VG given below.

(2) The income so computed is deemed to be the profits chargeable under the head "Profits and gains of business or profession".

(3) Where income is so computed under section 115VG, the relevant shipping income (referred to in section 115V-I(1)) will not be chargeable to tax.

Computation of tonnage income [Section 115VG]

(1) The tonnage income for a previous year is the aggregate of the tonnage income of each qualifying ship.

(2) The tonnage income of a qualifying ship is to be calculated on the basis of the daily tonnage income of such ship multiplied by the number of days in the previous year.

(3) In case the ship is operated by the company as a qualifying ship for only part of the previous year, the tonnage income of the ship will be calculated on the basis of daily tonnage of such ship multiplied by the number of days in part of the previous year.

(4) The daily tonnage income of a qualifying ship has to be computed as under –

Qualifying ship having net tonnage	Amount of daily tonnage income
Up to 1000	₹ 70 for each 100 tons
Exceeding 1,000 but not more than 10,000	₹ 700 plus ₹ 53 for each 100 tons exceeding 1,000 tons
Exceeding 10,000 but not more than 25,000	₹ 5,470 plus ₹ 42 for each 100 tons exceeding 10,000 tons
Exceeding 25,000	₹ 11,770 plus ₹ 29 for each 100 tons exceeding 25,000 tons

(5) "Tonnage" means the tonnage of a ship indicated in the "valid certificate" (i.e. referred to in section 115VX) and includes deemed tonnage computed in the prescribed manner.

(6) "Deemed tonnage" means the tonnage in respect of an arrangement of purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel.

(7) The tonnage is to be rounded off to the nearest multiple of hundred tons. For this if the last figure that amount of tonne is fifty or more, the tonnage shall be increased to the next higher tonnage which is a multiple of 100, otherwise, shall be reduced to the next lower tonnage which is a multiple of 100.

(8) No deduction or set-off is allowed in computing the tonnage income under this Chapter.

Calculation of tonnage income in case of joint operation [Section 115VH]

(1) Where a qualifying ship is operated by two or more companies –

(a) by way of joint interest in the ship or by way of an agreement for the use of the ship and

(b) their respective shares are definite and ascertainable,

the tonnage income of each such company shall be an amount equal to a share of income proportionate to its share of interest.

(2) Where two or more companies are operators of a qualifying ship, the tonnage income of each company shall be computed as if each had been the only operator, if the conditions specified in (a) and (b) of (1) above are not satisfied.

Meaning of "Relevant shipping income" [Section 115V-I]

(1) The "relevant shipping income" of a tonnage tax company means its profits from core activities and its profits from incidental activities

(2) Where the aggregate of income from incidental activities exceeds one-fourth per cent of the turnover from core activities, such excess will not form part of relevant shipping income for the purposes of this Chapter and shall be taxable under the other provisions of this Act.

(3) The core activities of a tonnage tax company are –

(i) its activities from operating qualifying ships; and

(ii) Other ship-related activities, being,

(a) shipping contracts in respect of –

(1) earnings from pooling arrangements i.e.

(i) agreement between two or more persons for providing services through a pool or

(ii) operating one or more ships and sharing earnings or operating profits on the basis of mutually agreed terms;

(2) contracts of affreigtment i.e. a service contract under which a tonnage tax company agrees to transport a specified quantity of specified products at a specified rate, between designated loading and discharging ports over a specified period.

(b) Specific shipping trades, being, -

(1) on-board or on-shore activities of passenger ships comprising of fares and food and beverages consumed on board;

(2) slot charters, space charters, joint charters, feeder services, container box leasing of container shipping.

(4) The incidental activities of the tonnage tax company are the activities which are incidental to the core activities and which may be prescribed for the purpose.

(5) The Central Government can, by notification, exclude any activity under “other ship-related activities” mentioned in (3) above or prescribe the limit up to which such activities can be included in the core activities.

(6) Every notification issued under this Chapter has to be laid before each House of Parliament to make the same effective.

(7) If both Houses agree in making any modification therein, the notification will have effect in such modified form.

(8) Similarly, if both Houses agree that the notification should not be issued, then such notification will be of no effect.

(9) However, such modification or annulment will not affect anything previously done under that notification.

(10) Where a tonnage tax company operates a non-qualifying ship, then the income attributable to operation of the non-qualifying ship should be computed in accordance with the other provisions of this Act.

(11) In the following cases, the relevant shipping income is to be computed as if the transfer had been at market value of the goods and services as on the date of transfer–

(i) Where any goods or services held for the purposes of tonnage tax business are transferred to any other business carried on by a tonnage tax company, or

(ii) where any goods or services held for the purposes of any other business carried on by such tonnage tax company are transferred to the tonnage tax business, and

(iii) In both the above cases, the consideration, if any, for such transfer as recorded in the accounts of the tonnage tax business does not correspond to the market value of such goods or services as on the date of the transfer,

(12) Market value in relation to any goods and services means the price that such goods or services would ordinarily fetch on sale in the open market.

(13) Where the computation of the relevant shipping income in the manner specified above presents exceptional difficulties, the Assessing Officer may compute such income on such reasonable basis as he may deem fit.

(14) If the Assessing Officer is of the opinion that owing to the close connection between the tonnage tax company and such other person or for any other reason, the affairs of the business transacted between the tonnage tax company and any other person are arranged in such a manner that the company gets more than the ordinary profits which might be expected to arise in the tonnage tax business, then he may take into account the amount of income which may be reasonably deemed to have been derived therefrom for computing the relevant shipping income.

(15) In case the relevant shipping income of a tonnage tax company is a loss, then, such loss is to be ignored for the purposes of computing tonnage income.

Treatment of common costs [Section 115VJ]

(1) Where a tonnage tax company also carries on any business or activity other than the tonnage tax business, the common costs attributable to the tonnage tax business should be determined on a reasonable basis.

(2) Where any asset, other than qualifying ship, is not exclusively used for the tonnage tax business by the tonnage tax company, depreciation on such asset has to be allocated between its tonnage tax business and other business.

(3) Such allocation of depreciation has to be done on a fair proportion to be determined by the Assessing Officer, having regard to the use of such asset for the purpose of the tonnage tax business and for the other business.

Depreciation [Section 115VK]

(1) The depreciation for the first previous year of the tonnage tax scheme has to be computed on the written down value of the qualifying ships.

(2) The written down value of the block of assets, being ships, as on the first day of the previous year, has to be divided in the ratio of the book written down value of the qualifying ships (qualifying assets) and the book written down value of the non-qualifying ships (other assets).

(3) The block of qualifying assets would constitute a separate block of assets.

(4) The manner of computing the book written down value of the block of qualifying assets and the block of other assets is as follows –

(a) the book written down value of each qualifying asset and each other asset as on the first day of the previous year is to be determined by taking the book written down value of each asset appearing in the books of account as on the last day of the preceding previous year;

(b) Any change in the value of assets consequent to their revaluation after 10.9.04 is to be ignored;

(c) The book written down value of all the qualifying assets and other assets are to be aggregated;

(d) The ratio of the aggregate book written down value of the qualifying assets to the aggregate book written down value of the other assets has to be determined.

(5) In case an asset forming part of the block of qualifying assets begins to be used for purposes other than the tonnage tax business, an appropriate portion of the written down value allocable to such asset has to be reduced from the written down value of that block and added to the block of other assets.

(6) In case an asset forming part of the block of other assets begins to be used for tonnage tax business, an appropriate portion of the written down value allocable to such asset i.e., the amount which bears the same proportion to the written down value of the block of other assets as on the first day of the previous year as the book written value of the asset beginning to be used for tonnage tax business bears to the total book written down value of all the assets forming the block of other assets, has to be reduced from the written down value of the block of other assets and has to be added to the block of qualifying asset.

(7) Depreciation computed for the previous year on such asset mentioned in (6) shall be allocated in the ratio of number of days for which the asset was used for the tonnage tax business and for purposes other than tonnage tax business.

(8) Depreciation on the block of qualifying assets and block of other assets so created shall be allowed as if the written down value as on the first previous year has been brought forward from the preceding previous year.

(8) The expression "book written down value" means the written down value as appearing in the books of account.

Deemed deduction and set-off and carry forward of losses etc. [Section 115VL]

(1) Any loss/allowance or deduction under sections 30 to 43B relating to or allowable for any of the relevant previous years, would be deemed to have been given full effect to in that previous year itself;

(2) No set-off or carry forward of losses referred to in –

(i) sections 70(1) and 70(3); or

(ii) sections 71(1) and 71(2); or

(iii) section 72(1) or

(iv) section 72A(1),

relating to the business of operating qualifying ships of the company is permissible where such loss relates to any of the previous years when the company is under the tonnage tax scheme;

(3) No deduction under Chapter VI-A is allowable in relation to the profits and gains from the business of operating qualifying ships;

(4) In computing the depreciation allowance under section 32, the written down value of any asset used for the purposes of the tonnage tax business has to be computed as if the company has claimed and has been actually allowed the deduction in respect of depreciation for the relevant previous year.

Set-off and carry forward of losses of tonnage tax business [Section 115VM]

(1) Any losses attributable to its tonnage tax business that have accrued to a company before its entry in tonnage tax scheme can be set off only against the relevant shipping income when the company is under the tonnage tax scheme.

(2) Such losses will not be available for set off against any income other than relevant shipping income in any previous year beginning on or after the date when the company exercises its option under section 115VP.

(3) Any apportionment necessary to determine such losses should be made on a reasonable basis.

Capital gains from transfer of tonnage tax assets [Section 115VN]

(1) Profits or gains arising from the transfer of a capital asset being an asset forming part of the block of qualifying assets is chargeable to income-tax in accordance with the provisions of section 45, read with section 50.

(2) The capital gains so arising has to be computed in accordance with the provisions of sections 45 to 51.

Book profit or loss to be excluded for the purpose of section 115JB [Section 115VO]

This section seeks to exclude the book profits or loss derived from the activities of a tonnage tax company (referred to in section 115V-I(1)) for the purposes of section 115JB.

(II) Procedure for Option of Tonnage Tax Scheme

Method and time of opting for tonnage tax scheme [Section 115VP]

(1) A qualifying company may opt for the tonnage tax scheme by making an application to the Joint-Commissioner having jurisdiction over the company in the prescribed form and manner.

(2) An existing qualifying company should make an application at any time after 30th September, 2004 but before 1st January, 2005, which is the initial period.

(3) In case of a company incorporated after the initial period or a company incorporated before the initial period but which becomes a qualifying company for the first time after the initial period, an application can be made within three months of the date of its incorporation or the date on which it became a qualifying company, as the case may be.

(4) The Joint Commissioner, on receipt of an application for option for tonnage tax scheme, may call for such information or documents from the company as he thinks necessary in order to satisfy himself about the eligibility of the company.

(5) After satisfying himself about the eligibility of the company to make such option for tonnage tax scheme, he can either pass an order in writing approving the option for tonnage tax scheme or, if he is not so satisfied, pass an order in writing refusing to approve the option for tonnage tax scheme.

(6) A copy of such order should be sent to the applicant.

(7) An order refusing to approve the option for tonnage tax scheme can be passed only after giving the applicant a reasonable opportunity of being heard.

(8) Every order granting or refusing the approval of the option for tonnage tax scheme should be passed before the expiry of one month from the end of the month in which the application was received.

(9) Where an order granting approval for tonnage tax scheme is passed, the provisions of this Chapter will apply from the assessment year relevant to the previous year in which the option for tonnage tax scheme is exercised.

Period for which the tonnage tax option will remain in force [Section 115VQ]

(1) An option for tonnage tax scheme (after it has been approved under section 115VP(3)) would remain in force for a period of ten years from the date on which such option has been exercised.

(2) For this purpose, the option would be taken into account from the assessment year relevant to the previous year in which such option is exercised.

(3) An option for tonnage tax scheme would cease to have effect from the assessment year relevant to the previous year in which –

(i) the qualifying company ceases to be so or

(ii) a default is made in complying with the provisions contained in section 115VT or section 115VU or section 115VV.

(4) The tonnage tax option will also cease to have effect in case –

(i) a company is excluded from the tonnage tax scheme under section 115VZC or

(ii) the qualifying company furnishes to the Assessing Officer, a declaration in writing to the effect that the provisions of this Chapter may not be made applicable to it.

(5) In such a case, the profits of the company from the business of operating qualifying ships shall be computed in accordance with the other provisions of the Income-tax Act.

Renewal of tonnage tax scheme [Section 115VR]

(1) An option for tonnage tax scheme approved under section 115VP may be renewed within one year from the end of the previous year in which the option ceases to have effect.

(2) The provisions of sections 115VP and 115VQ discussed above would apply in relation to a renewal of the option for tonnage tax scheme in the same manner as they apply in relation to the approval of option for tonnage tax scheme.

Bar from opting for tonnage tax scheme in certain cases [Section 115VS]

(1) A qualifying company is not eligible to opt for the tonnage tax scheme if –

(i) the company, on its own, opts out of the tonnage tax scheme or

(ii) it makes a default in complying with the provisions of section 115VT or section 115VU or section 115VV or

(iii) its option has been excluded from tonnage tax scheme in pursuance of an order made under section 115VZC(1).

(2) In such cases, the qualifying company will not be eligible to opt for tonnage tax scheme for a period of ten years from the date of such opting out or default or order, as the case may be.

(III) Conditions for Applicability of Tonnage Tax Scheme

Transfer of profits to Tonnage Tax Reserve Account [Section 115VT]

(1) A tonnage tax company is required to credit to a reserve account (called Tonnage Tax Reserve Account) an amount not less than 20% of the book profits derived from its core and incidental activities (referred to in section 115V-I(1)) in each previous year to be utilised in the manner laid down below –

(i) The amount credited should be utilized for acquiring a new ship before the expiry of 8 years for the purposes of the business of the company; and

(ii) Until the acquisition of a new ship, the amount can be utilized for the purposes of the business of operating qualifying ships other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India. [Sub-section (3)]

(2) A tonnage tax company may transfer a sum in excess of twenty per cent of the book profits. Such excess sum transferred should also be utilised in above manner.

(3) "Book profit" will have the same meaning as in the *Explanation* to section 115JB(2) so far as it relates to income derived from the core and incidental activities.

(4) Where the company has book profit from the business of operating qualifying ships and book loss from any other source, and consequently, the company is not in a position to create the full or any part of the reserves as required, then –

(a) the company should create the reserves to the extent possible in that previous year.

(b) The shortfall, if any, will be added to the amount of the reserves required to be created for the following previous year.

(c) Such shortfall will be deemed to be part of the reserve requirement of that following previous year.

(5) **Consequences of misutilisation / non-utilisation [Sub-section (4)]**

(i) Where any amount credited to the Tonnage Tax Reserve Account has –

(a) been utilized for any purpose other than that referred to in (1) above; or

(b) not been utilized for the purpose of acquiring a new ship for the purpose of the business of the company within 8 years; or

(c) has been utilized for acquiring a new ship within 8 years but such ship is sold or transferred, otherwise than in any scheme of demerger, within 3 years from the end of the previous year in which it was acquired

then, an amount which bears the same proportion to the total relevant shipping income of the year in which such reserve was created, as the amount out of such reserve so utilized or not utilized bears to the total reserve created during that year shall be taxable under the other provisions of the Act i.e.

Taxable amount =

$$\text{Relevant shipping income} \times \frac{\text{Extent of reserves unutilized or misutilised}}{\text{Total reserve created during the year}}$$

(ii) Such amount as calculated above would be taxable -

(a) in case (a) of (i) above, in the year in which the amount was so utilized; or

(b) in case (b) of (i) above, in the year immediately following the period of 8 years;

(c) in case (c) of (i) above, in the year in which the sale or transfer took place.

(iii) However, the income so taxable under the other provisions of the Act will be reduced by the proportionate tonnage income charged to tax in the year of creation of such reserves.

(6) **Shortfall in credit to Tonnage Tax Reserve Account [Sub-section (5)]**

If there is any shortfall in the amount credited to the Tonnage Tax Reserve Account, then the amount which bears the same proportion to the total relevant shipping income as the shortfall in credit to the reserves bears to the minimum reserve required to be credited, will be taxable under the other provisions of the Act i.e.

$$\text{Taxable amount} = \text{Relevant shipping income} \times \frac{\text{Shortfall in credit to reserves}}{\text{Minimum reserve to be credited}}$$

(7) **Consequences of failure to create reserve for two consecutive previous years [Sub-section (6)] -** If the reserve required to be created is not created for any two consecutive previous years, the option of the company for tonnage tax scheme will cease to have effect from the beginning of the previous year following the second consecutive previous year in which the failure to create the reserve had occurred.

(8) **Meaning of "new ship":** A new ship includes a 'qualifying ship', which before the date of its acquisition by the qualifying company was used by any other person. However, it should not have been owned by any person resident in India before the date of such acquisition.

Minimum training requirement for a tonnage tax company [Section 115VU]

(1) A tonnage tax company, after its option has been approved under section 115VP(3) is required to comply with the minimum training requirement in respect of trainee officers in accordance with the guidelines framed by the Director-General of Shipping and notified in the Official Gazette by the Central Government. [Sub-section (1)]

(2) A copy of the certificate issued by the Director-General of Shipping to the effect that such company has complied with the minimum training requirement in accordance with the guidelines referred to in sub-section (1) for the previous year is required to be furnished along with the return of income.

(3) If the minimum training requirement is not complied with for any five consecutive previous years, the option of the company for tonnage tax scheme shall cease to have effect from the start of the previous year following the fifth consecutive year in which the failure to comply with the minimum training requirement occurred.

Limit for charter in of tonnage [Section 115VV]

(1) Every company which has opted for tonnage tax scheme should charter in not more than forty-nine per cent of the net tonnage of the qualifying ships operated by it during any previous year. The term "chartered in" does not include a ship chartered in by the company on bareboat charter-cum-demise terms.

(2) Such proportion of net tonnage in respect of a previous year is to be calculated based on the average of net tonnage during that previous year.

(3) The average of net tonnage is to be computed in such manner as may be prescribed in consultation with the Director-General of Shipping.

(4) Where the net tonnage of ships chartered in exceeds the limit of 49% during any previous year, the total income of such company in relation to that previous year is to be computed as if the option for tonnage tax scheme does not have effect for that previous year.

(5) Where the said limit of 49% is exceeded in any two consecutive previous years, the option for tonnage tax scheme shall cease to have effect from the beginning of the previous year following the second consecutive previous year in which the limit had exceeded.

Maintenance and audit of accounts [Section 115VW]

An option for tonnage tax scheme by a tonnage tax company will not have effect in relation to a previous year unless such company –

(i) maintains separate books of account in respect of the business of operating qualifying ships and

(ii) furnishes, along with the return of income for that previous year, the report of an accountant, in the prescribed form duly signed and verified by such accountant.

Determination of tonnage [Section 115VX]

(1) The tonnage of the ship shall be determined in accordance with the valid certificate indicating its net tonnage.

(2) "Valid certificate" means –

(i) in case of ships registered in India—

(a) having a length of less than twenty-four metres, a certificate issued under the Merchant Shipping (Tonnage Measurement of Ship) Rules, 1987 made under the Merchant Shipping Act, 1958;

(b) having a length of twenty-four metres or more, an international tonnage certificate issued under the provisions of the Convention on Tonnage Measurement of Ships, 1969 as specified in the Merchant Shipping (Tonnage Measurement of Ship) Rules, 1987 made under the Merchant Shipping Act, 1958;

(ii) in case of ships registered outside India,

(a) a licence issued by the Director-General of Shipping under section 406 or section 407 of the Merchant Shipping Act, 1958 specifying the net tonnage on the basis of Tonnage Certificate issued by the Flag State Administration where the ship is registered or

(b) any other evidence acceptable to the Director-General of Shipping produced by the ship owner while seeking permission for chartering in the ship.

(IV) Amalgamation and Demerger of Shipping Companies

Amalgamation [Section 115VY]

(1) In case of amalgamation, the provisions relating to the tonnage tax scheme would apply to the amalgamated company if it is a qualifying company.

(2) However, where the amalgamated company is not a tonnage tax company, it should exercise an option for tonnage tax scheme under section 115VP(1) within three months from the date of the approval of the scheme of amalgamation.

(3) Where the amalgamating companies are tonnage tax companies, the provisions of this Chapter would apply to the amalgamated company for such period as the option for tonnage tax scheme which has the longest unexpired period continues to be in force.

For example, if two tonnage tax companies X Ltd. and Y Ltd. are amalgamated to form a new company Z Ltd., and the option for tonnage tax scheme of X Ltd. has an unexpired period of 8 years and Y Ltd. has an unexpired period of 6 years, then the provisions of this Chapter would apply to the new company Z Ltd. for a period of 8 years.

(4) Where one of the amalgamating companies is a qualifying company on 1st October, 2004 and has not exercised option for tonnage tax scheme within the initial period, then –

(i) the provisions of this Chapter will not apply to the amalgamated company and

(ii) the income of the amalgamated company from the business of operating qualifying ships has to be computed in accordance with the other provisions of the Act.

Demerger [Section 115VZ]

(1) Where in a scheme of demerger, the demerged company transfers its business to the resulting company before the expiry of the option for tonnage tax scheme, then the scheme would apply to the resulting company for the unexpired period if it is a qualifying company.

(2) The option for tonnage tax scheme in respect of the demerged company would remain in force for the unexpired period of the tonnage tax scheme if it continues to be a qualifying company.

(V) Other Provisions

Effect of temporarily ceasing to operate qualifying ships [Section 115VZA]

(1) A temporary cessation (as against permanent cessation) of operating any qualifying ship by a company would not be considered as a cessation of operating of such qualifying ship. The company would still be deemed to be operating such qualifying ship for the purposes of this Chapter.

(2) Where a qualifying company continues to operate a ship, which temporarily ceases to be a qualifying ship, then such ship will not be considered as a qualifying ship for the purposes of this Chapter.

(VI) Cases where provisions of this Chapter does not apply

Avoidance of tax [Section 115VZB]

(1) The tonnage tax scheme will not apply where a tonnage tax company is a party to any transaction or arrangement which amounts to an abuse of the tonnage tax scheme.

(2) A transaction or arrangement will be considered as an abuse if the entering into or the application of such transaction or arrangement results, or would, but for this section have resulted, in a tax advantage being obtained by –

(a) a person other than a tonnage tax company; or

(b) a tonnage tax company in respect of its non-tonnage tax activities.

(3) "Tax advantage" includes,—

(i) (a) the determination of the allowance for any expense or interest, or

(b) the determination of any cost or expense allocated or apportioned,

which has the effect of reducing the income or increasing the loss, as the case may be, from activities other than tonnage tax activities chargeable to tax.

Such computation should be on the basis of entries made in the books of account in respect of the previous year in which the transaction was entered into; or

(ii) a transaction or arrangement which produces to the tonnage tax company more than ordinary profits which might be expected to arise from tonnage tax activities.

Exclusion from tonnage tax scheme [Section 115VZC]

(1) Where a tonnage tax company is a party to any transaction or arrangement which amounts to an abuse of the tonnage tax scheme, the Assessing Officer has the power to exclude such company from the tonnage tax scheme, by an order in writing, after giving an opportunity of being heard to such company.

(2) However, no order to this effect can be passed without the previous approval of the Principal Chief Commissioner or Chief Commissioner.

(3) This section does not apply where the company shows to the satisfaction of the Assessing Officer that the transaction or arrangement was a bona fide commercial transaction and has not been entered into for the purpose of obtaining tax advantage under this Chapter.

Where an order has been passed by the assessing officer excluding the tonnage tax company from the tonnage tax scheme, then, the option for tonnage tax scheme shall cease to be in force from the first day of the previous year in which the transaction or arrangement was entered into.

12.2 TAX ON INCOME DISTRIBUTED BY SPECIFIED COMPANY OR A MUTUAL FUND [CHAPTER XII-E: SECTIONS 115R, 115S AND 115T]

(1) Tax on income distributed [Section 115R(2)]

Any amount of income distributed by the specified company as defined in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 or a Mutual Fund to its unit holders on or after 1.4.03 shall be chargeable to tax and the specified company or the Mutual Fund shall be liable to pay additional income-tax at the rate specified in the table below. Thus, the income from units received by a unit holder on or after 1.4.03 is exempt from income-tax under section 10(35).

Type of Fund	Person to whom income is distributed	Rate of tax on income distributed
Money market mutual fund (MMMF) or liquid fund	Individual or HUF	25%
	Any other person	30%
Equity oriented fund	Any person	10%
Fund other than MMMF or liquid fund or equity-oriented fund	Individual or HUF	25%
	Any other person	30%
Infrastructure Debt Fund set up as a Mutual Fund	Non-corporate non-resident or a foreign company	5%

However, this does not apply in respect of any income distributed by the Administrator of the specified undertaking to the unit holders. ***Further, no additional income-tax shall be chargeable in respect of any amount of income distributed on or after 1st September, 2019 by a specified Mutual Fund, out of its income derived from transactions made on a recognised stock exchange located in any International Financial Services Centre and where the consideration for such transaction is paid or payable in convertible foreign exchange.***

(2) Grossing up of income distributed [Section 115R(2A)]

For the purposes of determining the additional income-tax payable in accordance with section 115R(2), the amount of distributed income shall be increased to such amount as would, after reduction of the additional income-tax on such increased amount at the rate specified in section 115R(2), be equal to the amount of income distributed by the Mutual Fund.

(3) **Time limit to deposit the tax [Section 115R(3)]**

The person responsible for making the payment of income distributed by the UTI or a Mutual Fund and the UTI or the Mutual Fund itself, as the case may be, shall be liable to pay the tax under this provision to the credit of the Central Government within fourteen days from the date of distribution or payment of such income, whichever is earlier.

(4) **No deduction under any other provision [Section 115R(4)]**

No deduction under any provision of the Income-tax Act, 1961 shall be allowed to the UTI or to a Mutual Fund in respect of income, which has been subject to tax under section 115R(2).

Clarification regarding scope of additional income-tax on distributed income under section 115R [*Circular No. 6/2014, dated 11.2.2014*]

Section 115R provides for levy of additional tax on distributed income to unit holders. Some Assessing Officers have taken a view that mutual funds/specified companies are required to pay additional income-tax under section 115R not only on income distributed by way of dividend but also on payments made at the time of redemption/repurchase of units as well as at the time of allotment of bonus units to existing investors.

On these issues, the CBDT has clarified the following –

(i) Section 115R(2) requires payment of additional income-tax at the rates prescribed thereunder in respect of any amount distributed by a specified company or a mutual fund to its unit holders. The income so distributed by such entities constitutes dividend paid to the unit holders and is liable to tax thereunder. However, redemption of units or repurchase of units would not attract levy of tax under section 115R(2) as such income is not in the nature of income "distributed" to the unit holders and hence, lies outside the purview of this section.

(ii) Further, the income so distributed by the mutual fund or the specified company is specifically exempt from tax under section 10(35) in the hands of the recipient unit holders. As per the proviso to section 10(35), exemption of income thereunder is not applicable to those cases where transfer of units take place. The recipient of income is, therefore, liable to pay capital gains tax, if applicable, as per the relevant provisions of the Act, on transfer of such units.

(iii) Also, since issue of bonus units is not akin to distribution of income by way of dividend, the same would not be subject to additional income tax under section 115R. This inference can be drawn from the provisions of section 55, prescribing "cost of acquisition" of bonus shares as Nil for the purposes of computation of capital gains tax.

Thus, in view of the above position, the CBDT has, in exercise of its powers under section 119, clarified that additional income-tax under section 115R(2) is to be levied on income distributed by way of dividend to unit-holders of mutual fund or specified companies. Further, it is specifically clarified that receipts from redemption/repurchase of units or allotment of additional units by way of bonus units would not be subject to levy of additional income-tax thereunder.

(5) Interest on non-payment of tax [Section 115-S]

If the person responsible for making payment of the income distributed by the specified company or a Mutual Fund and the specified company or the Mutual Fund, as the case may be, fails to pay the additional income-tax to the credit of the Central Government within the time allowed under section 115-R, he or it shall be liable to pay simple interest at the rate of 1% for every month or part thereof on such amount of tax which has not been paid or was not paid in time for the period beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

(6) Deemed assesse-in-default [Section 115-T]

If the person responsible for making payment of the income distributed by the specified company or a Mutual Fund and the specified company or the Mutual Fund, as the case may be, fails to pay the additional income-tax to the credit of the Central Government, he or it shall be deemed to be an assessee in default in respect of the amount of tax payable and all the provisions of this Act for the collection and recovery of income-tax shall apply.

(7) Meaning of certain terms

S.No.	Term	Meaning
(a)	Mutual Fund	A Mutual Fund specified under section 10(23D).
(b)	Equity oriented fund	a fund set up under a scheme of a mutual fund specified under section 10(23D) and (i) in a case where the fund invested in the units of another fund which is traded on a recognised stock exchange – I. a minimum of 90% of the total proceeds of such fund is invested in the units of such other fund; and II. such other fund also invests a minimum of 90% of its total proceeds in the equity shares of domestic companies listed on a recognised stock exchange; and (ii) in any other case, a minimum of 65% of the total proceeds of such fund is invested in the equity shares of domestic companies listed on a recognised stock exchange. However, the percentage of equity shareholding or unit held in respect of the fund, as the case may be, shall be computed with reference to the annual average of the monthly averages of the opening and closing figures
(c)	Unit Trust of India	The Unit Trust of India established under the Unit Trust of India Act, 1963.

(d)	Money market mutual fund	A money market mutual fund as defined in clause 2(p) of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 i.e. it means a scheme of a mutual fund which has been set up with the objective of investing exclusively in money market instruments.
(e)	Liquid fund	A scheme or plan of a mutual fund which is classified by the Securities and Exchange Board of India as a liquid fund in accordance with the guidelines issued by it in this behalf under the Securities and Exchange Board of India Act, 1992 or regulations made thereunder.
(f)	***Convertible foreign exchange***	***Foreign exchange which is for the time being treated by RBI as convertible foreign exchange for the purpose of the Foreign Exchange Management Act, 1999 and the rules made thereunder.***
(g)	***Specified mutual fund***	***A mutual fund specified under section 10(23D) located in any IFSC of which all the units are held by non-residents.***
(h)	***Unit***	***Beneficial interest of an investor in the fund.***

12.3 TAXATION REGIME FOR SECURITIZATION TRUSTS AND ITS INVESTORS

(1) Meaning of Securitisation Trust [Clause (d) of *Explanation* below section 115TCA]:

"Securitisation trust" means a trust being a -

	Form	Regulation
(i)	A special purpose distinct entity	SEBI (Public Offer and Listing of Securitised Debt Instrument) Regulations, 2008
(ii)	A special purpose vehicle	The guidelines on securitisation of standard assets issued by RBI
(iii)	A trust setup by a securitisation company or a reconstruction company	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) (or) the RBI directions/guidelines.

(2) Exemption of income of securitisation trust from the activity of securitisation:

The income of securitisation trust from the activity of securitisation shall continue to be exempt under section 10(23DA).

(3) Taxability of income from securitisation trust in the hands of the investor [Section 115TCA(1)]:

Section 115TCA(1) provides that the income accruing or arising to, or received by, a person, being an investor from the securitisation trust, out of investments made in the securitisation trust, shall be taxable in the hands of investor in the same manner as if the investor had made investment directly in the underlying assets and not through the trust.

(4) Nature of income paid or credited by securitisation trust in the hands of the investor [Section 115TCA(2)]:

The income paid or credited by the securitisation trust shall be deemed to be of the same nature and in the same proportion in the hands of the investor of the securitisation trust, as if it had been received by, or had accrued and arisen to, the securitisation trust during the previous year.

(5) Deemed credit to investor [Section 115TCA(3)]:

If the income accruing or arising to, or received by, the securitisation trust, during a previous year has not been paid or credited to the investor, the same shall be deemed to have been credited to the account of the said person on the last day of the previous year in the same proportion in which such person would have been entitled to receive the income had it been paid in the previous year.

(6) Statement specifying the details of nature of income to be furnished to investor and prescribed income-tax authority [Section 115TCA(4)]:

The securitisation trust shall provide breakup regarding nature and proportion of its income and such other relevant details to the investors and also to the prescribed income-tax authority in the prescribed form and verified in the prescribed manner, within the prescribed period.

Rule 12CC - Prescribed period for furnishing the statement containing the details of nature of income paid or credited to the investor by the securitisation trust and to the prescribed income-tax authority under section 115TCA(4) [Notification No. 107/2016, dated 28-11-2016]

Rule 12CC provides that the statement of income distributed by a securitisation trust to its investor has to be furnished to the Principal Commissioner or the Commissioner of Income-tax within whose jurisdiction the principal office of the securitisation trust is situated, **by 30th November of the financial year** following the previous year during which such income is distributed.

Further, the statement of income distributed also has to be furnished to the investor by **30th June of the financial year** following the previous year during which the income is distributed.

(7) **Income taxed in the year of accrual not taxable again in the year of payment [Section 115TCA(5)]:**

Where income has been included in the total income of the investor in a previous year, on account of it having accrued or arisen in the said previous year, the same shall not be included in the total income of such person in the previous year in which such income is actually paid to him by the securitisation trust.

(8) **Deduction of tax at source in respect of income payable to investor [Section 194LBC]:**

Tax deduction at source under section 194LBC shall be effected by the securitisation trust at the time of payment or credit of income to the account of the investor, whichever is earlier.

	Payee	Rate of TDS
(i)	Resident individuals and HUF	25%
(ii)	Resident payees, other than individuals and HUF	30%
(iii)	Non-corporate non-residents and foreign companies	Rates in force

Where any income as aforesaid is credited to any account in the books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and tax has to be deducted at source. The account to which such income is credited may be called "Suspense account" or by any other name.

(9) **Application for low or nil deduction of tax at source:**

The facility for the investors to obtain low or nil deduction of tax certificate would be available; the investor can make an application to the Assessing Officer, and he can, on an application made by the assessee in this behalf, issue a certificate under section 197 in this behalf for no deduction of income-tax or deduction of income-tax at a lower rate.

(10) **Meaning of certain terms:**

Explanation	Term	Meaning
(a)	Investor	Means a person who is holder of any securitised debt instrument or securities or security receipt issued by the securitisation trust
(b)	Securities	Means debt securities issued by a Special Purpose Vehicle as referred to in the guidelines on securitisation of standard assets issued by RBI

12.4 SCHEME FOR TAXATION OF REAL ESTATE INVESTMENT TRUST (REIT) AND INFRASTRUCTURE INVESTMENT TRUST (INVIT) [CHAPTER XII-FA – SECTION 115UA]

(1) The SEBI has notified the regulations relating to two categories of investment vehicles namely, the Real Estate Investment Trust (REIT) & Infrastructure Investment Trust (Invit).

(2) The SEBI (Real Estate Investment Trusts) Regulations, 2014 ("REIT Regulations") provide a framework for registration and regulation of Real Estate Investment Trusts ("REIT's").

Salient features of the REIT Regulations, as approved by the SEBI:

(a) REITs shall be set up as a trust and registered with SEBI. It shall have parties such as Trustee, Sponsor group includes sponsor and Manager.

(b) The trustee of a REIT shall be a SEBI registered debenture trustee who is not an associate of the Sponsor or manager.

(c) REIT shall invest in commercial real estate assets, on a freehold or leasehold basis, either directly or through a holdco and/or special purpose vehicles (SPVs).

In case of investment through a holdco, REIT shall hold or propose to hold not less than 50% of the equity share capital or interest in such holdco. Such holdco in turn would make investments in other SPVs, which ultimately hold the properties. Holdco should not be engaged in any activity other than holding of the underlying SPVs, holding of real estate/properties and any other activities pertaining to and incidental to such holdings.

In such SPVs, a REIT or the holdco shall hold or propose to hold not less than 50% of the equity share capital or interest. Further, such SPVs shall hold not less than 80% of its assets directly in properties and shall not invest in other SPVs. Such SPVs should also not be engaged in any activity other than holding and developing property and any other activity incidental to such holding or development.

(d) Once registered, the REIT shall raise funds through an initial offer. Subsequent raising of funds may be through follow-on offer, rights issue, qualified institutional placement, etc. The minimum subscription size from any investor shall be ₹ 50,000.

(e) Units of REITs shall be mandatorily listed on a recognized Stock Exchange and REIT shall make continuous disclosures in terms of the listing agreement. Trading lot for such units consist of 100 units.

(f) For coming out with an initial offer, the REIT assets shall be of value not less than ₹ 500 crore. Further, minimum issue size for initial offer shall be ₹ 250 crore. Further, the minimum number of unitholders should not be less than 200.

(g) The Trustee shall generally have an overseeing role in the activity of the REIT. The manager shall assume operational responsibilities pertaining to the REIT.

(h) A REIT may have multiple sponsors, subject to each holding at least 5% of the units of the REIT on post-initial offer basis. Such sponsors shall collectively hold not less than 25% of the units of the REIT for a period of not less than 3 years from the date of listing. After 3 years, the sponsors, collectively, shall hold minimum 15% of the units of REIT, throughout the life of the REIT.

(i) Not less than 80% of the value of the REIT assets shall be invested in completed and rent and/or income generating properties.

Upto 20% of the value of REIT assets shall be invested in following :

(1) developmental properties, whether directly or through a company or LLP;

(2) mortgage backed securities;

(3) listed/ unlisted debt of companies/body corporates in real estate sector;

(4) equity shares of companies which are listed on a recognized stock exchange in India which derive not less than 75% of their operating income from Real Estate activity;

(5) unlisted equity shares of companies which derive not less than 75% of their operating income from real estate activity

(6) government securities;

(7) unutilized FSI of a project where it has already made investment;

(8) TDR acquired for the purpose of utilization with respect to a project where it has already made investment;

(9) money market instruments or cash equivalents.

(j) REIT shall distribute not less than 90% of the net distributable cash flows, subject to applicable laws, to its investors, atleast on a half yearly basis.

(3) Likewise, the SEBI (Infrastructure Investment Trusts) Regulations, 2014 ("InvIT Regulations") provide a framework for registration and regulation of Infrastructure Investment Trusts ("InvITs").

(4) The Finance (No.2) Act, 2014 had introduced a special taxation regime for providing the manner of taxability of –

(i) income in the hands of business trusts; and

(ii) income distributed by such business trusts in the hands of the unit holders.

Section 2(13A) defines a business trust to mean a trust –

- registered as an Infrastructure Investment Trust (Invit) under SEBI (Infrastructure Investment Trusts) Regulations, 2014 or as a Real Estate Investment Trust (REIT) under SEBI (Real Estate Investment Trusts) Regulations, 2014 and
- the units of which are required to be listed on a recognized stock exchange in accordance with the aforesaid regulations.

Chapter XII-FA contains the special provisions relating to business trusts. Section 115UA(1) provides that any income distributed by a business trust to its unit holders shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder, as it had been received by, or accrued to the business trust.

(5) Exemption of certain income to business trust [Section 10(23FC)]

Section 10(23FC) exempts any income of a business trust by way of -

- interest received or receivable from a Special Purpose Vehicle (SPV). Thus, the business trust enjoys a pass-through status in respect of interest received or receivable from a SPV; or
- dividend referred to in section 115-O(7) i.e., any income of a business trust by way of dividend received from SPV, being a specified domestic company in which a business trust has become the holder of the whole of the nominal value of equity share capital of the company. Such dividend income is also exempt in the hands of the unit-holder.

"SPV" means any Indian company, -

(i) in which the REIT holds or proposes to hold not less than ***50%*** of the equity share capital or interest;

(ii) which holds not less than 80% of its assets directly in properties and does not invest in other special purpose vehicles; and

(iii) which is not engaged in any activity other than holding and developing property and any other activity incidental to such holding or development;

(6) Exemption of Rental income of REIT from directly owned real estate asset [Section 10(23FCA)]

Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the business trust.

(7) Section 115UA(2) provides that subject to the provisions of sections 111A and 112, the total income of a business trust shall be chargeable to tax at the maximum marginal rate.

(8) Any distributed income referred to in section 115UA received by unit holders is exempt in their hands under section 10(23FD) to the extent it does not comprise of

- interest referred to in sub-clause (a) of section 10(23FC) or
- rental income referred to in section 10(23FCA),

(9) Section 115UA(3) provides that distributed income or any part thereof, which is in the nature of interest income received by the business trust from the SPV [referred to in sub-clause (a) of section 10(23FC)] or rental income from real estate assets owned directly by the REIT [referred to in section 10(23FCA)] is deemed to be the income of the unit holder in the previous year of distribution and subject to tax in the hands of the unit holder in that year.

(10) Any person responsible for making payment of income distributed on behalf of the business trust to a unit holder is required to furnish a statement to the unit holder and the prescribed authority within the prescribed time.

The statement should be in the prescribed form and manner. It should contain the particulars of the nature of income paid during the previous year as well as the other details as may be prescribed [Section 115UA(4)].

Rule 12CA provides that the statement of income distributed by a business trust to its unit holder has to be furnished to the Principal Commissioner or the Commissioner of Income-tax within whose jurisdiction the principal office of the business trust is situated, **by 30th November of the financial year** following the previous year during which such income is distributed.

Further, the statement of income distributed also has to be furnished to the unit holder by **30th June of the financial year** following the previous year during which the income is distributed.

(11) Under section 139(4E), a business trust is mandatorily required to furnish a return of its income or loss in every previous year. All the provisions of the Income-tax Act, 1961 would apply as if it were a return required to be furnished under section 139(1).

(12) The scheme of taxability of income in the hands of the business trust, unit holders, sponsors etc. is briefed in the table given hereunder –

	Transaction	Section	Tax and TDS implications
(1)	Transfer of listed units of the business trust by the unit holders		**Tax implications in the hands of unit holders:** ➢ STT leviable on trading of listed units on a recognized stock exchange;
		2(42A)	➢ The period of holding of units of business trust to qualify as "long-term capital assets" is "more than 36 months";

		112A	➢ Long-term capital gains upto ₹ 1 lakh would be exempt in the hands of the unit-holders; Long-term capital gain exceeding ₹ 1 lakh would be taxable @ 10% plus surcharge, if applicable, and health and education cess @ 4%.
		111A	➢ **Short-term capital gains** would be subject to concessional rate of tax @ 15% (plus surcharge, if applicable, and *cess @ 4%*).
(2)	Exchange of shares in SPV by sponsor for units of Business Trust	47(xvii)	**Tax implications in the hands of the sponsor:** ➢ Such exchange is not treated as a transfer. Hence, taxability of capital gains on such transfer **deferred** to the time of disposal of units by the sponsor;
		112A & 111A	➢ the sponsor would get the same tax treatment on offloading of units under an Initial offer on listing of units as it would have been available had he offloaded the underlying shareholding through an IPO. STT shall be levied on sale of such units of business trust which are acquired in lieu of shares of SPV, under an initial offer at the time of listing of units of business trust in the like manner as in the case of sale of unlisted equity shares under an IPO. The benefit of concessional tax regime of tax @ 15% on STCG and @ 10% on LTCG exceeding ₹ 1 lakh under section 112A shall be available to the sponsor on sale of units received in lieu of shares of SPV subject to levy of STT.
		49(2AC)	➢ For computing capital gains in the hands of the sponsor, cost of acquisition of units would be deemed to be the cost of acquisition of shares to the sponsor;
		2(42A)	➢ For computing capital gains in the hands of the sponsor, the period of holding of units to include the period of holding of shares for determining whether the capital gains is long-term or short-term.

(3)	Interest income of business trust from SPV		**Tax implications in the hands of the business trust & unit holders and TDS implications in the hands of the SPV & business trust**: ➢ Pass-through status for interest received by business trust from SPV:
		10(23FC)	▪ Interest income is not taxable in the hands of the business trust; and
		194A(3)(xi)	▪ SPV is not required to deduct tax at source on interest paid to business trust. ➢ Tax consequences on distribution of such income by the business trust to the unit-holders:
		115UA(3)	The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of interest received or receivable from a SPV is deemed as income of unit holder.
		115A(1)(iiac)	▪ Interest income taxable in the hands of the unit holders – o @ 5%, in case of unit holders, being non-corporate non-residents or foreign companies; and o at normal rates of tax, in case of resident unit holders.
		194LBA	▪ Business trust to deduct tax at source on interest component of income distributed to unit holders at the time of payment or credit of income to the account of the unit holder, whichever is earlier: o @ 5%, in case of unit holders, being non-corporate non-residents or foreign companies; and o @ 10%, in case of resident unit holders.
(4)	Interest payments to non-resident lenders on ECBs by the business trust	194LC	**TDS implications in the hands of business trust**: ➢ TDS @ 5% on interest payments to non-resident lenders on ECBs by the business trust [Such interest would attract tax in the

			hands of the non-resident lenders @ 5% as per section 115A]. ➢ The above concessional rate of TDS is applicable to - moneys borrowed by the business trust in foreign currency from a source outside India – (a) under a loan agreement at any time on or after 1.7.2012 but before 1.7.2020; (b) by way of issue of long-term bonds at any time on or after 1.10.2014 but before 1.7.2020 with the approval of the Central Government and money borrowed by the business trust from a source outside India by way of issue of rupee denominated bond before 1.7.2020.
(5)	Dividend received by the business trust from SPV		**Tax implications in the hands of the SPVs, business trust and unit holders**:
		115-O(7)	➢ Dividend distributed by the SPV to the business trust is exempt from dividend distribution tax by virtue of section 115-O(7), if the SPV is a specified domestic company i.e., domestic company in which the business trust has become the holder of whole of the nominal value of equity share capital of the company.
		10(23FC)(b)	➢ Dividend referred to in section 115-O(7), received by the business trust would be exempt in its hands;
		10(23FD)	➢ The dividend component referred to in section 10(23FC)(b), of income distributed by the business trust to unit holders will be exempt from tax in the hands of unit holders.
		115-O & 10(34)	➢ If the SPV is not a specified domestic company i.e., business trust does not hold whole of the nominal value of equity share capital of the company, then, SPV would be subject to dividend distribution tax u/s 115-O and the dividend upto ₹ 10 lakh

			received by the business trust would be exempt in its hands under section 10(34).
(6)	Capital gains on disposal of assets by the Business Trust	115UA(2)	**Tax implications in the hands of the Business Trust and Unit holders**: ➢ Capital gains is chargeable at the applicable rates in the hands of the Business Trust: ▪ In case of long-term capital gains, the provisions of section 112 would apply; ▪ In case of short-term capital gains on sale of listed shares, the provisions of section 111A would apply; ▪ Short-term capital gains, other than the gains subject to tax under section 111A, would be subject to maximum marginal rate.
		10(23FD)	➢ If such capital gains are further distributed to unit-holders, the component attributable to capital gains would be exempt in the hands of the unit holders.
(7)	Rental income arising to REIT from real estate property directly held by it	10(23FCA)	➢ **Rental income of REIT from directly owned real estate asset** Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the business trust
		194-I	➢ **Rental income received or credited to a REIT** Where the income by way of rent is credited or paid to a business trust, being a REIT, in respect of any real estate asset, owned directly by such business trust, tax is **not** deductible at source.
		115UA(3)	➢ **Distributed income received by unit holder** The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed as income of unit holder.

		194LBA	➢ **Distribution by REIT to unit holders of rental income from real estate assets directly owned by it** ► TDS @ 10% in case of distribution to a resident unit holder. ► TDS at rates in force in case of distribution to a non-resident unit holder.
(8)	Income of business trust [Other than interest and dividend from SPV and capital gains subject to tax u/s 112/ 111A]	115UA(2) 10(23FD)	**Tax implication in the hands of the Business Trust and Unit holders**: ➢ Any other income of the trust is chargeable to tax at the maximum marginal rate (i.e., **@ *42.744%***). ➢ Such income distributed to unit holders would be exempt in their hands.

ILLUSTRATION 7

A business trust, registered under SEBI (Real Estate Investment Trusts) Regulations, 2014, gives particulars of its income for the P.Y.2019-20:

(1) Interest income from Beta Ltd. – ₹ 4 crore;

(2) Dividend income from Beta Ltd. – ₹ 2 crore;

(3) Short-term capital gains on sale of listed shares of Beta Ltd. – ₹ 1.5 crore;

(4) Short-term capital gains on sale of developmental properties – ₹ 1 crore

(5) Interest received from investments in unlisted debentures of real estate companies – ₹ 10 lakh;

(6) Rental income from directly owned real estate assets – ₹ 2.50 crore

Beta Ltd. is an Indian company in which the business trust holds 100% of the shareholding.

Discuss the tax consequences of the above income earned by the business trust in the hands of the business trust and the unit holders, assuming that the business trust has distributed ₹ 10 crore to the unit holders in the P.Y. 2019-20.

SOLUTION

Tax consequences in the hands of the business trust and its unit holders

(1) Interest income of ₹ 4 crore from Beta Ltd.: There would be no tax liability in the hands of business trust due to pass-through status enjoyed by it under sub-clause (a) of section 10(23FC) in respect of interest income from Beta Ltd., being the special purpose vehicle. Therefore, Beta Ltd. is not required to deduct tax at source on interest payment to the business trust.

The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of interest income received or receivable from a SPV is deemed income of the unit holder as per section 115UA(3).

The business trust has to deduct tax at source under section 194LBA –

- @ 10%, on interest component of income distributed to resident unit holders; and
- @ 5%, on interest component of income distributed to non-corporate non-resident and foreign companies unit holders.

Interest component of income distributed to unit holders is taxable in the hands of the unit holders – @ 5%, in case of unit holders, being non-corporate non-residents or foreign companies; and at normal rates of tax, in case of resident unit holders.

The interest component of income received from the business trust in the hands of each unit-holder would be determined in the proportion of 4/11.1, by virtue of section 115UA(1).

(2) **Dividend income of ₹ 2 crore from Beta Ltd.:** The dividend distributed by the SPV to the business trust is exempt by virtue of section 115-O(7), since the SPV is a specified domestic company in which the business trust has become the holder of whole of the nominal value of equity share capital of the company. Further, there would be no tax liability in the hands of the business trust, due to specific exemption provided under sub-clause (b) of section 10(23FC).

Any distributed income referred to in section 115UA, to the extent it does not comprise of interest [referred to in sub-clause (a) of section 10(23FC)] and rental income from real estate assets owned directly by the business trust [referred to in section 10(23FCA)] received by unit holders, is exempt in their hands under section 10(23FD). Therefore, by virtue of section 10(23FD), there would be no tax liability on the dividend component [referred to in sub-clause (b) of section 10(23FC)] of income distributed to unit holders in their hands.

(3) **Short-term capital gains of ₹ 1.50 crore on sale of listed shares of Beta Ltd.:** As per section 115UA(2), the business trust is liable to pay tax @ 15% under section 111A in respect of short-term capital gains on sale of listed shares of special purpose vehicle. There would, however, be no tax liability on the capital gain component of income distributed to unit holders, by virtue of the exemption contained in section 10(23FD).

(4) **Short-term capital gains of ₹ 1 crore on sale of developmental properties:** It is taxable at maximum marginal rate of 42.744% in the hands of the business trust as per section 115UA(2). There would be no tax liability in the hands of the unit holders on the capital gain component of income distributed to them, by virtue of the exemption contained in section 10(23FD).

(5) **Interest of ₹ 10 lakh received in respect of investment in unlisted debentures of real estate companies:** Such interest is taxable @ 42.744%, being the maximum marginal rate, in the hands of the business trust, as per section 115UA(2). However, there would be no tax liability in the hands of the unit holders on the interest component of income distributed to them, by virtue of section 10(23FD).

(6) **Rental income of ₹ 2.50 crore from directly owned real estate assets:** Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the trust as per section 10(23FCA).

Where the income by way of rent is credited or paid to a business trust, being a REIT, in respect of any real estate asset held directly by such REIT, no tax is deductible at source under section 194-I.

The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit holder as per section 115UA(3). The business trust has to deduct tax at source @ 10% under section 194LBA in case of distribution to a resident unit holder and at rates in force in case of distribution to a non-resident unit holder.

The rental income component received from the business trust in the hands of each unit-holder would be determined in the proportion of 2.5/11.1, by virtue of section 115UA(1).

12.5 SPECIAL TAXATION REGIME FOR INVESTMENT FUNDS AND INCOME RECEIVED FROM SUCH FUNDS [CHAPTER XII-FB] [SECTIONS 115UB, 10(23FBA) & 10(23FBB)]

(1) Tax liability of the unit holders:

Any income accruing or arising to, or received by, a person, being a unit holder of an investment fund, out of investments made in the investment fund shall be chargeable to income-tax in the same manner as if it were the income accruing or arising to, or received by, such person had the investments made by the investment fund, been made directly by him [Section 115UB(1)].

Note – *Accordingly, income in the hands of the non-resident investor from off shore investments routed through Category I or Category II AIFs, being a deemed direct investment outside India by the non-resident investor, is not taxable in India under section 5(2) of the Act [Circular No. 14/2019, dated 3.7.2019].*

(2) **Exemption of income of investment fund other than income under the head profits and gains from business and profession [Section 10(23FBA)]**

The Scheme provides for exemption of income, other than income chargeable under the head "Profits and gains of business or profession", in the hands of investment fund. The income in the nature of profits and gains of business or profession shall be taxable in the hands of the investment fund.

(3) **Exemption to unit holder of income under the head "Profits and gains from business or profession" of investment fund [Section 10(23FBB)]**

Income accruing or arising to, or received by, a unit holder of an investment fund, being that proportion of income which is of the same nature as income chargeable under the head "Profits and gains of business or profession" at investment fund level, shall be exempt under section 10(23FBB).

(4) **TDS in respect of income of units of investment fund to unit holders [Section 194LBB]**

Investment fund to deduct tax at source on any income (other than the proportion of income which is of the same nature as income chargeable under the head "Profits and gains of business or profession" which is taxable at investment fund level) payable by the investment fund to a unit holder

- @ 10% in case of payable to a resident unit holder
- at rates in force in case of payable to a non-corporate non-resident or foreign company unit holder

In case of income payable to a non-corporate non-resident or foreign company unit holder, no deduction is to be made in respect of any income that is not chargeable to tax under the Act.

Such tax has to be deducted at the time of credit of such income to the account of the payee or at the time of payment, whichever is earlier.

For this purpose, any such income credited to any account, whether called "suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be the credit of such income to the account of the payee, and the provisions of section 194LBB shall apply accordingly.

(5) **Pass - through status for current year losses**:

If in any year there is a loss under any head of income at the fund level and such loss cannot be or is not wholly set-off against income under any other head of income of the said previous year, then out of such losses, *(i) the loss arising to the Investment Fund under the head "Profits & Gains of Business or Profession" shall not be allowed to be passed through to the investors but has to be carried over at fund level to be set off against income of the next year in accordance with the provisions of Chapter VI*

(ii) loss other than loss under the head "profits and gains from business or profession" would not be allowed be passed through to the investors if such loss has arisen in respect of a unit which has not been held by the unit holder for a period of at least 12 months [Section 115UB(2)].

Note – *By implication, losses other than those referred to in (i) and (ii) above, which cannot be wholly set-off against current year income, would be passed on to the unit holders to be carry forward and set-off in their individual hands in accordance with the provisions of Chapter VI.*

(6) Pass - through status for losses accumulated as on 31.3.2019:

Losses, other than loss under the head "profits and gains from business or profession", if any, accumulated at the level of investment fund as on 31.3.2019, shall be

- *deemed to be the loss of a unit holder who held the unit as on 31.3.2019 in respect of the investment made by him in the investment fund in the same manner as it were the loss incurred by him had he made such investments directly and*
- *shall be allowed to be passed through to the investors for the remaining period calculated from the year in which the loss has occurred for the first time taking that year as the first year and set off against their income in accordance with the provisions of Chapter VI.*

Further, such accumulated losses shall not be available to the investment fund on or after 1.4.2019.

Note – *Even capital loss on sale of units held for less than 12 months, accumulated as on 31.3.2019, would be allowed to be carry forward and set-off by the unit holders.*

(7) Nature of income in the hands of unitholders:

The income paid or credited by the investment fund shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder as if it had been received by, or had accrued or arisen to, the investment fund during the previous year. [Section 115UB(3)].

(8) Tax on total income:

As per section 115UB(4), the total income of the investment fund is chargeable to tax as follows:

Investment Fund	Rate of tax
A company or a firm	Rate or rates specified in the Finance Act of the relevant year (30%/25%, as the case may be, for a company and 30% for firm for A.Y.2020-21)
Other than a company or a firm	Maximum marginal rate

(9) Non-applicability of DDT:

Income paid by an investment fund to its unit holders would not be subject to dividend distribution tax under Chapter XII-D or tax on distributed income under Chapter XII-E [Section 115UB(5)].

(10) Deemed credit on the last day of the previous year:

If the income accruing or arising to, or received by, an investment fund, during a previous year is not paid or credited to the unit-holders, it shall be deemed to have been credited to the account of the unit-holder on the last day of the previous year in the same proportion in which such person would have been entitled to receive the income had it been paid in the previous year [Section 115UB(6)].

(11) Summary:

The following table gives a summary of the above provisions:

	Particulars	Investment Fund	Unit holder
(i)	Income under the head "Profits and gains of business or profession" of the Investment Fund	Taxable	Exempt
(ii)	Income, other than profits and gains of business or profession	Exempt. Tax to be deducted on such income distributed to unit-holders - @ 10% in case of resident payee - at rates in force in case of non-resident payee	Taxable, as if he had directly made the investment.
(iii)	Loss under the head "Profits and gains of business or profession" incurred by the investment fund	To be carried forward for set-off as per Chapter VI at the Fund level	Not passed on to investors
(iv)	*Capital loss on transfer of units (i.e., units held by a unit holder for less than 12 months) – remaining after set-off against capital gains in the current year*	*Not allowed to be carried forward for set-off by the Investment Fund*	*Not allowed to be carried forward by the unit-holder. He cannot set-off such losses against his income.*

(v)	*Losses (other than losses referred to in (iii) and (iv) above) remaining after set-off against current year income.*	*Not allowed to be carried forward for set-off by the Investment Fund*	*Unit-holder can carry forward and set-off such losses against his income as per Chapter VI*
(vi)	*Dividend distribution tax and tax on distributed income*	*Chapter XII-D and XII-E not to apply to income paid to unit holders.*	*-*

Note – *Losses, other than business losses, accumulated at the level of the investment fund as on 31.3.2019 would be deemed to be the loss of the unit holder who held the unit as on 31.3.2019 in respect of the investments made by him in the investment fund, in the same manner as it were the loss incurred by him had he made such investments directly. Such loss can be carried forward by the unit-holder for the remaining period calculated from the year in which the loss had occurred for the first time taking that year as the first year. Accordingly, he can set-off such loss in accordance with the provisions of Chapter VI. The loss so deemed to be the loss of the unit-holder shall not be available to the investment fund on or after 1.4.2019.*

(12) Statement to be furnished:

The person responsible for crediting or making payment of the income on behalf of an investment fund and the investment fund are required to furnish, within the prescribed time, to the person who is liable to tax in respect of such income and to the prescribed income-tax authority, a statement in the prescribed form and verified in the prescribed manner. Such statement should give details of the nature of the income paid or credited during the previous year and such other relevant details as may be prescribed [Section 115UA(7)].

Rule 12CB provides that the statement of income paid or credited by an investment trust to its unit holder has to be furnished to the Principal Commissioner or the Commissioner of Income-tax within whose jurisdiction the principal office of the investment trust is situated, **by 30th November of the financial year** following the previous year during which such income is paid or credited.

Further, the statement of income paid or credited also has to be furnished to the unit holder by **30th June of the financial year** following the previous year during which the income is paid or credited.

(13) Every investment fund has to compulsorily file its return of income or loss under section 139(4F), if it is not required to do so under any other provision of section 139. The provisions of the Act would apply as if such return of income or loss were a return required to be furnished under section 139(1).

(14) Income taxed in the year of accrual not taxable again in the year of payment [*Explanation* 2 below section 115UB]:

It has been clarified that any income which has been included in the total income of the unit holder of an investment fund in a previous year, on account of it having accrued or arisen in the said previous year, would not be included in his total income in the previous year in which such income is actually paid to him by the investment fund.

(15) Meaning of certain terms:

	Term	Meaning
(a)	Investment fund	Any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or a Category II Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012, made under the Securities and Exchange Board of India Act, 1992;
(b)	Trust	A trust established under the Indian Trusts Act, 1882 or under any other law for the time being in force.
(c)	Unit	Beneficial interest of an investor in the investment fund or a scheme of the investment fund and shall include shares or partnership interests.

ILLUSTRATION 8

The following are the particulars of income of three investment funds for P.Y.2020-21:

Particulars	*A*	*B*	*C*
		₹ in lakh	
Business Income		*2*	*(2)*
Capital Gains	*16*	*14*	*(6)*
Income from other sources	*4*	*4*	*8*

Compute the total income of the investment funds and unit-holders for A.Y.2020-21, assuming that:

(1) each investment fund has 20 unit holders each having one unit; and

(2) income from investment in the investment fund is the only income of the unit-holder.

If Investment Fund C has the following income components for A.Y. 2021-22, what would be the total income of the fund and the unit holder for that year?

Business Income ₹ 2 lakh

Capital Gains ₹ 9 lakh

Income from Other Sources ₹ 8 lakh

SOLUTION

Computation of total income of the investment fund for A.Y. 2020-21

Particulars	A	B	C
		₹	
Business Income	Nil	2,00,000	Nil
Total Income	**Nil**	**2,00,000**	**Nil**

Computation of total income of a unit holder of the following Investment funds for A.Y. 2020-21

Particulars	A	B	C
		₹	
Capital Gains	80,000	70,000	-
Income from other sources	20,000	20,000	30,000
Total Income	**1,00,000**	**90,000**	**30,000**

Notes:

(i) The total income of Investment Fund B would be chargeable to tax @30% if the fund is a firm and @ 30%/25%, as the case may, if the fund is a company and at the maximum marginal rate, in any other case.

(ii) In case of Investment Fund C, the business loss of ₹ 2 lakh is set-off against income from other sources of ₹ 8 lakh. Loss of ₹ 6 lakh under the head "Capital gains" cannot be set-off against income under any other head. The same has to be carried forward by the Unit-holder for set-off in the subsequent years, if the units are held for a period of 12 months or more. However, if the units are held for less than 12 months, the loss arising therefrom can neither be carried forward by the investment fund nor by the unit-holders.

(iii) For A.Y.2021-22, the brought forward capital loss of ₹ 30,000 [₹ 6 lakh/20] can be set-off against capital gains of ₹ 45,000 [₹ 9 lakh/20] by the unit-holder, assuming that the period of holding of units is 12 months or more. Otherwise, such capital loss has to be ignored. Business income of ₹ 2 lakh would be taxable in the hands of the Investment Fund. Income from other sources of ₹ 40,000 (₹ 8 lakh/20) would be taxable in the hands of the unit-holders.

12.6 ASSESSMENT OF OTHER ENTITIES

(1) Levy of Alternate Minimum Tax (AMT) on all persons claiming profit-linked deductions, other than companies [Chapter XII-BA–Sections 115JC to 115JF]

(i) Background: The Finance Act, 2011 had introduced the concept of AMT initially in relation to LLPs and accordingly the LLPs were subject to AMT @18.5% of adjusted total income.

Though the concept of Alternate Minimum Tax (AMT) was similar to MAT in case of corporates, however, the tax base in the case of LLPs was the adjusted total income computed as per the Income-tax Act, 1961 and not the book profit computed after making the specified adjustments to the profit as per the profit and loss account prepared in accordance with Schedule VI to the Companies Act, 1956.

The Finance Act, 2012 extended the levy of AMT to certain persons other than companies, in order to widen the tax base *vis-à-vis* profit-linked deductions. Accordingly, any person other than a company, who has claimed deduction under any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" or under section 10AA would be subject to AMT with effect from A.Y.2013-14 [Section 115JEE(1)].

The provisions of AMT would, however, not be applicable to an individual, HUF, AOPs, BOIs, whether incorporated or not, or artificial juridical person, if the adjusted total income of such person does not exceed ₹ 20 lakh [Section 115JEE(2)].

Investment-linked tax deduction claimed under section 35AD also falls within the scope of alternate minimum tax.

(ii) Levy of AMT@18.5% on Adjusted Total Income: Accordingly, where the regular income-tax payable by a person, other than a company, for a previous year computed as per the provisions of the Income-tax Act, 1961 (other than Chapter XII-BA) is less than the AMT payable for such previous year, the adjusted total income shall be deemed to be the total income of the person. Such person shall be liable to pay income-tax on the adjusted total income @ 18.5% [Section 115JC].

(iii) Meaning of Adjusted Total Income: "Adjusted total income" would mean the total income before giving effect to Chapter XII-BA as increased by the deductions claimed, if any, under –

(1) any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes";

(2) section 10AA; and

(3) section 35AD, as reduced by the depreciation allowable under section 32, as if no deduction under section 35AD was allowed in respect of the asset for which such deduction is claimed.

(iv) **Furnishing Report by Chartered Accountant:** Such persons to whom this section applies should obtain a report in the prescribed form from a Chartered Accountant certifying that the adjusted total income and the AMT have been computed in accordance with the provisions of this Chapter. The report has to be furnished on or before the due date of filing of return under section 139(1).

(v) **Levy of AMT@ 9% of Adjusted Total Income in case of a unit located in IFSC:** Where the person subject to AMT is a unit located in an International Financial Services Centre (IFSC) deriving its income solely in convertible foreign exchange, AMT would be leviable @ 9% of Adjusted Total Income, instead of 18.5%.

(vi) **Applicability of Interest and Penal provisions:** Section 115JE specifically provides that "save as otherwise provided in this Chapter, all other provisions of this Act shall apply to a person referred to in this Chapter". Hence, all other provisions relating to self-assessment under section 140A, advance tax, interest under sections 234A, 234B and 234C, penalty etc. would also apply to a person who is subject to AMT.

Tax credit for AMT [Section 115JD]

(i) AMT paid in excess of the regular income-tax payable under the provisions of the Income-tax Act, 1961 for the year would be eligible for credit to be carried forward and set-off against income-tax payable in the later year to the extent of excess of regular income-tax payable under the provisions of the Act over the AMT payable in that year. The balance tax credit, if any, shall be carried forward to the next year for set-off in that year in a similar manner.

Where the amount of tax credit in respect of any income-tax paid in any country or specified territory outside India under section 90 or section 90A or section 91, allowed against the alternate minimum tax payable, exceeds the amount of the tax credit admissible against the regular income-tax payable by the assessee, then, while computing the amount of credit under this sub-section, such excess amount shall be ignored.

In other words, the amount of tax credit in respect of AMT shall not be allowed to be carried forward to subsequent year to the extent such credit relates to the difference between the amount of foreign tax credit (FTC) allowed against AMT and FTC allowable against the regular tax payable by the assessee.

(ii) AMT credit can be carried forward for set-off upto a maximum period of ***15 assessment years*** succeeding the assessment year in which the credit becomes allowable.

(iii) No interest shall, however, be payable on such tax credit.

(iv) If the amount of regular income-tax or AMT is reduced or increased as a result of any order passed under the Income-tax Act, 1961, the amount of tax credit allowed under section 115JD would also vary accordingly.

Tax Credit allowable even if Adjusted Total Income does not exceed ₹ 20 lakh in the year of set-off [Section 115JEE(3)]

The credit for tax paid under section 115JC shall be allowed in accordance with the provisions of section 115JD, notwithstanding the conditions mentioned in sub-section (1) or (2) of section 115JEE. Hence, even if the assessee has not claimed any deduction under section 10AA or section 35AD or Chapter VI-A under the heading "C- Deductions in respect of certain incomes" in any previous year and the adjusted total income of that year does not exceed ₹ 20 lakh, it would still be entitled to set-off his brought forward AMT credit in that year.

Related Provisions

(i) Correspondingly, under section 140A, for determination of self-assessment tax payable, tax credit claimed to be set-off in accordance with section 115JD has also to be reduced.

(ii) Such tax credit allowed to be set-off in accordance with the provisions of section 115JD has to be reduced from the amount of tax on total income determined under section 143(1) or on regular assessment, on which interest under section 234A is leviable for default in furnishing return of income.

(iii) Similarly, section 234B levies interest for default in payment of advance tax, to enable reduction of tax credit under section 115JD while computing "assessed tax".

(iv) Likewise, in section 234C levying interest for deferment of advance tax, such tax credit under section 115JD has to be reduced for computing "tax due on the returned income".

ILLUSTRATION 9

Mr. Rajesh has income of ₹ 45 lakhs under the head "Profits and gains of business or profession". One of his businesses is eligible for deduction @ 100% of profits under section 80-IB for A.Y. 2020-21. The profit from such business included in the business income is ₹ 20 lakhs. Compute the tax payable by Mr. Rajesh, assuming that he has no other income during the P.Y. 2019-20.

SOLUTION

Computation of regular income-tax payable under the provisions of the Act

Particulars	₹
Profits and gains of business or profession	45,00,000
Less: Deduction under section 80-IB	20,00,000
Total Income	**25,00,000**
Tax payable	
Up to ₹ 2,50,000	Nil
5% on next ₹ 2,50,000	12,500

20% on next ₹ 5,00,000	1,00,000
30% on balance ₹ 15,00,000	4,50,000
	5,62,500

Computation of Alternate Minimum Tax (AMT)

Particulars	₹
Total Income as per the Income-tax Act, 1961	25,00,000
Add: Deduction under section 80-IB	20,00,000
Adjusted Total Income	**45,00,000**
AMT = 18.5% × 45,00,000 =	8,32,500

Since the regular income-tax payable as per the provisions of the Act is less than the AMT, the adjusted total income of ₹ 45 lakhs would be deemed to be the total income of Mr. Rajesh and he would be liable to pay tax @ 18.5% thereof. The tax payable by Mr. Rajesh for the A.Y.2020-21 would, therefore, be ₹ 8,32,500 plus health and education cess @ 4%, totaling ₹ 8,65,800.

Mr. Rajesh would be eligible for credit to the extent of ₹ 2,80,800 [₹ 8,65,800 – ₹ 5,85,000 (i.e., ₹ 5,62,500 + 4% cess)] to be set-off in the year in which tax on total income computed under the regular provisions of the Act exceeds the AMT. Such credit can be carried forward for succeeding 15 assessment years.

(2) Assessment of Individuals

The term "individual" as such has nowhere been defined in the Income-tax Act, 1961. Section 2(31), however, states that "person" *inter alia*, includes an individual. In the commonly understood sense of the term, an individual means a human being or a single person. The person may be major, minor, married or unmarried, possessing sound or unsound mind. All the same, he is assessable as an 'individual' and is liable to pay tax, if the total income earned by him during any previous year exceeds the prescribed limit exempted from tax. If an individual who is liable to pay tax for any year dies before he is assessed to tax, his executor, administrator or legal representative is treated as the individual assessee for purposes of assessment of the income of the deceased person. In the case of an individual who is a minor or a lunatic, the assessment of his income will be made on his guardian or the trustee. However, if the incapacitated person has no trustee or guardian or trustee or guardian is a non-resident and cannot be traced, the assessment can be made directly on the minor or lunatic. The rights and duties of all representative assessees are the same as those of the persons they are representing.

(i) **Total income of an individual:** The Total Income of an individual is arrived at after making deductions under Chapter VI-A from the Gross Total Income. As we have learnt earlier, Gross Total Income is the aggregate of the net income computed under the five heads of income, after giving effect to the provisions for clubbing of income and set-off and carry forward and setoff of losses.

(ii) Assessment of a non-resident individual

The manner for computation of total income explained above is also applicable to an individual who is a non-resident during the previous year. The scope of deemed income taxable in the hands of a non-resident as laid down in section 5 is explained in section 9(1) which extends the liability to tax of a non-resident individual in respect of income which although not actually accruing or arising in India deemed to be so accruing or arising, assumes significance in the assessment of non-resident individual. For better understanding of the provisions of section 9, students are advised to refer to Chapter 2 - "Non-resident Taxation in Module 4 of the Study material containing the chapters relating to Part II: International Taxation.

(iii) Flat rate of tax on winnings from lotteries, crossword puzzles etc. [Section 115BB]

Under section 115BB, gross winnings from lotteries, crossword puzzles, races including horse races (other than income from the activity of owning and maintaining race horses), card games and other games of any sort or from gambling or betting of any nature whatsoever shall be chargeable to income-tax at a flat rate of 30% on the gross winnings.

(iv) Special concessions in the case of individuals not being citizens of India

Although basically the law of income-tax is applicable alike to both citizens and non-citizens of India, and there is no difference in the general principles for computing the total income under the Income-tax Act, 1961, however, on a consideration of the peculiar circumstances in which a foreigner might come to or live in India, certain concessions and reliefs are granted to them under section 10(6). These have been discussed in detail in Chapter 2 - "Non-resident Taxation in Module 4 of the Study material containing the chapters relating to Part II: International Taxation.

(v) Exemptions and reliefs available to individuals

The tax exemptions and reliefs available under the Act to individuals in respect of income chargeable to tax fall under the following categories:

(a) Income altogether excluded from the total income, and on which in consequence, no income-tax is payable [Section 10].

(b) Deductions from gross total income both in respect of income, a part of which is not chargeable to income-tax and payments made by the assessee, a part or the whole of which is deductible from the gross total income.

(c) Relief in tax when salary is paid in arrears [Section 89].

(vi) Rebate of tax and relief in certain cases

- **Income from association of persons or bodies of individuals:** If the assessee is a member of an association of persons or a body of individuals (other than a company, co-operative society or society) income-tax shall not be payable by him in respect of any portion of the amount receivable by him from the association or body on which tax has already been paid by the association or body at the maximum marginal rate or any higher rate [Section 86].

  In any other case, the share of member shall form part of his total income.

  Further, if the total income of AOP or BOI is not chargeable to income-tax, then the share of member shall be chargeable to tax as part of his total income.

  For the purposes of this provision in the case of an association of persons which is assessable under section 67A, the members of the AOP whose shares in the income are indeterminate or unknown, will be entitled to receive equal shares in the income of the AOP and the individual share of such member will be determined accordingly.

- **Rebate of income-tax to certain individuals:** Section 87A provides a rebate from the tax payable by an assessee, being an individual resident in India, whose total income does not exceed ***₹ 5,00,000***. Such assessee shall get a tax relief of ***₹ 12,500***. In effect, the rebate would be the tax payable or ***₹ 12,500***, whichever is less.

- **Relief when salary etc. is paid in arrears or in advance [Section 89]:** It has already been explained in the Chapter relating to salaries that arrears or advances of salaries are assessable in the hands of the recipients in the year in which these are received. Consequently, in a financial year, an employee may become chargeable to tax in respect of salary for more than 12 months. Likewise, any payment in the nature of profit in lieu of salary (within the meaning of section 17(3)) is also chargeable in the year of receipt in addition to the normal salary received by the employee. In consequence, the aggregate salary income may become liable to tax at a rate higher than that at which it would otherwise have been assessed. To obviate such a hardship, the Assessing Officer has been empowered to grant relief in appropriate cases, on the employee making an application, in accordance with Rule 21A of the Income-tax Rules, 1962.

  In appropriate cases coming under section 192(2A), where the employer is the Government or a public sector undertaking, co-operative society, local authority, university, institution or body, such employer himself is entitled to take into account the relief under section 89(1).

- **Rates of Surcharge Applicable to Individuals**

  The Finance (No.2) Act, 2019 has levied an enhanced surcharge of 25% and 37%, where the total income of individuals/HUF/AOPs/BoIs exceeds ₹ 2 crores and ₹ 5 crores, respectively. However, vide Press Release dated 24.8.2019, the enhanced surcharge has been withdrawn on tax payable at special rates under section 111A and 112A on short-term capital gains and long-term capital gains arising from the transfer of equity share in a company or unit of an equity-oriented fund/business trust, which has been subject to securities transaction tax. Accordingly, the Taxation Laws (Amendment) Ordinance, 2019, promulgated by the President of India on 20.9.2019, has amended the Finance (No.2) Act, 2019 to give effect to the withdrawal of enhanced surcharge on tax payable under section 111A and 112A [Table containing the rates *of* surcharge *applicable to individuals* is given as **Annexure 2** at the end of this chapter]. *These rates would have effect from A.Y.2020-21, after the Taxation Laws (Amendment) Ordinance, 2019 is passed by the Parliament.*

(3) Assessment of Hindu Undivided Families

(i) **Concept of HUF:** A Hindu undivided family (HUF) is treated as a separate entity for the purpose of assessment under the Income-tax Act, 1961. It is included in the definition of the term "person" under section 2(31). The levy of income-tax is on "every person". Therefore, income-tax is payable by a HUF. "Hindu undivided family" has not been defined under the Income-tax Act. The expression is, however, defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and daughters. (Concept of HUF is already discussed in detail in Chapter 1: Basic Concepts).

(ii) **Assessment of Hindu Undivided family:** The income of a HUF is to be assessed in the hands of the HUF and not in the hands of any of its members. This is because HUF is a separate and a distinct tax entity.

(iii) **Assessment of HUF after partition of HUF [Section 171]:** There are two types of partition. They are –

(a) **Total partition** – is a partition by which the entire family property is divided amongst the coparceners. After the total partition, the HUF ceases to exist as such.

(b) **Partial partition** – is a partition which is partial as regards either the persons constituting the joint family or as regards the properties belonging to the joint family or both. In case of a partial partition as regards persons constituting the joint family, some coparceners may separate from the joint family while the others might continue to remain as part of the joint family. In case of a partial partition as regards the property, there may be a division or severance of interest in respect of some part of the estate of the joint family, while the rest of the estate may continue to remain as property of the joint family.

Effect of partial partitions made after 31st December, 1978: However, partial partitions after 31st December, 1978 are not recognized for tax purposes. If any partial partition has been effected after 31.12.1978, then no claim of such partial partition shall be recorded by the Assessing Officer. Such family will continue to be assessed as if no such partial partition has been effected. Every member of the HUF, immediately before such partial partition, and the HUF shall be jointly and severally liable for any sum payable under the Act. The several liability of a member would be proportionate to the share of joint family property allotted to him on such partial partition.

When a claim of total partition of HUF has been made by any member of the HUF on behalf of the HUF, the Assessing Officer shall inquire into such claim. For this purpose, he shall give notice to all the members of the HUF. Thereafter, the Assessing Officer shall, on completion of inquiry, record a finding as to whether total partition has taken place and if so, the date when such partition was effected.

If partition has been effected in the previous year, the total income of the HUF for the previous year up to the date of partition shall be assessed as income of the HUF. Every member of the HUF, in addition to any tax for which he is separately liable, is jointly and severally liable for payment of tax on such assessed income of the HUF. The several liability of a member would be proportionate to the share of joint family property allotted to him on such partition.

If partition has been effected after expiry of previous year, the total income of the HUF for the previous year shall be assessed as income of the HUF. Every member of the HUF is jointly and severally liable for payment of tax on such assessed income of the HUF.

If partition has already taken place: If the Assessing Officer finds after completion of the assessment of a HUF that the partition has already taken place, the Assessing Officer shall proceed to recover the tax from every person who was a member of the family before the partition.

Every such member of the HUF is jointly and severally liable for payment of tax on such assessed income of the HUF.

(iv) Computation of total income of HUF: The following points should be taken into consideration while determining the total income of HUF -

(a) Income from the transfer of a self-acquired property by an individual to his HUF for inadequate consideration or conversion of the self-acquired property into property of the HUF is not considered as the income of the HUF. It would be included in the income of the individual member who transferred the property to the HUF [Section 64(2)]

(b) Income from an impartible estate is included in the hands of the holder of the estate and not in the hands of the HUF. Even if the impartible estate is owned by the HUF, income from such estate is includible in the hands of the holder of the estate who is the eldest member of the HUF.

(c) Section 10(2) exempts any receipt by an individual as a member of a HUF out of the family income.

(d) If a member of the HUF receives any fee or remuneration as a director or a partner in a company or firm as a consequence of the investment made in such concern out of the funds of the HUF, such fee/ remuneration shall constitute income of the HUF. However, any such fee or remuneration earned by a member of a HUF as a director or partner for services rendered purely in his personal capacity, will be included in the income of the individual member and not the HUF.

(v) Rates of Surcharge Applicable to HUF

The Finance (No.2) Act, 2019 has levied an enhanced surcharge of 25% and 37%, where the total income of individuals/HUF/AOPs/BoIs exceeds ₹ 2 crores and ₹ 5 crores, respectively. However, vide Press Release dated 24.8.2019, the enhanced surcharge has been withdrawn on tax payable at special rates under section 111A and 112A on short-term capital gains and long-term capital gains arising from the transfer of equity share in a company or unit of an equity-oriented fund/business trust, which has been subject to securities transaction tax. Accordingly, the Taxation Laws (Amendment) Ordinance, 2019, promulgated by the President of India on 20.9.2019, has amended the Finance (No.2) Act, 2019 to give effect to the withdrawal of enhanced surcharge on tax payable under section 111A and 112A. The table containing the rates of surcharge applicable to HUFs is given as ***Annexure 2*** *at the end of this chapter. These rates would have effect from A.Y.2020-21, after the Taxation Laws (Amendment) Ordinance, 2019 is passed by the Parliament.*

(vi) Conversion of separate property into property of HUF: However, to the above exemption there is an exception provided by section 64(2). Even though we have discussed this in the appropriate place it will be better to recapitulate.

Before this, let us understand the concept of conversion. Generally, income from self-acquired property of an individual, who is a member of a HUF will be assessed as his personal income and not as the income of the family. However, the individual can convert his separate properties into the property of the HUF. There are no legal formalities to be complied with. These principles have been upheld by various judicial rulings.

It naturally follows that once the assets belonging to the individual are impressed with the character of joint family property, the income arising therefrom, should be assessed as the income of the HUF. However, the deeming provisions of section 64(2) specifically provide that the entire income from the converted property is taxable as the income of the transferor. This provision applies not only to property converted in the above manner but also covers transfer of property by an individual, directly or indirectly, to the family otherwise than for adequate consideration, in other words, gifts. Accordingly, where an individual makes direct or indirect gift of his separate property to the Hindu Undivided family of which he is a member or if he transfers his separate property to his family for less than its fair market value, the provisions of section 64(2) will be attracted and the entire income from such separate property converted into HUF property will be included in the total income of the individual.

(vii) **Business in the personal capacity of the Karta or member:** Where the Karta or any member of a joint family carries on a business on his personal capacity, the income from any such business would constitute his personal income. It does not matter even if the business of the member and of the joint family are identical in nature and size. Suppose the capital for the individual's business is borrowed from the funds of the family what will be the position? Consider the following example.

Example: *A HUF consists of the Karta, his wife, two sons and daughter. The HUF runs a departmental store. One of the two sons is qualified in business administration and the other one is an automobile engineer. Together they start a garage for repairing all types of motor cars. The technical aspects are looked after by the engineer while the general administration is taken care of by the son qualified in business administration. For starting the business the HUF has advanced an interest-free loan of ₹ 50,000. The business is yielding good profits. Now the question arises whether the income from the business should be assessed in the hands of the Hindu undivided family.*

It is obvious that the family, in providing the interest-free loan to the business of the brothers has suffered a detriment. However, the Delhi High Court has laid down the following proposition in this connection in the case of *CIT vs. Charan dass Khanna & Sons (1980) 123 ITR 194 (Delhi)*. If investment plays a minor role and it is primarily the personal efforts, specialised skill and enterprise of the individual coparceners which resulted in the new business being set up and the profits accruing, it may not essentially be said that the income belongs to the HUF. In the given example the good profits are more due to the specialised skills acquired by the two sons in their respective fields. Of course, the capital, got from the family as interest free loan, has its role to play but it is nevertheless a minor one. Therefore, we can say that the income from the business set up by the brothers is assessable in their hands as individuals according to the agreed rate of sharing and not as the income of the family.

The Supreme Court has also upheld this principle in *K.S. Subbiah Pillai vs. CIT (237 ITR 11).* It was held that remuneration received on account of personal qualification and exercise of individual exertion was assessable as individual income and not as income of

HUF. The following principles have been broadly applied by the Supreme Court for determining the character of the receipt by way of remuneration paid to a coparcener:

(i) when the remuneration received by the coparcener though not in form but in substance was one of the modes of return made to the family because of investment of the family funds, it has to be assessed as the income of Joint Hindu Family.

(ii) when the remuneration is not paid to the detriment of the family funds, it is assessable as the income of recipient Karta or coparcener as an individual.

(iii) when it is a compensation for the services, skill or labour of the coparcener, it has to be assessed as the income of such a coparcener in his individual capacity.

Example: *The Karta of a HUF receives salary in his capacity as a treasurer and secretary of a bank. The HUF has furnished ₹ 1,00,000 as security deposit. Decide whether the salary can be assessed as the income of the HUF.*

The position of treasurer and secretary requires considerable personal skill and integrity on the part the incumbent. It is true that the security deposit might have been furnished by the HUF, however, since the salary is paid to the Karta primarily for the exercise of his personal skill and integrity, it is to be assessed as his individual income.

Hence, students should carefully understand the following:

(a) Where the funds of a HUF are invested in a company or a partnership firm, the dividends or share of profits are generally taxable as the income of the family. In such a case the fee, salary, commission or other remuneration received by the Karta, or any member of the family, in his capacity as director or partner would also be taxable as income of the family. The reasons for this treatment are as follows:

  (1) The income is earned by the detriment to the joint family funds.

  (2) It is earned with the aid of joint family funds.

  (3) There is real and sufficient connection between the investment of the joint family funds and the income by way of remuneration earned.

(b) However, where the income is earned by the karta or any other member of the family by the exercise of the personal skill, the income should be assessed in their individual hands even if some detriment is caused to the family funds, say, by way of loan, guarantee etc. whose role is only secondary.

(viii) Members of HUF and Partnership firms: A Hindu undivided family can become a partner in a firm. However, since it has no separate legal entity of its own, its Karta alone can be partner in the firm representing the family. The coparcenery has no place in the partnership.

When the Karta of joint Hindu family enters into a partnership with strangers, the member of the family do not, *ipso facto,* become partners in that firm. They have no right to take part in its management or to sue for its dissolution. The creditors of the firm are entitled to proceed against the joint family assets including the shares of the non-partner coparceners for their debts. This is because under Hindu Law, the Karta has the right when carrying on business to pledge the credit of the joint family to the extent of its assets. The liability on the part of other members of the HUF arises by reason of their status as coparceners and not by reason of any contract of partnership by them.

Partnership between Karta representing family and Coparcener: A Karta of a HUF representing the family on the one hand, and a member of that family in his individual capacity on the other, can enter into a valid partnership. An individual coparcener, while remaining joint, can possess, enjoy and utilise in any way he likes, property which is his individual property. Therefore, when he enters into partnership with the family he retains his share and interest in the property of the family while he simultaneously enjoys the benefit of his separate property and fruits of its investment.

(ix) **Salary paid to Karta for managing the family's business:** If remuneration is paid to the Karta of Hindu undivided family under a valid agreement which is *bona fide* and in the interest of and expedient for the business of the family and the payment is genuine and not excessive, such remuneration would be an expenditure laid out wholly and exclusively for the purpose of the business of the family and would be allowable as an expenditure.

(x) **Salary paid to member:** A Hindu undivided family can be allowed to deduct salaries paid to member of the family if the payment is made as a matter of commercial or business expediency, but the service rendered must be to the family.

(xi) **Gifts by HUF:** A HUF as such is incapable of making a gift to any of its member. However, the Karta of a HUF has power to gift out of joint family property for certain approved purposes. The gift should be reasonable. For example, a father may make a gift of the ancestral moveable properties of the joint family, of which he is the Karta, for the purpose of discharging duties prescribed by Hindu Law. The income of the joint family will stand reduced to the extent to the income arising out of the assets thus gifted out.

(xii) **Gifts to HUF:** Can an outsider make a gift to HUF? Under what circumstances will a gift made by an outsider be considered as a gift to the HUF? The answers to these questions are as follows:

(a) If the HUF to which such a gift is made consists of only one coparcener, then the gifted property can be held by the members of the family only as tenants-in-common, i.e., the income arising out of such gifted property can be assessed as income in the hands of the Association of Persons (AOP).

(b) If the HUF to which such a gift is made consists of minimum two coparceners, then the gifted property can be held by the members of the family as joint tenants and the income arising out of such gifted property can be assessed as income in the hands of the joint Hindu family.

Section 56(2)(x) provides that any sum of money or value of property received by a HUF without consideration would be chargeable to income-tax under the head "Income from other sources", if the aggregate value or in case of immovable property stamp duty value of the property exceeds ₹ 50,000 during a year. However, a sum received by a HUF from its relative, i.e., a member of the HUF, is exempt. For details, refer Chapter 8 on "Income from other sources".

ILLUSTRATION 10

Mr. Ram (aged 56) is Karta of his HUF. The HUF consists of himself, his wife and two sons viz. Mr. C (aged 28) and Minor D (aged 16). The HUF is assessed to income tax and has business income from the year 2010-11 onwards. The business income of HUF for the year ended 31.3.2020 is ₹ 5,00,000 (computed). Mr. Ram is employed in a private company and his salary income for the same period is ₹ 6,10,000 (computed).

You are requested to answer the following treating each of them as independent situations:

(i) Mr. C gave cash gift of ₹ 1,00,000 to the HUF of Mr. Ram. What would be the total income of HUF?

(ii) The HUF has one house property fetching rent of ₹ 10,000 per month and some movable assets. There is a proposal to make a partial partition of HUF by allotting the house property to Mr. C. Is it advisable to do a partial partition?

(iii) Minor D earned ₹ 70,000 by use of his special skill and talent. How would his income be taxed?

(iv) A car owned personally by Mr. Ram was blended with HUF during the year. It was leased out for a monthly rent of ₹ 10,000 from 1-10-2019. How would this income be taxed?

SOLUTION

(i) Cash gift of ₹ 1 lakh by Mr. C, Ram's major son, to the HUF of Mr. Ram would not be taxable in the hands of the HUF, since gifts from a relative of the HUF does not fall within the scope of income taxable under section 56(2)(x). Since Mr. C, being Mr. Ram's son, is a member of Ram's HUF, he is a relative of the HUF. Hence the total income of HUF would be ₹ 5 lakhs, being the business income computed.

Note *- Salary income of Mr. Ram, the Karta of the HUF, who is employed in a private company would be taxed in his individual hands, since the remuneration earned by the Karta on account of the personal qualifications and exertions and not on account of the investment of the family funds cannot be treated as income of the HUF.*

(ii) Partial partition (after 31.12.1978) is not recognized and the HUF, which has been hitherto assessed to tax, shall continue to be liable to be assessed as if no such partial partition has taken place [Section 171(9)].

The rental income in this case would continue to be assessed in the hands of the HUF, even after partial partition. Therefore, it is not advisable to do a partial partition.

(iii) Income of ₹ 70,000 earned by Minor D by use of his special skill and talent would be taxable in his individual hands. It will not be included in the hands of his parent by virtue of the exception to section 64(1A) contained in the proviso to section 64(1A).

(iv) As per section 64(2), where a member of the HUF blends his self-acquired property for inadequate consideration with the HUF, income derived therefrom is deemed to arise to the transferor-member and not to the HUF. In this case, Mr. Ram has blended his personal property (i.e., car) with the HUF.

Since there is no consideration in case of blending, the income from car computed in the prescribed manner, [which can be as per the presumptive provisions or lease rental of ₹ 60,000 (₹ 10,000 × 6 months) less depreciation] would be deemed as the income of Mr. Ram.

(4) Assessment of Local Authority

(i) **General meaning:** The expression "local authority" has not been defined by the Income-tax Act, 1961. A local authority is a person under section 2(31) of the Income-tax Act, 1961, and thus, constitutes a separate unit of assessment. It is chargeable to tax on its total income in respect of the previous year, computed in accordance with and under the basic provisions of the Act, which apply to other taxable entities and for all purposes of the Act, this entity is included in the term 'person'. All municipal corporations, or councils, committees, panchayat boards, port trusts, district boards and other authorities legally entitled to or entrusted by the Central or State Government with the control and/or management of a municipal or local fund are covered by the expression 'local authority'.

(ii) **Exemptions:** Under section 10(20), the income of a local authority which is chargeable to tax under the heads 'Income from house property,' 'Capital gains' and 'Income from other sources' accruing or arising to it anywhere in or outside India and income from a trade or business carried on by it which accrues or arises to it from the supply of a commodity or service with its own jurisdiction area or from the supply of water or electricity within or outside its own jurisdictional area are totally exempt from tax.

In other words, a local authority is taxable only in respect of the income arising to it from any business carried on by it provided that such income arises from the supply of any commodity or service, not being water or electricity outside its jurisdictional area, i.e., territorial limits.

A local authority is said to be resident at the place where the control and management of its affairs are situated and its residential status is governed by section 6(4). A local authority in India is always resident in India, except where the control and management of its affairs is exercised wholly from outside India.

(iii) **Tax rate:** After total income, i.e., the income of a local authority chargeable to tax has been determined, the whole of it would attract tax at the rate applicable i.e., the one prescribed by the relevant Finance Act. There is no minimum amount exempt from tax in the case of a local authority. For income tax purposes, local authority is chargeable to tax on the whole of its income at 30%. Surcharge ***@ 12%*** is applicable where total income exceeds ₹ 1 crore. *Health and Education cess @ 4%* have to be added to the income-tax and surcharge, wherever applicable.

(5) Assessment of firms/ LLPs and their partners

A firm is to be assessed as a unit and the share income from the firm in the hands of the partners is exempt. There is no need for registration.

(i) General: Meaning of terms 'firm', 'partner' and 'partnership' has already discussed in Chapter 1: Basic Concepts. Under section 2(23) of the Income-tax Act, 1961, the terms 'firm', 'partner' and 'partnership' have the same meanings respectively as have been assigned to them under the Indian Partnership Act, 1932, but the expression 'partner' also includes any other person who being a minor, has been admitted to the benefits of an existing partnership. In addition, the definitions also include the terms limited liability partnership, a partner of limited liability partnership as they have been defined in the Limited Liability Partnership Act, 2008.

A firm though not a legal person or juridical entity, is chargeable to tax as a separate entity distant from the partners and the partners are assessable as individuals and not as an association persons or body of individuals. The term 'firm' as used in the Act covers both registered and unregistered firms.

The residential status of a firm to be determined depending upon the fact whether or not the control and management of its affairs is exercised from within India. Even if the negligible part of the control and management is exercised from within India, the firm would be resident in India for all the purposes. For determining the residential status of a firm, it is immaterial to ascertain the residential status of partners thereof because a firm may be resident even in cases where all the partners are not resident in India and they control or manage the affairs from India.

Every firm is liable to pay tax flat rate of 30% on its total income of the previous year computed in accordance with the provisions of the Act, ***plus*** surcharge @ 12% if its total income exceeds ₹ 1 crore***,*** *plus* health and education cess@4%.

The following are the salient features of assessment of partnership firms:

(a) The firm will be taxed as a separate entity. There will be no distinction between registered and unregistered firm.

(b) The share of the partner in the income of the firm will not be included in the hands of the partner. It will be exempt under section 10(2A).

(c) Any salary, bonus commission or remuneration, by whatever name called, which is due to or received by a partner will be allowed as a deduction subject to certain restrictions.

(d) Where a firm pays interest to any partner, the firm can claim deduction of such interest from its total income subject to certain conditions. However, the maximum rate at which interest can be allowed to a partner will be 12% per annum.

(e) The income of the firm will be taxed at a flat rate of 30% plus surcharge **@ 12%** if its total income exceeds ₹ 1 crore plus health and education cess @ 4%.

(ii) Partnership Firm Assessed As Such (PFAS) [Section 184]

♦ **Conditions to be fulfilled:**

To get the status of PFAS, the firm should be evidenced by an “instrument”. The word “instrument” means a document of legal nature by which any right or liability is created, limited, extended, or extinguished.

Instrument does not necessarily mean a regular partnership deed, but it may constitute any other relevant document. If the terms of a partnership are contained in a number of documents or in the correspondence between the parties, the documents or letters would constitute “instrument” for the purposes of section 184(1)(i).

The next condition is that the individual shares of partners must be specified in the instrument. A firm cannot get the status of PFAS unless the instrument of partnership specifies the individual shares of partners in the profits of the partnership. Evidence regarding the shares of partners should be available within the framework of the instrument. It should not involve searching of a number of documents.

The next condition is that a certified copy of the instrument should accompany the first return of income of a firm. As already noted “instrument” in this sense refers not only to the partnership deed but also other documents from which the existence of partnership can be proved. Accordingly, certified copies of all documents will have to be submitted. Section 184 requires that the copy of the instrument shall be certified in writing by all partners other than minors. If, however, the return is made after the dissolution of the firm, it should be certified by all partners other than minors who were partners in the firm immediately before dissolution and by the legal representative of any such partner who is deceased. The certified copy of the instrument of partnership shall accompany the return of income of the firm of the previous year relevant to the assessment year.

If there is any change in the constitution of the firm or profit-sharing ratio during any previous year, a certified copy of the revised instrument of partnership should be filed along with the return of income of the relevant assessment year. Even if there is a change in remuneration/payment of interest to partners but there is no change in profit sharing ratio, a copy of the revised instrument of partnership should be submitted along with return to comply with the provisions of section 40(b).

Section 184(5) provides that where the firm commits any default as mentioned in section 144, the firm shall be assessed as a firm and not as an AOP. However, no deduction for payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by the firm to any partner shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession". However, the interest, salary, bonus, commission or remuneration so disallowed shall not be charged to tax in the hands of the partners under section 28(v).

♦ **Computation of income of partnership firm**: While computing the income of a firm assessed as such, we have to keep in mind the following points:

(a) Remuneration is to be allowed

(b) Interest is to be allowed

(c) Unabsorbed depreciation and other losses should be provided for.

♦ **Remuneration paid to partners**: First let us discuss the question of deduction of remuneration to the partners. In this context we have to remember the conditions prescribed by section 37 as regards the allowability of residuary expenses. Accordingly, no capital expenditure or personal expenses will be allowed. Further the remuneration paid must be only and exclusively for the purposes of the business of the firm. Apart from the general conditions prescribed in section 37 there are certain specific conditions prescribed by section 40(b).

They are as follows: -

(1) Such remuneration should be paid only to the working partner.

(2) It should be authorised by the partnership deed.

(3) It should not pertain to a period prior to partnership deed.

(4) It should not exceed the permissible limit.

Payment should be to a working partner:

Explanation 4 to section 40(b) defines working partner as one who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner. This definition is very general. It seems that a partner can be a working partner in more than one firm. If a partner is employed somewhere else too, he can still be a working partner in the firm. However, in all such situations the partner must infact be a working partner in the firm. In other words, merely because a person is working somewhere else too, such a fact does not by itself debar him from being a working partner in a firm in which he is a partner. As stated before, to *be a working partner, the partner has to be actively engaged in conducting the affairs of the business or profession of the firm. Now in order to be actively engaged in conducting the affairs of the business or profession does not require either expressly or by implication that the concerned partner should be so actively engaged in conducting the business affairs on a full-time basis. A partner can be said to be actively engaged in conducting the affairs of the firm even if he devotes a part and not the whole of his working hours.*

Further, in order to be actively engaged in the affairs, a partner is not expected to be engaged in the whole of the affairs of the business of the firm, nor is he expected to know everything about the affairs of the business of the firm. For example, in a firm with many partners, one partner may be looking after purchases, another after sales and another after production and still another after administration, finance and accounts. It cannot be contended that just because they are not overall incharge, they cannot be considered as working partner.

Another significant point to be noted here is that the definition of "working partner" in *Explanation 4* contemplates an individual. Therefore, a partner other than an individual (example a company) cannot be working partner. An interesting situation may be considered here. When a company is a partner in a firm, a director or shareholder of the company can very well be an employee of the firm in which the company is a partner. Any salary/ remuneration paid by the firm to such an employee would be totally outside the ambit of disallowance under section 40(b). This would be so because the individual who is an employee of the firm is not a partner in the firm. It is the company in which he is the director which is the partner and, section 40(b) contemplates allowance of remuneration paid by a firm to its partners and not to other employees.

It should be authorised by the Partnership Deed:

Any payment of salary, bonus, commission or remuneration by whatever name called to a working partner is not allowed as a deduction if the payment is not authorised by partnership deed or it is not in accordance with the terms of partnership deed. As a result, a mere general authority in the partnership deed that such and such working partners would be paid remuneration as may be agreed upon between the partners from time to lime will not be sufficient. The partnership deed will have to contain clear direction as to the quantum of remuneration to be paid to the working partners. For example, such remuneration may be specified by way of annual fixed payment or as a certain specified percentage of the firm's book profit at the year end. It may be noted that such remuneration need not be paid on a monthly basis. An item like commission can be paid even as a percentage of sales. Remuneration also can be a yearly payment.

Now, a question arises whether the names of individual working partners should be specified in the partnership deed or whether it is sufficient if the total remuneration payable to the working partners as a whole is indicated. One opinion is that it is not necessary that the individual partners should be identified or designated. It will be sufficient to lay down an authorisation in the deed to the effect that remuneration will be payable to the class of working partners up to so and so percentage of the book profit. And further that, within such limits the working partners shall share such remuneration in any ratio as may be agreed upon. In other words this concept gives recognition to the working partners as a class and authorising remuneration for the class rather than identifying or designating individual working partners and authorising remuneration for each individual working partner. There is nothing in the section 40(b) which prohibits this type of interpretation. However, in order to avoid litigation, it is better that the deed identifies and designates the working partners as well as the remuneration payable to them.

As a result of this stipulation, every firm constituted on or after April 1, 1992 will have to provide for an appropriate clause in its partnership deed satisfying this requirement. However, so far as the existing firms are concerned, they will have to execute a supplementary deed or a deed of change in the constitution so as to incorporate a clause within the deed of partnership relating to payment of remuneration to its working partners.

It should not pertain to period prior to partnership deed:

By virtue of a further restriction contained in 40(b)(iii), such remuneration paid to the working partners will be allowed as deduction to the firm from the date of such partnership deed and not from any period prior thereto. Consequently, if for instance a firm incorporates the clause relating to payment of remuneration to the working partners by executing an appropriate deed as on July 1st, but effective from April 1st, the firm would get deduction for the remuneration paid to its working partners from July 1st onwards but not for the period from April 1st to June 30th. In other words, it will not be possible to give retrospective effect to oral agreements entered into *vis-a-vis* such remuneration prior to putting the same in a written partnership deed.

Example: A and B entered into partnership agreement on April 1, 2019. As per the deed, each of them will be entitled to salary of ₹2,000 per month apart from profit. On August 1, 2019, they executed a supplementary deed by which they increased the remuneration to ₹3,000 each effective from 1st April 2019. Discuss the validity of the supplementary deed.

Remuneration will be payable effective from the date of the deed which provides for the payment of such remuneration. In the given case, the original deed provides for remuneration at the rate of ₹ 2,000 for each partner from April 1, 2019 onwards. The supplementary deed is executed on August 1, 2019 increasing the limit of remuneration. Such increase in the limit of remuneration will be allowable only from 1st August 2019, being the date of supplementary deed. Hence, for the period from 1st April 2019 to 31st July 2019, the partners will be allowed remuneration only at the rate of ₹ 2,000 per month.

It should not exceed the permissible limit:

As we have seen earlier, salary, bonus, commission or other remuneration may be paid to any working partner in accordance with and as authorised by the terms of the partnership deed and in relation to any period falling after the partnership deed. However, the maximum amount of such payment to all the partners during the previous year should not exceed the limits given below:-

Book Profit	Quantum of Deduction
On the first ₹ 3 lakh of book profit or in case of loss	₹ 1,50,000 or 90% of book profit, whichever is higher
on the balance of book profit	60% of book profit

Book Profit:

The permissible remuneration is to be computed as a percentage of book profit. For this purpose we have to draw up the profit and loss account and find the net profit. This profit and loss account is to be prepared in the manner laid down in Chapter IV-D. It may be noted that Chapter IV-D contains the provisions relating to computation of income under the head 'Profits and gains of business or profession'. Further, *Explanation 3* also lays down that if while arriving at the above net profit, the remuneration paid/payable by a firm to its partners is debited to such a profit and loss account, the aggregate of such remuneration paid/payable to the partners shall be added to the net profit in order to arrive at the book profit.

When the Act says that the profit and loss account should be prepared in the manner laid down in Chapter IV-D, it means that only those items which are chargeable under section 28 as income will be taken into account and only deductions permissible thereunder will be allowed. For example, rent from house property, dividend, interest on bank deposit or government securities are not chargeable as income from business or profession under section 28. Therefore, if the profit and loss account of a firm contains these above receipts, they have to be excluded while calculating the net profit. In the same way, items which are to be disallowed under the various provisions from sections 28 to 44D will have to be eliminated. It naturally follows, therefore, that brought forward business losses will not be deducted while calculating book profit.

The above table shows the upper limits up to which deduction is allowed to firm in respect of the remuneration paid to its working partners. It does not mean that a firm is prohibited from paying remuneration beyond these limits. A firm can pay remuneration to working partners beyond these limits but it will suffer disallowance in respect of such excess under section 40(b) and consequently pay tax on it @ 30%. If a firm pays remuneration to non-working partners, the same will be the result. However, the above limits apply to the remuneration paid to the group of all working partners in a firm taken together and not to each individual partner. Finally, it may be noted that section 40(b) does not compel a firm to pay remuneration to its working partners. It is purely at the discretion of the firm. However, once a firm pays remuneration to its working partners it will be subject to the restrictive provisions of section 40(b). It is also open to a firm to pay salary only to a few working partners and not all the working partners.

- **Interest payable to partners:** So far as allowability of interest paid by a firms to its partners under section 40(b) is concerned, the following conditions have been prescribed by section 40(b):

  (1) The interest payable by a firm to its partners should be authorised by and in accordance with the partnership deed.

  (2) The interest payable by a firm to its partners should not be for a period falling prior to the date of such partnership deed authorizing the payment of such interest.

  (3) The rate of interest payable to the partners shall not exceed 12% simple interest per annum.

  Apart from the above conditions the conditions prescribed by section 36(1)(iii) and section 40(a)(i) should also be satisfied. Section 36(1)(iii) provides that the amount of interest paid in respect of capital borrowed must be for the purposes of the business or profession. Section 40(a)(i) provides that any interest which is payable outside India or in India to a non-corporate non-resident or to foreign company will not be allowed as a deduction unless tax has been deducted therefrom.

  An important question could be regarding the amount with reference to which this interest @ 12% will have to be calculated. For example, a partner may have contributed capital to the firm and in addition may also advance loan to the firm. The question would be whether the interest paid by the firm on capital would be allowable or that on the loan would be allowable. Moreover, some firms have an accounting system of maintaining current accounts of partners in addition to the capital accounts. When some balance is standing to the credit of a partner in such current account as well the question arises whether the interest paid on the balance in the current account will be allowable within the meaning of section 40(b).

In this regard, it may be noted that section 40(b) does not refer to nor does it make any distinction between the capital contributed by a partner to the firm, the loan advanced by a partner to the firm or the balance in the current account of a partner. Therefore, the interest paid by a firm to its partners on the credit balance standing in all the accounts/whether in capital account, loan account or current account, shall be allowed as deduction to the firm under section 40(b). The idea seems to be to allow interest on the funds employed in the firm by a partner.

As it happens, many a time, a partner may have debit balance in his current account and credit balance in his capital account or loan account. The question which would arise in such a situation could be whether the interest payable to such a partner at the rate of interest authorised by and in accordance with partnership deed will be reckoned with reference to the aggregate of the credit balance in the capital account and the loan account including the debit balance in the current account or whether it should be calculated on the net balance that is the aggregate of the credit balance in the capital account and in the loan account as reduced by the debit balance in the current account. It appears that in such a situation the equitable principle would be to allow interest reckoned with reference to the net balance. Alternatively, if interest is recovered from a partner on the debit balance in his account and interest is paid to the same partner on the credit balance in his account, the net amount paid to that partner would be subjected to the provisions of section 40. However, interest received from one partner cannot be set-off against interest paid to another partner under this proviso.

The next issue which is to be considered here is the point of time at which interest should be credited to the partners' accounts. For example, a firm may adopt a policy of crediting interest quarterly to the credit of the partners' accounts. In such a case, the firm would be paying in effect interest on interest at the year end. This would amount to compounding interest quarterly. This is not permitted under section 40(b) because what that section contemplates is simple interest and simple interest here would mean interest which is calculated yearly or annually. Paying the interest on interest credited periodically during a year would be contrary to the concept of simple interest per annum.

ILLUSTRATION 11

M/s. HIG, a firm, consisting of three partners namely, H, I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1.4.2010. H, I and G were partners in their individual capacity.

The deed of partnership provided for payment of salary amounting to ₹ 1,25,000 each to H and G, who were the working partners. A new deed of partnership was executed on 1.10.2019 which, apart from providing for payment of salary to the two *working partners as mentioned in the deed of partnership executed on 1.4.2010, for the first time provided for payment of simple interest @ 12% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2019.*

The firm was dissolved on 31.3.2020 and the capital assets of the firm were distributed among the partners on 20.4.2020. The net profit of the firm for the year ended 31.3.2020 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was ₹ 1,50,000:

(i) Interest amounting to ₹ 1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from 1.4.2019 to 31.3.2020.

(ii) Interest amounting to ₹ 50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2019 to 31.3.2020.

(iii) Interest amounting to ₹ 20,000 paid to the Hindu undivided family of partner H @ 18% per annum.

(iv) Payment of ₹ 25,000 towards purchase of television sets (stock in trade) made by crossed cheque on 1.11.2019.

(v) ₹ 30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.

(vi) Depreciation amounting to ₹ 15,000 on motor car bought and used exclusively for business purposes, but registered in the name of partner 'H'.

(vii) Depreciation under section 32(1)(ii) amounting to ₹ 37,500 of new machinery bought and installed for manufacture of pens on 1.11.2019 at a cost of ₹ 5,00,000.

(viii) Interest amounting to ₹ 25,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

(a) Closing stock-in-trade was valued at ₹ 60,000 as per the method of lower of cost or net realizable value consistently followed by it. The net realizable value of the closing stock-in-trade was ₹ 65,000.

(b) Brought forward business loss relating to the assessment year 2019-20 was ₹ 50,000.

(c) The fair market value of the capital assets as on 31.3.2020 was ₹ 20,00,000 and the cost of their acquisition was ₹ 15,00,000.

Compute the total income of M/s. HIG for the assessment year 2020-21.

You are required to furnish explanations for the treatment of the various items given above.

SOLUTION

Computation of total income of M/s. HIG for the A.Y. 2020-21

Particulars	₹	₹
Net profit as per profit & loss account		1,50,000
Add: Interest to partners on capital accounts for the period from 1.4.2019 to 30.9.2019 disallowed (total interest ₹ 1,00,000 but deduction limited to 6 months only hence 50% thereof is deductible and the balance is added) **[Note (i)]**	50,000	
Interest to partners on current accounts from 1.4.2019 to 31.3.2020 – not authorized by the deed, hence disallowed **[Note (ii)]**.	50,000	
100% of ₹ 25,000 paid towards purchase of television sets otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account ***or through such other electronic mode as may be prescribed*** (being stock in trade, hence disallowed) **[Note (iv)]**.	25,000	
Difference on account of valuation of closing stock-in-trade at market value (₹ 65,000 less ₹ 60,000) [Note (ix)]	5,000	
Salary paid to working partners considered separately.	2,50,000	3,80,000
		5,30,000
Less: Additional depreciation on new machinery (₹ 5,00,000 x 20%) = ₹ 1,00,000. Only 50% is allowable as deduction. **[Note (vii)]**		50,000
		4,80,000
Less: Interest received from bank on fixed deposits considered separately		25,000
		4,55,000
Less: Salary to working partners -		
(i) As per limit in section 40(b)		
On first ₹ 3,00,000 @ 90%	2,70,000	
On the balance of ₹ 1,55,000 @ 60%	93,000	
	3,63,000	
(ii) Salary actually paid	2,50,000	

Deduction allowed being (i) or (ii) whichever is less		2,50,000
		2,05,000
Less: Business loss relating to assessment year 2019-20 set off		50,000
Income from business		**1,55,000**
Income from other sources		
Interest received from bank on fixed deposits **[Note (viii)]**.		25,000
Total Income		**1,80,000**

Notes:

(i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2019 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2019. Interest for the period prior to 1.10.2019 is not allowed.

(ii) The partnership deed of 1.10.2019 provides for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in *Novel Distributing Enterprises v. DCIT (2001) 251 ITR 704 (Ker)*, on identical facts, held that interest paid to the partners on their current account balances is not allowable.

(iii) Since H is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner H does not attract disallowance under section 40(b)(iv).

(iv) Section 40A(3) provides for disallowances @ 100% of the expenditure incurred otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account ***or through such other electronic mode as may be prescribed***. Since the firm has made payment of ₹ 25,000 towards purchase of television sets by a crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.

(v) Gold jewellery valued at ₹ 30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business. Since it has already been credited to profit and loss account, no further adjustment is required.

(vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in *Mysore Minerals Ltd. v. CIT (1999) 239 ITR 775*.

(vii) The firm is entitled to additional depreciation @ 20% under section 32(1)(iia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e. it is restricted to 10%. The balance additional depreciation can be claimed in the immediately succeeding financial year.

(viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.

(ix) As per para 24 of ICDS II: Valuation of Inventories, closing stock has to be valued at net realizable value in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the net realizable value of ₹ 65,000. Since it has been valued at ₹ 60,000, being the cost, the balance ₹ 5,000 has to be added.

(x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners constitutes book profit as per *Explanation 3* to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2019-20 is not considered for calculation of book-profit.

(xi) Section 45(4) is not applicable to the firm for the assessment year 2020-21, though the dissolution of the firm took place on 31.3.2020, as there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 20.4.2020. The capital gains will, therefore, be assessable in the assessment year 2021-22.

♦ **Partner in a representative capacity**: If an individual is a partner in a firm in a representative capacity (that is on behalf and for the benefit of another person) and not in his personal capacity then, interest paid by the firm to such individual in his personal capacity and not as a representative capacity will not be subject to the conditions and ceiling as prescribed for disallowance. But interest paid by the firm to such individual as representative partner or person represented shall be subject to the conditions and ceiling as prescribed *(Explanation 1).*

> ***Example:*** *X is a partner in a firm in a representative capacity for and on behalf of his HUF. Supposing the firm pays interest of ₹ 6,000 to X in his personal capacity and not in his capacity as the representative of HUF, it will be allowed as deduction and the prescribed ceiling will not apply. However, if such payment is made to X as a representative and partner or if the firm has paid the interest directly to the HUF, then the payment will be subject to the conditions and ceiling as prescribed.*

- **Interest received by a non-representative partner**: If interest is paid to an individual partner who is not the representative partner and the interest received by him is on behalf of or for the benefit of another person, then such interest payment shall be allowed without applying the ceiling limits.

> ***Example:*** *X is a partner of a firm in his individual capacity and is not a representative partner. Interest is paid by the firm to him in respect of a deposit made by his wife. This will be allowed as a deduction because such interest is received by him purely on behalf of another person.*

- **Computation of income of partner of a firm (PFAS)**: While computing the income of a partner including a minor partner of a firm, the following points have to taken into consideration.

  Share income exempt under section 10(2A): The partner's share in the total income of firm (PFAS) will be exempt in his hands and will not be included in his total income. His share in the total income of the firm will be calculated as follows:-

$$\text{Total income of firm} \times \frac{\text{Partner's share in profits of firm as per partnership deed}}{\text{Total profit of the firm}}$$

  By virtue of this exemption, a partner of PFAS will not be taxed in respect of his share in the firm's income since the firm itself will be taxed as a separate entity @ 30%. There will be no allocation of income among the partners. On account of this exemption, he will not be entitled to set-off his share in the firm's loss against his other personal income.

- **Chargeability of remuneration and interest**: Remuneration and interest received by a partner of a PFAS in accordance with the conditions prescribed under section 40(b) will be taxable in his hands as income from profits and gains of business or profession.

  If remuneration or interest paid to a partner is disallowed in the assessment of the firm due to the fact that they are not in accordance with the conditions prescribed under section 40(b) then the partner will not be taxed in respect of the amount disallowed because in such a case the firm itself will be liable to pay tax on the amount which has been disallowed in its assessment. In other words, if the firm is given the benefit of deduction of remuneration and interest paid to a partner then the liability to tax in respect of such amount will be that of a partner. If the firm is not given the benefit of deduction because of the non-compliance with the provisions of section 40(b) then the firm itself will be liable in respect of the amount and the partner will not be taxed in respect of it in his personal assessment. It is obvious that such remuneration or interest which has been disallowed in the hands of the firm but actually received by a partner will be assumed to be his share in the income of such firm and exemption under section 10(2A) will operate.

Suppose a portion of the remuneration and interest in the assessment of the firm is disallowed since they exceed the overall ceiling limit prescribed under section 40(b), the question arises as to how to allocate such disallowance in the hands of the partner. One reasonable basis is to assume that the remuneration and interest paid to the partners concerned has been disallowed in proportion to the gross remuneration and interest paid to them and the exemption of the disallowed sum should be available to the partners in the same proportion.

♦ **Assessment of firms – Some of the important issues to be considered by the Assessing Officer while framing assessment [Circular 12/2019, dated 19.6.2019]:**

(i) *While computing remuneration which is allowable to a working partner under section 40(b)(v), the term 'in accordance with the terms of the partnership deed' in clauses (ii) and (v) of section 40(b) implies that remuneration should not be undetermined or undecided. Hence, in all situations, partnership deed should form the basis for determination of remuneration payable to the working partners. Furthermore, in situations where the remuneration either so specified in the partnership deed or computed as per the method indicated therein falls short of the amount allowable under section 40(b)(v), it would be restricted to the figure computed on the basis of the partnership deed.*

(ii) *While computing remuneration payable to the working partners under section 40(b)(v) of the Act, the remuneration should not exceed a particular aggregate amount which is based upon the figure of 'book profit'. Explanation 3 to section 40(b) contains definition of 'book profit' for the purposes of determination of remuneration of the partners and provides that 'book profit' shall mean the net profit, as shown in the profit & loss account for the relevant previous year, computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while calculating the net profit. Therefore, while computing 'book profit' for purposes of section 40(b)(v), all incomes such as capital gain, interest, rental income, income from other sources etc. which do not fall under the head 'Profits and gains of business or profession', should be excluded.*

(iii) *Under section 185, any non-compliance by the firm or its partners with provisions of section 184 may result in denial of expenses such as remuneration, interest etc. payable to the partners which are otherwise allowable under the provisions of the Act.*

(iv) *Where firms try to inflate the profits eligible for deduction under section 80-IA by not claiming expenditure towards remuneration, salary, interest etc. which are payable to the partners, the Assessing Officers may examine these transactions in light of provisions of section 80-IA(10) which empower Assessing Officer to re-compute profit of the eligible business after excluding the profits of the related activity/business which produced the excessive profit.*

(v) *While framing assessments in case of firms claiming carry forward and set off of losses, Assessing Officers have to verify such claims taking into consideration provisions of section 78 which disallow such a carry forward and set off in case of change in constitution of the firm or on succession.*

- **Rate of tax:** A PFAS will be chargeable in respect of its total income at the rate of 30% plus surcharge **@ 12%** if its total income exceeds ₹ 1 crore, plus health and education cess @ 4% thereon.

- **Treatment of losses**: If PFAS incurs any loss, the firm alone can set off and forward such losses to be set off against income of the subsequent years. The firm will not be allowed to apportion its unabsorbed losses among its partners.

- **Set off of carry forward loss in case of change in the constitution of the firm [Section 78]**: If there is a change in the constitution of the firm, the loss of a retired/ deceased partner can be carried forward by the firm only to the extent that it does not exceed such partner's share in the profits of the firm of the relevant previous year. However, it is to be carefully noted that section 78 is applicable only in case there is a change in the constitution of the firm as result of retirement or death of a partner in the previous year. In other words, it does not apply when there is a change in the profit sharing ratio or change in the constitution because of induction of a new partner. Similarly, section 78 will not apply to set off and carry forward of unabsorbed depreciation etc.

- **Tax rate of firm [Section 167A]:** In the case of a firm which is assessable as a firm, tax shall be charged at the rate as specified in the Finance Act of the relevant year.

- **Liability of partner of LLP in liquidation [Section 167C]:** This section provides for the liability of partners of LLP in liquidation. In case of liquidation of an LLP, where tax due from the LLP cannot be recovered, every person who was a partner of the LLP at any time during the relevant previous year will be jointly and severally liable for payment of such tax unless he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP. This provision would also apply where tax is due from any other person in respect of any income of any previous year during which such other person was a LLP. "Tax due", for the purpose of this section includes penalty, interest or any other sum payable under the Income-tax Act, 1961.

♦ **Assessment in case of change in constitution, succession and dissolution of a firm [Section 187 to 189A]**

Change in constitution of a firm: Where at the time of making an assessment under section 143 or 144 it is found that a change has occurred in the constitution of a firm, assessment shall be made on the firm as constituted at the time of making the assessment.

Meaning of change in constitution of the firm: It means

(a) If one or more of the partners cease to be partners (other than a case where ceases to be a partner by way of demise of the partner) or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change.

(b) All the partners of firm continue to be the partner of the firm but there is a change in their profit sharing ratio or change in shares of some of them.

Succession of one firm by another: In a case where a firm carrying on a business or profession is succeeded by another firm, separate assessment will be made on the predecessor firm and the successor firm in accordance with the provisions of section 170.

Liability of partners: Where any tax, penalty or other sum payable by the firm for the relevant previous year is due, then every person being a partner of a firm and the legal representative of deceased partner during the previous year shall be jointly and severally liable along with the firm in respect of such sum.

Dissolution of firm or discontinuance of business: Where a firm is dissolved or business or profession is discounted by the firm, the assessing officer shall make an assessment of the total income of the firm as if no discontinuance or dissolution has taken place and all the provisions of the Act relating to levy of a penalty or any other sum chargeable under this Act, shall be applicable accordingly.

Every person who was at the time of dissolution or discontinuance a partner of a firm and the legal representative of deceased partner shall be jointly and severally liable for the amount of tax, penalty or other sum payable by the firm and all the provisions of the Act shall apply accordingly. If any proceedings have commenced in respect of any assessment year before dissolution or discontinuance, the proceeding may be continued against such persons (i.e., partner and legal representative) from that stage. The liability of legal representative is limited to the extent to which the estate is capable of meeting the liability.

ILLUSTRATION 12

Vijay Agencies, a partnership firm constituted by three partners with equal shares was dissolved on 1-04-2019 after a search. The tax liability of the firm outstanding to be paid was determined at ₹ 15 lakhs. Out of three partners, one was declared insolvent on 18-03-2020 by the Court. The Assessing Officer, for recovering the demand, attached the Bank Accounts of other two partners and could recover an amount of ₹ 6 lakhs from the Account of one such partner. You are asked by the partners of the dissolved firm the following questions:

(i) About the liability of each of them to pay outstanding demand.

(ii) Whether the action of Assessing Officer to attach the Bank Account of partners to recover the tax demand of the dissolved firm is justified?

SOLUTION

(i) As per section 189(3), every person who was at the time of dissolution, a partner of the firm, shall be jointly and severally liable for the amount of tax, penalty or other sum payable and all the provisions of the Act relating to assessment of such tax or imposition of such penalty or other sum, shall apply. Therefore, the three partners (till one was declared as insolvent by the Court) are jointly and severally liable for making the payment of outstanding dues of ₹ 15 Lakhs. After insolvency of one partner, the other two partners are jointly and severally liable to pay such demand.

(ii) Accordingly, the action of the Assessing Officer to attach the bank accounts of the partners for recovery of outstanding demand is correct and the amount of ₹ 6 lakhs recovered by attachment of the bank account of one of the partners is also in order.

- **Conversion of company into a LLP**

(i) Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 had incorporated the taxation scheme of LLPs in the Income-tax Act, 1961 on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.

(ii) Under section 56 and section 57 of the Limited Liability Partnership Act, 2008, conversion of a private company or an unlisted public company into an LLP is permitted. However, under the Income-tax Act, no exemption is available on conversion of a company into an LLP. As a result, transfer of assets on conversion would attract capital gains tax. Further, there is no specific provision enabling the LLP to carry forward the unabsorbed losses and unabsorbed depreciation of the predecessor company.

(iii) Therefore, section 47(xiiib) provides that -

(1) any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP; or

(2) any transfer of a share or shares held in a company by a shareholder

on conversion of a company into a LLP in accordance with section 56 and section 57 of the Limited Liability Partnership Act, 2008, shall not be regarded as a transfer for the purposes of levy of capital gains tax under section 45, subject to fulfillment of certain conditions. This clause has been introduced to facilitate conversion of small private and unlisted public companies into LLPs. These conditions are as follows:

(1) the total sales, turnover or gross receipts in business of the company should not exceed ₹ 60 lakh in any of the three preceding previous years;

(2) all the shareholders of the company immediately before conversion become partners of the LLP in the same proportion as their shareholding in the company;

(3) no consideration other than share in profit and capital contribution in the LLP arises to the shareholders;

(4) the erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for a period of 5 years from the date of conversion;

(5) The total value of assets as appearing in the books of account of the company in any of the three previous years preceding the previous year in which the conversion takes place, should not exceed ₹ 5 crore;

(6) all assets and liabilities of the company become the assets and liabilities of the LLP; and

(7) no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of 3 years from the date of conversion.

(iv) However, if subsequent to the transfer, any of the above conditions are not complied with, the capital gains not charged under section 45 would be deemed to be chargeable to tax in the previous year in which the conditions are not complied with, in the hands of the LLP or the shareholder of the predecessor company, as the case may be [Section 47A(4)].

(v) Further, the successor LLP would be allowed to carry forward and set-off the business loss and unabsorbed depreciation of the predecessor company [Section 72A(6A)].

(vi) However, if the entity fails to fulfill any of the conditions mentioned in (iii) above, the benefit of set-off of business loss/unabsorbed depreciation availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfill any of the conditions listed above.

(vii) The tax credit under section 115JAA for MAT paid by the company under section 115JB would not be allowed to the successor LLP [Sub-section (7) of section 115JAA].

(viii) The actual cost of the block of assets in the case of the successor LLP shall be the written down value of the block of assets as in the case of the predecessor company on the date of conversion [*Explanation 2C* to section 43(6)].

(ix) The aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. Such depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of the number of days for which the assets were used by them [Section 32(1)].

(x) The cost of acquisition of the capital asset for the successor LLP shall be deemed to be the cost for which the predecessor company acquired it. It would be further increased by the cost of improvement of the asset incurred by the predecessor company or the successor LLP [Section 49(1)].

(xi) If the capital asset became the property of the LLP as a result of conversion of a company into an LLP, and deduction has been allowed or is allowable in respect of such asset under section 35AD, the actual cost would be taken as Nil [*Explanation 13* to section 43(1)].

However, where an asset, in respect of which deduction is claimed and allowed under section 35AD is deemed to be the income of the assessee in accordance with the provisions of section 35AD(7B) (on account of being used for a purpose other than specified business under section 35AD), the actual cost of the asset to the assessee shall be actual cost to assessee as reduced by the amount of depreciation allowable had the asset been used for the purpose of business, calculated at the rate in force, since the date of its acquisition [Proviso to *Explanation 13* to section 43(1)]

(xii) If a company eligible for deduction under section 35DDA in respect of expenditure incurred under Voluntary Retirement Scheme (one-fifth of such expenditure allowable over a period of five years) is converted into a LLP and such conversion satisfies the conditions laid down in section 47(xiiib), then, the LLP would be eligible for such deduction from the year in which the transfer took place.

(xiii) If a shareholder of a company receives rights in a partnership firm as consideration for transfer of shares on conversion of a company into a LLP, then the cost of acquisition of the capital asset being rights of a partner referred to in section 42 of the LLP Act, 2008 shall be deemed to be the cost of acquisition to him of the shares in the predecessor company, immediately before its conversion [Section 49(2AAA)].

(6) Assessment of AOPs/ BOIs and their members

Section 2(31) defines "person" as including "association of persons" or a body of individuals. The expression association of persons is to be understood in its ordinary sense meaning there by a group or congregation of persons. The expression association of persons is of a wider connotation and scope than that of a body of individuals. An association of persons may have as its members not only individuals (including minors) but also companies, firms, joint families and other associations. When there is a group of persons formed for the promotion of an enterprise or when co-adventures join together in a common action they are assessable as an association of persons. Ordinarily, there can be no association of persons in business unless the members of the group join together out of their own volition or will.

In order to constitute an association of persons, the members thereof must join any common purpose or common action and the object of the association must be to produce income. Mere receipt of income by a group of members in common will not make it an association unless income is earned by its own effort in common.

The co-owners, co-legatees and joint receivers joining for a **common purpose** or action would be assessable as an association of persons. For example, if the funds of a number of beneficiaries are put together and one business is carried on with the combined resources by the trustee, guardian or administrator, the business must be regarded as a single business assessable in the hands of an association of persons. However, section 26 specifically provides an exception to the assessment of co-owners as an association of persons. According to that section, where the shares of the co-owners in respect of income from house property are defined and ascertainable, the co-owners must be assessed not as an association of persons but individually even if the property may be owned and managed and developed jointly by the co-owners.

For the purpose of assessment, it is not necessary that the association should be legally constituted. In other words, it is not necessary that there must be mutual rights and obligations amongst the members enforceable in law. The illegality, invalidity or incorrectness in the constitution of an association does not in any way affect its liability to tax or its chargeability as a unit of assessment. A partnership which is illegal or otherwise void will have to be assessed as an association of persons. The question whether there is an association of persons or not depends upon the facts and circumstances of each case.

Computation of total income of AOPs/BOIs

1. Computation of total income in the case of an association of persons or body of individuals will be done in the same manner as in the case of any other assessee.
2. In computing the total income, interest, salary, bonus, commission, remuneration, by whatever name called, paid to members will not be allowed.

However, in the case of payment of interest the following provisions will apply:

Explanation 1: If interest is paid by an AOPs/BOIs to any member who has also paid interest to the AOPs/BOIs then only that amount of interest paid by the AOPs/BOIs will be disallowed in its assessment which is in excess of the interest paid by the member to the AOPs/BOIs.

Explanation 2: If an individual is a member of an AOPs/BOIs in a representative capacity, on behalf of or for the benefit of another person, then interest paid by the AOPs/BOIs to such individual in his personal capacity will not be taken into account for the purpose of disallowance. However, interest paid by the AOPs/BOIs to such individual or *vice-versa* as representative member or interest paid by the AOPs/BOIs directly to the beneficiary will be taken into account for the purpose of disallowance.

Explanation 3: If interest is paid to a member who is not a member in a representative capacity but such interest is received by him on behalf of or for the benefit of another person the interest payment will be allowed.

♦ **Computation of tax where shares of members in AOPs/BOIs are unknown [Section 167B]**: Tax on the total income would be computed as follows:

	Circumstances	Taxability
1.	If individual share of any member is not known	Tax will be levied at the maximum marginal rate. However, if total income of any member of AOPs/BOIs is taxable at a rate higher than maximum marginal rate then total income of AOPs/BOIs shall be chargeable to tax at such higher rate of tax.
2.	If individual share of a member is known and	
	(a) total income of any member (excluding his share from	The AOPs/BOIs will pay tax at the maximum marginal rate. However, if total income of any member of AOPs/BOIs is taxable at a rate higher than maximum marginal rate (for

	AOPs/BOIs) exceeds the basic exemption limit	example, a foreign company which is a member), then, total income of AOPs/BOIs shall be chargeable to tax as follows: • Portion of income attributable to such member shall be taxable at such higher rate as applicable to that member. • Balance income shall be taxable at the maximum marginal rate of tax.
	(b) no member has total income (excluding his share from AOPs/BOIs) exceeding the basic exemption limit	The AOPs/BOIs will pay tax at the normal rates applicable to an individual

- ***Rate of Surcharge Applicable to AOP /BOI whether incorporated or not, having income under section 115AD of the income tax Act***

  The Finance (No.2) Act, 2019 has levied an enhanced surcharge of 25% and 37%, where the total income of individuals/HUF/AOPs/BoIs exceeds Rs.2 crores and Rs.5 crores, respectively. However, vide Press Release dated 24.8.2019, the enhanced surcharge has been withdrawn on tax payable at special rates under section 115AD on short-term capital gains and long-term capital gains arising from the transfer of securities referred to in 115AD(1)(b). Accordingly, the Taxation Laws (Amendment) Ordinance, 2019, promulgated by the President of India on 20.9.2019, has amended the Finance (No.2) Act, 2019 to give effect to the withdrawal of enhanced surcharge on tax payable on capital gains arising from the transfer of securities referred to in section 115AD(1)(b). The table containing the rates of surcharge applicable to AOPs/BOIs is given as ***Annexure 3****. These rates would be effective from A.Y.2020-21, after the Taxation Laws (Amendment) Ordinance, 2019 is passed by the Parliament.*

- **Assessment of share in the hands of member [Section 86]:**

  - *A member's share in the total income of an AOPs/BOIs will be treated as follows:*

    If an AOPs/BOIs has paid tax at the maximum marginal rate, or a higher rate, the member's share in the total income of the firm will not be included in his total income.

    If the AOPs/BOIs has paid tax at regular rates applicable to an individual, the member's share in the income of the AOPs/BOIs computed under section 67A shall form part of his total income. However, the member will be allowed rebate under section 110 at the average rate in respect of such share.

- If the AOPs/BOIs has not paid tax on its total income, the member's share in the total income of the AOPs/BOIs will be included in his total income and taxed at regular rates.

♦ **Computation of member's share in the total income of AOPs/BOIs [Section 67A]**: A member's share in the income of an AOPs/BOIs (wherein the shares of members are determinate and known) will be computed as follows:

(a) Any interest, salary, bonus, commission, remuneration, etc. paid to a member during the previous year will be deducted from the total income of the association or body, and the balance will be apportioned among the members in proportion to their respective shares.

(b) If the amount apportioned to a member as per (a) is a profit, any interest, salary, etc. paid to him by the association or body during the previous year will be added to that amount and the aggregate sum will be such member's share in the income of the AOPs/BOIs.

(c) If the amount apportioned to a member as per (a) is a loss, any interest, salary, etc., paid to him by the association or body will be deducted from the amount of loss and the balance sum will be such member's share in the income of the AOPs/BOIs.

The share of a member in the income/loss of the AOPs/BOIs will, for the purposes of assessment, be apportioned under the various heads of income in the same manner in which income/loss of the association has been determined under each head.

Any interest paid by a member on capital borrowed by him for the purpose of investment in the AOPs/BOIs will be allowed as deduction while computing his share of income under the head "Profits and gains of business or profession."

♦ **Determination of tax where total income includes income on which no tax is payable [Section 110]:**

If the total income of an assessee includes any income on which no income-tax is payable, the assessee would be entitled to a deduction, from the amount of income-tax with which he is chargeable on his total income, of an amount equal to the income-tax calculated at the average rate of income-tax on the amount on which no income-tax is payable.

♦ **Share of member of an AOPs/BOIs in the income of the AOPs/BOIs to be reduced from net profit for computing book profit for levy of MAT [Section 115JB]**

(i) Under section 115JB, in the case of a company, if the tax payable on the total income computed as per the normal provisions of the Income-tax Act, 1961 is less than ***15%*** of its book profit, such book profit shall be deemed to be the total income of the company and the tax payable for the relevant previous year shall be ***15%*** of its book profit.

(ii) *Explanation 1* below section 115JB(2) provides that the expression "book profit" means profit as shown in the statement of profit and loss account prepared in accordance with the provisions of the Companies Act or in accordance with the provisions of the relevant statute governing a company, as increased or reduced by certain adjustments, as specified thereunder.

(iii) Under section 86, no income-tax is payable on the share of a member of an AOPs/BOIs in the income of the AOPs/BOIs in certain circumstances. A company which is a member of an AOPs is also not required to pay tax in respect of its share in the income of the AOPs in such cases. However, under section 115JB, a company which is a member of an AOPs is liable to MAT on such share also, since such income is not excluded from the book profit while computing the MAT liability of the member. It may be noted that in a similar situation, in the case of a partner of a firm, the share in the profits of the firm is exempt in the hands of the partner as per section 10(2A) and no MAT is payable by the partner on such profits, since income to which any provision of section 10 applies, has to be reduced for computing book profit.

(iv) In order to ensure equity, clause (iic) in *Explanation 1* below section 115JB(2) provides that the share of a member of an AOPs or BOIs, in the income of the AOPs or BOIs, on which no income-tax is payable in accordance with the provisions of section 86, should be reduced while computing book profit for levy of MAT under 115JB, if any such amount is credited to statement of profit and loss account. Consequently, clause (fa) has been inserted in *Explanation 1* to add back the expenditures, if any, debited to the statement to profit and loss, corresponding to such income, while computing book profit for levy of MAT**.**

ILLUSTRATION 13

JK Associates is an Association of Persons (AOPs) consisting of two members, J and K. Shares of the members are: 60%(J) and 40%(K). Income of the AOPs for the previous year 2019-20 is ₹ 7 lacs.

Compute tax liability of the AOP and the members in the following situations:

(i) J and K have their income, other than income from AOPs, amounting to ₹ 1 lac and ₹ 2.7 lacs, respectively.

(ii) J and K's income, other than income from AOPs, amount to ₹ 1.50 lac and ₹ 2.30 lacs, respectively.

SOLUTION

Computation of tax of AOPs is governed by section 167B of the Income-tax Act, 1961. Tax on total income of AOP is computed as follows:

(i) If individual share of a member is known, and the total income of any member, excluding his share from such AOPs, exceeds the basic exemption limit, then the AOPs will pay tax at the maximum marginal rate.

(ii) If individual share of a member is known and no member has total income (excluding his share from AOPs) exceeding the basic exemption limit, then the AOP will pay tax at the rates applicable to an individual.

Section 86 provides for assessment of share in the hands of members of AOPs as follows:

A member's share in the total income of AOPs will be treated as follows:-

(i) If an AOPs has paid tax at the maximum marginal rate or a higher rate, the member's share in the total income of AOPs will not be included in his total income and will be exempt.

(ii) If the AOPs has paid tax at regular rates applicable to an individual, the member's share in the income of AOPs will be included in his total income and he will be allowed rebate at the average rate of tax in respect of such share.

Tax Liability of J K Associates, AOPs

(i) As K's income, other than that from the AOPs, exceeds the basic exemption limit, the AOPs shall pay tax at ***maximum marginal rate of 42.744 % (i.e. 30% plus 37% surcharge plus health and education cess @ 4%).*** Thus, the tax payable by AOP = ₹ 7,00,000 x 42.744 % = ₹ 2,99,208.

(ii) Since none of the members have income, other than income from the AOPs, exceeding the basic exemption limit, the AOPs would be taxed at the rates applicable to an individual. Therefore, the AOP's tax liability = ₹ 52,500 + ₹ 2,100 = ₹ 54,600.

Tax Liability of J and K

	Particulars	J ₹	K ₹
(i)	Share of profit from AOP	Exempt	Exempt
	Income from other sources	1,00,000	2,70,000
	Total Income	1,00,000	2,70,000
	Tax liability	NIL	1,000
	Less: Rebate under section 87A	-	1,000
	Total tax payable	NIL	NIL
(ii)	Share of profit from AOP	4,20,000	2,80,000
	Income from other sources	1,50,000	2,30,000
	(A)	5,70,000	5,10,000
	Tax liability	26,500	14,500

	Add: Health and Education cess @ 4%	1,060	580
	Total tax payable (B)	**27,560**	**15,080**
	Average rate of tax [B/A x 100]	4.835%	2.957%
	Total tax liability	27,560	15,080
	***Less*: Rebate under section 86 read with section 110 in respect of share of profit from AOP** (share in AOP x Average rate of tax)	20,307	8,280
	Tax liability of members	7,253	6,800
	Tax Payable (Rounded off)	7,250	6,800

(7) Assessment of Co-operative Societies

(i) **General provisions:** The expression "co-operative society" means a society registered under the Cooperative Societies Act, 1912 or under any other law for the time being in force in any State for the registration of co-operative societies [Section 2(19)]. For purposes of taxation, it is treated as a separate assessable entity. The profits of any business of insurance carried on by a co-operative society are to be computed in accordance with the rules set out in the First Schedule to the Act. Apart from this, the computation of income in the case of a co-operative society should also be made in the same way under each head of income as in the case of any other assessee. Entrance fees received by a co-operative society from its members is taxable as its income from business irrespective of the nature of the business carried on by the society as was held in *Co-operative Central Bank vs. C.I.T. (1965) 57 ITR 579.*

A member of a co-operative society to whom a building or a part thereof is allotted or leased under a house building scheme of the society must be deemed to be the owner of that building or part thereof under section 27(iii). Accordingly, the co-operative society is not liable to pay tax in respect of the income from the house property even though it may be the real owner according to official records and the tenant may have taken the building on lease. But where the tenant is not a member of the society or where the house is allotted to him otherwise than under a house building scheme of the society, the society will be liable to tax in respect of the income of the house property.

(ii) **Exemptions**: Section 80P provides certain exemptions to co-operative societies. However, the exemption is not available to co-operative banks, other than primary agricultural credit societies and primary co-operative agricultural and rural development banks. Students may refer to the detailed discussion of this provision in Chapter 11 "Deductions from Gross Total Income".

It may also be noted that the provisions of section 194A which require deduction of income-tax at source from interest other than interest on securities, credited or paid, do not apply to such income credited or paid–

(i) by a co-operative society (other than a co-operative bank) to a member thereof or to any other co-operative society;

(ii) in respect of deposits with a primary agricultural credit society or a primary credit society or a co-operative land mortgage bank or a co-operative land development bank;

(iii) in respect of deposits (other than time deposits) with a co-operative society, other than a co-operative society or bank engaged in carrying on the business of banking.

ILLUSTRATION 14

Transfer fees are received by a cooperative housing society from its incoming and outgoing members. Are such transfer fees liable to tax in the hands of the cooperative society?

SOLUTION

The issue under consideration is whether the transfer fees received by a co-operative housing society from its incoming and outgoing members is taxable or exempt on the principle of mutuality.

On this issue, the High Court, in *Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47*, observed that under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class.

The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on account of the principle of mutuality, since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Applying the rationale of the above ruling, transfer fees received by a co-operative housing society from its incoming and outgoing members would not be liable to tax in the hands of the co-operative society.

(8) Assessment of Mutual Concerns

(i) General principles of mutuality –

(a) The first principle of mutuality is that no person can trade with himself or make income out of himself. A mutual association arises where persons forming a group associate together with a common object and contribute monies for achieving that object and divide the surplus amongst themselves in the character. The cardinal requirement in the case of mutual association is that all the contributors to the common fund must be entitled to participate in the surplus and all the participators to the surplus must be contributors to the common fund. In other words, there must be complete identity between the contributors and the participators.

(b) The participation in the surplus need not be immediate but it may assume the shape of a reduction in the future contribution or a division of the surplus on dissolution.

(c) It does not make any difference whether the persons joining together form an association or incorporate a company because the fact of incorporation does not destroy the identity of the contributors and participators.

(d) Where there is mutuality, the fact that some members alone take advantage of the mutual enterprise would not affect the mutual character of the association.

(e) There is nothing in law which prohibits a mutual association from carrying on a trade so long as it is confined to its own members.

(f) It is not necessary that the surplus should be returned to every member of the association pro rata. The identification between the contributors and the participators should be regarded as one whole and not in relation to each individual.

(g) It is not necessary that all the activities of such an association should be mutual in character. There may be activities of a non-mutual character but the exemption from tax will apply to the surplus arising out of the mutual enterprise.

From the above principles we can conclude that one cannot trade with one self and earn taxable profits thereby. Hence if there is a mutual concern, ordinarily there should be no tax on the profits arising out of mutual operations. But the Income-tax Act, 1961 provides for assessment of the income of a mutual concern in the following circumstances:

(1) Where the mutual concern is a mutual insurance society and the income is derived from the carrying on of any business of insurance.

(2) Where the mutual concern is a trade, professional or similar association and the income in question is derived from specific service performed for its members.

(ii) **Insurance business:** Under section 2(24)(vii) any surplus accruing to life as well as general mutual insurance concerns will fall within the definition of the word "income" and as such would be taxable as income from business. Section 44 expressly provides the profits and gains of any business of insurance including that carried on by a mutual insurance company or a cooperative society shall be computed not according to the provisions of the Act for computation of income under the various heads but according to the method prescribed in the Rules contained in the First Schedule to the Act.

(iii) **Trade and professional associations:** A trade, professional or similar association may be a mutual concern. Section 28(iii) enacts that "income derived by a trade, professional or similar association from specific services performed for its members" shall be taxable as business profits. Under section 2(24)(v) any sum chargeable under section 28(iii) is deemed to be income. The object of these provisions seems to be to tax as profit the surplus arising from specific services rendered to members by a mutual trade, professional or similar association which otherwise may not be liable to tax in view of the general principles applicable to mutual concerns.

It may carefully be noted that a trade association is not the same thing as a trading association. A trade association means an association of tradesmen or businessmen for the protection or advancement of their common interests. Again clause (iii) of section 28 taxes the profit accruing only on specific services rendered by an association to its members. Any surplus arising to a mutual association in other way e.g. from entrance fees or members' periodic subscriptions would be outside the scope of this clause and would be non-taxable on the general principles stated above.

Since the surplus arising to trade, professional or similar association during the process of advancement of the common interest of the members is not includible in the taxable income it follows that the concerned expenditure will not also be allowed. Section 44A gives a benefit in this regard. It provides that in the case of such trade associations which did not distribute any parts of its income to its members, the amount of any deficit (deficiency) (excess of expenditure incurred for the advancement of the common interest of the members of the association over receipt from the members) would be deductible from the assessable income of the association to the maximum extent of 50% of such income.

This deficiency is to be deducted in the first instance from the assessable income under the head "Profits and gains of business or profession". If the deficiency exceeds such income the balance of deficiency can be set off against assessable income from any other head. The maximum limit of 50%, however, still operates. It can be carried forward to the next year and set-off against income of the relevant assessment year. It should be noted that any adjustment of the deficiency is permissible only after effect has been given as provided in the Act to all losses, allowances etc., for the year in question or brought forward from earlier years.

(iv) **Clubs:** The consensus of judicial opinion is that any surplus accruing to a members' club from the subscriptions and charges for various conveniences paid by members is not income or profit at all, nor can a social club be deemed to trade as far as its dealings with its own members are concerned. The position would be the same even though the club may be incorporated as a company or registered as a society. But a club is taxable on the profit derived from subscriptions and charges paid by non-members and on the income derived from its capital assets. Where a club is an incorporated company carrying on business it may be taxable on the money received from its members as well as non-members in the course of its business.

However, if the club is not a member's club but is a proprietary club i.e. if the club is owned by an outsider and not by the members themselves, the proprietor would be taxable on the profits earned by running the club. The position would not in any way be affected by the fact that the proprietor is a limited company and some of the shareholders are members of the club.

12.7 OTHER PROVISIONS RELATED TO VARIOUS ENTITIES

(1) Tax on income from life insurance business

Section 115B provides for a concessional rate of tax for taxing the profits and gains derived from the business of life insurance. Under these provisions, in the case of an assessee whose total income includes any profits and gains derived from the business of life insurance computed in accordance with the First Schedule to the Income-tax Act, 1961, the income-tax payable shall be the aggregate of -

(i) the amount of income-tax calculated on the income from life insurance business included in total income at the rate of 12½% and

(ii) the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the amount of profits and gains from the life insurance business.

Income accruing or arising to a company from life insurance business referred to in section 115B would not be subject to MAT. [Section 115JB(5A)]

Taxation of income/ loss of non-life insurance business: Rule 5 of the First Schedule to the Income-tax Act, 1961 provides that the profits and gains of non-life insurance business would be the profit before tax and appropriations as disclosed in the profit and loss account prepared in accordance with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999, subject to following adjustment -

- expenditure or allowances not allowable under sections 30 to 43B,

- any provision for diminution in the value of investment debited to profit and loss account has to be added back
- any gain or loss on realization of investments not credited or debited to profit and loss account, shall be added or deducted, as the case may be
- reserve for unexpired risk as prescribed shall be allowed.

(2) Special Rates of tax in respect of certain specified income or assets

♦ **Tax on income from GDRs purchased in foreign currency or capital gains arising from transfer of such GDRs[Section 115ACA]**

(i) **Eligible assessee [Section 115ACA(1)(a)/(b)] -** This section applies to resident individuals who are employees of an Indian company engaged in specified knowledge based industry or service, or employee of its subsidiary engaged in specified knowledge based industry or service.

(ii) **Eligible income and special rate of tax [Section 115ACA(1)(a)/(b)] -** Where the total income includes the following income namely –

(a) income by way of dividends (other than dividends referred to in section 115-O) in respect of Global Depository Receipts of an Indian company engaged in specified knowledge based industry or service, purchased by an eligible assessee in foreign currency issued in accordance with such employees' stock option scheme as the Central Government may specify in this behalf,

(b) income by way of long-term capital gains arising from the transfer of the aforesaid Global Depository Receipts,

then the same will be taxed at the rate of 10%.

(iii) **No deduction is allowed [Section 115ACA(2)] -** In the case of the aforesaid resident employee, no deduction shall be allowed under any provisions of this Act, where the gross total income consists only of income by way of dividend from Global Depository Receipts.

However, where the gross total income includes dividend income or long term capital gain from such Global Depository Receipts, the deduction under any provisions of the Act shall be allowed only on that portion of gross total income which does not include such income from the Global Depository Receipts.

(iv) **No benefit of first and second proviso of section 48 [Section 115ACA(3)] -** The first and second provisos to section 48 relating to the computation of capital gains shall not apply in case of transfer of Global Depository Receipts of an Indian company purchased by the resident employee in foreign currency. In other words, no indexation will be available even if the assets are long term capital assets.

(v) **Meaning of certain terms:**

S. No.	Term	Meaning
1.	Global Depository Receipts	Any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India and issued to investors against the issue of – (i) ordinary shares of issuing company, being a company listed on a recognized stock exchange in India; or (ii) foreign currency convertible bonds of issuing company;
2.	Specified knowledge based industry or service	(i) information technology software; (ii) information technology service; (iii) entertainment service; (iv) pharmaceutical industry; (v) bio-technology industry; and (vi) any other industry or service, as may be notified by the Central Government
3.	Subsidiary	The term includes subsidiary incorporated outside India
4.	Information technology service	Any service which results from the use of any information technology software over a system of information technology products for realising value addition
5.	Overseas Depository Bank	A bank authorised by the issuing company to re-issue Global Depository Receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company.

♦ **Concessional Taxation Regime for royalty income in respect of patent developed and registered in India [Section 115BBF]**

(i) The Finance Act, 2016 introduced a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development.

(ii) The purpose of the concessional taxation regime is for encouraging entities to retain and commercialise existing patents and for developing new innovative patented products.

(iii) Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture and exploitation of patents in India.

(iv) The nexus approach has been recommended by the OECD under Action Plan 5 in Base Erosion and Profit Shifting (BEPS) project. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership.

(v) **Concessional rate of tax -** Section 115BBF provides that where the total income of the eligible assessee includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess). For this purpose, developed means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

(vi) **No expenditure is allowed -** No deduction for any expenditure or allowance in respect of such royalty income shall be allowed under the Act.

(vii) **Option of concessional rate to be exercised before due date under section 139(1) -** The eligible assessee has to exercise the option for taxation of income by way of royalty in respect of a patent developed and registered in India in accordance with the provisions of section 115BBF in the prescribed manner, on or before the due date specified under section 139(1) for furnishing the return of income for the relevant previous year.

(viii) **Not eligible to opt for concessional taxation under this section for 5 assessment years -** Where an eligible assessee opts for taxation of income by way of royalty in respect of a patent developed and registered in India for any previous year in accordance with section 115BBF, and the assessee offers the income for taxation for any of the five assessment years relevant to the previous year succeeding the previous year not in accordance with section 115BBF(1), then the assessee shall not be eligible to claim the benefit of section 115BBF for five assessment years subsequent to the assessment year relevant to the previous year in which such income has not been offered to tax in accordance with section 115BBF(1).

(ix) **Non-applicability of MAT provisions -** Further, the amount of income by way of royalty in respect of patent chargeable to tax under section 115BBF would not be subject to MAT under section 115JB. The same would be reduced while arriving at the book profit. Consequently, the related expenditure would be added back for arriving at the book profit.

(x) **Meaning of certain terms**

S. No.	Term	Meaning
1	Eligible assessee	Eligible assessee **means**: • A person resident in India, • who is the true and first inventor of the invention and • whose name is entered on the patent register as the patentee in accordance with Patents Act, 1970. Eligible assessee **includes:** every such person, being the true and the first inventor of the invention, where more than one person is registered as patentee under Patents Act, 1970 in respect of that patent.
2	Royalty	"Royalty", in respect of a patent, means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains" or consideration for sale of product manufactured with the use of patented process or the patented article for commercial use) for the— (1) transfer of all or any rights (including the granting of a licence) in respect of a patent; or (2) imparting of any information concerning the working of, or the use of, a patent; or (3) use of any patent; or (4) rendering of any services in connection with the activities referred to in (1) to (3) above.
3	Lumpsum	"Lump sum" includes an advance payment on account of such royalties which is not returnable

(3) Tax on income from transfer of Carbon credits [Section 115BBG]

(i) Carbon credits is an incentive given to an industrial undertaking for reduction of the emission of GHGs (Green House gases).

(ii) A reduction in emissions entitles the entity to a credit in the form of a Certified Emission Reduction (CER) certificate. The CER is tradable and its holder can transfer it to an entity which needs Carbon Credits to overcome an unfavourable position on carbon credits.

(iii) To bring clarity on the issue of taxation of income from transfer of carbon credits and to encourage measures to protect the environment, section 115BBG provides that where the total income of the assessee includes any income from transfer of carbon credit, such income shall be taxed at a concessional rate of 10% (plus applicable surcharge and cess)

(iv) **No expenditure is allowed -** No expenditure or allowance in respect of such income shall be allowed under the Act.

(4) Tax incentives to International Financial Services Centres [Sections 111A, 112A, 115JB, 115JC & 115-O]

In order to encourage the growth of International Financial Services Centres (IFSCs) into a world class financial services hub, it is necessary to ensure a competitive tax regime to International Financial Services Centre. Accordingly, the following incentives have been provided to units set up in the IFSC under the Income-tax Act, 1961:

	Section	Exemption/Levy	Incentive to IFSCs
(i)	**-**	**Levy of STT and CTT** The provisions of Chapter VII of the Finance (No.2) Act, 2004 provides for levy of securities transaction tax (STT) on transactions in taxable securities. The provisions of Chapter VII of the Finance Act, 2013 provides for levy of commodities transaction tax (CTT) on transactions in taxable commodities.	**Exemption from levy of STT and CTT** Provisions of Chapter VII of the Finance (No.2) Act, 2004 providing for levy of STT, **not** to apply to taxable securities transactions entered into by any person on a recognised stock exchange located in IFSC where the consideration for such transaction is paid or payable in foreign currency, thereby exempting such transactions from STT with effect from 1st June, 2016 The provisions of Chapter VII of the Finance Act, 2013 providing for levy of CTT, not to apply to taxable commodities transactions entered into by any person on a recognised association located in unit of IFSC where the consideration for such transaction is paid or payable in foreign currency, thereby exempting such transaction from CTT with effect from 1st June, 2016.
(ii)	**112A**	**Exemption of LTCG upto ₹ 1 lakh and taxability @ 10% on Long term capital gain exceeding ₹ 1 lakh only if STT is paid**: Exemption of income by way of long term capital gains ₹ 1 lakh arising from transfer of listed equity shares or listed units of an equity oriented fund or business trust provided securities	**Exemption of LTCG upto ₹ 1 lakh and taxability @ 10% on Long term capital gain exceeding ₹ 1 lakh even if STT not paid**: Section 112A(3) exempts tax on long-term capital gains upto ₹ 1 lakh and subjects long term capital gains exceeding ₹ 1 lakh @ 10%, in respect of income arising from transaction undertaken in foreign currency on a recognised stock exchange located in an International Financial Services Centre even when securities transaction tax is **not** paid in respect of such transaction.

		transaction tax is paid at the time of sale and at the time of acquisition in certain cases. Long term capital gains in excess of ₹ 1 lakh is subject to tax @ 10%, if STT is paid as above.	
(iii)	111A	**Levy of STCG @ 15% if STT is paid** Short term capital gains arising from transfer of listed equity shares or listed units of an equity oriented fund or business trust is taxable at a concessional rate of 15% provided securities transaction tax is paid.	**Levy of STCG @ 15% even if STT is not paid** Second proviso to section 111A(1) provides that short term capital gains arising from **transaction undertaken in foreign currency** on a recognised stock exchange located in an International Financial Services Centre would be taxable at a concessional rate of 15% **even when securities transaction tax is not paid** in respect of such transaction.
(iv)	115JB	**MAT levy @ *15%***: In case of a company, if the tax payable on the total income as computed under the Income-tax Act, is less than 15% of its book profit, such book profit shall be deemed to be the total income of the company and the Minimum Alternate Tax (MAT) payable by the company for the relevant previous year shall be ***15%*** **of such book profit**.	**Concessional rate of MAT @ 9%**: Sub-section (7) of section 115JB provides that in case of a company, being a unit located in International Financial Services Centre and deriving its income solely in convertible foreign exchange, the minimum alternate tax shall be chargeable at the rate of **9%** instead of ***15%***.
(v)	115JC	**AMT levy @ 18.5%:** Where the regular income-tax payable by a person, other than a company, computed under Income-tax Act, 1961 is less than the AMT payable, then adjusted total income would be deemed to be the total income of the person and such person shall be	***Concessional rate of AMT @ 9%:*** *Sub-section (4) has been inserted in section 115JC to provide that where the person subject to AMT is a unit located in International Financial Services Centre and deriving its income solely in convertible foreign exchange, the alternate minimum tax shall be chargeable at the rate of* ***9%*** *instead of 18.5%.*

		liable to pay income-tax on the adjusted total income @ 18.5%.	
(vi)	115-O	**Levy of DDT @ 15%:** Additional income-tax @15% is attracted on any amount declared, distributed or paid by a domestic company by way of dividends.	**Exemption from levy of DDT:** Sub-section (8) of section 115-O provides that no tax on distributed profits shall be chargeable in respect of the total income of a company being a unit located in International Financial Services Centre, deriving income solely in convertible foreign exchange, for any assessment year on any amount declared, distributed or paid by such company, by way of dividends (whether interim or otherwise) on or after 1st April, 2017 out of its current income, either in the hands of the company or the person receiving such dividend. *Further, any dividend paid out of income accumulated as a unit of International Financial Services Centre after 1st April, 2017 shall not be liable for tax on distributed profits either in the hands of the company or the person receiving such dividend*
(vii)	115-R	**Levy of tax on distributed profits** Additional income-tax is attracted on any amount of income distributed by specified company or mutual fund to its unit holders.	**Exemption from of tax on distributed profits** ***No additional income-tax shall be chargeable in respect of any amount of income distributed on or after 1st September, 2019 by a specified Mutual Fund, out of its income derived from transactions made on a recognised stock exchange located in any International Financial Services Centre and where the consideration for such transaction is paid or payable in convertible foreign exchange.***
(viii)	80LA	**Deduction in respect of certain income of off shore banking units and IFSC** Deduction@100% of such income of offshore banking	**Deduction@100% of profits increased to 10 consecutive assessment years out of 15 consecutive assessment years** ***Section 80LA has been amended to provide 100% deduction in respect of income of unit***

		unit in a SEZ is allowed for 5 consecutive assessment years. Thereafter, 50% of such income is allowable as deduction for the next 5 consecutive assessment years.	***of IFSC from its business which is approved for setting up in SEZ for any 10 consecutive assessment years at the option of the assessee, out of 15 assessment years, beginning with the assessment year relevant to the previous year, in which the permission under section 23(1)(a) of the Banking Regulation Act, 1949 or permission or registration under the SEBI Act, 1992 or any other relevant law was obtained.***
(ix)	**115A**	**Special rate of tax on dividend and interest income in case of non-corporate non-resident and foreign company** Section 115A(1) provides special rate of tax on, *inter alia,* interest and dividend income arising to non-corporate non-resident and foreign company. Section 115A(4) prohibits any deduction under chapter VI-A from such income.	***Section 115A(4) has been amended to provide that such condition of non-availability of deduction under section 80LA shall not be applicable to deduction allowed to a unit of IFSC i.e., a unit of an IFSC can claim deduction under section 80LA against interest and dividend income specified therein.***

EXERCISE

Question 1

XYZ Ltd. is engaged in the manufacture of textile since 01-04-2009. Its Statement of Profit & Loss shows a profit of ₹ 700 lakhs after debit/credit of the following items:

(1) Depreciation calculated on the basis of useful life of assets as per provisions of the Companies Act, 2013 is ₹ 50 lakhs.

(2) Employer's contribution to EPF of ₹ 2 lakhs and Employees' contribution of ₹ 2 lakhs for the month of March, 2020 were remitted on 8th May 2020.

(3) The company appended a note to its Income Statement that industrial power tariff concession of ₹ 2.5 lakhs was received from the State Government and credited the same to Statement of P & L.

(4) The company had provided an amount of ₹ 25 lakhs being sum estimated as payable to workers based on agreement to be entered with the workers union towards periodical wage revision once in 3 years. The provision is based on a fair estimation on wage and reasonable certainty of revision once in 3 years.

(5) The company had made a provision of 10% of its debtors towards bad and doubtful debts. Total sundry debtors of the company as on 31-03-2020 was ₹ 200 lakhs.

(6) A debtor who owed the company an amount of ₹ 40 lakhs was declared insolvent and hence, was written off by debit to Statement of Profit and loss.

(7) Sundry creditors include an amount of ₹ 50 lakhs payable to A & Co, towards supply of raw materials, which remained unpaid due to quality issues. An agreement has been made on 31-03-2020, to settle the amount at a discount of 75% of the outstanding. The amount waived is credited to Statement of Profit and Loss.

(8) The opening and closing stock for the year were ₹ 200 lakhs and ₹ 255 lakhs, respectively. They were overvalued by 10%.

(9) Provision for gratuity based on actuarial valuation was ₹ 500 lakhs. Actual gratuity paid debited to gratuity provision account was ₹ 300 lakhs.

(10) Commission of ₹ 1 lakhs paid to a recovery agent for realization of a debt. Tax has been deducted and remitted as per Chapter XVIIB of the Act.

(11) The company has purchased 500 tons of industrial paper as packing material at a price of ₹ 30,000/ton from PQR, a firm in which majority of the directors are partners. PQR's normal selling price in the market for the same material is ₹ 28,000/ton.

***Additional Information**:*

(1) There was an addition to Plant & Machinery amounting to ₹ 50 lakhs on 10-06-2019, which

was used for more than 180 days during the year. Additional depreciation has not been adjusted in the books.

(2) *Normal depreciation calculated as per Income-tax Rules, 1962 is ₹ 80 lakhs.*

(3) *The company had credited a sub-contractor an amount of ₹ 10 lakhs on 31-03-2019 towards repairing a machinery component. The tax so deducted was remitted on 31-12-2019.*

(4) *The company has collected ₹ 7 lakhs as GST from its customers and paid the same on the due dates. However, on an appeal made, the High Court directed the Department to refund ₹ 3 lakhs to the company. The company in turn refunded ₹ 2 lakhs to the customers from whom the amount was collected and the balance of ₹ 1 lakh is still lying under the head "Current Liabilities".*

Compute total income and tax payable for A.Y. 2020-21. Ignore MAT provisions and the provisions of section 115BAA.

Note - *The turnover of XYZ Ltd. for the P.Y.2017-18 was ₹ 405 crore.*

Answer

Computation of Total Income of XYZ Ltd. for the A.Y.2020-21

Particulars	Amount (₹)	
Profits and Gains from Business and Profession		
Profit as per Statement of profit and loss		7,00,00,000
***Add:* Items debited but to be considered separately or to be disallowed**		
(a) Depreciation as per Companies Act, 2013	50,00,000	
(b) Employees' contribution to EPF ***[See Note 1 below]*** *[Since employees' contribution to EPF has not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per section 36(1)(va). Since the same has been debited to Statement of profit and loss, it has to be added back for computing business income].*	2,00,000	
(c) Employer's contribution to EPF *[As per section 43B, employers' contribution to EPF is allowable as deduction since the same has been deposited on or before the 'due date' of filing of return under section 139(1). Since the same has been debited to Statement of profit and loss, no further adjustment is necessary]*	Nil	
(d) Provision for wages payable to workers *[The provision is based on fair estimate of wages and*	Nil	

	reasonable certainty of revision, the provision is allowable as deduction, since ICDS X requires 'reasonable certainty for recognition of a provision, which is present in this case. As the provision has been debited to Statement of profit and loss, no adjustment is required while computing business income]		
(e)	Provision for doubtful debts [10% of ₹ 200 lakhs] *[Provision for doubtful debts is allowable as deduction under section 36(1)(viia) only in case of banks, public financial institutions, state financial corporations, state industrial investment corporations and non-banking financial corporations. Such provision is not allowable as deduction in the case of a manufacturing company. Since the same has been debited to Statement of profit and loss, it has to be added back for computing business income]*	20,00,000	
(f)	Bad debts written off *[Bad debts write off in the book of account is allowable as deduction under section 36(1)(vii). Since the same has already been debited to Statement of profit and loss, no further adjustment is required]*	Nil	
(g)	Provision for gratuity *[Provision of ₹ 500 lakhs for gratuity based on actuarial valuation is not allowable as deduction as per section 40A(7). However, actual gratuity of ₹ 300 lakhs paid is allowable as deduction. Hence, the difference has to be added back]*	2,00,00,000	
(h)	Commission paid to recovery agent for realization of a debt. *[Commission of ₹ 1 lakh paid to a recovery agent for realisation of a debt is an allowable expense under section 37 as per DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All). Since the same has been debited to Statement of profit and loss, no further adjustment is required]*	Nil	
(i)	Purchase of paper at a price higher than the fair market value *[As per section 40A(2), the difference between the purchase price (₹ 30,000 per ton) and the fair market value (₹ 28,000 per ton) multiplied by the quantity purchased (500 tons) has to be added back since the purchase is from a related party, a firm in which majority of the directors are partners, at a price higher than the fair market value]*	10,00,000	
(j)	Sales tax not refunded to customers out of sales tax refund	1,00,000	
	[The amount of sales tax refunded to the company by the		

	Government is a revenue receipt chargeable to tax under section 41(1). Deduction can be claimed of amount refunded to customers [CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)]. Hence, the net amount of ₹ 1,00,000 (i.e., ₹ 3,00,000 minus ₹ 2,00,000) would be chargeable to tax]		2,83,00,000
			9,83,00,000
***Less**:*	**Items credited but to be considered separately/ permissible expenditure and allowances**		
(k)	Industrial power tariff concession received from State Government	Nil	
	[Any assistance in the form of, inter alia, concession received from the Central or State Government would be treated as income as per section 2(24)(xviii). Since the same has been credited to Statement of profit and loss, no adjustment is required.		
(l)	Discount given by Sundry Creditors for supply of raw materials	Nil	
	[Discount of 75% given by Sundry Creditors for supply of raw materials is taxable under section 41(1). Since the same has already been credited to Statement of profit and loss, no further adjustment is required]		
(m)	Depreciation as per Income-tax Act, 1961	80,00,000	
(n)	Over-valuation of stock [₹ 55 lakhs × 10/110]	5,00,000	
	[The amount by which stock is over-valued has to be reduced for computing business income. ₹ 50 lakhs, being the difference between closing and opening stock, has to be adjusted to remove the effect of over-valuation]		
(o)	Additional Depreciation ***[See Note 2 below]***	10,00,000	
	[Additional depreciation @ 20% is allowable on ₹ 50 lakhs, being actual cost of new plant & machinery acquired on 10.06.2019, as the same was put to use for more than 180 days in the P.Y.2019-20.]		
(p)	Payment to a sub-contractor where tax deducted last year was remitted after the due date of filing of return ***[See Note 3 below]***	3,00,000	
	[30% of ₹ 10 lakhs, being payment to a sub-contractor,		

would have been disallowed under section 40(a)(ia) while computing the business income of A.Y.2019-20, since tax deducted was remitted after the due date of filing of return. However, the same is allowable in A.Y.2020-21, since the remittance has been made on 31.12.2019]		98,00,000
Total Income		**8,85,00,000**

Computation of tax liability of XYZ Ltd. for A.Y.2020-21

Particulars	₹
Tax @ 30% on the above total income (since the turnover exceeded ₹ 400 crore in the P.Y. 2017-18)	2,65,50,000
Add: Surcharge @ 7% (since total income exceeds ₹ 1 crore but less than ₹ 10 crore)	18,58,500
	2,84,08,500
Add: Health and Education cess @ 4%	11,36,340
Total tax liability	**2,95,44,840**

Notes:

(1) Employees contribution to PF deposited after the due date mentioned under the PF Act is not allowable as deduction as per section 36(1)(va). The same has also been affirmed by the Gujarat High Court in *CIT v. Gujarat State Road Transport Corporation (2014) 366 ITR 170.* Hence, in the above solution, employees' contribution to PF has been disallowed while computing business income.

The CBDT has, vide Circular No. 22/2015, dated 17.12.2015, clarified that the employer contribution to provident fund remitted on or before due date of filing of return under section 139(1), is allowable as deduction while computing Business Income. Further, it has also clarified that the circular does not apply to claim of deduction relating to employee's contribution welfare funds which are governed by section 36(1)(va) of the Act.

Alternate View *- An alternate view has, however, been expressed in CIT v. Kiccha Sugar Co. Ltd. (2013) 356 ITR 351 (Uttarakhand), CIT v. AIMIL Ltd (2010) 321 ITR 508 (Del) and CIT v. Nipso Polyfabriks Ltd (2013) 350 ITR 327 (HP) that employees contribution to PF, deducted from the salaries of the employees of the assessee, shall be allowed as deduction from the income of the employer-assessee, if the same is deposited by the employer-assessee with the provident fund authority on or before the due date of filing of return for the relevant previous year. If this view is considered, then no disallowance would be attracted in this case, since the employees' contribution has been remitted before the due date of filing of return of income.*

(2) ₹ 50 lakhs, being the addition to plant and machinery on 10.6.2019 qualifies for additional depreciation @ 20% under section 32(1)(iia). Since only the normal depreciation as per Income-tax Rules, 1962, has been debited to profit and loss account, additional depreciation of ₹ 10 lakhs (being 20% of ₹ 50 lakhs) has to be deducted while computing business income.

(3) Since the tax deducted during the P.Y.2018-19 was remitted only on 31.12.2019, i.e., after the due date of filing of return for A.Y. 2019-20, ₹ 3,00,000, being 30% of ₹ 10 lakh would have been disallowed while computing the business income of that year. Since the tax deducted has been remitted on 31.12.2019, ₹ 3,00,000 would be allowed as deduction while computing the business income of the A.Y.2020-21.

Question 2

Parik Hospitality Limited is engaged in the business of running hotels of 3-star category. The company's Statement of Profit and Loss for the previous year ended 31st March, 2020 shows a profit of ₹ 152 lakhs after debiting or crediting the following items:

(a) Payment of ₹ 0.25 lakh and ₹ 0.30 lakh in cash on 3rd December, 2019 and 10th December, 2019, respectively, for purchase of crab, lobster and squid to Mr. Raja, a fisherman, and Mr. Khalid, a middleman for these products, respectively.

(b) Contribution towards employees' pension scheme notified by the Central Government under section 80CCD for a sum of ₹ 3 lakhs calculated at 12% of basic salary and Dearness Allowance payable to the employees.

(c) Payment of ₹ 6.50 lakhs towards transportation of various materials procured by one of its hotels to M/s. Bansal Transport, a partnership firm, without deduction of tax at source. The firm opts for presumptive taxation under section 44AE and has furnished a declaration to this effect. It also furnished its Permanent Account Number in the tender document.

(d) Profit of ₹ 12 lakhs on sale of a plot of land to Avimunya Limited, a domestic company, the entire shares of which are held by the assessee company. The plot was acquired by Parik Hospitality Limited on 1st June, 2018.

(e) Contribution of ₹ 2.50 lakhs to Indian Institute of Technology with a specific direction for use of the amount for scientific research programme approved by the prescribed authority.

(f) Expense of ₹ 10 lakhs on foreign travel of two directors for a collaboration agreement with a foreign company for a brewery project to be set up. The negotiation did not succeed and the project was abandoned.

(g) Fees of ₹ 1 lakh paid to independent directors for attending Board meeting without deduction of tax at source under section 194J.

(h) Depreciation charged ₹ 10 lakhs.

(i) ₹ 10 lakhs, being the additional compensation received from the State Government pursuant to an interim order of Court in respect of land acquired by the State Government in the previous year 2015-16.

(j) Dividend received from a foreign company ₹ 5 lakhs.

Additional information:

(i) As a corporate debt restructuring, the bank has converted unpaid interest of ₹ 10 lakhs upto 31st March, 2019 into a new loan account repayable in five equal annual installments. The first installment of ₹ 2 lakhs was paid in March, 2020 by debiting new loan account.

(ii) Depreciation as per Income-tax Act, 1961 ₹ 15 lakhs.

(iii) The company received a bill for ₹ 2 lakhs on 31st March 2020 from a supplier of vegetables for supply made in March, 2020. The bill was omitted to be recorded in the books in March, 2020. The bill was paid in April, 2020 and the necessary entry was made in the books then.

Compute total income of Parik Hospitality Limited for the Assessment Year 2020-21 indicating the reason for treatment of each item. Ignore the provisions relating to minimum alternate tax and the provisions of section 115BAA.

Answer

Computation of Total Income of Parik Hospitality Ltd. for the A.Y.2020-21

Particulars	Amount (₹)	
Profit as per Statement of profit and loss		1,52,00,000
***Add:* Items debited but to be considered separately or to be disallowed**		
(a) Payment to middleman for purchase of crab etc. in an amount exceeding ₹ 10,000 [Under section 40A(3), disallowance is attracted in respect of expenditure for which cash payment exceeding ₹ 10,000 is made on a day to a person. Payment of ₹ 25,000 to fishermen for purchase of crab etc. is covered by exception under Rule 6DD. However, payment of ₹ 30,000 to middlemen for purchase of crab etc. is not covered under the exception - *CBDT Circular 10/2008 dated 5/12/2008*].	30,000	
(b) Contribution towards employees' pension scheme in excess of 10% of salary disallowed under section 40A(9) [Contribution to the extent of 10% of salary (basic salary + dearness allowance, if it forms part of pay for retirement benefits) is allowable as deduction under section 36(1)(iva). In this case, it is presumed that dearness allowance forms part of pay for retirement benefits]	50,000	

(c) Payment to transport contractor without deduction of tax at source	-	
[Since the contractor opts for presumptive taxation under section 44AE and furnished a declaration to this effect, tax is not required to be deducted at source under section 194C in respect of payment to transport contractor].		
(f) Expenses on foreign travel of two directors for a collaboration agreement which failed to materialize	10,00,000	
[Where expenditure is incurred for a project not related the existing business and the project was abandoned without creating a new asset, the expenses are capital in nature as per *Mc Gaw-Ravindra Laboratories (India) Ltd. v. CIT (1994) 210 ITR 1002 (Guj.).* Brewery project is not related to the existing business of running three star hotels]		
(g) Fees paid to directors without deducting tax at source [30% of ₹ 1 lakh]	30,000	
[Disallowance @ 30% would be attracted under section 40(a)(ia) for non-deduction of tax at source from director's remuneration on which tax is deductible under section 194J]		11,10,000
		1,63,10,000
***Less:* Items credited but to be considered separately/ Expenditure to be allowed**		
(d) Profit on sale of plot of land to 100% subsidiary	12,00,000	
[Short-term capital gains arise on sale of plot of land held for less than 24 months. However, in this case, since the transfer is to a 100% subsidiary company and the subsidiary company is an Indian company, the same would not constitute a transfer for levy of capital gains tax as per section 47(iv). Since this amount has been credited to the statement of profit and loss, the same has to be deducted for computing business income].		
(e) Contribution to IIT for scientific research	1,25,000	
[Contribution to IIT for scientific research programme approved by the prescribed authority qualifies for weighted deduction @ 150% under section 35(2AA). Since 100% of contribution has already been debited to the statement of profit and loss, the balance 50% has to be deducted while computing business income][8].		

[8] From assessment year 2021-22 it is deductible @ 100%

(h) Depreciation [Depreciation allowable under the Income-tax Act, 1961 is ₹ 15 lakhs whereas the depreciation as per books of account debited to the statement of profit and loss is ₹ 10 lakhs. Hence, the additional amount of ₹ 5 lakhs has to be deducted while computing business income]	5,00,000	
(i) Additional compensation received from State Government [Since the additional compensation has been received pursuant to an interim order of the Court, the same would be deemed as income chargeable to tax under the head "Capital Gains" in the year of final order as per section 45(5). Since the compensation has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	10,00,000	
(j) Dividend received from foreign company [Dividend received from foreign company is taxable under the head "Income from other sources". Since the said dividend has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	5,00,000	
(i) Interest paid during the year [Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose section 43B. The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since ₹ 2 lakhs has been paid in the P.Y. 2019-20, the same is allowable as deduction]	2,00,000	
(iii) Purchases omitted to be recorded in the books [Since the purchase is made in March, 2020 (i.e., P.Y. 2019-20), in respect of which bill of ₹ 2 lakhs received on 31.3.2020 has been omitted to be recorded in the books in that year, it has to be deducted to compute the business income *[Kedarnath Jute Manufacturing Company Ltd. v. CIT (1971) 82 ITR 363 (SC)]*. It is logical to assume that the company is following mercantile system of accounting.].	2,00,000	37,25,000
Income under the head "Profits and Gains of Business or Profession"		**1,25,85,000**

Income from Other Sources		
Dividend received from foreign company [Dividend received from a foreign company is chargeable to tax under the head "Ïncome from other sources".]		5,00,000
Gross Total Income		**1,30,85,000**
Less: Deduction under Chapter VI-A		Nil
Total Income		**1,30,85,000**

Question 3

Hyper Ltd., engaged in diversified activities, earned a profit of ₹ 14,25,000 after debit/credit of the following items to its statement of profit and loss for the year ended on 31.3.2020:

(a)	*Items debited to Statement of Profit and Loss*	*₹*
	Provision for loss of subsidiary	*70,000*
	Provision for income-tax demand	*1,05,000*
	Expenses on purchase/sale of equity shares	*15,000*
	Depreciation	*3,60,000*
	Interest on deposit credited to buyers on 31.3.2020 for advance received from them, on which TDS was deducted in April 2020 and was deposited on 31.7.2020	*1,00,000*
(b)	*Items credited to Statement of Profit and Loss*	
	Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale	*3,60,000*
	Income from units of UTI	*75,000*

The company provides the following additional information:

(i) *Depreciation includes ₹ 1,50,000 on account of revaluation of fixed assets.*

(ii) *Depreciation allowable as per Income-tax Rules is ₹ 2,80,000.*

(iii) *Brought forward Business Loss/ Unabsorbed Depreciation:*

F.Y.	*Amount as per books*		*Amount as per Income-tax*	
	Loss *₹*	*Depreciation* *₹*	*Loss* *₹*	*Depreciation* *₹*
2015-2016	*2,50,000*	*3,00,000*	*2,00,000*	*2,50,000*
2016-2017	*Nil*	*2,70,000*	*1,00,000*	*1,80,000*
2017-2018	*3,50,000*	*3,15,000*	*1,20,000*	*2,10,000*

You are required to:

(i) compute the total income of the company for the assessment year 2020-21 giving the reasons for treatment of items and

(ii) examine the applicability of section 115JB of the Income-tax Act, 1961, and compute book profit and the tax credit to be carried forward.

Assume the tax rate applicable to Hyder Ltd for the P.Y. 2019-20 is 30%. Ignore the provisions of section 115BAA.

Answer

Computation of total income of M/s Hyper Ltd. for the A.Y. 2020-21

Particulars	₹	₹
Profit as per Statement of Profit & Loss		14,25,000
Add: **Items disallowed/ considered separately**		
Provision for loss of subsidiary [since it is not wholly and exclusively for the purpose of business of the assessee]	70,000	
Provision for income-tax [disallowed under section 40(a)(ii)]	1,05,000	
Expenses on transfer of shares [not deductible from business income. It is to be deducted from gross sale consideration while computing capital gains]	15,000	
Interest on deposit credited on 31.3.2020 and tax deducted in April 2020 which was deposited on 31.7.2020 [30% disallowed under section 40(a)(ia) since, tax is deducted only in the next year].	30,000	
Depreciation debited to statement of profit and loss [only depreciation calculated as per the Income-tax Rules, 1962 is allowable as deduction]	3,60,000	5,80,000
		20,05,000
Less: **Items credited but not includible under business income or are exempt under the provisions of the Act**		
Long-term capital gain on sale of equity shares on which securities transaction tax was paid, since it is not a business income.	3,60,000	
Income from units of UTI, since it is not a business income.	75,000	4,35,000
		15,70,000
Less: Depreciation (allowable as per the Income-tax Rules, 1962)		2,80,000
		12,90,000
Less: Set-off of brought forward business loss and unabsorbed depreciation		
Brought forward business loss under section 72	4,20,000	

Brought forward depreciation under section 32	6,40,000	10,60,000
Income from business		**2,30,000**
Capital Gains		
Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale		3,60,000
Income from Other Sources		
Income from units of UTI	75,000	
Less: Exempt under section 10(35)	75,000	Nil
Total Income		**5,90,000**
Tax on LTCG exceeding ₹ 1 lakh @ 10%		26,000
Tax on other income of ₹ 2,30,000 @ 30%		69,000
		95,000
Add: Health and Education cess @ 4%		3,800
Tax Payable as per the Income-tax Act, 1961		**98,800**

Computation of Book Profit under section 115JB

Particulars	₹	₹
Profit as per Statement of Profit & Loss		14,25,000
***Add:* Net Profit to be increased by the following amounts as per *Explanation 1* below section 115JB(2)**		
Provision for loss of subsidiary	70,000	
Provision for income-tax	1,05,000	
Depreciation debited to statement of profit and loss	3,60,000	5,35,000
		19,60,000
***Less:* Net Profit to be reduced by the following amounts as per *Explanation 1* below section 115JB(2)**		
Depreciation debited to statement of profit and loss (excluding depreciation on account of revaluation of fixed assets) (i.e., ₹ 3,60,000 – ₹ 1,50,000)	2,10,000	
Income from UTI [since it is an income exempt u/s 10(35)]	75,000	
Brought forward business loss or unabsorbed deprecation as per books of account, whichever is less, taken on cumulative basis	6,00,000	8,85,000
Book Profit		**10,75,000**
15% of book profit		1,61,250
Add: Health and Education cess @ 4%		6,450
		1,67,700

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than ***15%*** of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be ***15%*** thereof plus health and education cess @ 4%.

Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than ***15%*** of book profit, the book profit of ₹ 10,75,000 is deemed to be the total income and income-tax is payable @ ***15%*** thereof plus health and education cess @ 4%. The tax liability, therefore, works out to be ₹ 1,67,700.

Section 115JAA provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid, over and above the tax payable under the other provisions of the Income-tax Act, 1961, will be allowed as tax credit in the subsequent years.

The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act. This tax credit is allowed to be carried forward for 15 assessment years succeeding the assessment year in which the credit became allowable.

Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Particulars	₹
Tax on book profit under section 115JB	1,67,700
Less: Tax on total income computed as per the other provisions of the Act	98,800
Tax credit to be carried forward under section 115JAA	**68,900**

Question 4

The profit as per the statement of profit and loss of XYZ Ltd., a resident company, for the year ended 31.3.2020 is ₹ 190 lacs arrived at after making the following adjustments:

	Particulars	*₹ (in lacs)*
(i)	*Depreciation on assets*	*100*
(ii)	*Reserve for currency exchange fluctuation*	*50*
(iii)	*Provision for tax*	*40*
(iv)	*Proposed dividend*	*120*

Following further information are also provided by company:

(a) Profit includes ₹ 10 lacs, being dividend received from an Indian subsidiary company.

(b) Provision for tax includes ₹ 16 lacs of tax payable on distribution of profit and of ₹ 2 lacs of interest payable on income-tax.

(c) Depreciation includes ₹ 40 lacs towards revaluation of assets.

(d) Amount of ₹ 50 lacs credited to statement of P & L was drawn from revaluation reserve.

(e) Balance of statement of profit and loss shown in balance sheet at the asset side as at 31.3.2019 was ₹ 30 lacs which includes unabsorbed depreciation of ₹ 10 lakhs.

Compute the book profit for the year ended 31.3.2020.

Answer

Computation of book profit of XYZ Ltd. for the year ended 31.3.2020

Particulars	₹	₹
Profit as per Statement of Profit & Loss		1,90,00,000
Add: **Net profit to be increased by the following amounts as per *Explanation 1* below section 115JB(2)**		
Depreciation on assets debited to Statement of P&L	1,00,00,000	
Reserve for currency exchange fluctuation, since the amount carried to any reserve, by whatever name called, is to be added back	50,00,000	
Provision for tax **(See Note below)**	40,00,000	
Proposed dividend	1,20,00,000	3,10,00,000
		5,00,00,000
Less: **Net profit to be decreased by the following amounts as per *Explanation 1* below section 115JB(2)**		
Depreciation other than depreciation on revaluation of assets (₹ 100 lacs - ₹ 40 lacs)	60,00,000	
Withdrawal from revaluation reserve restricted to the extent of depreciation on account of revaluation of assets (₹ 50 lacs or ₹ 40 lacs, whichever is less)	40,00,000	
Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. Unabsorbed depreciation ₹ 10 lakhs and brought forward business loss ₹ 20 lakhs – whichever is less	10,00,000	
Dividend income [since the same is exempt under section 10(34)]	10,00,000	1,20,00,000
Book profit		**3,80,00,000**

Note – For the purpose of section 115JB, book profit means the profit as per the statement of profit and loss prepared in accordance with Schedule III to the Companies Act, 2013, as adjusted by certain additions/deductions as specified. One of the adjustments is to add back income-tax paid or payable, and the provisions therefor. *Explanation 2* after sub-section (2) of section 115JB clarifies that income-tax includes, *inter alia*, dividend distribution tax/ tax on distributed income and interest. Therefore, the entire provision of ₹ 40 lacs for income-tax is added back for computing book profit for levy

Question 5

Mr. Harish, aged 66, running business as a proprietor furnishes the particulars of his income for the year ended 31.03.2020 as under:

(a) Net Profit of ₹ 3,65,500 from the wholesale business of textiles and fabrics arrived at after charge of following expenses in the Profit & Loss Account:

(i) Personal travelling expenses of ₹ 12,750.

(ii) Purchase of furniture items for shop on 13.6.2019 of ₹ 25,000 but charged in shop expenses.

(b) He owns a house with two floors constructed with the financial assistance of HDFC, out of which ground floor is used by him for self-use and first floor was let out on rent for ₹ 8,500 p.m. from April, 2019. The municipal tax paid for the whole house was of ₹ 2,500 and interest paid on housing loan for the construction was ₹ 52,000. Both the floors of the house are identical.

(c) He deposited insurance premium on the life of self of ₹ 12,500, wife ₹ 13,500, son and daughter of ₹ 28,000, repaid housing loan of ₹ 50,000 and paid ₹ 55,000 by credit card for health insurance of himself and his family.

Compute taxable income and the amount of tax payable by Mr. Harsh on such income for the Assessment Year 2020-21.

Answer

Computation of total income of Mr. Harsh for the A.Y.2020-21

Particulars	₹	₹
Income from house property		
Self-occupied portion (50%)		
Annual Value under section 23(2)	Nil	
Less: Deduction under section 24(b)		
Interest on housing loan [₹ 52,000 × 50%]	26,000	(26,000)
Let-out portion (50%)		

Income of let out portion being rent of ₹ 8,500 p.m. received for 12 months **(Rent received has been taken as the GAV in the absence of other information)**.		
Gross Annual Value under section 23(1) (₹ 8,500 × 12)	1,02,000	
Less: 50% of municipal taxes paid allowable in respect of rented out portion (i.e., 50% of ₹ 2,500)	1,250	
Net Annual Value (NAV)	1,00,750	
***Less:* Deduction under section 24**		
30% of NAV under section 24(a)	30,225	
Interest on housing loan under section 24(b)	26,000	44,525
		18,525
Profits and gains of business or profession		
Net profit as per profit and loss account of wholesale business of textiles and fabrics	3,65,500	
Add: Expenses charged in profit and loss account either not allowable or to be considered separately -		
Personal travelling expenses of proprietor	12,750	
Purchase of furniture wrongly debited to shop expenses	25,000	
	4,03,250	
Less: Depreciation on furniture @ 10% on ₹ 25,000	2,500	4,00,750
Gross Total Income		**4,19,275**
Less: **Deduction under Chapter VI-A**		
Under section 80C		
- Life insurance premium		
Self	12,500	
Wife	13,500	
Son and daughter	28,000	
- Housing loan repaid	50,000	
	1,04,000	
Under section 80D [Medical insurance premium]		
Mediclaim insurance premium of ₹ 55,000 [maximum deductible is ₹ 50,000 where it covers a resident senior citizen]	50,000	1,54,000
Total Income		**2,65,275**
Total Income (rounded off)		2,65,280
Tax on total income of ₹ 2,65,280		Nil
(The basic exemption limit for senior citizen is ₹ 3,00,000 for A.Y. 2020-21)		

Question 6

X, Y and HUF of Z (represented by Z) are partners with equal shares in profits and losses of a firm, M/s Popular Cine Vision, which is engaged in the production of TV serials and telefilms. In the previous year 2018-19, one partner 'A' retired, but his dues have been settled in the previous year 2019-20.

The earlier partnership deed did not authorise payment of remuneration or interest to partners. The partnership deed was revised by the partners on 1st June, 2019 to authorise payment of remuneration of ₹ 1 lac per month to each working partner and simple interest at 15% per annum on partners' capital. X, Y and Z are actively associated with the affairs of the firm.

The Profit & Loss Account of the firm for the year ended 31st March, 2020 shows a net profit of ₹ 10 lacs after debiting/crediting the following:

(a) Interest amounting to ₹ 5 lacs each was paid to partners on the balances standing to their capital accounts from 1stJune, 2019 to 31st March, 2020.

(b) Remuneration to the partners including partner in representative capacity ₹ 30 lacs.

(c) Interest amounting to ₹ 2 lacs paid to Z on loan provided by him in his individual capacity at 16% interest.

(d) Royalty of ₹ 5 lacs paid to partner X, who is a professional script writer, for use of his scripts as per agreement between the firm and X. The same is authorized by partnership deed.

(e) Two separate payments of ₹ 18,000 and ₹ 15,000 made in cash on 1st February, 2020 to Altaf, a hairdresser, against his bill for services rendered in January, 2020 and two payments of ₹ 19,000 and ₹ 10,000 made in cash on 1st February and 2nd February, 2020, respectively, to Priyam, an assistant cameraman, against her bill for services provided in January, 2020.

(f) Amount of ₹ 5 lacs provided in the books on 31st March 2020 as liability for remuneration to Shreya, a film artist and a non-resident. Tax deducted at source under section 195 from the amount so credited was paid on 3rd June, 2020.

(g) Amount of ₹ 6 lacs provided as gratuity for the year on the basis of actuarial valuation. Gratuity actually paid to one retired employee during the year is ₹ 1.50 lacs.

(h) Interest of ₹ 1.20 lacs received on income-tax refund under section 244(1A) in respect of A.Y. 2017-18.

The firm has also provided the following additional information:

The amount due to A, an ex-partner, was ₹ 15 lacs which was settled on 30th September, 2019 by transferring a plot of land purchased one year back having book value of ₹ 10 lacs. The difference of ₹ 5 lacs was credited to partners' capital accounts in their profit-sharing ratio. The value of plot for stamp duty valuation on the date of transfer was ₹ 16 lacs.

Compute the total income of the firm for the assessment year 2020-21 stating the reasons for treatment of each item.

Answer

Computation of Total Income of M/s. Popular Cine Vision for the A.Y.2020-21

Particulars	₹	₹
Profits and Gains from Business or Profession		
Net Profit as per Profit & Loss A/c		10,00,000
Add: Expenses disallowed or considered separately:		
Interest to partners in excess of 12% **(Note 1)**	3,00,000	
Disallowance under section 40A(3) for aggregate cash payment exceeding ₹ 10,000 in a single day **(Note 5)**	52,000	
Provision for gratuity **(Note 7)**	4,50,000	
Partners' Remuneration	30,00,000	
Royalty paid to Partner X **(Note 4)**	5,00,000	43,02,000
		53,02,000
Less: Interest on income-tax refund **(Note 8)**		1,20,000
Book Profit		**51,82,000**
Less: Partners' remuneration allowable under section 40(b)(v)		
(i) As per limit prescribed in section 40(b)		
On first ₹ 3,00,000 90%	2,70,000	
On the balance ₹ 48,82,000 60%	29,29,200	
	31,99,200	
(ii) Remuneration actually paid or payable (₹ 1,00,000 × 10 months × 3 partners) + (Royalty ₹ 5 Lacs)		
(i) or (ii) whichever is less, is deductible	35,00,000	31,99,200
		19,82,800
Capital Gain		
Short-term capital gain on transfer of land **(Note 9)**		6,00,000
Income from other sources		
Interest on income-tax refund		1,20,000
Gross Total Income		**27,02,800**
Deductions under Chapter VI-A		Nil
Total Income		**27,02,800**

Notes:

1. As per section 40(b), simple interest at 12% p.a. to partners relating to the period after the date of partnership deed is allowable. Excess interest @ 3% paid from 1st June, 2019 to 31st March, 2020 is to be disallowed. Excess interest of 3% being ₹ 15,00,000 x 3/15 = ₹ 3,00,000.

2. Even though Z is a partner in a representative capacity, he is still a partner. Therefore, remuneration to Z should also be subject to the limits prescribed in section 40(b). This view finds support from the decision of the Supreme Court in the case of *Rashik Lal & Co. vs CIT (1998) 229 ITR 458 (SC).*

3. As per *Explanation 1* to section 40(b), where an individual is a partner in a firm in representative capacity, the provisions of section 40(b) shall not apply to any interest payable by the firm to such individual in his personal capacity. Z represents his HUF in the firm. However, Z gave the loan in his individual capacity. Hence, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.

4. It may be noted that the limits specified under section 40(b)(v) are applicable in case of payment of salary, bonus, commission, or remuneration, by whatever name called, to a working partner. From a plain reading of the section, it is clear that any remuneration, by whatever name called, paid to a working partner, is subject to the limits laid down in section 40(b)(v). Therefore, the royalty of ₹ 5 Lacs paid to partner X would also be subject to the limits laid down in section 40(b)(v). Hence, the same has to be added back for computing book profits.

5. Section 40A(3) provides for disallowance of any expenditure in respect of which the actual payment exceeding ₹ 10,000 is made otherwise than by an account payee cheque, account payee bank draft or use of ECS through bank account ***or through such other electronic mode as may be prescribed*** in a single day to a person. Hence, the payments of ₹ 18,000 and ₹ 15,000 in cash on 1.2.2020 to Altaf, a hairdresser, shall be disallowed, since the aggregate payment of ₹ 33,000 exceeds the limit of ₹ 10,000.

   The payment of bill of the assistant cameraman of ₹ 19,000 on 1st February is also liable for disallowance under section 40A(3) since the aggregate payment in cash on a single day has exceeded ₹ 10,000.

6. As per section 40(a)(i), any sum payable to a non-resident shall not be allowed as deduction, if tax has not been deducted at source or after deduction, has not been paid on or before the due date specified under section 139(1). Tax deducted from the amount of remuneration credited to payee's account on 31st March 2020 has to be deposited latest by 31st July 2020/ 30th September, 2020 (as the case may be). The firm has paid the tax on 3rd June, 2020 and hence, the remuneration shall be allowed. Since the same is already debited to profit and loss account, no further adjustment is made.

7. As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, gratuity of ₹ 1.50 lacs paid to retired employees is allowable as deduction. Hence, the balance provision of ₹ 4.50 lacs (i.e., ₹ 6 lacs – ₹ 1.50 lacs) is to be disallowed.

8. Interest on income-tax refund is assessable under the head "Income from other sources".

9. Distribution of a capital asset by a firm to its partner on dissolution or otherwise attracts capital gains tax liability as per the provisions of section 45(4) and the fair market value of the asset on the date of transfer is deemed to be the full value of consideration received or accruing as a result of the transfer. The words "or otherwise" includes within its scope, cases of distribution of capital assets on retirement of a partner also. [*CIT vs. A. N. Naik Associates (2004) 265 ITR 346 (Bom.)]*. Therefore, distribution of a plot of land on retirement of a partner would attract section 45(4).

   ₹ 16 lacs, being the fair market value of the plot on the date of transfer, is deemed to be the full value of consideration. Therefore, the short-term capital gain would be ₹ 6 lacs (i.e., ₹ 16 lacs – ₹ 10 lacs).

Question 7

PQR LLP, a limited liability partnership set up a unit in Special Economic Zone (SEZ) in the financial year 2015-16 for production of washing machines. The unit fulfills all the conditions of section 10AA of the Income-tax Act, 1961. During the financial year 2018-19, it has also set up a warehousing facility in a district of Tamil Nadu for storage of agricultural produce. It fulfills all the conditions of section 35AD. Capital expenditure in respect of warehouse amounted to ₹ 75 lakhs (including cost of land ₹ 10 lakhs). The warehouse became operational with effect from 1st April, 2019 and the expenditure of ₹ 75 lakhs was capitalized in the books on that date.

Relevant details for the financial year 2019-20 are as follows:

Particulars	*₹*
Profit of unit located in SEZ	*40,00,000*
Export sales of above unit	*80,00,000*
Domestic sales of above unit	*20,00,000*
Profit from operation of warehousing facility (before considering deduction under Section 35AD).	*1,05,00,000*

Compute income tax (including AMT under Section 115JC) payable by PQR LLP for Assessment Year 2020-21.

Answer

Computation of total income and tax liability of PQR LLP for A.Y.2020-21
(under the regular provisions of the Income-tax Act, 1961)

Particulars	₹	₹
Profits and gains of business or profession		
Unit in SEZ	40,00,000	
Less: Deduction under section 10AA **[See Note (1) below]**	32,00,000	
Business income of SEZ unit chargeable to tax		8,00,000
Profit from operation of warehousing facility	1,05,00,000	
Less: Deduction under section 35AD **[See Note (2) below]**	65,00,000	
Business income of warehousing facility chargeable to tax		40,00,000
Total Income		**48,00,000**
Computation of tax liability (under the normal/ regular provisions)		
Tax @ 30% on ₹ 48,00,000		14,40,000
Add: Health and Education cess @ 4%		57,600
Total tax liability		**14,97,600**

Computation of adjusted total income of PQR LLP for levy of Alternate Minimum Tax

Particulars	₹	₹
Total Income (as computed above)		**48,00,000**
Add: Deduction under section 10AA		32,00,000
		80,00,000
Add: Deduction under section 35AD	65,00,000	
Less: Depreciation under section 32		
On building @ 10% of ₹ 65 lakhs[9]	6,50,000	58,50,000
Adjusted Total Income		**1,38,50,000**
Alternate Minimum Tax @ 18.5%		25,62,250
Add: Surcharge @ 12% (since adjusted total income > ₹ 1 crore)		3,07,470
		28,69,720

[9] Assuming the capital expenditure of ₹ 65 lakhs is incurred entirely on buildings

Add: Health and Education cess @ 4%		1,14,789
		29,84,509
Tax liability under section 115JC (rounded off)		**29,84,510**

Since the regular income-tax payable is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income and tax is leviable @ 18.5% thereof *plus* surcharge @ 12% and cess @ 4%. Therefore, the tax liability is ₹ 29,84,510.

AMT Credit to be carried forward under section 115JEE

	₹
Tax liability under section 115JC	29,84,510
Less: Tax liability under the regular provisions of the Income-tax Act, 1961	14,97,600
	14,86,910

Notes:

(1) **Deduction under section 10AA in respect of Unit in SEZ =**

$$\text{Profit of the Unit in Sez} \times \frac{\text{Export turnover of the Unit in SEZ}}{\text{Total turnover of the Unit in SEZ}}$$

$$₹\ 40,00,000 \times \frac{₹\ 80,00,000}{₹\ 1,00,00,000} = ₹\ 32,00,000$$

(2) Deduction @ 100% of the capital expenditure is available under section 35AD for A.Y.2020-21 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 01.04.2012.

Further, the expenditure incurred, wholly and exclusively, for the purposes of such specified business, shall be allowed as deduction during the previous year in which he commences operations of his specified business if the expenditure is incurred prior to the commencement of its operations and the amount is capitalized in the books of account of the assessee on the date of commencement of its operations.

Deduction under section 35AD would, however, not be available on expenditure incurred on acquisition of land.

In this case, since the capital expenditure of ₹ 65 lakhs (i.e., ₹ 75 lakhs – ₹ 10 lakhs, being expenditure on acquisition of land) has been incurred in the F.Y.2018-19 and capitalized in the books of account on 1.4.2019, being the date when the warehouse became operational, ₹ 65,00,000, being 100% of ₹ 65 lakhs would qualify for deduction under section 35AD.

Question 8

Victory Polyfibres, a partnership firm, has earned a gross total income of ₹ 300 lacs for the year ended 31-3-2020. The firm has not undertaken any international transaction or specified domestic transaction during the said year.

The above includes a profit of ₹ 220 lacs from an undertaking having a turnover of ₹ 80 crores. This is the fifth year and deduction under section 80-IA of the Income-tax Act, 1961 is available to the extent of ₹ 200 lacs.

There are some grey areas in the taxation workings and hence, the assessee is contemplating to file the return of income on 7-12-2020, after seeking clarifications from tax experts.

Advise the assessee-firm by working out the total income and tax payable, where the return is filed on 30-09-2020 or when the same is filed on 7-12-2020.

What is the practical solution as regards obtaining clarifications, which might or might not have an impact on the total income? You may ignore interest under section 234A, 234B, 234C and 234F while making the computation in support of your advice.

Answer

As per section 80AC, while computing the total income of an assessee of a previous year ***(P.Y.2019-20, in this case)*** relevant to any assessment year ***(A.Y.2020-21, in this case)***, any deduction is admissible, *inter alia,* under section 80-IA, such deduction shall not be allowed unless it furnishes a return of income for such assessment year on or before the 'due date' specified in section 139(1).

Since the turnover of the partnership firm has exceeded ₹ 200 lacs in the previous year 2019-20, it would be subject to audit under section 44AB, in which case the 'due date' of filing its return of income for A.Y.2020-21 would be 30th September, 2020 as per section 139(1).

Computation of total income and tax liability of M/s. Victory Polyfibres for A.Y.2020-21

I. Where the firm files its return of income on 30th September 2020:

Particulars	₹ in lacs
Gross Total Income	300.00
Less: Deduction under section 80-IA	200.00
Total Income	**100.00**
Tax liability @ 30%	30.00
Add: Health and Education cess @ 4%	1.20
Regular income-tax payable	**31.20**

Computation of Alternate Minimum Tax payable [Section 115JC]

Particulars	₹ in lacs
Total Income	100.00
Add: Deduction under section 80-IA	200.00
Adjusted Total Income	**300.00**
Alternate Minimum Tax (AMT) @ 18.5% on ₹ 300 lacs	55.50

Add: Surcharge @ 12% (Since adjusted total income >₹ 1 crore)	6.66
	62.16
Add: Health and Education cess @ 4%	2.49
Total tax payable (AMT)	**64.65**

Since the regular income-tax payable by the firm is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income of the firm for P.Y.2019-20 and it shall be liable to pay income-tax on such total income @ 18.5% **[Section 115JC(1)]**. Therefore, the tax payable for the A.Y.2020-21 would be ₹ 64.65 lacs.

Tax credit for Alternate Minimum Tax [Section 115JD]

	₹ in lacs
Total tax payable for A.Y.2020-21 (Alternate Minimum Tax)	64.65
Less: Regular income-tax payable	31.20
To be carried forward for set-off against regular income-tax payable (upto a maximum of fifteen assessment years).	33.45

II. Where the firm files its return of income on 7th December 2020:

Where the firm files its return on 7-12-2020, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under section 80-IA would not be available. In such circumstances, the gross total income of ₹ 300 lacs would be the total income of the firm.

Particulars	**₹ in lacs**
Income-tax @ 30% of ₹ 300 lacs	90.000
Add: Surcharge @ 12% (since total income exceeds ₹ 100 lacs)	10.800
Income-tax (plus surcharge)	100.800
Add: Health and Education cess @ 4%	4.032
Total tax liability	**104.832**

Practical solution regarding obtaining clarifications

The practical solution regarding obtaining clarifications would be to file the return of income under section 139(1) on or before the 'due date', i.e., 30.9.2020, and claim deduction under section 80-IA. In such a case, the firm can claim deduction of ₹ 200 lacs under section 80-IA. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return under section 139(5) within 31.3.2021 (i.e., within the end of A.Y.2020-21) which would replace the original return filed under section 139(1). A revised return filed under section 139(5) would replace the original return filed under section 139(1).

If the firm files the return of income under section 139(1) on or before 30.9.2020, its tax liability would stand reduced to ₹ 64.65 lacs, as against ₹ 104.832 lacs to be paid if return is furnished after due date. Further, it would also be eligible for tax credit for alternate minimum tax under section 115JD to the extent of ₹ 33.45 lacs. Therefore, the firm is advised to file its return of income on or before 30.9.2020.

Question 9

Prakash, a member in two AOPs, namely, "AOP & Co." and "Prakash & Akash", provides the following details of his income for the year ended 31.3.2020:

(a) "AOP & Co.", assessed at normal rates of tax, had credited in his account, amount of ₹ 2,10,000 as interest on capital, ₹ 4,96,000 as salary and ₹ 20,000 as share of profit.

(b) A house property located at Jaipur was purchased on 1.7.2010 with the borrowed capital in "Prakash & Akash" jointly shared equally and occupied by both of them for self-residential purposes. Total interest paid for the year 2019-20 on the borrowed capital was ₹ 4,10,000.

Compute the income and the tax liability thereon for the A.Y. 2020-21 and support your answer with brief reasons and the provisions of the Act.

Answer

Mr. Prakash is a member in two AOPs, namely, AOP & Co. and Prakash & Akash. Though Prakash & Akash is an AOPs, the income from the house property will not be assessed as income of the AOPs, but will be included in the hands of the individual members as per section 26, since the share of each member is definite and ascertainable. Hence, Prakash's share of income from house property would be assessed in his individual hands.

Since AOP & Co., has been taxed at normal rates of tax, Mr. Prakash's share income from the AOPs (i.e. salary, interest on capital and his share of profit) would be included in his total income. Mr. Prakash, however, would be entitled to a relief under section 86 read with section 110 in respect of this income which has been included in his total income but on which tax has already been paid by the AOPs. As per section 110, the relief shall be allowed at the average rate of tax calculated on the total income inclusive of such income.

Hence, the tax liability in the hands of Mr. Prakash would be as under:-

Particulars	₹	₹
Annual Value (½ share in house property used for own residence);	Nil	
Less: Interest on loan [½ share in ₹ 4,10,000] – Since the loan is borrowed on or after 1.4.1999 and is used for acquiring property within 5 years, deduction would be available upto a maximum of ₹ 2,00,000. This limit of ₹ 2,00,000 applies for each member separately.	2,00,000	
Loss from house property		(-) 2,00,000

Share income from AOP & Co.		
- Interest on capital	2,10,000	
- Salary	4,96,000	
- Share of profit	20,000	7,26,000
Total Income		**5,26,000**

Particulars		**₹**
Tax on ₹ 5,26,000		17,700
Add: Health and Education Cess @ 4%		708
Tax Liability		18,408
Less: Rebate under section 86 read with section 110 = ₹ 18,408 x 100/₹ 5,26,000	3.5%	
Rebate available ₹ 7,26,000 x 3.5% = ₹ 25,410		
Restricted to		18,408
Tax payable		**Nil**

Question 10

T and Q are individuals, who constitute an Association of Persons, sharing profit and losses in the ratio of 2:1. For the accounting year ended 31st March, 2020, the Profit and Loss account of the business was as under:

		Figures are in ₹ '000s	
Cost of goods sold	*4,250*	*Sales*	*4,900*
Remuneration to:		*Dividend from Indian companies*	*25*
T	*130*	*Capital gains-Long term (computed)*	*640*
Q	*170*		
Employees	*256*		
Interest to:			
T	*48.3*		
Q	*35.7*		
Other expenses	*111.7*		
Sales-tax penalty due	*39*		
Net profit	*524.3*		
	5,565		***5,565***

Additional information furnished:

(i) Other expenses included:

(a) *wrist watches costing ₹ 2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;*

(b) *employer's contribution of ₹ 6,000 to the Provident Fund was paid on 14th January, 2020.*

(c) *₹ 30,000 was paid in cash to an advertising agency for publicity.*

(ii) *Outstanding sales tax penalty was paid on 15th October, 2020. The penalty was imposed by the Sales-tax Officer for non-filing of returns and statements by the due dates.*

T and Q had, for this year, income from other sources of ₹ 3,60,000 and ₹ 2,32,000 respectively.

Required to:

(i) *Compute the total income of the AOPs for the assessment year 2020-21; and*

(ii) *Discuss the tax implication for that year in the hands of the individual members.*

Answer

(i) Computation of total income of the AOP for A.Y.2020-21

Particulars	₹
Profit & gains of business **(See Working Note below)**	3,12,300
Long term capital gain	6,40,000
Income from other sources [Dividend is exempt under section 10(34)]	-
Total income	9,52,300

Working Note - Computation of profits and gains of business

Particulars	₹	₹
Net profit as per profit & loss account		5,24,300
Add: Inadmissible payments		
Interest to members T & Q (₹ 48,300 + ₹ 35,700)	84,000	
Advertising [Disallowance under section 40A(3) (100% of ₹ 30,000 being a cash payment)]	30,000	
Remuneration to members T & Q (₹ 1,30,000 + ₹ 1,70,000)	3,00,000	
Sales tax penalty **(See Note 3 below)**	39,000	4,53,000
		9,77,300
Less: Income not taxable under this head		
Dividend from Indian companies	25,000	
Long term capital gain	6,40,000	6,65,000
Profits and gains of business		**3,12,300**

Notes:

1. Since the employer's contribution to PF has been paid during the previous year itself, it is allowable as deduction.

2. Penalty imposed for delay in filing sales tax return is not deductible since it is on account of infraction of the law requiring filing of the return within the specified period. – *CIT v. Ratanchand Bholanath (S.S) (1986) 160 ITR 500 (M.P.)*

(ii) Tax implication in the hands of members T & Q for the A.Y.2020-21

Members of the AOPs have to pay tax on their total income taking into account savings/ investments etc.

Since one of the members has individual income more than the basic exemption limit, the AOPs will be assessed at the maximum marginal rate.

Since the AOPs is taxed at maximum marginal rate, the share income of members is not taxable in their hands individually.

Question 11

The assessee, Pandey Co-operative Housing Society, is a registered co-operative housing society, formed with the objective of maintaining the property owned by it, to effect repairs and maintenance of the common property of the members, and to confer to the members, the usual rights and privileges. For the assessment year 2020-21, the assessee has received ₹ 3 lacs as transfer fees from the transferor members and like amount from the transferees, who at the time of transfer, were not members of the society. Discuss the exigibility to tax the aforesaid receipts in the hands of the assessee.

Answer

Transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality where the predominant activity of such co-operative society is maintenance of property of the society. It was so held by the Bombay High Court in *Sind Co-op Housing Society v. ITO (2009) 317 ITR 47*.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Therefore, ₹ 3 lacs received as transfer fees by Pandey Co-operative Housing Society from its transferor members and its transferees, is not chargeable to tax.

SIGNIFICANT SELECT CASES

1 **Can dividend distribution tax under Section 115-O of Income-tax Act, 1961 be levied in respect of the dividend declared out of agricultural income?**

Union of India v. Tata Tea and Others [2017] 398 ITR 260 (SC)

Facts of the case: The petitioner is a tea company engaged in cultivating and processing tea in its factory for marketing. The cultivation of tea is an agricultural process while the processing of tea in the factory is an industrial process. The petitioners contend that when the company distributes dividend, it is taxed under Section 115-O. The tax on dividend declared by it in this case is nothing but a tax on agricultural income. The legislative competence for taxing agricultural income lies with the State Government and not the Central Government.

Issue: Can dividend distribution tax be levied on dividend income of a tea company under section 115-O?

Supreme Court's Observations: As per entry 82 of List I the Union Parliament has the competence to tax "income other than agricultural income." Section 115-O pertains to additional tax at the stage of distribution of dividend by domestic company which is covered by entry 82 in List I. When dividend is declared to be distributed and paid to a company's shareholders it is not impressed with character of the source of its income. The Court relied on *Mrs. Bacha F Guzdar v. CIT AIR 1955 SC 74* which looked into the nature of the dividend income in the hands of the shareholders. Dividend is derived from the investment made in the company's shares and the foundation rests on the contractual relations between the company and the shareholder.

Dividend is not 'revenue derived from land' and hence cannot be termed as agricultural income in the hands of a shareholder. Hence, despite the petitioner's company being involved in agricultural activities, in the shareholder's hands, the income is only dividend and not agricultural income.

The Calcutta High Court had upheld the vires of section 115-O but put a qualification that additional tax levied under section 115-O shall be only to the extent of 40% which is the taxable income of the tea company. The Supreme Court overturned this cap placed by the Calcutta High Court. Section 115-O is within the competence of the Parliament and hence, no limits can be placed on the same.

Supreme Court's Decision: When dividend is declared to be distributed and paid to a company's shareholders, it is not impressed with character of the source of its income. Section 115-O is within the competence of the Union Parliament and therefore dividend distribution tax can be levied in respect of the entire dividend declared and distributed by a tea company.

2. **Whether certain receipts by co-operative societies from its members (non-occupancy charges, transfer charges, common amenity fund charges) are exempt based on the doctrine of mutuality?**

Income-tax Officer v. Venkatesh Premises Co-operative Society Ltd. [2018] 402 ITR 670 (SC)

Supreme Court's observations: The doctrine of mutuality is based on the common law principle that a person cannot make a profit from himself. The income of a co-operative society from business is taxable under section 2(24)(vii) and will stand excluded based on 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. 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.

The Supreme Court made the following observations:

- If for convenience, part of the transfer charges were paid by the transferee, they would not partake of the nature of profit. The amount is appropriated only after the transferee was inducted as a member. In the event of non-admission, the amount was returned. The moment the transferee was inducted as a member the principles of mutuality would apply.
- Non-occupancy charges were levied by the society and were payable by a member who did not himself occupy the premises but let them out to a third person. The charges were utilised only for common benefit of facilities and amenities to the members.
- Contribution to the common amenity fund taken from a member disposing of property was utilized for meeting heavy repairs to ensure hazard-free maintenance of the properties of the society which ultimately benefitted the members. Membership forming a class, the identity of the individual member not being relevant, induction into membership automatically attracted the doctrine of mutuality.
- If a society had surplus floor space index available, it was entitled to utilise it by making fresh construction in accordance with law. Naturally, such additional construction would entail extra maintenance charges. If the society first inducted new members who were required to contribute to the common fund for availing of the common facilities, and then granted only occupancy rights to them by draw of lots, the ownership remaining with the society, the receipts could not 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.

Supreme Court's Decision: The doctrine of mutuality, is based on the common law principle that a person cannot make a profit from himself. Accordingly, the transfer charges, non-occupancy charges common amenity fund charges and other charges are exempt owing to application of the doctrine of mutuality.

3. **Where land inherited by three brothers is compulsorily acquired by the State Government, whether the resultant capital gain would be assessed in the status of "Association of Persons" (AOP) or in their individual status?**

CIT v. Govindbhai Mamaiya (2014) 367 ITR 498 (SC)

Facts of the case: Three brothers inherited a property consequent to demise of their father. A part of this bequeathed land was acquired by the State Government and compensation was paid for it. On appeal, compensation was enhanced and the enhanced compensation was paid with interest.

Issue: The issue under consideration is regarding the status in which capital gain arising on transfer of property would be assessed. The assessees' offered income in their status as "individual" but the Revenue sought to tax the same in their status as "Association of Persons" (AOP).

High Court's Observations: The High Court found that the parties inherited the property and there was no material on record to suggest consensus *ad idem* between the brothers for formation of AOP. It referred to *CWT v. Chander Sen (1986) 161 ITR 370 (SC)* to hold that as per section 4 of the Hindu Succession Act, 1956, income from the asset inherited by a son from his father has to be assessed as income of the son individually. Further, as per section 8 of the Hindu Succession Act, 1956, the property of the father devolves on his son in his individual capacity and not as karta of HUF. Thus, it was held that the income is chargeable to tax in their individual status and not as AOP.

Supreme Court's Observations: The Supreme Court referred to its earlier decision in the case of *Meera & Co v. CIT (1997) 224 ITR 635* in which the earlier precedent in the case of *CIT v. Indira Balakrishna (1960) 39 ITR 546 (SC)* was followed. The Apex Court noted that "Association of Persons" means an association in which two or more persons join in a common purpose or common action.

The Supreme Court also referred to its judgment in *G. Murugesan & Bros. v. CIT (1973) 4 SCC 211*. In that case, it was held that an association of persons could be formed only when two or more persons voluntarily combined together for certain purposes.

In this case, the property in question came to the assessees' possession through inheritance i.e., by operation of law. It is not a case where any 'association of persons" was formed by volition of the parties. Further, even the income earned in the form of interest is not because of any business venture of the three assessees, but is the result of the act of the Government in compulsorily acquiring the said land. Thus, the basic test to be satisfied for making an assessment in the status of AOP is absent in this case.

Apex Court's Decision: The Apex Court, accordingly, held that the income from asset inherited by the legal heirs is taxable in their individual hands and not in the status of AOP.

4. **Would the ancestral property received by the assessee after the death of his father, be considered as HUF property or as his individual property, where the assessee's father had received such property as his share when he went out of the joint family under a release deed?**

Commissioner of Income-tax v. D. L. Nandagopala Reddy (Individual) (2014) 360 ITR 0377 (Kar)

Facts of the case: In the present case, Laxmaiah Reddy had no sons and therefore, he adopted the assessee vide a registered adoption deed dated June 25, 1956. The property, which is the subject matter of the suit, originally belonged to Venkateshwaraiah (assessee's grandfather). The assessee's father (Laxmaiah Reddy), took his share in the joint family property and executed a release deed in favour of the remaining members of the joint family *vide* a registered release deed dated November 23, 1927 and bequeathed all his properties in favour of the assessee. The assessee, in turn, distributed the property in favour of his wife and children. This was done by oral partition which was evidenced by a memorandum of partition dated August 6, 1998.

Thereafter, a transaction was entered into by the assessee with the builder for development of the property. The Assessing Officer treated the consideration received from the builder by the assessee and his wife as their individual income and assessed the same to tax in their individual hands.

Assessing Officer's contention: The Revenue contended that when assessee's father got the property under a release deed, it ceased to be the joint family property. Since that property was bequeathed in favour of the assessee, he became its owner after the death of his father. Therefore, it was a separate property and, consequently, the income derived therefrom is assessed to tax in the hands of the assessee as separate property.

High Court's Observations: The High Court observed that the property originally belonged to Hindu Undivided Family (HUF). One of the members of the family (i.e., the assessee's father) went out of the joint family under a release deed and the remaining members continued to be the members of joint family. After the death of assessee's father and mother, the assessee, being the adopted son, became the sole surviving co-parcener. When such property came to the hands of the assessee it was not his individual property; it was the property of his Hindu Undivided Family.

High Court's Decision: The High Court held that that when the property came to the hands of the assessee, it was not his self-acquired property; it was property belonging to his HUF. The assessee had given a portion of the property to his wife without a registered document, which is possible only if the property is a HUF property. If such property is treated as a self-acquired property, then assessee would have been able to give the portion of the property to his wife only by registered document.

5. **Under which head of income is rental income from plinths inherited by individual co-owners from their ancestors taxable - "Income from house property" or "Income from other sources"? Further, would such income be assessable in the hands of the individual co-owners or in the hands of the Association of Persons?**

Sudhir Nagpal v. Income-tax Officer (2012) 349 ITR 0636 (P & H)

First Issue: The first issue relates to the head of income under which rental income from plinths, inherited by individual co-owners from their ancestors, is taxable – whether "Income from house property" or "Income from other sources"?

High Court's Observations: As regards the head of income under which rental income from plinths is assessable, the High Court referred to the Division Bench judgment in *Gowardhan Das and Sons v. CIT (2007) 288 ITR 481,* wherein it was observed that it is the income from property consisting of any building or land appurtenant thereto which is assessed under section 22 and not the income from renting out of open land or some kutcha plinth only.

High Court's Decision: Therefore, the Court held that the income from letting out the plinths is assessable under section 56 as "Income from other sources" and not under the head "Income from house property".

Second Issue: The second issue relates to whether such rental income is assessable in the hands of the individual co-owners or in the hands of the Association of Persons. To appreciate this issue, it is necessary to understand the complete facts of the case.

Facts of the case: In the present case, five persons of the Nagpal family were co-owners of the agricultural land "Nagpal farms" inherited from their forefathers. The co-owners executed a power of attorney in favour of Mr. Sudhir Nagpal, one of the co-owners, appointing him to construct plinths on the agricultural land and to further lease out such open plinths to any party on their behalf. The co-owners had, therefore, not purchased the land for the said purpose but had inherited the land. They were owners not in their joint capacity but in their individual capacity with a definite/defined proportion of share. The co-owners filed their individual returns of income disclosing their rental income and also paid tax on such income.

The Assessing Officer, however, issued notice under section 148 to all the co-owners of the property in the name of Mr. Sudhir Nagpal on the ground that there is an association of persons formed by the co-owners and therefore, income had escaped assessment in the hands of association of persons.

The assessee contended that since no land was purchased, therefore, the status of the co-owners cannot be treated as association of persons.

The Assessing Officer did not agree with the contention of the assessee and assessed the entire rental income from the plinths as income from other sources in the hands of the association of persons and determined the tax payable by applying section 167B(2). The Commissioner (Appeals) and the Tribunal confirmed the action of the Assessing Officer.

High Court's Observations: On appeal, the High Court observed that in order to assess individuals as "association of persons", the individual co-owners should have joined their resources and thereafter, acquired property in the name of association of persons and the property should have been commonly managed. It is only in such a case that income could be assessed in the hands of "association of persons". Mere accruing of income jointly to more persons than one would not constitute them an association of persons in respect of such income. In other words, unless the associates have done some acts or performed some operations together, which have helped to produce the income in question, they cannot be termed as an association of persons. Unless the members combine or join in a common purpose, it cannot be held that they have formed themselves into an association of persons.

High Court's Decision: In this case, the co-owners had inherited the property from their ancestors and there was nothing to show that they had acted as an association of persons. Thus, the High Court held that the rental income from the plinths has to be assessed in the status of individual and not association of persons and consequently, section 167B would not be attracted in this case.

6. **Would the interest earned on surplus funds of a club deposited with institutional members satisfy the principle of mutuality to escape taxability?**

Madras Gymkhana Club v. DCIT (2010) 328 ITR 348 (Mad.)

Facts of the case: The assessee-club providing facilities like gym, library, etc, to its members earned interest from fixed deposits which it had made by investment of its surplus funds with its corporate members.

High Court's Decision: The High Court held that interest earned from investment of surplus funds in the form of fixed deposits with institutional members does not satisfy the principle of mutuality and hence cannot be claimed as exempt on this ground. The interest earned is, therefore, taxable.

7. **Can transfer fees received by a co-operative housing society from its incoming and outgoing members be exempt on the ground of principle of mutuality?**

Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47 (Bom)

High Court's Observations: On this issue, the High Court observed that under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality.

Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class.

High Court's Decision: The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

8. **In a case where the partnership deed does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration, would the assessee-firm be entitled to deduction in respect of remuneration paid to partners?**

CIT v. Anil Hardware Store (2010) 323 ITR 368 (HP)

Facts of the case: The partnership deed of the assessee-firm provided that in case the book profits of the firm are up to ₹ 75,000, then the partners would be entitled to remuneration up to ₹ 50,000 or 90% of the book profits, whichever is more. In respect of the next ₹ 75,000, it is 60% and for the balance book profits, it is 40%. Thereafter, it is further clarified that the book profits shall be computed as defined in section 40(b) of the Income-tax Act, 1961, or any other provision of law as may be applicable for the assessment of the partnership firm. It has also been clarified that in case there is any loss in a particular year, the partners shall not be entitled to any remuneration. Clause 7 of the partnership deed laid down that the remuneration payable to the partners should be credited to the respective accounts at the time of closing the accounting year and clause 5 stated that the partners shall be entitled to equal remuneration.

High Court's Decision: The High Court held that the manner of fixing the remuneration of the partners has been specified in the partnership deed. In a given year, the partners may decide to invest certain amounts of the profits into other ventures and receive less remuneration than that which is permissible under the partnership deed, but there is nothing which debars them from claiming the maximum amount of remuneration payable in terms of the partnership deed. The method of remuneration having been laid down, the assessee-firm is entitled to deduct the remuneration paid to the partners under section 40(b)(v).

Notes:

(1) Payment of remuneration to working partners is allowed as deduction if it is authorized by the partnership deed and is subject to the overall ceiling limits specified in section 40(b)(v). The limits for partners' remuneration under section 40(b)(v) has revised upwards and the differential limits for partners' remuneration paid by professional firms and non-professional firms have been removed. On the first ₹ 3 lakh of book profit or in case of loss, the limit would be the higher of ₹ 1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.

(2) The CBDT had, vide Circular No. 739 dated 25-3-1996, clarified that no deduction under section 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.

In this case, since the partnership deed lays down the manner of quantifying such remuneration, the same would be allowed as deduction subject to the limits specified in section 40(b)(v).

9. Can interest under sections 234B and 234C be levied where a company is assessed on the basis of book profits under section 115JB?

Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470 (SC)

Supreme Court's Observations: On this issue, the Supreme Court observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted. Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C.

Supreme Court's Decision: The Supreme Court, therefore, held that interest under sections 234B and 234C shall be payable on failure of the company to pay advance tax in respect of tax payable under section 115JB.

Note *– According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year. Under section 115JB(1), where the tax payable on total income is less than **15%** of "book profit" of a company, the "book profit" would be deemed to be the total income and tax would be payable at the rate of **15%**. Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of* *section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.*

10. Can long-term capital gain exempted by virtue of section 54EC be included in the book profit computed under section 115JB?

N. J. Jose and Co. (P.) Ltd. v. ACIT (2010) 321 ITR 132 (Ker.)

Facts of the case: The assessee claimed exemption under section 54E on the income from long-term capital gains by depositing amounts in specified assets in terms of the said provision. In the computation of book profit under section 115J, the assessee claimed exclusion of capital gains because of exemption available on it by virtue of section 54E. The Assessing Officer reckoned the book profits including long-term capital gains for the purpose of assessment under section 115J.

High Court's Decision: The High Court held that once the Assessing Officer found that total income as computed under the provisions of the Act was less than 30 per cent of the book profit, he had to make the assessment under section 115J which does not provide for any deduction in terms of section 54E. As long as long-term capital gains are part of the profits included in the profit and loss account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956 (*now, Statement of Profit and Loss prepared in accordance with Part II of Schedule III to the Companies Act, 2013*), capital gains cannot be excluded unless provided under the Explanation to section 115J(1A).

***Note** – It may be noted that the rationale of this decision would apply even where minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than **15%** of book profits. If an assessee has claimed exemption under section 54EC by investing in bonds of NHAI/ RECL, within the prescribed time, the long-term capital gains so exempt would be taken into account for computing book profits under section 115JB for levy of minimum alternate tax (MAT), since Explanation 1 to section 115JB does not provide for such deduction.*

11. Can income derived by an Indian shipping company from slot charter arrangement in other ships be computed applying the special provisions under Chapter XII-G of the Income-tax Act, 1961, relating to Tonnage Tax Scheme, inspite of non-fulfillment of the condition of holding a valid certificate in respect of such ships indicating its net tonnage in force?

CIT v. Trans Asian Shipping Services (P) Ltd (2016) 385 ITR 637 (SC)

Facts of the case: The assessee-company owned a qualifying ship and fulfilled all the requisite conditions for availing tonnage tax scheme contained in Chapter XII-G of the Income-tax Act, 1961. Thus, the income generated from the qualifying ship is exigible to tax as per the said scheme, since it has exercised the requisite option in this behalf and submitted valid certificate in respect of such qualifying ship. In addition to the income from qualifying ship, it has also earned income from “slot charter” arrangement in other ships in the previous years relevant to the assessment years 2005-06 and 2008-09. In the return of income filed for the relevant previous years, the assessee company also included the income earned from such slot charter for the purpose of computation of income as per the tonnage tax scheme.

Revenue’s contentions *vis-à-vis* Assessee’s contention: The Assessing Officer opined that the income earned from slot charter arrangement did not qualify for the purpose of computation of tonnage income under the tonnage tax scheme, since the said income was not generated from the ship owned by it nor was such income earned from the entire ship chartered by it. He was also of the opinion that in order to avail the benefit of Tonnage Tax Scheme, the assessee had to show that it operated a qualifying ship and it is incumbent to produce a valid certificate in respect of such ship indicating its net tonnage as provided in section 115VX(1)(b). Thus, production of valid certificate is an essential requirement contained in section 115VD which cannot be done away with because of the formula that is contained in section 115VG for the computation of tonnage income. The Revenue further contended that computation of tonnage income under the tonnage tax scheme has to be as per the provisions of section 115VG(4) which defines "Tonnage" to mean tonnage of a ship indicated in the certificate referred to in section 115VX.

The assessee company, however, contended that the requirement of producing valid certificate would apply in respect of own ships and ships hired fully. It also contended that as per method of computation provided under section 115VG, the income for the full ship is to be computed on the basis of “net tonnage” shown in the valid certificate, whereas deemed tonnage in respect of slot charter arrangement in other ships has to be computed as per Rule 11Q(1) of the Income-tax Rules, 1962.

However, the Assessing Officer rejected the contention of the assessee and held that the income from slot charter arrangement could not be included for computation of tonnage income under the tonnage tax scheme.

The order of the Assessing Officer denying the benefit of applying the tonnage tax scheme under Chapter XII-G for slot charter arrangement was upheld by CIT (Appeals) and by the Appellate Tribunal.

High Court’s Decision: The High Court, however, held that the income earned under slot charter arrangement comes under definition of “deemed tonnage tax” as per Explanation to section 115VG(4), therefore, the exclusion of such income while assessing the same under the special provisions was inappropriate. Accordingly, the High Court held that the assessee is eligible for tonnage tax scheme in respect of income from slot charter arrangement also.

Supreme Court’s Observations: The Apex Court noted that a company would regarded as operating a ship “if it operates any ship whether owned or chartered by it in an arrangement such as slot charter, space charter or joint charter”. Thus, even an arrangement such as slot charter would be regarded as operating a ship.

A perusal of the provisions of section 115VD, containing the conditions for a ship to qualify as a "qualifying ship" would indicate that all the conditions laid down therein are fulfilled by the assessee, except the condition stipulated in clause (c) which imposes an obligation on the assessee to produce a valid certificate in respect of such a ship indicating its net tonnage in force.

The Supreme Court, noted that provisions of section 115VG(4) are in two parts in so far as computation of tonnage is concerned. When it comes to tonnage of a ship, a valid certificate is to be produced. The second part of this provision talks about "deemed tonnage" in contradistinction to the "actual tonnage" mentioned in the certificate. *Explanation* to sub-section 115VG(4), *inter alia*, mentions that in so far as slot charter arrangements are concerned, purchase of such slot charter shall be treated as deemed tonnage.

The requirement of producing a certificate would not apply when entire ship is not chartered and the arrangement pertains only to purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel. This position becomes abundantly clear by reading Rule 11Q(1) which specifies the basis/formula of computing deemed tonnage in respect of arrangement of slot charter.

Supreme Court's Decision: The Apex Court, accordingly, held that the requirement of producing a certificate would not apply when entire ship is not chartered and the arrangement pertains only to purchase of slots, slot charter etc. It held that the contention of the assessee is valid and the legal fiction created by section 115VG(4) is to be given proper meaning.

Accordingly, income from slot charter arrangement in other ships can be computed applying the special provisions under Chapter XII-G.

Note: *As per section 115VG(4), for the purposes of Chapter XII-G, the tonnage shall mean the tonnage of a ship indicated in the certificate referred to in section 115VX and includes the deemed tonnage computed in the prescribed manner. The manner has been prescribed in Rule 11Q of the Income-tax Rules, 1962.*

Further, the Explanation to section 115VG(4) provides that for the purposes of this sub-section, 'deemed tonnage' shall be the tonnage in respect of an arrangement of purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel.

Rules 11Q(1) provides that for the purpose of Explanation to section 115VG(4), deemed tonnage in respect of an arrangement of purchase of slots and slot charter shall be computed on the following basis:

2.5 TEU = 1 Net Tonnage (1NT)

Where TEU is Twenty foot Equivalent Unit (Container of this size)

ANNEXURES

ANNEXURE – 1: Special Provisions for taxation of income of certain domestic companies

ANNEXURE – 2: Rate of Surcharge applicable to Individuals/HUF/AOPs/BOIs for A.Y.2020-21

ANNEXURE – 3: Rate of Surcharge applicable on tax on total income of an AOPs/BOIs (having any income under section 115AD) for payment of advance tax for A.Y.2020-21

Annexure 1

Special Provisions for taxation of income of certain domestic companies

Two new sections, namely, section 115BAA and section 115BAB have been inserted with effect from A.Y.2020-21, providing for concessional rates of tax on income of certain domestic companies. The provisions of these two sections are discussed hereunder:

(1)	**(2)**	**(3)**	**(4)**
	Particulars	**Section 115BAB**	**Section 115BAA**
(1)	Applicability	Domestic manufacturing company	Any domestic company
(2)	Rate of tax	15%	22%
(3)	Rate of surcharge	10%	10%
(4)	Effective rate of tax (including sur-charge & cess)	17.16%	25.168%
(5)	Applicability of concessional rate of tax on total income of company	The rate of tax (i.e., 17.16%) is notwithstanding anything contained in the Income-tax Act, 1961 but subject to the provisions of Chapter XII, other than section 115BA and 115BAA.	The rate of tax (i.e., 25.168%) is notwithstanding anything contained in the Income-tax Act, 1961, but subject to the provisions of Chapter XII, other than section 115BA and 115BAB.
		***Note** – This implies that this rate (i.e., 17.16%/25.168%) would prevail in respect of all income, other than income subject to special rates of tax under Chapter XII, for which the special rates would continue to apply. For example, in case of such companies opting for section 115BAA or 115BAB, long-term capital gains chargeable to tax under section 112 and 112A and short-term capital gains chargeable to tax under section 111A would be subject to tax at the rates mentioned in the said sections. However, other income, like short term capital gains (other than those covered under section 111A), income from house property and income from other sources would be taxable at the rate of 17.16%/25.168%, as the case may be.*	
(6)	Conditions to be fulfilled for availing the concessional rate of tax and exemption from MAT	(i) The company should be **set-up and registered on or after 1.10.2019.**	No time limit specified. Both existing companies and new companies can avail benefit.
		(ii) It should **commence manufacturing on or before 31.3.2023.**	Need not be a manufacturing company

		(iii)	It should **not be formed by splitting up or the reconstruction of a business already in existence** (except in case of an undertaking formed by reconstruction or revival of a person of the business of any undertaking referred to in section 33B in the circumstances and within the period specified therein)	No similar condition has been prescribed
		(iv)	It does **not** use any machinery or plant previously used for any purpose **[Refer Note at the end]**	No similar condition has been prescribed
		(v)	It does **not** use any building previously used as a hotel or a convention centre [meanings assigned in section 80-ID(6)]	No similar condition has been prescribed
		(vi)	It should **not** be engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it.	No similar condition has been prescribed
(7)	Common condition for both sections for availing the concessional rate of tax and exemption from MAT	The total income should be computed -		
		(i)	Without providing for deduction under any of the following provisions -	
			Section	**Provision**
			10AA	Exemption of profits and gains derived from export of articles or things or from services by an assessee, being an entrepreneur from his Unit in SEZ.

			32(1)(iia)	Additional depreciation @20% or 35%, as the case may be, of actual cost of new plant and machinery acquired and installed by manufacturing and power sector undertakings.
			32AD	Deduction@15% of actual cost of new plant and machinery acquired and installed by an assessee in a manufacturing undertaking located in the notified backward areas of Andhra Pradesh, Telengana, Bihar and West Bengal.
			33AB	Deduction@40% of profits and gains of business of growing and manufacturing tea, coffee or rubber in India, to the extent deposited with NABARD in accordance with scheme approved by the Tea/Coffee/ Rubber Board.
			33ABA	Deduction@20% of the profits of a business of prospecting for, or extraction or production of, petroleum or natural gas or both in India, to the extent deposited with SBI in an approved scheme or deposited in Site Restoration Account.
			35(1)(ii)/ (iia)/(iii)	Deduction/weighted deduction for payment to any research association, company, university etc. for undertaking scientific research or social science or statistical research.
			35(2AA)	Weighted deduction@150% of payment to a National Laboratory or University or IIT or approved specified person for scientific research
			35(2AB)	Weighted deduction@150% of in-house scientific research expenditure incurred by a company engaged in the business of bio-technology or in the business of manufacture or production of an article or thing.
			35AD	Investment-linked tax deduction for specified businesses.
			35CCC	Weighted deduction@150% of expenditure incurred on notified agricultural extension project

			35CCD	Weighted deduction@150% of expenditure incurred by a company on notified skill development project.
			80-IA to 80RRB	Deductions from gross total income under Chapter VI-A under the heading "C-Deductions in respect of certain incomes" other than the provisions of section 80JJAA.
		(ii)	Without set-off of any loss carried forward from any earlier assessment year, if such loss is attributable to any of the deductions listed in (i) above [Such loss would be deemed to have been already given effect to and no further deduction for such loss shall be allowed for any subsequent year]	
		(iii)	By claiming depreciation u/s 32 determined in the prescribed manner. However, additional depreciation u/s 32(1)(iia) cannot be claimed.	
		***Note** – A domestic company exercising option for availing benefit of lower tax rate under section 115BAA shall not be allowed to claim set off of any brought forward loss on account of additional depreciation for an Assessment Year for which the option has been exercised and for any subsequent Assessment Year.* *Since there is no time line within which option under section 1l5BAA can be exercised, a domestic company having brought forward losses on account of additional depreciation may, if it so desires, exercise the option after set of the losses so accumulated.*		

	Particulars	Section 115BAB	Section 115BAA
(8)	Applicability of MAT	Not applicable	Not applicable
(9)	Availability of set-off of MAT credit brought forward from earlier years	Since it is a new company, there would be no brought forward MAT credit	Brought forward MAT credit cannot be set-off against income u/s 115BAA.
(10)	Adjustments for transactions with persons having close connection	If the Assessing Officer opines that the course of business between the company and any other person having close connection therewith is so arranged that the business transacted between them produces more than the ordinary profits to the	No such requirement to make any adjustment

		company, he is empowered to take into account the amount of profits as may be reasonably deemed to have been derived therefrom, while computing profits and gains of such company. In case the arrangement referred to above involves a specified domestic transaction referred to in section 92BA, then, the amount of profits from such transaction would be determined by considering the arm's length price (ALP). ***Note** – The scope of "specified domestic transaction" referred to in section 92BA has been expanded to include within its ambit, any business transacted between such persons with close connection, where one such person is a company claiming benefit under section 115BAB.*	
(11)	Exercise of option by the company within the prescribed time	The beneficial provisions of this section would apply only if option is exercised in the prescribed manner on or before the due date u/s 139(1) for furnishing **the first of the returns of income for any previous year** relevant to A.Y.2020-21 or any subsequent assessment year. Such option, once exercised, would apply to subsequent assessment years. Further, once the option has been exercised for any previous year, it **cannot be subsequently withdrawn** for the same or any other previous year.	The beneficial provisions of this section would apply if option is exercised in the prescribed manner on or before the due date u/s 139(1) for furnishing the return of income for any previous year relevant to A.Y.2020-21 or any subsequent assessment year. Such option, once exercised, would apply to subsequent assessment years. Further, once the option has been exercised for any previous year, it **cannot be subsequently withdrawn** for the same or any other previous year.

		Note – *The option has to be exercised at the time of furnishing the* ***first of the returns of income*** *for any previous year. If a person fails to so exercise such option, he cannot exercise the option for any subsequent previous year.*	**Note** – *The option can be exercised even in a later year, but once exercised, cannot be withdrawn subsequently.* *Further, where the person exercises option under section 115BAA, the option under section 115BA may be withdrawn.*

Note - *For the purpose of point no.7(iv) in column (3) of the above table, any machinery or plant which was used outside India by any other person shall not be regarded as machinery or plant previously used for any purpose, if all the following conditions are fulfilled, namely:—*

(a) such machinery or plant was not, at any time previous to the date of the installation by the person, used in India;

(b) such machinery or plant is imported into India from any country outside India;

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of the Income-tax Act, 1961 in computing the total income of any person for any period prior to the date of installation of the machinery or plant by the person.

Further, where in the case of a person, any machinery or plant or any part thereof previously used for any purpose is put to use by the company and the total value of the machinery or plant or part so transferred does not exceed 20% of the total value of the machinery or plant used by the company, then, the condition specified that the company does not use any machinery or plant previously used for any purpose would be deemed to have been complied with.

Annexure 2

Rate of Surcharge applicable to Individuals/HUF/AOPs/BOIs for A.Y.2020-21

	Particulars	Rate of surcharge on income-tax	Example	
			Components of total income	Applicable rate of surcharge
(i)	Where the total income (including income under section 111A and 112A) exceeds ₹ 50 lakhs but does not exceed ₹ 1 crore	10%	• STCG u/s 111A ₹ 10 lakhs; • LTCG u/s 112A ₹ 5 lakhs; and • Other income ₹ 40 lakhs	Surcharge would be levied@10% on income-tax computed on total income of ₹ 55 lakhs.
(ii)	Where total income (including income under section 111A and 112A) exceeds ₹ 1 crore but does not exceed ₹ 2 crore	15%	• STCG u/s 111A ₹ 20 lakhs; • LTCG u/s 112A ₹ 25 lakhs; and • Other income ₹ 80 lakhs	Surcharge would be levied@15% on income-tax computed on total income of ₹ 1.25 crores.
(iii)	Where total income (excluding income under section 111A and 112A) exceeds ₹ 2 crore but does not exceed ₹ 5 crore The rate of surcharge on the income-tax payable on the portion of income chargeable to tax under section 111A and 112A	25% 15%	• STCG u/s 111A ₹ 24 lakh; • LTCG u/s 112A ₹ 25 lakh; and • Other income ₹ 3 crores	Surcharge would be levied @15% on income-tax on: • STCG of ₹ 24 lakhs chargeable to tax u/s 111A; and • LTCG of ₹ 25 lakhs chargeable to tax u/s 112A. Surcharge@25% would be leviable on income-tax computed on other income of ₹ 3 crores included in total income

(iv)	Where total income (excluding income under section 111A and 112A) exceeds ₹ 5 crore Rate of surcharge on the income-tax payable on the portion of income chargeable to tax under section 111A and 112A	37% 15%	• STCG u/s 111A ₹ 40 lakhs; • LTCG u/s 112A ₹ 55 lakhs; and • Other income ₹ 6 crore	Surcharge@15% would be levied on income-tax on: • STCG of ₹ 40 lakhs chargeable to tax u/s 111A; and • LTCG of ₹ 55 lakhs chargeable to tax u/s 112A. Surcharge@37% would be leviable on the income-tax computed on other income of ₹ 6 crores included in total income.
(v)	Where total income (including income under section 111A and 112A) exceeds ₹ 2 crore in cases not covered under (iii) and (iv) above	15%	• STCG u/s 111A ₹ 40 lakhs; • LTCG u/s 112A ₹ 55 lakhs; and • Other income ₹ 1.30 crore	Surcharge would be levied@15% on income-tax computed on total income of ₹ 2.25 crore.

ANNEXURE – 3

Rate of Surcharge applicable on tax on total income of an AOPs/BOIs (having any income under section 115AD) for payment of advance tax for A.Y.2020-21

	Particulars	Rate of surcharge on income-tax	Example	
			Components of total income	Applicable rate of surcharge
(i)	Where the total income > ₹ 50 lakhs but is ≤ ₹ 1 crore	10%	• Capital gains on securities referred to in section 115AD(1)(b) ₹ 30 lakhs; and • Other income ₹ 60 lakhs;	Surcharge would be levied@10% on income-tax computed on total income of ₹ 90 lakhs.
(ii)	Where total income > ₹ 1 crore but is ≤ ₹ 2 crore	15%	• Capital gains on securities referred to in section 115AD(1)(b) ₹ 70 lakhs; and • Other income ₹ 80 lakhs;	Surcharge would be levied@15% on income-tax computed on total income of ₹ 1.50 crore.
(iii)	Where total income [excluding STCG/LTCG on securities referred to in section115AD(1)(b)] > ₹ 2 crore ≤ ₹ 5 crore Rate of surcharge on the income-tax payable on the portion of income chargeable to tax u/s 115AD(1)(b)	25% 15%	• Capital gains on securities referred to in section 115AD(1)(b) ₹ 30 lakhs; and • Other income ₹ 3 crores;	Surcharge would be levied: @15% on income-tax leviable on capital gains of ₹ 30 lakhs referred to in section 115AD; and @25% on income-tax computed on other income of ₹ 3 crores included in total income

(iv)	Where total income [excluding STCG/LTCG on securities referred to in section 115AD(1)(b)] > ₹ 5 crore Rate of surcharge on the income-tax payable on the portion of income chargeable to tax u/s 115AD(1)(b)	37% 15%	• Capital gains on securities referred to in section 115AD(1)(b) ₹ 70 lakhs; and • Other income ₹ 6 crore	Surcharge would be levied @15% on income-tax leviable on capital gains of ₹ 70 lakhs referred to in 115AD; and @37% on income-tax computed on other income of ₹ 6 crore included in total income
(v)	Where total income [including STCG/LTCG on securities referred to in 115AD(1)(b)] > ₹ 2 crore in cases not covered under (iii) and (iv) above	15%	• Capital gains on securities referred to in section 115AD(1)(b) ₹ 90 lakhs; and • Other income ₹ 1.60 crore;	Surcharge would be levied@15% on tax on total income of ₹ 2.50 crore.

CHAPTER 13

CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS, POLITICAL PARTIES AND ELECTORAL TRUSTS

LEARNING OUTCOMES

After studying this chapter, you would be able to -

❑ **appreciate** the conditions to be fulfilled by universities, other educational institutions, hospitals and other medical institutions to claim the benefit of exemption under section 10(23C);

❑ **identify** the inclusions in the definition of "charitable purpose", to appreciate whether a trust or institution would qualify for the benefit of exemption under sections 11 and 12;

❑ **appreciate** the conditions to be fulfilled by a trust or institution to claim benefit of exemption under section 11**;**

❑ **appreciate** the procedure to be followed for registration of a trust or institution;

❑ **examine** the special provisions relating to taxability of anonymous donations received by a trust or institution;

❑ **appreciate** the special provisions for taxability of accreted income of certain trusts and institutions;

❑ **analyse and apply** the above provisions to compute the total income and tax liability of trusts and institutions and address related issues;

❑ **identify** the income of political parties which are exempt from tax and the conditions to be satisfied to avail the exemption;

❑ **examine** the conditions to be satisfied by an electoral trust to avail exemption in respect of voluntary contributions received by it;

❑ **apply** the above provisions relating to political parties and electoral trusts in making computations and addressing related issues.

13.1 INTRODUCTION

Section 10(23C*), inter alia*, exempts income received by any person on behalf of university, or other educational institution or any hospital. Section 11 provides exemption in respect of income derived from property held under trust wholly for charitable or religious purposes. Section 13A exempts certain categories of income derived by a political party and section 13B exempts voluntary contributions received by electoral trusts.

13.2 INCOME OF UNIVERSITIES, HOSPITALS, EDUCATIONAL INSTITUTIONS, MEDICAL INSTITUTIONS ETC. [SECTION 10(23C)]

As we have read in Chapter 3, exemption is available in respect of any income received by any person on behalf of the certain funds and institutions. In particular, in this chapter, we would be dealing with income of universities, educational institutions, hospitals and other medical institutions covered under sub-clauses (iiiab), (iiiac), (iiiad), (iiiae), (iv), (v), (vi) and (via) of section 10(23C):

(1) any university or other educational institution wholly or substantially financed by the Government which exists solely for educational purposes and not for profit [Sub-clause (iiiab)];

(2) any hospital or other institution wholly or substantially financed by the Government, which exists solely for philanthropic purposes and not for profit and which exists for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of convalescing persons or persons requiring medical attention or rehabilitation [Sub-clause (iiiac)];

> If the government grant to a university or other educational institution, hospital or other institution during the relevant previous year exceeds **50%** of the total receipts (including any voluntary contributions), of such university or other educational institution, hospital or other institution, as the case may be, then, such university or other educational institution, hospital or other institution shall be considered as being **substantially financed by the Government** for that previous year.

(3) any university or other educational institution existing solely for educational purposes and not for profit and its aggregate annual receipts do not exceed ₹ 1 crore [Sub-clause (iiiad)];

(4) any hospital or other institution as described in (2) above if its aggregate annual receipts do not exceed the prescribed limit of ₹ 1 crore [Sub-clause (iiiae)];

(5) any other fund or institution for charitable purposes approved by the prescribed authority having regard to the objects of the fund or institution and its importance throughout India or throughout any State or States [Sub-clause (iv)];

(6) any trust (including any other legal obligation) or institution wholly for public religious or wholly for public religious and charitable purposes approved by the prescribed authority having regard to ensure the income applies for the objects of the fund or institution [Sub-clause (v)];

(7) any other university or educational institution existing solely for educational purposes and not for purposes of profit and which may be approved by the prescribed authority [Sub-clause (vi)];

(8) any other hospital, or other medical institution as described in (2) above approved by the prescribed authority [Sub-clause (via)].

Notes:

(i) **Application in prescribed form:** The application form for such exemption will have to be made in the prescribed form and manner.

(ii) **Commissioner of Income-tax (Exemptions) to act as "prescribed authority" for the purpose of section 10(23C)(iv)/(v)/(vi)/(via):** Commissioner of Income-tax (Exemptions) is empowered to call for such documents or information as it considers necessary in order to satisfy itself about the genuineness of the activities of the fund or trust or institution or any university or other educational institution or any hospital or other medical institution, ***and the compliance of such requirements under any other law for the time being in force by such fund or trust or institution or any university or other educational institution or any hospital or other medical institution, as the case may be, as are material for the purpose of achieving its objects*** before approving the same under section 10(23C)(iv)/(v)/(vi)/(via). Such documents may include audited annual accounts. The prescribed authority may also make such inquiries as it may deem necessary for this purpose.

(iii) **Conditions to be fulfilled for exemption**: For exemption under section 10(23C)(iv)/(v)/(vi)/(via), the fund or trust or institution etc. must fulfill the following conditions:

(a) It should apply its income or accumulate it for application wholly and exclusively to the objects for which it is established,

(b) In case where more than 15% of its income is accumulated, the period of accumulation of the amount exceeding 15% of its income shall be maximum 5 years.

(c) Funds should be invested or deposited in the forms or modes specified in section 11(5). This condition would however not apply to the following funds–

— any assets held by the fund, trust or institution or any university or other educational institution or any hospital or other medical institution, where such assets form part of the corpus of the fund, trust or institution or any university or other educational institution or any hospital or other medical institution as on 1.6.1973;

- any asset, being equity shares of a public company, held by any university or other educational institution or any hospital or other medical institution where such assets form part of its corpus as on 1.6.1998;
- any debentures, issued by or on behalf of any company or corporation, acquired by the fund, trust or institution, etc. before 1.3.1983;
- any bonus shares allotted to the fund, trust or institution, etc. in respect of the shares mentioned above forming part of the corpus of such fund, etc.
- voluntary contributions received and maintained in the form of jewellery, furniture or other article as the Board may specify for any period during the previous year.

(iv) **Applicability of exemption to profits and gains of business of the trust/fund etc.** - Exemption under section 10(23C)(iv)/(v)/(vi)/(via) would not apply to profits and gains of business in all cases. However, where the business is incidental to the attainment of its objectives and separate books of account are maintained in respect of the business, the exemption would apply to such business profits also.

(v) **Period of validity of notification issued by the Central Government** - Any notification issued by the Central Government [under sub-clauses (iv) or (v)] on or after 13.7.2006 will be valid until withdrawn.

(vi) **Time limit for passing order of approval/rejection** - Where an application form for exemption is made on or after 13.7.2006, every notification under sub-clause (iv)/(v) shall be issued or approval under sub-clause (iv)/(v)/(vi)/(via) shall be granted or an order rejecting the application shall be passed within the period of 12 months from the end of the month in which such application was received.

(vii) **Audit of accounts** - If the total income of any entity referred to in sub-clauses (iv), (v), (vi) and (via) of section 10(23C), without giving effect to the provisions of the said sub-clauses, exceeds the basic exemption limit in any previous year, it shall –

(1) get its accounts audited in respect of that year by a chartered accountant; and

(2) furnish such audit report along with the return of income for the relevant assessment year. The report must be in the prescribed form, duly signed and verified by the accountant, and must contain such particulars as may be prescribed.

(viii) **Payment or credit to another fund, trust etc. out of accumulated income not to be considered as application of income** - Where the fund/ trust/ institution/ university/ hospital etc. does not apply its income during the year of receipt and accumulates it, and subsequently makes a payment or credit out of such accumulated income, to any institution or trust registered u/s 12AA or to any fund/ trust/ institution/ university/ hospital, such payment or credit shall not be considered to be an application of income for its specified objectives.

(ix) **Provisions of sections 40(a)(ia), 40A(3) and 40A(3A) apply in case of application of income by Fund/ Trust/ Institution etc**. – In case where an expenditure is incurred on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or after deduction, has not been paid on or before the due date under section 139(1), 30% of sum paid would not be treated as application of income in that year. The same would be, however, be treated as application in the year in which tax is deducted and paid.

Likewise, where the trust/fund etc. incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque/bank draft/ECS, exceeds ₹ 10,000, the same would not be considered as application of income.

Further, where any liability incurred has been allowed as application during the P.Y., say P.Y. 2019-20 and subsequently, say during the P.Y. 2020-21, the trust/fund/institution etc. makes payment in respect thereof, otherwise than by way of account payee cheque/bank draft/ECS, payment so made shall be deemed as income of the trust/fund/institution etc. of the year in which payment is made, if the payment or aggregate of payments made to a person in a day exceeds ₹ 10,000.

(x) **Withdrawal of approval** - The Central Government, or prescribed authority shall have the power to withdraw the approval or rescind the notification if:

(a) such fund/ institution/university/hospital etc. has not applied its income or invested/ deposited its funds in accordance with the provisions; or

(b) the activities of such fund, etc. are not genuine; or

(c) such activities are not being carried out in accordance with the conditions based upon which it was notified or approved; or

(d) such fund/institution/university/hospital etc. has not complied with the requirement of any other law for the time being in force, and the order, direction or decree, by whatever name called, holding that such non-compliance has occurred, has either not been disputed or has attained finality

However, the approval or notification can be withdrawn or rescinded only after issuing a show cause notice and giving reasonable opportunity to such fund, etc. of being heard. After withdrawing the approval or rescinding the notification, a copy of the order is to be forwarded to the concerned fund/institution, etc. as well as to the Assessing Officer.

(xi) **Time limit for making an application for grant of exemption** - The time limit for making an application for grant of exemption or continuation thereof under section 10(23C) by a fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clauses (iv)/(v)/(vi)/(via) of section 10(23C) has been specified in respect of such applications made on or after 1.6.2006. Such applications have to be filed on or before 30th September of the succeeding financial year. For example, if an educational institution seeks exemption under clause (vi) for P.Y.2019-20 (i.e. A.Y.2020-21), it has to make an application for grant of exemption by 30.9.2020.

(xii) **Anonymous donation to be included in total income** - Any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income.

(xiii) **Amount credited or paid out of income of any fund, trust etc. by way of corpus donation to any trust or institution registered under section 12AA not considered as application** - Any amount credited or paid out of income of any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv)/(v)/(vi)/(via), to any trust or institution registered under section 12AA, being voluntary contribution made with a specific direction that they shall form part of the corpus of the trust or institution, shall not be treated as application of income to the objects for which such fund or trust or institution or university or educational institution or hospital or other medical institution, as the case may be, is established.

(xiv) **Trust not entitled to exemption if its commercial receipts exceed 20% of total receipts** - If the purpose of a trust or institution referred to in sub-clauses (iv)/(v) of section 10(23C) does not remain charitable in a previous year on account of the commercial receipts exceeding 20% of total receipts of the trust or institution, then, such trust or institution would not be entitled to get benefit of exemption in respect of its income for that previous year in which the commercial receipts exceed the specified threshold. The denial of exemption would be compulsory by operation of law and would not be dependent on any approval being withdrawn or registration being cancelled or a notification being rescinded.

Such trust and institution cannot get benefit of tax exemption in the year in which its receipts from commercial activities exceed 20% of total receipts, whether or not the registration or approval granted or notification issued is cancelled, withdrawn or rescinded in respect of such trust or institution.

(xv) **No benefit of exemption under section 10 to entities eligible for exemption under section 10(23C)** - Entities which have been approved or notified for claiming benefit of exemption under section 10(23C) would not be entitled to claim any benefit of exemption under any other provision of section 10 [except exemption under section 10(1) in respect of agricultural income]. This is to ensure that once a trust or institution voluntarily opts for the special dispensation under this section, it should be governed by these provisions and should not be allowed the flexibility of being governed by the general provisions of section 10. Allowing such flexibility may have adverse effects on the objective for which this section was enacted.

(xvi) **Depreciation not allowable if cost of asset claimed as application** - Income for the purposes of application under section 10(23C) shall be determined without allowing any deduction or allowance for depreciation or otherwise, where the cost of acquisition of the asset has been claimed as application of income under section 10(23C) in the same previous year or any other previous year.

ILLUSTRATION 1

An educational institution having annual receipts of ₹ 1.20 crore during the P.Y. 2019-20, has to make an application to the prescribed authority before 31.3.2020 for claiming tax exemption under section 10(23C). Discuss the correctness or otherwise of this statement.

SOLUTION

This statement is **not** correct.

According to the first proviso to section 10(23C), an educational institution having aggregate annual receipts exceeding ₹ 1 crore, is required to make an application to the prescribed authority for grant of exemption under section 10(23C)(vi). Further, it is provided that such application can be made on or before 30th September of the relevant assessment year from which the exemption is sought.

Therefore, in the given case, the educational institution (having annual receipts of ₹ 1.20 crore during the P.Y. 2019-20) can make an application for grant of exemption in the prescribed form to the prescribed authority on or before 30th September, 2020, for claiming exemption under section 10(23C)(vi) for previous year 2019-20.

13.3 CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS [SECTIONS 11 TO 13]

(1) General discussion on trusts - Before considering the provisions of sections 11 to 13 which govern the exemption in respect of income from property held for charitable or religious purposes, let us see briefly what exactly the term trust signifies, the types of trusts and the manner of their creation. Though this aspect of the topic does not strictly fall within the purview of income-tax, such a general knowledge would be useful in understanding the provisions of tax laws relating to charitable trusts.

A trust is an obligation annexed to the ownership and arising out of a confidence reposed in and accepted by the owner if declared and accepted by him for the benefit of another or of another and the owner. The person who reposes or declares the confidence is called the 'author of the trust'; the person who accepts the confidence is called the trustee; the person for whose benefit the confidence is accepted is called the 'beneficiary'; the subject matter of the trust is called the 'trust property'; the 'beneficial interest' or 'interest' of the beneficiary is his right against the trustees or owner of the trust property and the instrument, if any, by which trust is declared is called the 'instrument of trust'.

Trusts can be broadly classified into two groups - Public and Private. The distinction between a public and private trust is that, whereas in the former, the beneficiaries are the general public or a class thereof, in the latter they are specific individuals. While in the former the beneficiaries constitute a body which is incapable of ascertainment, in the latter they are persons who are ascertained or capable of being ascertained. In some cases, private trusts may enure for the benefit of the public. Some religious trust may also be in the nature of public-cum-private trust.

Private trusts are governed by the Indian Trust Act, 1882. This Act does not apply to the following:

(1) The rules of Mohammedan law as to waqf;

(2) The mutual relations of the members of undivided family as determined by any customary or personal law;

(3) Public or private religious or charitable endowments; and

(4) Trust to distribute prizes taken in war among the captors.

From the above, it will be clear that public charitable trusts are not governed by the Indian Trust Act.

There are three requirements for creation of a public trust. They are (1) a declaration of trust which is binding on the settlor, (2) setting apart definite property and depriving himself of the ownership, and (3) a statement of objects for which the property is thereafter to be held. In the case of a private trust also, more or less similar requirements exist.

The word 'trust' as used in the context of sections 11 to 13 includes, in addition to the 'trust' as explained above, 'any other legal obligation'. This is made clear in *Explanation 1 to section 13*. The words 'any other legal obligation' are wide enough to cover Muslim wakfs, Hindu endowments and dedications to deities. It would also cover a case in which the trustees of a settlement are to pay the income to other trustees who in their turn are bound to apply it for purposes which are religious or charitable.

(2) Tax Exemption [Section 11] - Subject to the provisions of sections 60 to 63, the income of a religious or charitable trust or institution, to the extent specified in the Act, is exempt from tax when certain prescribed conditions are fulfilled. The relevant income does not even form part of the total income of the trust or institution.

Section 11 deals with the exemption of income from property held in trust or other legal obligation for religious or charitable purposes wholly or in part. Section 12 deals with exemption of income derived by such a trust from voluntary contributions. Section 12A prescribes the conditions as to registration of trust etc. Section 13 enumerates the circumstances under which the exemption available under sections 11 to 12 will be denied.

(i) Income from property held for charitable or religious purposes - The following income shall not be included in the total income of the previous year of the person in receipt of the income:

(a) Income derived from property held under trust wholly for charitable and religious purposes to the extent such income is applied in India for such purpose.

(b) Income derived from property held under trust in part only for such purpose, to the extent such income is applied in India for such purposes. However, the trust in question must have been created before 1.4.1962.

(c) Income derived from property held under trust, created on after 1.4.1952 for charitable purpose which tends to promote international welfare in which India is interested to the extent to which such income is applied to such purpose outside India. This does not cover religious trusts.

Income derived from property held under a trust for charitable or religious purposes, created before 1.4.1952, to the extent to which such income is applied for such purposes outside India.

In both the cases, the CBDT should have, by general or special order, directed that such income shall not be included in the total income of the person in receipt of such income.

(d) Income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

Thus, it may be noted that only such income derived from property held under trust wholly for charitable or religious purposes is exempt. If the property is held in part only for such purposes, it is necessary that such a trust must have been created before the commencement of the Act. In both the cases, the exemption is limited to the extent such income is applied in India for such specified purposes.

(ii) **Types of trusts** **-** To get exemption in respect of income applied outside India, the trusts are divided into two types:

(a) If the object of the trust is to promote international welfare in which India is interested, such trust may have been created on or after 1.4.1952.

(b) If the trust is for any other charitable purpose it must have been created before 1.4.1952. Here also, the exemption is limited to the extent to which such income is applied outside India for such specified purposes. It is to be noted however that a direction from CBDT by a general or special order is necessary before such exemption can be claimed.

(iii) **Conditions for claiming exemption**

(a) **Property should be held under trust -** The exemptions explained in the preceding paragraphs are available if and only if there is a valid trust or there is a legal obligation, under which the income derived from the property held under such trust or legal obligation is to be applied for charitable or religious purposes. If there is no trust nor any legal obligation, the income will not be exempt even if the whole of such income is applied to charitable or religious purposes. A mere creation of a trust for the income is not sufficient, there must be a trust of the property out of which the income is derived before one can consider any exemption under section 11.

(b) **Income should be applied for charitable purposes -** Section 2(15) states that 'charitable purpose' includes relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility.

The definition of "charitable purpose" includes "any other object of general public utility" The question arises as to what is an object of "general public utility". This expression has not been defined anywhere in the Act.

In *CIT v. Gujarat Maritime Board (2007) 295 ITR 561*, the Supreme Court observed that the Gujarat Maritime Board was established for the predominant purpose of development of minor ports within the State of Gujarat, the management and control of the Board was essentially with the State Government and there was no profit motive. The assessee, Gujarat Maritime Board, was under a legal obligation to apply its income which was directly and substantially from the business held under trust for the development of minor ports in Gujarat. Therefore, the Supreme Court held that the assessee was entitled to be registered as "charitable trust" under section 12A.

A number of entities functioning on commercial basis claim exemption of their income either under section 10(23C) or section 11 on the foundation that they are charitable institutions. This is based on the contention that they are engaged in the "advancement of an object of general public utility" as is included in the fourth part of the present definition of "charitable purpose". There were many decisions rendered in the past supporting the view that if unconnected business is held under a trust for promoting the object of general public utility and if profits are used for promoting such objects, income thereof shall be exempt, for example, the decision of the Supreme Court in *CIT v. Madras Stock Exchange Ltd. (1981) 130 ITR 184*. However, such a claim in respect of an activity carried out on commercial basis, goes against the basic intention of the provision.

Therefore, in order to limit the ambit of the phrase "advancement of any other object of general public utility", section 2(15) provides that "the advancement of any other object of general public utility" would not be a charitable purpose if it involves the carrying on of –

(a) any activity in the nature of trade, commerce or business or,

(b) any activity of rendering of any service in relation to any trade, commerce or business, for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity, or the retention of such income, by the concerned entity.

Thus, the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless,-

(1) such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and

(2) the aggregate receipts from such activity or activities, during the previous year, does not exceed 20% of the total receipts, of the trust or institution undertaking such activity or activities, for the previous year .

Therefore, in effect, "advancement of any other object of general public utility" would continue to be a "charitable purpose", if the activity in the nature of trade, commerce or business is undertaken in the course of actual carrying out of such advancement of any other object of general public utility **and** the aggregate receipts from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed 20% of the total receipts of the trust or institution undertaking such activity or activities, for the previous year.

ILLUSTRATION 2

An institution having its main object as "advancement of general public utility" received ₹ 30 lakhs in aggregate during the P.Y.2019-20 from an activity in the nature of trade. The total receipts of the institution, including donations, was ₹ 140 lakhs. It applied 85% of its total receipts from such activity during the same year for its main object i.e. advancement of general public utility.

(i) What would be the tax consequence of such receipt and application thereof by the institution?

(ii) Would your answer be different if the institution's total receipts had been ₹ 150 lakhs (instead of ₹ 140 lakhs) in aggregate during the P.Y.2019-20?

(iii) What would be your answer if the main object of the institution is "relief of the poor" and the institution receives ₹ 30 lakhs from a trading activity, when its total receipts are ₹ 140 lakhs and applies 85% of the said receipts for its main object?

SOLUTION

(i) As the main object of the institution is "advancement of object of general public utility", the institution will lose its "charitable" status for the P.Y.2019-20, since it has received ₹ 30 lakhs from an activity in the nature of trade, which exceeds ₹ 28 lakhs, being 20% of the total receipts of the institution undertaking that activity for the previous year. The application of 85% of such receipt for its main object during the year would not help in retaining its "charitable" status for that year. The institution will lose its charitable status and consequently, the benefit of exemption of income for the P.Y.2019-20, irrespective of the fact that its approval is not withdrawn or its registration is not cancelled.

(ii) If the total receipts of the institution is ₹ 150 lakhs, and the institution receives ₹ 30 lakhs in aggregate from an activity in the nature of trade during the P.Y.2019-20, then it will not lose its "charitable" status since receipt of upto 20% of the total receipts of the institution in a year from such activity is permissible. The institution can claim exemption subject to fulfilment of other conditions under sections 11 to 13. Further, such activity should also be undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(iii) The restriction regarding carrying on of a trading activity for a cess, fee or other consideration will not apply if the main object of the institution is "relief of the poor". Therefore, receipt of ₹ 30 lakhs from a trading activity by such an institution will not affect its "charitable" status, even if it exceeds 20% of the total receipts of the institution. The institution can claim exemption subject to fulfilment of other conditions under sections 11 to 13**.**

ILLUSTRATION 3

(a) ***"Save Wild Life"*** *an institution having its main object as 'preservation of wildlife', used the entire income derived from an activity in the nature of trade for its main object during the previous year ended on 31.03.2020. Would such utilization of its income be treated as utilisation for "charitable purpose"? Examine. Would your answer be different, if the main object of the institution is "advancement of object of general public utility"?*

(b) *A charitable trust derives its income from the business of providing mineral water to various companies situated in Software Technology Park in Hyderabad. A sum of ₹ 30 lacs has been derived as net income from such business activity, which has been applied for the object of general public utility. The total receipts of the trust during the P.Y. 2019-20 was ₹ 140 lakhs. Examine the taxability of application of the income, if the income so derived relates to the previous year 2019-20. Would your answer be different, if the trust runs a school in a backward district and applies the profits from the business for such school's activity?*

SOLUTION

(a) Section 2(15) defines “charitable purpose” to include relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, the “advancement of any other object of general public utility” shall not be a charitable purpose, if the institution is carrying on any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income derived from such activity.

Therefore, preservation of wildlife is included in the definition of “charitable purpose” under section 2(15). Further, an institution having the preservation of wildlife as its main object would not be subject to the restrictions which are applicable to the “advancement of any other object of general public utility”. Such institution would continue to retain its “charitable” status, even if it derives income from an activity in the nature of trade.

However, if an institution having its main object as “advancement of any other object of general public utility”, derives income from an activity in the nature of trade during a financial year, it would lose its “charitable” status for that year, even if it applies such income for its main objects.

It may be noted that if the receipts from such activity does not exceed 20% of the total receipts in that year, then, the institution would not lose its “charitable” status, even if its main object is “advancement of any other object of general public utility”, if such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(b) In the first case, net income from the business of supplying mineral water to various companies i.e., ₹ 30 lakhs is not eligible for exemption under section 11, since the receipt from such activity exceeds 20% of total receipts (i.e., 20% of ₹ 140 lakhs) during the year. This is because “advancement of any object of general public utility” would not be a charitable purpose if it involves carrying on of any activity in the nature of trade, commerce or business, for example, supply of mineral water for a consideration, as in this case. It is immaterial that the net income from such business is applied for the object of general public utility.

On the other hand, where the trust runs a school in a backward district, this restriction is not applicable. The reason is that the restriction contained in section 2(15) is applicable only to the last limb of the definition of “charitable purpose” i.e. advancement of object of general public utility. It does not affect the other limbs of the definition viz. “relief of the poor”, “education”, “medical relief” etc.

Section 11(4) clarifies that “property held under trust” includes a business undertaking so held. As per section 11(4A), exemption can be availed in respect of profits and gains of business, if such business is incidental to the attainment of the objectives of the trust and separate books of account are maintained in respect of such business. Therefore, in the second case, the profit from the business shall be eligible for exemption under section 11, assuming that the said business is incidental to the attainment of the objects of the trust (i.e., education) and books of account for such business activity is maintained separately.

Circular No.11/2008 dated 19.12.2008

Exemption under section 11 in case of an assessee claiming both to be a charitable institution as well as a mutual organisation

The proviso to section 2(15) will apply only to entities whose purpose is advancement of any other object of general public utility i.e. the last limb of the definition of charitable purpose contained in section 2(15). Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C), if they carry on commercial activities. Whether such an entity is carrying on an activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity.

There are industry and trade associations who claim exemption from tax under section 11 on the ground that their objects are for charitable purpose as these are covered under any other object of general public utility. Under the principle of mutuality, if trading takes place between persons who are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants.

Therefore, where industry or trade associations claim to be both charitable institutions as well as mutual organizations and their activities are restricted to contributions from and participation of only their members, these would not fall within the purview of the proviso to section 2(15) owing to the principle of mutuality. However, if such organizations have dealings with non-members, their claim to be charitable organizations would be governed by the additional conditions stipulated in the proviso to section 2(15).

In the final analysis, however, whether the assessee has, for its object, the advancement of any other object of general public utility is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or business or renders any service in relation to trade, commerce or business, it would not be entitled to claim that its object is charitable purpose. In such a case, the object of general public utility will be only a mask or a device to hide the true purpose which is trade, commerce or business or the rendering of any service in relation to trade, commerce or business. Each case would, therefore, be decided on its own facts and no generalization is possible.

Circular No.395, dated 24.9.1984 – Promotion of sports and games is considered to be a charitable purpose within the meaning of section 2(15). Therefore, an association or institution engaged in the promotion of games and sports can claim exemption under section 11 even if it is not approved under section 10(23).

A trust will be treated as a charitable trust under section 2(15) even if its object involves the carrying on of an activity for profit. Such a trust will not be denied exemption under section 11 on the ground that its objects are non-charitable.

(iv) **Application and accumulation** - We have seen that the exemption is limited to the extent to which such income is applied in India or outside India, as the case may be. Is it necessary that the entire income should be so applied? The Act gives a concession here. It is possible to claim the exemption even if the trust or institution applies only 85% of the income derived from the trust property for the purpose of the trust, during the relevant previous year.

An accumulation not exceeding 15% of the income from such property is permissible. For computing this 15%, voluntary contributions referred to in section 12 shall be deemed to be part of the income. It must be clearly noted that accumulation must be with the object of application of the accumulated amount for charitable or religious purpose in India at a later date. Such a facility for accumulation is not available for those trusts whose income is to be applied outside India.

(v) **Inability to apply in full 85% of the income** - It is clear from the above discussion that free accumulation not exceeding 15% of income[1] from property is permissible. Hence, the balance 85% must be applied during the previous year for the purposes for which the trust has been created. However, it is possible that the trust is unable to apply the minimum of 85% of its income during the previous year due to either of the following reasons.

(1) The whole or any part of the income has not been received during that year.

(2) Any other reason.

In the first class of cases, the period of application is extended to cover the previous year in which the income is actually received and the previous year immediately following the year. However, the amount which may be so claimed to have been so applied during the subsequent previous year cannot exceed the amount of the income which had not been

[1] As per the Supreme Court ruling in *CIT v. Programme for Community Organisation (2001) 116 Taxman 608,* 15% of gross receipts would be eligible for accumulation under section 11(1)(a).

received earlier but received during a subsequent previous year. In the second case, the period of application is extended to the previous year immediately following the previous year in which the income was derived.

Example

During the previous year ending 31st March, 2020, a charitable trust earned an income of ₹ 1,00,000 but it received only ₹ 60,000 in that year. The balance of ₹ 40,000 is received in the year ending 31-3-2021.

Solution

	₹
Total income earned during the P.Y.2019-20	*1,00,000*
Actual receipt in P.Y.2019-20	*60,000*
Permissible accumulation @15% of ₹ 1,00,000	*15,000*
Balance to be applied during P.Y.2019-20	*45,000*
Amount received in P.Y.2020-21 to be applied in P.Y.2020-21 or P.Y.2021-22	*40,000*

Since this amount of ₹ 40,000 is received during the P.Y. 2020-21, this can be applied in the P.Y.2020-21 or in the P.Y.2021-22. If the entire amount of ₹ 40,000 is duly spent for charitable purposes in these two years, the exemption is fully available but if only part of the amount is so spent within the period, the exemption is restricted to that part only.

There may be a case where the inability springs from some other reason e.g., late receipt of the income making it impossible to spend it before the end of the year.

Example

A trust receives a sum of ₹ 50,000 on 30th March, 2020. Its previous year ends on 31-3-2020.

Solution

It is obvious that it is impossible to apply the requisite sum within one day. Therefore, it has been provided that such sum can be applied at any time during the immediately following previous year i.e., up to 31-3-2021.

(vi) **Amount credited or paid out of income of any trust by way of corpus donation to any trust or institution registered under section 12AA not considered as application -** Any amount credited or paid, out of income derived from property held under trust, to any trust or institution registered under section 12AA, being voluntary contribution made with a specific direction that they shall form part of the corpus of the trust or institution, shall not be treated as application of income for charitable or religious purpose.

(vii) **Provisions of sections 40(a)(ia), 40A(3) and 40A(3A) apply in case of application of income by trust** – In case where an expenditure is incurred on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or after deduction, has not been paid on or before the due date under section 139(1), 30% of sum paid would not be treated as application of income in that year. The same would be, however, be treated as application in the year in which tax is deducted and paid.

Likewise, where the trust incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque/ bank draft/ ECS, exceeds ₹ 10,000, the same would not be considered as application of income.

Further, where any liability incurred has been allowed as application during the P.Y., say P.Y. 2019-20 and subsequently, say during the P.Y. 2020-21, the trust makes payment in respect thereof, otherwise than by way of account payee cheque/bank draft/ECS, payment so made shall be deemed as income of the trust of the year in which payment is made, if the payment or aggregate of payments made to a person in a day exceeds ₹ 10,000.

(viii) **Procedural Formalities: Exercise of option** **-** To avail the facility of the extended period of application of income, the trust has to exercise an option in writing that the income applied later as prescribed may be deemed to be income applied to the relevant charitable purposes during the previous year in which the income was derived. Such option has to be exercised before the expiry of the time allowed statutorily under section 139(1).

The income so deemed to have been applied shall, however, not be taken into account in calculating the amount of income applied to such purposes, during the previous year in which the income is actually received or during the immediately following previous year, as the case may be. Thus, in the Example 1 given above, the amount of ₹ 40,000, received subsequently in the year 2020-21 and applied to charitable purposes in the year 2020-21, will by virtue of the option exercised by the trust, be deemed to be applied for charitable purposes in the year 2019-20 itself. Therefore, such an amount will not be taken into consideration in determining the amount of income applied for charitable purposes in the year 2020-21.

Section 11(1B) provides that where the income for which an option has been exercised as discussed above, is not actually applied, it is to be treated as the income of the previous year immediately following the year of receipt or the previous year in which it was derived, as the case may be.

(ix) **Conditional accumulation** **-** As per section 11, application of income derived from property held under trust for charitable purposes in India is the main condition for grant of exemption to trust or institution in respect of income derived from property held under such trust. In case such income cannot be applied during the previous year, the same can be accumulated and applied for such purposes, subject to satisfaction of the conditions provided therein.

Section 11 permits accumulation of 15% of the income indefinitely by the trust or institution. However, 85% of income can only be accumulated for a period not exceeding 5 years subject to the conditions that such person submits the prescribed form i.e., Form 10 to the Assessing Officer and the money so accumulated or set apart is invested or deposited in the specified forms or modes.

If the accumulated income is not applied for charitable purposes or ceases to be accumulated or set apart for accumulation or ceases to remain invested or deposited in specified modes, then, such income is deemed to be taxable income of the trust or institution.

For the purpose of clarifying the period within which the assessee is required to file Form 10, and to ensure due compliance of the above conditions within time, section 11(2) provides that -

(1) such person should furnish a statement in the prescribed form and in the prescribed manner to the Assessing Officer, stating the purpose for which the income is being accumulated or set apart and the period for which the income is being accumulated or set apart, which shall, in no case, exceed five years.

In computing the period of five years, the period during which the income could not be applied for the purpose for which it is so accumulated or set apart, due to an order or injunction of any court, shall be excluded.

(2) the money so accumulated or set apart should be invested or deposited in the modes specified in section 11(5).

(3) the statement in Form 10 should be filed on or before the due date of filing return of income specified under section 139(1).

In case the statement in Form 10 is not submitted on or before this date, then, the benefit of accumulation would not be available and such income would be taxable at the applicable rate. Further, the benefit of accumulation would also not be available if return of income is not furnished on or before the due date of filing return of income specified in section 139(1) **[Section 13(9)].**

ILLUSTRATION 4

A charitable institution registered under section 12AA of the Income-tax Act, 1961 filled in Form No.10 for seeking permission to accumulate unapplied income under section 11(2) of the Act for the objects of the institution and submitted it to the Assessing Officer along with the resolution for accumulation. The Assessing Officer found that the objects for which accumulation was sought were not particularised in as much as they covered the entire range of objects of the institution. Can the Assessing Officer deny the benefit of accumulation in such a case?

SOLUTION

Section 11(2) permits a charitable trust or institution to accumulate its unspent income where 85% of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India during the previous year. The institution or trust has to specify, by notice in writing given to the Assessing Officer, the purpose for which the income is being accumulated or set apart and the period for which such income is to be accumulated or set apart.

In the given case, the assessee institution sought the permission of the Assessing Officer to accumulate unapplied income for the objects of the institution. The institution had not stated any objects in particular for which the unspent income was sought to be accumulated or set apart. In *Bharat Krishak Samaj vs. Deputy Director of Income-tax (Exemption) (2008) 306 ITR 153 (Del.)*, it was held that it is not necessary for a charitable trust to particularize each and every object for which accumulation is sought. It is enough if the assessee seeks permission for accumulation for the objects of the trust. Therefore, the Assessing Officer cannot deny the benefit of accumulation in such a case.

Modes specified in section 11(5):

(1) Investment in Government Saving Certificates.

(2) Deposits with Post Office Savings Banks.

(3) Deposit with Scheduled banks or Co-operative Banks.

(4) Investment in units of the Unit Trust of India.

(5) Investment in Central or State Government Securities.

(6) Investments in debentures issued by or on behalf of any company or corporation. However, both the principal and interest thereon must have been guaranteed by the Central or the State Government.

(7) Investment or deposits in any public sector company.

Where an investment is made in the shares of any public sector company and such public sector company ceases to be a public sector company, the investment so made shall be deemed to be an investment made for a period of three years from the date of such cessation and in the case of any other investment or deposit, till the date of its maturity.

(8) Investment in bonds of approved financial corporation providing long term finance for industrial development in India and eligible for deduction under section 36(1)(viii).

(9) Investment in bonds of approved public companies whose principal object is to provide long-term finance for construction or purchase of houses in India for residential purposes and eligible for deduction under section 36(1)(viii).

(10) Deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

"Long-term finance" means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years.

"Urban infrastructure" means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, road, bridges and flyovers or urban transport.

(11) Investment in immovable property excluding plant and machinery, not being plant and machinery installed in a building for the convenient occupation thereof.

(12) Deposits with Industrial Development Bank of India.

(13) Any other mode of investment or deposit as may be prescribed. Rule 17C specifies the following other modes: (1) Investments in units issued under any scheme of mutual fund referred to in section 10(23D); (2) Any transfer of deposits to Public Account of India; (3) Deposits made with an authority constituted in India or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both; (4) investment by way of acquiring equity shares of a 'depository'; (5) investment by a recognized Stock Exchange, in the equity shares of a company promoted by it to acquire the membership rights of other stock exchanges, where at least 51% of the paid-up share capital is held by the Stock Exchange and the balance is held by its members; (6) investment by way of acquiring equity shares of an incubatee by an incubator; (7) investment by way of acquiring shares of National Skill Development Corporation; (8) investment in debt instruments issued by any infrastructure finance company registered with RBI; (9) investment in Stock Certificate as defined in of Sovereign Gold Bonds Scheme, 2015.

Amount credited or paid, out of accumulated income of any trust, to any trust or institution registered under section 12AA or referred to in section 10(23C)(iv)/(v)/(vi)/(via), not considered as application of income [*Explanation* to section 11(2)]

Any amount credited or paid, out of income derived from property held under trust, which is not applied, but is accumulated or set apart, to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv)/(v)/(vi)/(via) of section 10(23C), shall not be treated as application of income for charitable or religious purpose, either during the period of accumulation or thereafter.

Deemed income in case of non-utilisation or mis-utilisation of accumulated amount

Where the accumulated income of the trust -

(a) is applied for purposes other than charitable or religious purposes; or

(b) ceases to be accumulated or set apart for application thereto; or

(c) ceases to remain invested or deposited in any of the modes mentioned under section 11(5) above; or

(d) is not utilised for the purpose for which it is so accumulated or set apart during the period specified (not exceeding 5 years) or in the year immediately following thereof.

However, in computing the aforesaid period of 5 years, the period during which the income could not be applied for the purposes for which it is so accumulated or set apart due to an order or injunction of any Court shall be excluded.

(e) accumulated or set apart for application to charitable and religious purposes in India, is credited or paid to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv)/(v)/(vi)/(via) of section 10(23C),

such income shall be deemed to be the income of the previous year –

(a) in which it is so applied; or

(b) in which it ceases to be accumulated or set apart; or

(c) in which it ceases to remain so invested or deposited; or

(d) immediately following the expiry of the period aforesaid; or

(e) in which it is paid or credited.

In *DIT (Exemption) v. Khetri Trust (2014) 367 ITR 723 (Del),* properties bequeathed to a trust could not be transferred to it due to ongoing court litigation and pendency of probate proceedings question arose if violation of the provisions of section 11(5) be attracted. In the facts of the case, trustees paid ₹ 1,10,000 for raising a memorial for late Raja Bahadur Sardar Singh and the said amount was given to a business entity for this purpose, but due to the ongoing dispute, such project was not completed the Commissioner (Appeals) observed that the validity of the will has been challenged in the probate proceedings; therefore, till the 'will' is probated and affirmed as genuine, the trust would not acquire the legal right on the property for the purpose of Act. In case the probate is denied, the properties would not devolve on the trust. The shares in foreign company were still in the name of the donor, late assessee and its acquisition by the trust is dependent upon the adjudication of the probate.

Further, with regard to the advance given to the business entity, the Commissioner (Appeals) found that the said amount cannot be treated as an investment which was covered and regulated by section 11(5), since the intent and purpose behind the payment was not investment. Based on the above factual findings, elucidated and affirmed by the Commissioner (Appeals) and the Tribunal, the High Court held that there was no violation of section 11(5) in this case.

Application to be made to Assessing Officer for application of income for other purposes

It is possible that due to circumstances beyond the control of the person in receipt of the income, any income invested or deposited in approved modes cannot be applied for the purpose for which it was accumulated or set apart. In such a case, an application may be made to the Assessing Officer specifying such other purposes as are in conformity with the objects of the trust. The Assessing Officer may allow the application of income to such other purposes. If such a permission is granted by the Assessing Officer, the new purposes will be deemed to be purposes specified in the written notice given to the Assessing Officer.

It is to be noted that the Assessing Officer cannot allow transfer of any such accumulated income to other charitable trusts/institutions as application of income towards charitable purposes. This has created genuine problems for those trusts and institutions which are wound up. However, in case of a trust or institution which has invested or deposited its income in any of the forms mentioned in section 11(5), the Assessing Officer can allow application of such income for crediting or payment to any trust or institution registered under section 12AA or any fund or institution or trust or university or education institution or hospital or medical institution covered by section 10(23C). Such application can be allowed only in the year in which such trust or institution is dissolved.

(x) **No deduction for depreciation where cost of asset has been claimed as application of income** - Income for the purposes of application under section 11 shall be determined without allowing any deduction or allowance for depreciation or otherwise, in respect of any asset, the cost of acquisition of which has been claimed as an application of income under this section in the same or any other previous year [Section 11(6)].

ILLUSTRATION 5

MSO Foundation, a charitable institution set up on 1st April, 2019 and registered under section 12AA with effect from that date, is engaged in providing education in hotel management. The organisation acquires a building for using the same for holding classes and office activities. It has approached you for your opinion on its eligibility to claim the cost of the building and also depreciation thereon in the current year and the subsequent year. Advise the institution indicating the reasons.

SOLUTION

(i) 15% of income from property held for charitable purposes is exempt from tax under section 11. The remaining 85% of such "income" would be exempt if it is "applied" for charitable purposes in India.

(ii) Application of the amount can be for revenue or capital purposes. As long as the expenditure is incurred out of income earned by the trust and for the purposes of carrying on the objects of the trust, it would be treated as application of income even if such expenditure is for capital purposes. Therefore, since the building is acquired by the organization for holding classes and office activities, which is for the purposes of carrying on the objects of the charitable institution i.e., for providing education in hotel management, the cost of the building would be treated as application of income.

However, section 11 provides that where the cost of building is claimed as application, no other deduction for depreciation or otherwise would be allowed as an application of income in respect of such asset for the same or any other previous year.

(xi) **No claim for exemption under section 10 permissible where trust has been granted registration for availing exemption under section 11** **-** Where a trust or an institution has been granted registration for purposes of availing exemption under section 11, and the registration is in force for a previous year, then such trust or institution cannot claim any exemption under any provision of section 10 [other than exemption of agricultural income under section 10(1) and exemption available under section 10(23C)] [Section 11(7)].

(xii) **Cases where trust property consists of a business undertaking** **-** Section 11(4) clarifies that for the purposes of section 11, property held under trust may consist of a business undertaking so held. If that be so, the trustees may claim that the income of such undertaking enjoys exemption under section 11. Section 11(4) provides for the following -

(a) The Assessing Officer shall have the power to determine the income of the undertaking in accordance with the provisions of the Act relating to assessment, and

(b) Where the income determined by the Assessing Officer is in excess of that shown in the books of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes.

(xiii) **Charitable trust engaged in business activity [Section 11(4A)]** **-** Consequently, a charitable trust engaged in business activity will be liable to any tax on income from the activity. However, exemption would be available to the trust in respect of income earned from such business activity if –

(a) such business is incidental to the attainment of the objects of the trust/institution; and

(b) separate books of account are maintained by such trust/institution in respect of such business.

Note – Profits derived by a trust/institution referred to in clauses (21), (23A), (23B), (23BB) and (23C) of section 10 will continue to be exempt from income-tax, since section 11(4A) does not override the provisions of section 10.

(xiv) Instances where capital gains would be deemed to have been applied for charitable purposes [Section 11(1A)]

(a) **Transfer of a capital asset held under trust wholly for charitable or religious purposes [Section 11(1A)(a)] -** Where the whole of the net consideration from the transfer of the capital asset is utilised for acquiring a new capital asset which is held under trust wholly for charitable or religious purposes, the entire amount of capital gains arising from the transfer would be deemed to have been applied for charitable or religious purposes. If, however, only a part of the net consideration is utilised in acquiring the new capital asset, the amount of capital gains deemed to have been utilised for charitable or religious purposes shall be equal to the excess of the proceeds utilised over the cost of the asset transferred.

Example

Original cost of capital asset transferred	*₹ 1,00,000*
Consideration for which it is transferred	*₹ 1,50,000*
Situation 1 Cost of new capital asset acquired	*₹ 1,50,000*
Situation 2 Cost of new capital asset acquired	*₹ 1,20,000*

Amount that will be deemed to have been applied for charitable purposes.

Situation 1	*₹ 50,000*
Situation 2	*₹ 20,000*

(b) **Transfer of a capital asset held under trust in part only for charitable and religious purposes [Section 11(1A)(b)] -** Where only a part of a capital asset has been transferred, only the "appropriate fraction" of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes. Where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain will be deemed to have been so applied. In any other case, the exemption will be limited to so much of the appropriate fraction of the amount utilised for acquiring the new asset as exceeds the appropriate fraction of the cost of the transferred asset.

"Appropriate fraction" means the fraction which represents the extent to which the income derived from the capital asset transferred was applicable to charitable or religious purposes before such transfer.

Example

A capital asset is being held under trust. Two-thirds of the income derived from such capital asset are being utilised for the charitable purposes of the trust. The asset is being transferred.

Cost of transferred asset	*₹ 1,20,000*
Net consideration	*₹ 1,80,000*
Cost of new asset acquired	*₹ 1,50,000*
Capital gains	*₹ 60,000 [₹ 1,80,000 – ₹ 1,20,000]*

Appropriate fraction 2/3rd

Income represented by 'appropriate fraction' = 2/3rds of ₹ 60,000 = ₹ 40,000

Since the entire net consideration has not been utilised in acquiring the new asset, the amount deemed to have been utilised for charitable purpose will be (2/3rds of ₹ 1,50,000) – (2/3rds of ₹ 1,20,000) = ₹ 1,00,000 – ₹ 80,000 = ₹ 20,000.

(xv) **Voluntary Contributions [Section 12]** - Any voluntary contribution received by a trust created wholly for charitable or religious purposes or by an institution established wholly for such purposes shall, for the purposes of section 11, be deemed to be income derived from property held under trust wholly for charitable or religious purposes. However, corpus donations (i.e. contributions made with a specific direction that they shall from part of the corpus of the trust or institution) shall not be treated as income. Such corpus donations are treated as capital receipts not chargeable to tax. Other voluntary contributions would be treated as income. However, exemption can be claimed in respect of such income subject to fulfillment of the conditions mentioned below –

(a) The trust should be registered under section 12AA with the Principal Commissioner or Commissioner of Income-tax;

(b) If the total income of the trust exceeds the basic exemption limit, the accounts of the trust should be audited.

(c) The trust should apply at least 85% of its income for the approved purposes.

(d) The balance should be invested or deposited in specified forms or modes.

Note – It may be noted that the corpus donations are to be considered for the purpose of determining whether the accounts of the trust are to be audited. Further, corpus donations have to be invested only in the investments approved under section 11(5). If invested elsewhere, the income from unapproved investment would be chargeable to tax.

ILLUSTRATION 6

Hundi (charitable box) superscribing "contributions in this hundi form part of corpus of trust fund" kept at Lord Venkateshwara Temple, Tirumala, was opened on 30.3.2020. Cash of ₹ 100 lakhs and valuable articles worth ₹ 250 lakhs were found to have been contributed by the devotees. Discuss the tax implications.

SOLUTION

As per section 11(1)(d), income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of the recipient. In the given case, there is a specific declaration by the temple authorities that the contributions being put in the hundi (charity box) would form part of the corpus of the trust fund. Therefore, it is possible to take a view that those who put the contributions in the hundi give a tacit declaration that the contributions would form part of the corpus. Hence, a view can be taken that such contributions shall not be included in the total income of the recipient trust.

Further, it may be noted that the provision relating to taxability of anonymous donations under section 115BBC does not apply to voluntary contributions received by a trust or institution created or established wholly for religious purposes.

(3) Conditions for applicability of sections 11 & 12 [Section 12A]

(i) **Conditions to be satisfied and the assessment year from which exemption would be available**: The exemption provisions contained in section 11 and 12 as explained above shall not apply in relation to the income of any trust or institution unless the following conditions are satisfied:

(a) In respect an application for registration of trust was made before 1.6.2007, the requirement was that such application had to be made one year from the date of creation of the trust and the exemption provisions of section 11 and 12 applied from the date of creation of the trust or establishment of the institution [Section 12A(1)].

(b) This requirement of filing an application for registration under section 12A within one year of creation of the religious or charitable trust or institution has been removed in respect of applications made on or after 1.6.2007. The application can be filed at any time now.

(c) Accordingly, in respect of applications filed in the prescribed form to the Principal Commissioner or Commissioner on or after 1st June, 2007, the provisions of sections 11 and 12 would apply from the assessment year relevant to the financial year in which the application is made i.e., the exemption would be available only with effect from the assessment year relevant to the previous year in which the application is filed. It would not be available in respect of any earlier assessment year [Section 12A(2)].

(d) Thus, under section 12A, a trust or an institution can claim exemption under sections 11 and 12 only after registration under section 12AA has been granted. Also, in case of trusts or institutions which apply for registration after 1st June, 2007, the registration shall be effective only prospectively.

(ii) **Fresh registration of a trust in the event of adoption or undertaking modifications of the objects after the registration has been granted [Section 12A(ab)]**: Where a trust or an institution has been granted registration under section 12AA or has obtained registration at any time under section 12A [as it stood before its amendment by the Finance (No. 2) Act, 1996] and, subsequently, it has adopted or undertaken modifications of the objects which do not conform to the conditions of registration, it shall be required to obtain fresh registration by making an application within a period of thirty days from the date of such adoption or modification of the objects, to the Principal Commissioner or Commissioner, in the prescribed form and manner.

(iii) Circumstance when exemption would be granted for an earlier assessment year:

Non-application of registration for the period prior to the year of registration causes genuine hardship to charitable organisations. On account of non-registration, tax liability gets attracted in those years even though they may otherwise be eligible for exemption due to compliance with other substantive conditions. Further, condonation of delay in seeking registration is also not permitted. Therefore, three provisos have been inserted in section 12A by the Finance (No.2) Act, 2014, in order to remove the genuine hardship and provide relief to the trusts.

In case where a trust or institution has been granted registration under section 12AA, the benefit of sections 11 and 12 shall be available in respect of any income derived from property held under trust in any assessment proceeding for an earlier assessment year which is pending before the Assessing Officer as on the date of such registration.

(a) **Condition for grant of such exemption:**

The objects and activities of such trust or institution in the relevant earlier assessment year should be the same as those on the basis of which such registration has been granted.

(b) **Reassessment proceedings not to be initiated for earlier years due to reason of non-registration**

No action for reopening of an assessment under section 147 shall be taken by the Assessing Officer in the case of such trust or institution for any assessment year preceding the first assessment year for which the registration applies, merely for the reason that such trust or institution has not obtained the registration under section 12AA for the said assessment year.

(c) Non-availability of above benefits to a trust or institution in certain cases

The above benefits would, however, not be available in case of any trust or institution which at any time had applied for registration and the same was denied or a registration granted to it was cancelled at any time under section 12AA.

ILLUSTRATION 7

Can a trust created for charitable purposes in April 2019, having filed application for registration as per section 12A on 11.4.2020, claim benefits of sections 11 and 12 from Assessment Year 2020-21?

SOLUTION

In respect of applications filed on or after 1st June, 2007, the provisions of sections 11 and 12 shall apply from the assessment year relevant to the financial year in which the application is made i.e., the exemption would be available only with effect from the assessment year relevant to the previous year in which the application is filed. It would not be available in respect of any earlier assessment year.

Therefore, since the trust has filed application for registration only on 11.4.2020, it cannot claim benefit of sections 11 and 12 from A.Y.2020-21. Assuming that the registration has been granted under section 12AA, the exemption would be available only from the A.Y. 2021-22, being the assessment year relevant to the previous year in which application is filed [i.e., P.Y. 2020-21].

However, where a trust has been granted registration under section 12AA in the P.Y. 2020-21, the benefit of sections 11 and 12 shall be available in respect of any income derived from property held under trust for assessment year 2020-21, being the assessment year preceding the assessment year in which application is filed i.e., A.Y.2021-22, if assessment proceedings in respect of that year is pending before the Assessing Officer as on the date of such registration.

It may be noted that exemption in respect of an earlier assessment year can be claimed only if the objects and activities of such trust or institution in the relevant earlier assessment year are the same as those on the basis of which such registration has been granted.

ILLUSTRATION 8

Help All, a trust created on 1st January, 2020 for providing relief to the poor, applied for registration under section 12A on 1st March, 2020. On that date, its corpus fund comprised only of the initial contribution made by the trustees. The Commissioner denied registration solely on the ground that the trust had not commenced any charitable activity, due to which he could not satisfy himself about the genuineness of the trust. Is the ground for denial of registration by the Commissioner justified in this case? Discuss.

SOLUTION

The Karnataka High Court, in *DIT (Exemptions) v. Meenakshi Amma Endowment Trust (2013) 354 ITR 219,* opined that an application under section 12A for registration of the trust can be sought even within a week of its formation. The activities carried on by the trust are to be seen in a case where the registration is sought much later after formation of the trust.

The High Court further observed that the corpus fund included contribution made by the trustees only, which indicated that the trustees were contributing the funds by themselves in a humble way and were intending to commence charitable activities. The assessee-trust had not also collected any donation for the activities of the trust, by the time its application came up for consideration before them. When the application for registration was made, the trust, therefore, did not have sufficient funds for commencement of its activities.

The High Court observed that, with the money available with the trust, it cannot be expected to carry out activity of charity immediately. Consequently, in such a case, it cannot be concluded that the trust has not intended to do any activity of charity. In such a situation, where application is made shortly after formation of the trust, the objects of the trust as mentioned in the trust deed have to be taken into consideration by the authorities for satisfying themselves about the genuineness of the trust and not the activities carried on by it. Later on, if it is found from the subsequent returns filed by the trust, that it is not carrying on any charitable activity, it would be open to the concerned authorities to withdraw the registration granted or cancel the registration as per the provisions of section 12AA(3).

Applying the rationale of the above ruling, the Commissioner cannot deny registration solely on the ground that the trust had not commenced any charitable activity in this case, since the trust has applied for registration under section 12A within two months after its formation and the corpus fund comprised only of contribution made by the trustees. The Commissioner has to take into consideration the objects of the trust as mentioned in the trust deed to satisfy itself about the genuineness of the trust.

(iv) **Audit -** Where the total income of the trust without giving effect to the provisions of section 11 and 12 exceeds the maximum amount which is not chargeable to income-tax in any previous year, the accounts of the trust must be audited by a chartered accountant and the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such prescribed particulars, should be furnished along with the return.

(v) **Mandatory filing of return:** In order to provide further clarity, section 12A provides for further condition that the person in receipt of the income chargeable to income-tax shall furnish the return of income within the time allowed under section 139(4A) of the Act.

(4) **Procedure for Registration [Section 12AA] -** The Principal Commissioner or Commissioner, on receipt of an application for registration of a trust or institution made under section 12A(1) shall proceed as follows :

(i) He would call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about –

(a) the genuineness of activities of the trust or institution and

(b) the compliance of such requirements of any other law for the time being in force by the trust or institution as are material for the purpose of achieving its objects

and may also make such enquiries as he may deem necessary in this behalf.

(ii) After satisfying himself about the objects of the trust or institution and the genuineness of its activities ***as required in (i)(a) above and compliance of the requirements under (i)(b) above***, he shall pass an order in writing registering the trust or institution.

(iii) If he is not satisfied, he shall pass an order in writing refusing to register the trust or institution.

(iv) A copy of such an order issued under (ii) or (iii) above shall be sent to the applicant. However, an order under (iii) shall not be passed unless the applicant has been given a reasonable opportunity of being heard.

(v) Every order granting or refusing registration shall be passed within six months from the end of the month in which the application for registration of trust or institution is received by the Principal Commissioner or Commissioner.

(vi) Where a trust or an institution has been granted registration and subsequently, if the Principal Commissioner or Commissioner of Income-tax is satisfied that the activities of any trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution, he can pass an order in writing canceling the registration granted under section 12AA and 12A (as it stood before its amendment by the Finance (No.2) Act, 1996). However, the trust or institution should be given a reasonable opportunity of being heard.

(vii) Any order passed by the Principal Commissioner or Commissioner of Income-tax under section 12AA refusing registration is appealable under section 253 to the Income-tax Appellate Tribunal.

(viii) Where a trust or an institution has been granted registration, and subsequently it is noticed that its activities are being carried out in such a manner that,—

(a) its income does not enure for the benefit of general public;

(b) it is for benefit of any particular religious community or caste;

(c) any income or property of the trust is applied for benefit of specified persons like author of trust, trustees etc.; or

(d) its funds are invested in prohibited modes,

then, the Principal Commissioner or the Commissioner may cancel the registration of such trust or institution. ***The Commissioner may also cancel the registration of such trust or institution, if it has not complied with the requirement of any other law and the order, direction or decree, by whatever name called, holding that such non-compliance has occurred, has either not been disputed or has attained finality.*** However, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the above manner, the registration shall not be cancelled.

ILLUSTRATION 9

Educare, a trust created with the objective of promoting primary education in rural areas, filed an application for registration under section 12A on 30th April, 2019. Since the application was not disposed of by the Commissioner on or before 31st October, 2019 as required under section 12AA(2), the trust contended that it was deemed to be registered as per the provisions of section 12AA(1). Examine the correctness of contention of the trust.

SOLUTION

As per the provisions of section 12AA(2), every order granting or refusing registration under section 12AA(1)(b), **shall** be passed by the registering authority before the expiry of six months from the end of the month in which the application was received under section 12A(1)(a) or section 12A(1)(aa).

The Supreme Court, in *CIT v. Society for Promotion of Education (2016) 382 ITR 6,* held that once an application under section 12AA was made and the same was not responded to within six months, the trust would be deemed as registered with effect from the date following the expiry of the six month period.

Applying the rationale of the above Supreme Court ruling in this case, the trust would be deemed as registered with effect from 1.11.2019. The contention that the trust is deemed to be registered, since its application for registration has not been disposed of within six months is, therefore, correct.

Note: *The benefit of exemption under section 11 and 12 would be available from the A.Y. 2020-21, being the assessment year relevant to the financial year in which such application is made.*

ILLUSTRATION 10

A charitable trust, whose income can be exempt under section 11 of the Income-tax Act, 1961, was formed on 1st March, 2017. For the accounting year ended 31st March, 2020, it earned an income of ₹ 3,60,000.

It filed with the Commissioner of Income-tax its application for registration on 31st August, 2019 explaining that for good and sufficient reasons, it was prevented from filing the application for so long.

Examine -

(i) by which date the application for registration should have been filed;

(ii) whether such an application could have been filed before the formation of the trust;

(iii) in the absence of an order of registration from the Commissioner, can the trust be deemed to be registered;

(iv) the steps to be taken by the trust to secure exemption from income-tax;

(v) whether a certificate of registration once granted can be cancelled and if so, the conditions there for.

SOLUTION

(i) The requirement of filing an application for registration under section 12A within one year of creation of the trust has been removed. The application can be filed at any time now. Accordingly, the provisions of sections 11 and 12 would apply from the assessment year relevant to the financial year in which the application is made i.e. the exemption would be available only with effect from the assessment year relevant to the previous year in which the application was filed.

However, where registration has been granted to the trust under section 12AA and on the said date, assessment proceedings relating to earlier assessment years are pending, then, the benefit of sections 11 and 12 shall be available in respect of income derived from property held under trust in those years, provided the objects and activities of the trust remain unchanged.

(ii) No. The application for registration under section 12A cannot be filed before the formation of the trust.

(iii) As per section 12AA(2), every order granting or refusing registration should be passed before the expiry of 6 months from the end of the month in which the application was received under section 12A. The Supreme Court, in *CIT v. Society for Promotion of Education (2016) 382 ITR 6,* held that the trust would be deemed as registered if the application under section 12AA is not disposed of within the stipulated period of six months. Therefore, in this case, the trust would be deemed as registered with effect from 1st March, 2020. The benefit of exemption under section 11 and 12 would be available from A.Y. 2020-21, being the assessment year relevant to the financial year in which the application is made.

(iv) The following are the steps to be taken by the trust to secure exemption from income-tax:

(1) The trust should be registered with the Principal Commissioner or Commissioner of Income-tax under section 12AA.

(2) The accounts of the trust for the previous year must be audited by a Chartered Accountant if its total income without giving effect to the provisions of section 11 and section 12 exceeds the maximum amount which is not chargeable to tax. The audit report in the prescribed form, duly signed and verified by the Chartered Accountant, should be furnished along with the return of income of the trust for the relevant assessment year.

(3) At least 85% of the income is required to be applied for the approved purposes.

(4) The unapplied income and the money accumulated or set apart should be invested or deposited in the specified forms or modes, after filing statement in Form 10 on or before the due date of filing return of income specified under section 139(1).

(v) Yes, the certificate of registration can be cancelled by the Commissioner. According to section 12AA, if the Commissioner is satisfied that the activities of the trust are not genuine or are not being carried out in accordance with the objects of the trust, he shall, after giving the trust a reasonable opportunity of being heard, pass an order in writing cancelling the registration of the trust.

Further, section 12AA(4) provides that where a trust or an institution has been granted registration, and subsequently it is noticed that its activities are being carried out in such a manner that,—

(i) its income does not enure for the benefit of general public;

(ii) it is for benefit of any particular religious community or caste;

(iii) any income or property of the trust is applied for benefit of specified persons like author of trust, trustees etc.; or

(iv) its funds are invested in prohibited modes,

then, the Commissioner may cancel the registration of such trust or institution. ***The Commissioner may also cancel the registration of such trust or institution, if it has not complied with the requirement of any other law and the order, direction or decree, by whatever name called, holding that such non-compliance has occurred, has either not been disputed or has attained finality.*** However, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the above manner, the registration shall not be cancelled.

(5) Denial of Exemption [Section 13]

(i) Income not eligible for exemption under sections 11 and 12

(a) **Income from property held under a trust for private religious purposes -** Where the property is held under a trust for private religious purposes, no part of the income will be exempt if it does not ensure for the benefit of the public [Section 13(1)(a)].

(b) **Income from trust established for benefit of any particular religious community or caste -** Where a trust has been established for the benefit of any particular religious community or caste, the income thereof will not be eligible for exemption. However, a trust or institution created or established for the benefit of scheduled caste, backward classes, scheduled tribes or women and children shall not be treated as a trust or institution created or established for the benefit of a religious community or caste within the meaning of section 13(1)(b).

(c) **Income of trust enuring for the benefit of any person referred to in section 13(3) -** Where the trust or the institution has been created or established after 31.3.1962, if any part of its income enures directly or indirectly for the benefit of any person referred to in section 13(3).

Irrespective of the date of the creation of the trust or the establishment of the institution, if any part of its income or any property belonging to it during the relevant previous year is used or applied directly or indirectly for the benefit of any person referred to in section 13(3) [Section 13(1)(c)].

(d) **Deposit or investment of funds in impermissible modes -** Any income of a trust or institution, if –

(1) its funds are invested or deposited otherwise than in the forms or modes specified in section 11(5);

(2) it holds shares in a company other than -

(i) a public sector company; or

(ii) shares prescribed as a form or mode of investment under section 11(5)(xii).

However, these restrictions do not apply in respect of :

(a) any assets forming part of corpus of the trust as on 1-6-1973.

(b) any accretion to the corpus shares by way of bonus shares allotted to the trust.

(c) debentures issued by or on behalf of any company or corporation and acquired by the trust before March 1, 1983.

(d) any asset not covered under section 11(5), where such asset is held for not more than one year from the end of the previous year in which such asset is acquired.

(e) any funds representing the profits and gains of business, being profits and gains of any previous year relevant to the assessment year 1984-85 or any subsequent assessment year. However, such relaxation of the restriction will be denied unless the trust keeps separate accounts for the business. As already noted, subject to certain exceptions, such business profits are no longer eligible for exemption under section 11.

(ii) **Prohibited use or application** - We have noted above that when any part of the income or any property of the trust whenever created, is, during the previous year, used or applied directly, for the benefit of any person referred to in section 13(3), the denial of exemption operates. Section 13(2) specifies a few particular instances where the income or the property is to be deemed to have been used for the benefit of a person referred to in section 13(3). It should be noted that those particular instances do not in any way restrict the general meaning of the expression "used or applied for the benefit of a person". The provisions of section 13(2) are as follows:

The income or the property of the trust or institution or any part of such income or property is to be deemed to have been used or applied for the benefit of a person referred to in section 13(3) in the following cases:

(a) **Loan without adequate interest or adequate security -** If any part of the income or the property of the trust or institution is or continues to be lent to any person referred to in section 13(3) for any period during the previous year without either adequate security or adequate interest or both.

(b) **Allowing use of property without adequate rent -** If any land, building or other property of the trust or institution is or continues to be, made available, for the use of any person referred to in section 13(3) for any period during the previous year without charging adequate rent or other compensation.

(c) **Excess payment for services -** If any amount is paid out of the resources of the trust or institution to any of the persons referred to in section 13(3) for services rendered to the trust or institution but such amount is in excess of a reasonable sum payable for such services.

(d) **Inadequate remuneration for services rendered -** If the services of the trust or institution are made available to any person referred to section 13(3) without adequate remuneration or other compensation.

(e) **Excess payment for purchase of property -** If any share, security or other property is purchased by or on behalf of the trust or institution from any person referred to in section 13(3) during the previous year for a consideration which is more than adequate.

(f) **Inadequate consideration for property sold -** If any share, security or other property is sold by or on behalf of the trust or institution to any person referred to in section 13(3) during the previous year for a consideration which is less than adequate.

(g) **Diversion of income or property exceeding ₹ 1,000 -** If any income or property of the trust or institution is diverted during the previous year in favour of any person referred to in section 13(3) provided the aggregate value of such income and property diverted exceeds ₹ 1,000.

(h) **Investment in substantial interest concerns -** If any funds of the trust or institution are, or continue to remain, invested for any period during the previous year in any concern in which any person referred to in section 13(3) has a substantial interest.

Section 13(4) provides some respite where the aggregate of the funds invested in the said concern does not exceed five per cent of the capital of that concern. In such a case, the exemption under section 11 will be denied only in relation to such income as arises out of the said investment.

(iii) **Exemption not to be denied to charitable trusts providing educational or medical facilities to specified persons [Section 13(6)]** - A charitable or religious trust running an educational institution or a medical institution or a hospital shall not be denied the benefit of exemption under section 11 merely due to the reason that the benefit of educational or medical facilities have been provided to the specified persons referred to in section 13(3). However, the value of such facilities provided to such specified persons either free of cost or at a concessional rate would be deemed to be the income of the trust. Such income would not be eligible for exemption under section 11.

(iv) **Anonymous donations [Section 13(7)]** - The exemption provisions contained in section 11 or section 12 shall not be applicable in respect of any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of that section. For example, section 11(1)(d) provides that any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of such trust/institution for the relevant previous year.

However, if a trust or institution established wholly for charitable purposes receives an anonymous donation with a specific direction that the donation shall form part of the corpus of the trust or institution, such anonymous donation would not be exempt by virtue of section 11(1)(d). It would be taxable at 30% as provided in section 115BBC.

(v) **Exemption to be denied to a charitable trust having its main object as "advancement of any other object of general public utility" if its trading receipts exceed the specified threshold irrespective of withdrawal of approval or cancellation of registration or rescindment of notification [Section 13(8)]**

(a) Under sections 11 and 12, income of any charitable trust or institution is exempt if such income is applied for charitable purposes in India and such institution is registered under section 12AA.

(b) The definition of "charitable purpose" under section 2(15) provides that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless,-

(1) such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and

(2) the aggregate receipts from such activity or activities, during the previous year, does not exceed 20% of the total receipts, of the trust or institution undertaking such activity or activities, for the previous year .

(c) Thus, a charitable trust or institution pursuing "advancement of object of general public utility" may be a charitable trust in one year and not a charitable trust in another year depending on the percentage of receipts from commercial activities *vis-à-vis* its total receipts.

(d) Therefore, no exemption would be available to a trust or institution for the previous year in which the receipts from commercial activities exceed 20% of the total receipts of that year. However, this temporary excess in one year may not be treated as altering the very nature of the trust or institution so as to lead to cancellation of registration or withdrawal of approval or rescinding of notification issued in respect of trust or institution.

(e) Therefore, there is need to ensure that if the purpose of a trust or institution does not remain charitable in a previous year on account of the commercial receipts exceeding the specified percentage of total receipts, then, such trust or institution would not be entitled to get benefit of exemption in respect of its income for that previous year in which the commercial receipts exceed the specified percentage of total receipts. The denial of exemption would be compulsory by operation of law and would not be dependent on any approval being withdrawn or registration being cancelled or a notification being rescinded.

(f) Accordingly, section 13(8) ensures that such trust and institution does not get benefit of tax exemption under section 11 or 12 in the year in which its receipts from commercial activities exceed the specified percentage of total receipts, whether or not the registration or approval granted or notification issued is cancelled, withdrawn or rescinded in respect of such trust or institution.

Clarification regarding cancellation of registration u/s 12AA of the Income-tax Act, 1961 in certain circumstances [*Circular No - 21/2016 dated: May 27, 2016*]:

The CBDT has clarified that it shall not be mandatory to cancel the registration already granted u/s 12AA to a charitable institution merely on the ground that the cut-off specified (20% of the total receipts) in the proviso to section 2(15) is exceeded in a particular year without there being any change in the nature of activities of the institution.

If in any particular year, the specified cut-off is exceeded, the tax exemption would be denied to the institution in that year and cancellation of registration would not be mandatory unless such cancellation becomes necessary on the ground(s) prescribed under the Act.

With the introduction of Chapter XII-EB in the Act vide Finance Act, 2016, prescribing special provisions relating to tax on accreted income of certain trusts and institutions, cancellation of registration granted under section 12AA may lead to a charitable institution getting hit by sub-section (3) of section 115TD and becoming liable to tax on accreted income. The cancellation of registration without justifiable reasons may, therefore, cause additional hardship to an assessee-institution due to attraction of tax-liability on accreted income. The field authorities are, therefore, advised not to cancel the registration of a charitable institution granted u/s 12AA just because the proviso to section 2(15) comes into play. The process for cancellation of registration is to be initiated strictly in accordance with section 12AA(3) and 12AA(4) after carefully examining the applicability of these provisions

(vi) **Non-submission of statement in prescribed form on or before the due date of filing return of income under section 139(1) [Section 13(9)]** - In case the statement in Form 10 is not submitted on or before the due date of filing return of income under section 139(1), then, the benefit of accumulation would not be available and such income would be taxable at the applicable rate. Further, the benefit of accumulation would also not be available if return of income is not furnished on or before the due date of filing return of income specified in section 139(1).

(vii) **Prohibited category of persons** - Section 13(3) gives the list of persons, use or application of the income or property of a trust for whose direct or indirect benefit results in a denial of the exemption contemplated in section 11 for a charitable or religious trust or institution. The said persons are:

(1) The author of the trust or the founder of the institution.

(2) Any person who has made a substantial contribution to the trust or institution, that is, any person whose total contribution up to the end of the relevant previous year exceeds ₹ 50,000.

(3) Where the author, founder or the person making a substantial contribution is a HUF, any member of the family.

(4) Any trustee of the trust or manager (by whatever name called) of the institution.

(5) Any relative of any such author, founder, person, member, trustee or manager as referred to above.

(6) Any concern in which any of the persons referred to in clauses (1) to (5) above has a substantial interest.

Relative - The expression "relative", in relation to an individual, means -

(a) spouse of the individual;

(b) brother or sister of the individual;

(c) brother or sister of the spouse of the individual;

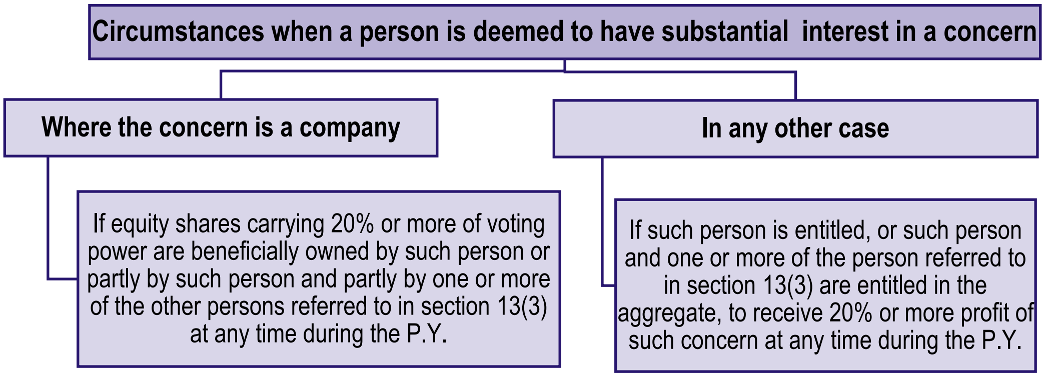
(d) any lineal ascendant or descendant of the individual;

(e) any lineal ascendant or descendant of the spouse of the individual;

(f) spouse of a person referred to in (b), (c), (d) or (e) above;

(g) any lineal descendant of a brother or sister of either the individual or the spouse of the individual;

Substantial interest in a concern - Section 13(2)(h), section 13(3) and section 13(4) refers to cases where a person has a substantial interest in a concern. These references occur where the "Prohibited use or application" and "Prohibited category of persons" have been described. The circumstances in which a person shall be deemed to have a substantial interest in a concern, have been laid down in *Explanation 3* to section 13.



Circumstances when a person is deemed to have substantial interest in a concern

Where the concern is a company

If equity shares carrying 20% or more of voting power are beneficially owned by such person or partly by such person and partly by one or more of the other persons referred to in section 13(3) at any time during the P.Y.

In any other case

If such person is entitled, or such person and one or more of the person referred to in section 13(3) are entitled in the aggregate, to receive 20% or more profit of such concern at any time during the P.Y.

(6) Anonymous Donations received by Charitable Trusts/Institutions to be subject to tax [Section 115BBC]

(i) As per the provisions of the Income-tax Act, 1961, tax exemption under section 10(23C) and section 11 are available to certain entities, as briefed in the table below, on fulfillment of the conditions prescribed under the relevant sections –

Entity	Applicable section
Charitable or religious trusts/institutions	11
Universities and other educational institutions	10(23C)(iiiad) and (vi)
Hospitals and other medical institutions	10(23C) (iiiae) and (via)
Notified funds or institutions established for charitable purposes	10(23C)(iv)
Notified trusts or institutions established wholly for public religious purposes or wholly for public religious and charitable purposes	10(23C)(v)

(ii) Section 115BBC has been inserted to tax anonymous donations received by the above entities at 30%.

(iii) In order to provide relief to these trusts and institutions and to reduce their compliance burden, an exemption limit has been introduced, and only the anonymous donations in excess of this limit would be subject to tax@30% under section 115BBC.

(iv) The exemption limit is the higher of the following –

(1) 5% of the total donations received by the assessee; or

(2) ₹ 1 lakh.

(v) The total tax payable by such institutions would be –

(1) tax@30% on anonymous donations exceeding the exemption limit as calculated above; and

(2) tax on the balance income i.e. total income as reduced by the anonymous donations which have been subject to tax@30% under section 115BBC**.**

(vi) The following table illustrates the calculation of anonymous donations liable to tax @30% under section 115BBC –

I	II	III	IV	V	VI
Situation	**Total donations during the year (₹)**	**Anonymous donations received during the year (₹)**	**Exemption (₹)**	**Anonymous donations taxable@30% (₹)**	**Donations subject to tax at normal rates # (₹)**
A	15,00,000	4,00,000	1,00,000	3,00,000	12,00,000
B	30,00,000	7,00,000	1,50,000	5,50,000	24,50,000
C	40,00,000	10,00,000	2,00,000	8,00,000	32,00,000

# It is possible to take a view that the remaining donations reflected in Column VI which are taxable at normal rates would be eligible for application of income and thereby, the benefit of exemption under section 11 would apply.

(vii) For this purpose, “anonymous donation” means any voluntary contribution referred to in section 2(24)(iia), where the person receiving such contribution does not maintain a record of the identity indicating the name and address of the person making such contribution and such other particulars as may be prescribed.

(viii) However, the above provision does not apply to a trust or institution created or established wholly for religious purposes.

(ix) Further, anonymous donations to trusts/institutions created or established wholly for religious and charitable purposes (i.e. partly charitable and partly religious institutions/trusts) would be taxed only if such anonymous donation is made with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution. Other anonymous donations received by such trusts/institutions are not taxable.

(x) Section 13(7) provides that the exemption provisions contained in section 11 or section 12 shall not be applicable in respect of any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of that section.

(xi) For example, section 11(1)(d) provides that any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of such trust/institution for the relevant previous year. However, if a trust or institution established wholly for charitable purposes receives an anonymous donation with a specific direction that the donation shall form part of the corpus of the trust or institution, such anonymous donation would not be exempt by virtue of section 11(1)(d). It would be taxable at 30% as provided in section 115BBC.

(xii) Similarly, section 10(23C) provides that any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income. Consequently, sections 10(23C) and 13 provide that any income by way of any anonymous donation which is taxable under the provisions of section 115BBC shall not be excluded from the total income of the trust or institution.

ILLUSTRATION 11

The following trusts claim that anonymous donations received by them during the financial year 2019-20 are not liable to tax under section 115BBC:

(i) *A charitable trust referred to in section 11 which applied the entire amount of anonymous donations for purposes of the trust during the relevant financial year.*

(ii) *A trust established wholly for religious purposes which applied 85% of the amount of anonymous donations for the purposes of the objects of the trust during the relevant financial* year.

Examine the validity of the claim made by the trusts.

SOLUTION

(i) Section 115BBC provides for levy of tax @ 30% on anonymous donation received by, *inter alia*, charitable trusts or institutions referred to in section 11 in the following manner:

(a) the amount of income-tax calculated @30% on the aggregate of anonymous donations received in excess of 5% of the total donations received by the assessee or one lakh rupees, whichever is higher; and

(b) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the aggregate of the anonymous donations received in excess of 5% of the total donations received by the assessee or ₹ 1 lakh, as the case may be.

Further, section 13(7) provides that the exemption provisions contained in sections 11 and 12 shall not be applicable in respect of any anonymous donation liable to tax under section 115BBC. As such, application of the anonymous donations received by the charitable trust for charitable purposes does not confer any exemption from tax. Therefore, the claim for non-taxability under section 115BBC of anonymous donations received by the charitable trust is not valid in law.

However, a view may be taken that anonymous donation upto higher of 5% of total donations or ₹ 1 lakh, which is taxable at normal rates would be eligible for application of income and thereby, the benefit of exemption under section 11 would apply.

(ii) Section 115BBC(2) provides that the provisions contained in section 115BBC(1) relating to the taxability of anonymous donations are not applicable to any trust or institution created or established wholly for religious purposes. As such, the trust established wholly for religious purposes is not liable to be taxed in respect of the anonymous donations received by it. Therefore, the claim made by the trust is valid in law. The application or non-application of such anonymous donation for the purposes of trust during the relevant financial year is not germane to the issue of taxability under section 115BBC.

13.4 TAX ON ACCRETED INCOME OF CERTAIN TRUSTS AND INSTITUTIONS [CHAPTER XII-EB]

(1) Background for introduction of Exit Tax

(i) As per section 2(24), "income" includes any voluntary contribution received by a charitable trust or institution or a fund.

(ii) Sections 11 and 12 provide exemption to trusts or institutions in respect of income derived from property held under trust and voluntary contributions, subject to the conditions stipulated thereunder.

(iii) The exemption is subject to the condition that the income derived from property held under trust should be applied for charitable purposes; and where such income cannot be applied during the previous year, it has to be accumulated and invested in the modes prescribed and applied for such purposes in accordance with specified conditions.

(iv) If the accumulated income is not applied in accordance with the conditions provided in the said section within a specified time, then such income is deemed to be taxable income of the trust or the institution. Section 12AA provides for registration of the trust or institution which entitles them to be able to get the benefit of sections 11 and 12. It also provides the circumstances under which the registration can be cancelled. Section 13 of the Act provides for the circumstances under which exemption under section 11 or 12 in respect of whole or part of income would not be available to a trust or institution.

(v) A society or a company or a trust or an institution carrying on charitable activity may –

(1) voluntarily wind up its activities and dissolve; or

(2) merge with any other charitable or non-charitable institution; or

(3) convert into a non-charitable organization.

There is, however, no specific provision in the income-tax law as to how the assets of such a charitable institution should be dealt with.

(vi) Under section 11, certain amount of income of prior period can be brought to tax on failure of certain conditions. However, there is no provision in the Income-tax Act, 1961, which ensure that the corpus and asset base of the trust accreted over a period of time, with promise of it being used for charitable purpose, continues to be utilised for charitable purposes and is not used for any other purpose.

(vii) Consequently, it is always possible for charitable institutions to transfer assets to a non-charitable institution.

(viii) In order to ensure that the benefit conferred over a period of time by way of exemption is not misused and to plug the gap in law that allows the charitable trusts having built up corpus/wealth through exemptions being converted into non-charitable organisation with no tax consequences, Chapter XII-EB imposes additional income-tax in the nature of an exit tax when the organization is converted into a non-charitable organization or gets merged with a non-charitable organization or does not transfer the assets to another charitable organisation.

(2) Salient Features:

	Section	Provision
(i)	115TD(1)	**Circumstances where levy of tax on accreted income is attracted**: The accreted income of a trust or institution registered under section 12AA shall be taxable at the maximum marginal rate (@34.944%) on – (1) conversion of the trust or institution into a form not eligible for grant of registration under section 12AA; or (2) merger with an entity not having similar objects and registered under section 12AA; or (3) non-distribution of assets on dissolution to any charitable institution registered under section 12AA or approved under section 10(23C) within a period of 12 months from the end of the month in which the dissolution takes place. This levy of exit tax shall be in addition to income chargeable in the hands of the entity.
(ii)	115TD(3)	**Deemed conversion into non-eligible form - Circumstances**: A trust or an institution shall be deemed to have been converted into any form not eligible for registration under section 12AA in a previous year, if,— (i) the registration granted to it under section 12AA has been cancelled; or (ii) it has adopted or undertaken modification of its objects which do not conform to the conditions of registration and,— (a) it has not applied for fresh registration under section 12AA in the said previous year; or (b) it has filed application for fresh registration under section 12AA but the said application has been rejected.
(iii)	115TD(2)	**Meaning of Accreted Income** : Aggregate FMV of total assets as on the specified date *Less* Total liability computed in accordance with the prescribed method of valuation *[See Method of Valuation prescribed by CBDT given at the end of para 13.4]*

Notes –

(1) Accreted income attributable to any asset which is established to have been directly acquired by the trust or institution out of its agricultural income exempt under section 10(1) would be ignored. Liability, in relation to such asset, also has to be ignored.

(2) Accreted income attributable to any asset acquired by the trust or institution during the period beginning from the date of its creation or establishment and ending on the date from which the registration under section 12AA became effective[2], if the trust or institution has not been allowed any benefit of sections 11 and 12 during the said period, would be ignored. Liability, in relation to such asset, also has to be ignored.

(3) The asset and the liability of the charitable organisation which have been transferred on dissolution to another charitable trust or institution registered under section 12AA or a fund/ institution/ trust/ university/ educational institution/ hospital/ medical institution approved under section 10(23C) within specified time have to be ignored while calculating accreted income.

Meaning of specified date [*Explanation* below section 115TD(7)]:

	Case	Specified Date
(i)	conversion of the trust or institution registered u/s 12AA into a form not eligible for registration u/s 12AA	The date of conversion
(ii)	merger with an entity not having similar objects or not registered u/s 12AA	The date of merger
(iii)	non-distribution of assets on dissolution to any charitable institution registered u/s 12AA or approved u/s 10(23C) within a period twelve months from dissolution.	The date of dissolution

[2] Where the benefit under sections 11 and 12 have been allowed to the trust or institution in respect of any previous year or years beginning prior to the date from which the registration under section 12AA became effective, then, the registration shall be deemed to have become effective from the first day of the earliest previous year. Thus, registration under section 12AA shall include any registration obtained under section 12A as it stood before its amendment by the Finance (No.2) Act, 1996.

<table>
<tr><td></td><td></td><td>Date of conversion [<i>Explanation</i> below section 115TD(7)]:
<table>
<tr><th></th><th>Case</th><th>Specified Date</th></tr>
<tr><td>(i)</td><td>Where the registration granted to it u/s 12AA has been cancelled</td><td>The date of the order cancelling registration u/s 12AA</td></tr>
<tr><td>(ii)</td><td>Where it has adopted or undertaken modification of its objects which do not conform to the conditions of registration and has not made an application for fresh registration or the application made has been rejected.</td><td>The date of adoption or modification of any object.</td></tr>
</table>
</td></tr>
<tr><td>(iv)</td><td>115TD(4)</td><td>Exit tax payable even if no income-tax is payable by the Trust/Institution:
Even if no income-tax is payable by the trust or institution on its total income, tax on accreted income shall be payable by the trust or institution, like any other additional income-tax.</td></tr>
<tr><td>(v)</td><td>115TD(5)</td><td>Period within which tax on accreted income has to be paid to the credit of the Central Government:
The principal officer or the trustee of the trust or the institution, as the case may be, and the trust or the institution shall also be liable to pay the tax on accreted income to the credit of the Central Government within fourteen days from,—
<table>
<tr><th></th><th>Circumstance</th><th>Relevant date</th></tr>
<tr><td>(1)</td><td>Where the registration granted u/s 12AA has been cancelled</td><td>the date on which –
(a) the period for filing appeal under section 253 against the order rejecting the application expires and no appeal has been filed by the trust or the institution; (or)
(b) the order in any appeal, confirming the cancellation of the application, is received by the trust or the institution</td></tr>
<tr><td>(2)</td><td>Where the trust has modified its objects and has not applied for fresh registration u/s 12AA</td><td>the end of the previous year</td></tr>
</table>
</td></tr>
</table>

<table>
<tr>
<td></td>
<td></td>
<td>
<table>
<tr><td>(3)</td><td>Where the trust has modified its objects and has filed application for fresh registration u/s 12AA, but the same was rejected</td><td>the date on which –
(a) the period for filing appeal under section 253 against the order rejecting the application expires an no appeal has been filed by the trust or institution; (or)
(b) the order in any appeal, confirming the cancellation of the application, is received by the trust or the institution</td></tr>
<tr><td>(4)</td><td>Where trust has merged with an entity not having similar objects or not registered u/s 12AA</td><td>the date of merger</td></tr>
<tr><td>(5)</td><td>Where the trust fails to transfer upon dissolution all its assets to another registered trust or institution or approved fund or institution within 12 months from the end of the month in which the dissolution takes place</td><td>the date on which the period of 12 months expires.</td></tr>
</table>
</td>
</tr>
<tr>
<td>(vi)</td>
<td>115TD(6)</td>
<td><u>No credit available for tax paid on accreted income:</u>
The tax on accreted income shall be final tax for which no credit can be taken by the trust or institution or any other person.</td>
</tr>
<tr>
<td>(vii)</td>
<td>115TD(7)</td>
<td><u>Non-availability of deduction under any other provision of the Act</u>:
No deduction is allowable under any other provision of the Act to the trust or institution or any other person in respect of the income which has been charged to tax or the tax thereon.</td>
</tr>
<tr>
<td>(viii)</td>
<td>115TE</td>
<td><u>Interest for non-payment of tax within prescribed time</u>:
In case of failure of payment of tax within the prescribed time, a simple interest@1% p.m. or part of it shall be applicable for the period of non-payment.</td>
</tr>
</table>

<table>
<tr><td></td><td></td><td>Period of non-payment:<table><tr><th>Beginning from</th><th>Ending with</th></tr><tr><td>The date immediately after the last date on which such tax was payable</td><td>The date on which the tax is actually paid.</td></tr></table></td></tr>
<tr><td>(ix)</td><td>115TF</td><td>Circumstance when trust or institution is deemed to be assessee-in-default:
The principal officer or the trustee and the trust or the institution shall be deemed to be assessee-in-default for non-payment of tax and all provisions related to the recovery of taxes shall apply. Further, in the case of transfer of assets upon dissolution of the trust or institution to a recipient, which is not a charitable organisation, the recipient of assets of the trust shall also be liable to be held as assessee-in-default in case of non-payment of tax and interest. However, in such a case, the recipient's liability shall be limited to the extent to which the assets received by him is capable of meeting the liability.</td></tr>
</table>

Note - As per section 115TD(2), "Accreted Income" means the aggregate FMV of total assets as on the specified date less total liability computed in accordance with the prescribed method of valuation. Accordingly, the CBDT has inserted Rule 17CB from 1.6.2016 providing for method of valuation of assets and liabilities.

Method of valuation for the purposes of sub-section (2) of section 115TD

<table>
<tr><th>Rule</th><th>Provision</th></tr>
<tr><td>(1)</td><td>The aggregate fair market value of the total assets of the trust or institution, shall be the aggregate of the fair market value of all the assets in the balance sheet as reduced by—
(i) any amount of income-tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of income-tax claimed as refund under the Act, and
(ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset.</td></tr>
<tr><td>(2)</td><td>The fair market value of the asset shall be determined in the following manner, namely -<table><tr><th colspan="3">(I) Shares and securities</th></tr><tr><td>(a)</td><td>Quoted shares and securities</td><td>(i) the average of the lowest and highest price of such shares and securities quoted on a recognised stock exchange as on the specified date; or
(ii) where on the specified date, there is no</td></tr></table></td></tr>
</table>

				trading in such shares and securities on a recognised stock exchange, the **average of the lowest and highest price of such shares and securities on a recognised stock exchange on a date immediately preceding the specified date** when such shares and securities were traded on a recognised stock exchange,
		(b)	**Unquoted equity shares**	$\frac{(A+B - L) \times (PV)}{(PE)}$ where, A = book value of all the assets in the balance sheet (other than bullion, jewellery, precious stone, artistic work, shares, securities, and immovable property) as reduced by- (i) any amount of income-tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of income-tax claimed as refund under the Act; and (ii) any amount shown in the balance sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset; B = fair market value of bullion, jewellery, precious stone, artistic work, shares, securities and immovable property as determined in the manner provided in this rule; L= book value of liabilities shown in the balance sheet, but not including the following amounts, namely: — (i) representing contingent liabilities other than arrears of dividends payable in respect of the paid-up capital in respect of equity shares; (ii) the amount set apart for payment of dividends on preference shares and equity shares; (iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation; (iv) any amount representing provision for taxation, other than amount of income-tax paid as deduction

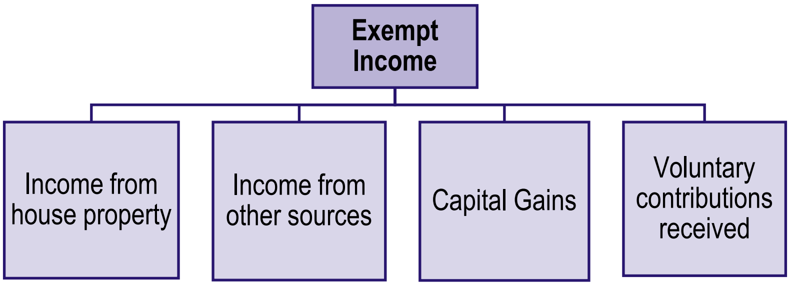
			or collection at source or as advance tax payment as reduced by the amount of income-tax claimed as refund under the Act, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto; (v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities; (vi) any amount of cumulative preference shares; PE = total amount of paid up equity share capital as shown in the balance-sheet; PV = the paid up value of such equity share.
	(c)	**Shares and securities other than equity shares**	The fair market value of shares and securities other than equity shares shall be estimated to be price it would fetch if sold in the open market on the specified date on the basis of the valuation report from a merchant banker or an accountant in respect of such valuation.
	II.	**Immovable property**	
		The fair market value of an immovable property shall be higher of the following: (a) price that the property shall ordinarily fetch if sold in the open market on the specified date on the basis of the valuation report from a registered valuer; and (b) stamp duty value as on the specified date.	
	III.	**A business undertaking**	
		The fair market value of a business undertaking, held by a trust or institution, shall be its net assets determined in accordance with the following formula: Fair market value = (A + B - L), The value of A, B and L would be determined in the same manner as discussed above in the case of unquoted equity shares.	
	IV.	**Any other asset**	
		The fair market value of any asset, other than those referred to in (I), (II) and (III), shall be the price that the asset shall ordinarily fetch if sold in the open market on the specified date on the basis of valuation report from a registered valuer. However, in case no valuer is registered for valuation of such assets, the valuation report shall be obtained from a valuer who is a member of any	

<table>
<tr><td></td><td><table><tr><td></td><td>one of the professional valuer bodies viz. Institution of Valuers, Institution of Surveyors (Valuation Branch), Institution of Government Approved Valuers, Practicing Valuers Association of India, the Indian Institution of Valuers, Centre for Valuation Studies, Research and Training, Royal institute of Chartered Surveyors; India Chapter, American Society of Appraisers, USA; Appraisal institute, USA or a valuer who is appointed by any public sector bank or public sector undertakings for valuation purposes.</td></tr></table></td></tr>
<tr><td>(3)</td><td>The total liability of the trust or institution shall be the book value of liabilities in the balance sheet on the specified date but not including the following amounts, namely -
(i) capital fund or accumulated funds or corpus, by whatever name called;
(ii) reserves or surpluses or excess of income over expenditure, by whatever name called;
(iii) any amount representing contingent liability;
(iv) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
(v) any amount representing provision for taxation, other than the amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of income-tax claimed as refund under the Act, to the extent of the excess over the income-tax payable with reference to the income in accordance with the law applicable thereto.</td></tr>
<tr><td>Expla-nation</td><td><u>Meaning of certain terms</u><table><tr><th>Term</th><th>Meaning</th></tr><tr><td>Accountant</td><td>A fellow of the Institute of Chartered Accountants of India within the meaning of the Chartered Accountants Act, 1949 who is not appointed by the trust or institution as an auditor;</td></tr><tr><td>Balance sheet</td><td>The Balance Sheet of such trust or institution (including the notes annexed thereto and forming part of the accounts) as drawn up on the specified date which has been audited by an accountant.</td></tr><tr><td>Quoted share or security</td><td>A share or security quoted on any recognised stock exchange with regularity from time to time, where the quotations of such shares or securities are based on current transaction made in the ordinary course of business;</td></tr></table></td></tr>
</table>

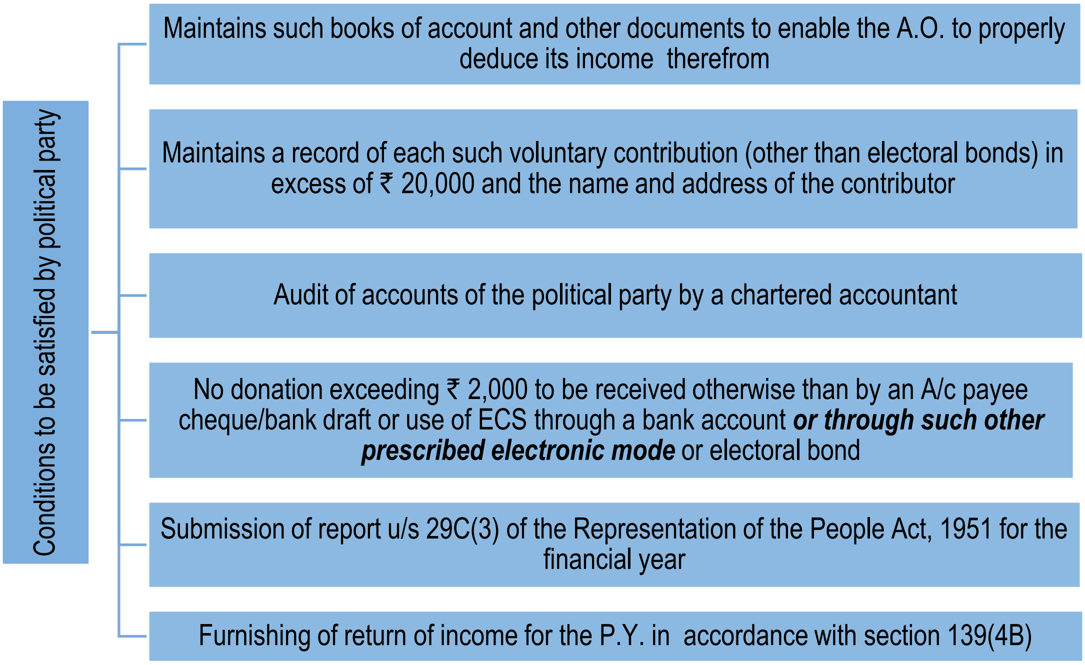
<table>
<tr><td rowspan="3"></td><td>Specified date</td><td>The date referred to in <i>Explanation</i> to section 115TD of the Act.
<u>Meaning of specified date [<i>Explanation</i> below section 115TD]</u>:
<table>
<tr><th></th><th>Case</th><th>Specified Date</th></tr>
<tr><td>(i)</td><td>Conversion of the trust or institution registered u/s 12AA into a form not eligible for registration u/s 12AA</td><td>The date of conversion</td></tr>
<tr><td>(ii)</td><td>merger with an entity not having similar objects or not registered u/s 12AA</td><td>The date of merger</td></tr>
<tr><td>(iii)</td><td>non-distribution of assets on dissolution to any charitable institution registered u/s 12AA or approved u/s 10(23C) within a period twelve months from dissolution</td><td>The date of dissolution</td></tr>
</table>
</td></tr>
<tr><td>Stamp duty value</td><td>The value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of payment of stamp duty in respect of an immovable property.</td></tr>
<tr><td>Unquoted share and security</td><td>Share or security which is not a quoted share or security.</td></tr>
</table>

13.5 EXEMPTION TO POLITICAL PARTIES [SECTION 13A]

Section 13A of the Income-tax Act, 1961 grants exemption from tax to political parties in respect of their income specified below:


Exempt Income
Income from house property
Income from other sources
Capital Gains
Voluntary contributions received

The aforesaid categories of income would qualify for exemption provided additional conditions for availing the benefit of the said section which are as under are met :



Conditions to be satisfied by political party

- Maintains such books of account and other documents to enable the A.O. to properly deduce its income therefrom
- Maintains a record of each such voluntary contribution (other than electoral bonds) in excess of ₹ 20,000 and the name and address of the contributor
- Audit of accounts of the political party by a chartered accountant
- No donation exceeding ₹ 2,000 to be received otherwise than by an A/c payee cheque/bank draft or use of ECS through a bank account ***or through such other prescribed electronic mode*** or electoral bond
- Submission of report u/s 29C(3) of the Representation of the People Act, 1951 for the financial year
- Furnishing of return of income for the P.Y. in accordance with section 139(4B)

For the purposes of this section, “political party” means a political party registered under section 29A of the Representation of the People Act, 1951.

ILLUSTRATION 12

Explain in the context of provisions of the Act, whether the income derived during the year ended on 31.03.2020 in following case shall be subject to tax in the A.Y. 2020-21:

A political party, duly registered under section 29A of the Representation of the People Act, 1951, received rent of ₹ 1,25,000 per month of one of its building let out to a bank from 01.06.2019.

SOLUTION

Rent received by the political party from the bank is an income chargeable under the head "Income from house property". However, according to the provisions of section 13A, income from, *inter alia*, house property shall not be included in total income of a political party registered under section 29A of the Representation of the People Act, 1951, provided the political party fulfils the conditions as specified therein including furnishing a return of income for the previous year in accordance with the provisions of section 139(4B) on or before the due date under section 139. Therefore, if the stipulated conditions are fulfilled by the political party, rent of ₹ 1,25,000 per month received by the registered political party from letting out of its building to a bank would not be included in its total income.

13.6 EXEMPTION FOR VOLUNTARY CONTRIBUTIONS RECEIVED BY ELECTORAL TRUSTS [SECTION 13B]

(1) Any voluntary contribution received by an electoral trust (as may be approved by the CBDT in accordance with the scheme to be made by the Central Government) shall be treated as its income under section 2(24), but shall be exempt under section 13B, if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year along with the surplus if any, brought forward from any earlier previous year.

(2) Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules made by the Central Government. Accordingly, the Central Government has notified Rule 17CA which provides that the following shall be the functions of an electoral trust referred to in section 13B –

(i) The electoral trust may receive voluntary contributions from

(a) an individual who is a citizen of India;

(b) a company which is registered in India; and

(c) a firm or Hindu undivided family or an Association of persons or a body of individuals, resident in India.

(ii) A receipt indicating the following shall be issued by the trust immediately on receipt of any contribution indicating the following:

(a) name and address of the contributor;

(b) Permanent account number of the contributor or passport number in the case of a citizen who is not a resident;

(c) amount and mode of contribution including name and branch of the Bank and date of receipt of such contribution;

(d) name of the electoral trust;

(e) Permanent account number of the electoral trust;

(f) date and number of approval by the prescribed authority; and

(g) Name and designation of the person issuing the receipt.

(iii) The electoral trust shall not accept contributions-

(a) from an individual who is not a citizen of India or from any foreign entity whether incorporated or not;

(b) from any other electoral trust which has been registered a company under section 25 of the Companies Act, 1956[3] and approved as an electoral trust under the Electoral Trusts Scheme, 2013;

(c) from a Government company as defined in section 2(45) of the Companies Act, 2013; and

(d) from a foreign source as defined in section 2(j) of the Foreign Contribution (Regulation) Act, 2010.

(iv) The electoral trust shall accept contributions only by way of an account payee cheque drawn on a bank or account payee bank draft or by electronic transfer to its bank account and shall not accept any contribution in cash.

(v) The electoral trust shall not accept any contribution without the PAN of the contributor, who is a resident and the passport number in the case of a citizen of India, who is not a resident.

(vi) A political party registered under section 29A of the Representation of the People Act, 1951 shall be an eligible political party and an electoral trust shall distribute funds only to the eligible political parties.

(vii) (a) The electoral trust may, for the purposes of managing its affairs, spend upto 5% of the total contributions received in a year subject to an aggregate limit of ₹ 5 lakh in the first year of incorporation and ₹ 3 lakh in subsequent years;

(b) the total contributions received in any financial year along with the surplus from any earlier financial year, if any, as reduced by the amount spent on managing its affairs, shall be the distributable contributions for the financial year;

(c) an electoral trust shall be required to distribute the distributable contributions received in a financial year, referred to in item (ii), to the eligible political parties before 31st March of the said financial year, subject to the condition that at least 95% of the total contributions received during the financial year along with the surplus brought forward from earlier financial year, if any, are distributed.

(viii) The trust shall obtain a receipt from the eligible political party indicating the name of the political party, its permanent account number, registration number, amount of fund received from the trust, date of the receipt and name and designation of person signing such receipt.

[3] Section 8 of the Companies Act, 2013

(ix) The electoral trust shall not utilize any contributions for the direct or indirect benefit of the members or contributors, or for any of the following persons, namely:

(a) the members (including members of its Executive Committee, Governing Committee or Board of Directors) of the electoral trust;

(b) any relative of such Members;

(c) where such member or contributor is a Hindu undivided family, a member of that Hindu undivided family;

(d) any person who has made a contribution to the trust;

(e) any person referred in section 13(3); and

(f) any concern in which any of the persons referred to in clauses (a),(b),(c),(d) and (e) has a substantial interest.

(x) (a) An electoral trust shall keep and maintain such books of account and other documents in respect of its receipts, distributions and expenditure as may enable the computation of its total income in accordance with the provisions of the Act;

(b) The electoral trust shall also maintain a list of persons from whom contributions have been received and to whom the same have been distributed, containing the name, address and permanent account number (PAN) of each such person along with the details of the amount and mode of its payment including the name and branch of the bank.

(xi) Every electoral trust shall get its accounts audited by an accountant as defined in the *Explanation* below section 288(2) and furnish the audit report in Form No.10BC along with particulars forming part of its Annexure, to the Commissioner of Income-tax or the Director of Income-tax, as the case may be, having jurisdiction over the electoral trust, on or before the due date specified for furnishing the return of income by a company under section 139.

(xii) An electoral trust shall maintain a regular record of proceedings of all meetings and decisions taken therein.

(xiii) Every electoral trust shall furnish a certified copy of list of contributors and a list of political parties, to whom sums were distributed in the manner prescribed in (vii) above, to the Commissioner of Income-tax or the Director of Income-tax, as the case may be, every year along with the audit report;

(xiv) Any change in the shareholders, subsequent to the approval granted under the Electoral Trusts Scheme, 2013 shall be intimated to the Board within thirty days of such change.

Section 2(22AAA) defines 'Electoral Trust' to mean a trust so approved by the CBDT, in accordance with the scheme made in this regard by the Central Government.

In exercise of the powers conferred by section 2(22AAA), the Central Government, has through *Notification No.9/2013 dated 31.1.2013*, notified the Electoral Trusts Scheme, 2013 to lay down the procedure for grant of approval to an electoral trust which will receive voluntary contributions and distribute the same to political parties.

Eligibility

A company registered for the purposes of section 25 of the Companies Act, 1956 satisfying all of the following conditions shall be eligible to make an application for approval as an electoral trust, namely –

1. The company should be registered on or after 1.4.2012 for the purposes of section 25 of the Companies Act, 1956;
2. The name of the company registered for the purposes of section 25 of the Companies Act, 1956 has to include the phrase "electoral trust";
3. The sole object of the electoral trust should be to distribute the contributions received by it to the political party, registered under section 29A of the Representation of the People Act, 1951;
4. The electoral trust should have a permanent account number.

Criteria for Approval

An electoral trust shall be considered for approval if it fulfills all of the following conditions, namely –

1. The company registered for the purposes of section 25 of the Companies Act, 1956, which satisfies the above conditions;
2. The object of the electoral trust shall not be to earn any profit or pass any direct or indirect benefit to its members or contributors, or to any person referred to in section 13(3) or any person referred to in Rule 17CA(10) of the Rules;
3. It has made adequate arrangement for recording the receipts from the contributors in accordance with Rule 17CA;
4. The stipulations contained in Rule 17CA for functioning of the electoral trust are specifically included in the articles of association of the company registered for the purposes of section 25 of the Companies Act, 1956.

Renewal of approval

1. The approval shall be valid for the assessment year relevant to the financial year in which such application has been made and for a further period, not exceeding three assessment years, as may be specified in the approval.

2. The electoral trust may apply for renewal of approval at any time during the financial year immediately preceding the last assessment year, for which the approval has been originally granted, and such renewal of approval may be granted after examining the application in the same manner as laid out for approval in this scheme.

Withdrawal of approval

1. The CBDT may withdraw the approval granted under this Scheme if it is satisfied that the electoral trust has ceased its activities or its activities are not genuine or are not carried out in accordance with all or any of the conditions laid down under this Scheme or the provisions of Rule 17CA of the Rules, or any other condition imposed in the approval granted.
2. In order to ascertain whether an electoral trust, after its approval, is functioning in accordance with the provisions of Rule 17CA of the Rules, the CBDT may call for information or documents as it may deem fit from the electoral trust or may get an enquiry conducted in this regard by an income-tax authority or any other agency.
3. If the Commissioner of Income-tax or the Director of Income-tax is satisfied that an approved electoral trust is not fulfilling any of the conditions specified under this Scheme or the conditions subject to which approval was granted to it or does not function in accordance with Rule 17CA, he may, after making appropriate enquiries, furnish a report to the CBDT in this regard and the Board may take such action on the report as it may deem fit.
4. An order for withdrawal of the approval shall be passed after giving the electoral trust an opportunity of being heard, and shall record the reasons in writing for the withdrawal of approval.
5. A copy of the order withdrawing the approval shall be sent to the applicant, the Assessing Officer and the Commissioner of Income-tax or the Director of Income-tax, as the case may be.

ILLUSTRATION 13

The books of account maintained by a National Political Party registered with Election Commission for the year ended on 31.3.2020 discloses the following receipts:

		₹
(a)	*Rent of property let out to a departmental store at Chennai*	*6,00,000*
(b)	*Interest on deposits other than banks*	*5,00,000*
(c)	*Contribution from 100 persons (who have secreted their names) of ₹ 21,000 each*	*21,00,000*
(d)	*Contribution from 10 persons by way of electoral bonds of ₹ 25,000 each*	*2,50,000*

(e)	*Cash contribution @ ₹ 2,100 each from 1,000 members (recorded in books of account)*	*21,00,000*
(f)	*Net profit of cafeteria run in the premises at Delhi*	*3,00,000*

Compute the total income of the political party for the assessment year 2020-21, with reasons for inclusion or otherwise.

SOLUTION

The total income of a political party registered with the Election Commission is to be computed as per section 13A under which the income derived from house property, income from other sources and income by way of voluntary contributions received from any person, on fulfilling of the conditions as mentioned thereunder, are exempt from tax. However, in this case, since cash contribution in excess of ₹ 2,000 is received from 1000 persons, the political party has violated the condition of receipt of donation through account payee cheque/draft or prescribed electronic modes. Further, the political party has also violated the condition of maintenance of records in case of donations exceeding ₹ 20,000 received otherwise than by way of electoral bonds. Hence, its total income has to be computed as under without providing for exemption available under section 13A:

Computation of total income of National Political Party

	Particulars	₹
(a)	The rent of the property of ₹ 6 lacs located at Chennai [assuming the same to be the Gross Annual Value] less 30% of Rs.6 lacs, being deduction u/s 24	4,20,000
(b)	Interest received on deposits	5,00,000
(c)	Contribution from 100 persons (who have secreted their names) of ₹ 21,000 each	21,00,000
(d)	Contribution from 10 persons by way of electoral bonds of ₹ 25,000 each	2,50,000
(e)	Cash contribution @ ₹ 2,100 each from 1,000 members (recorded in books of account)	21,00,000
(f)	Net profit of cafeteria at Delhi	3,00,000
Total Income		**56,70,000**

Note – *Alternatively, the political party can contend that only ₹ 45 lakh is taxable on account of non-maintenance of records and receipt of cash donations, in which the case the total income would be computed as under:*

Computation of total income of National Political Party

	Particulars	₹
(a)	Rent of the property of ₹ 6 lacs located at Chennai	Exempt
(b)	Interest received on deposits	Exempt

(c)	Contribution from 100 persons (who have secreted their names) of ₹ 21,000 each	21,00,000
(d)	Contribution from 10 persons by way of electoral bonds of ₹ 25,000 each	Exempt
(e)	Cash contribution @ ₹ 2,100 each from 1,000 members (recorded in books of account)	21,00,000
(f)	Net profit of cafeteria at Delhi	3,00,000
	Total Income	**45,00,000**

Note: *It is presumed that the conditions regarding maintenance of books of account, audit, submission of report under section 29C of the Representation of the People Act, 1951 and filing of return of income under section 139(4B) are fulfilled by the political party, and hence it is eligible for exemption of income under section 13A.*

EXERCISE

Question 1

A trust, unless created for "charitable purpose", does not qualify to claim exemption under Chapter III of the Act. In this context, explain the meaning of "charitable purpose" and examine whether the following objects constitute part of it:

(i) Rural reconstruction and upliftment of the masses through Cottage Industry.

(ii) Welfare of industrial workers with a stipulation that the workers of settlor of trust have got preference over others.

Answer

Section 2(15) defines "charitable purpose" to include relief of the poor, education, medical relief, yoga, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, "advancement of any other object of general public utility" would not be a charitable purpose, if it involves carrying on of any activity in the nature of trade, commerce or business or, any activity of rendering of any service in relation to any trade, commerce or business, for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity or the retention of such income, by the concerned entity.

"Advancement of any other object of general public utility" would continue to be a "charitable purpose", if the total receipt from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed 20% of the total receipts of the trust in the previous year, and such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(i) The Supreme Court has, in *Thiagarajar Charities vs. Addl. CIT (1997) 225 ITR 1010,* observed that "cottage industry" is associated with the idea of a small, simple enterprise or industry in which employees work in their own houses or in a small place, gathered together for the purpose, using their own equipments and is usually found in rural areas or so carried on, by the poorer section of the society. In substance, the activity of rural reconstruction and upliftment of masses through cottage industry is to afford relief to the poor and consequently, it is for charitable purpose.

(ii) The welfare of industrial workers with a stipulation that the workers of settlor of trust have preference over others would also constitute "charitable purpose" within the meaning of section 2(15). The Patna High Court has, *in CIT v. Tata Steel Charitable Trust (1993) 203 ITR 764*, observed that exemption under section 11(1) can be availed only if the following conditions are satisfied –

(1) the trust is created for a charitable purpose; and

(2) no part of the income of such trust enures or has been used or applied directly or indirectly for the benefit of any person referred to in section 13(3).

The list of persons contained in section 13(3) does not include employees of the settlor of the trust. Section 13(3)(d), which includes any relative of the author, can have no application because “relative” means a person connected by birth or marriage with another person. A person having relationship pursuant to a contract like that of an employer and an employee cannot be said to be a relative. The High Court concluded that it was immaterial that any employee of the settler of the trust had acquired any benefit out of the income of the trust as an ordinary member of the community. Therefore, the application of part of the income of the trust for the benefit of the employees of the settler cannot disentitle the trust from claiming exemption under section 11.

Question 2

How do you deal with the following situation? Give reasons for your answer.

Ramji Charitable Trust has filed return of income for the Assessment Year 2020-21 within the stipulated time under section 139(1) and applied only 50% of its income for specified purposes. It intends to accumulate the balance 35% of income to be spent in future years. While completing the assessment, the Assessing Officer disallowed the accumulated income of 35% and taxed the same on the ground that the trust has not made any application under section 11(2) along with return of income. Discuss the validity of the action of the Assessing Officer in this case.

Answer

Section 11(2) provides that a charitable trust has to apply 85% of its income to charitable purposes and where 85% of its income is not applied for such purposes, the trust may accumulate or set apart either the whole or part of its income for future application for such purposes in India. The requirement of the Act is that the trust has to make an application/intimation in the prescribed form, for accumulation of income, specifying the purpose and the period (not exceeding 5 years). The application should be filed or furnished before the assessing authority on or before the due date specified under section 139(1). Further, the money so set apart or accumulated should be invested/deposited in any one or more of these modes or forms specified under section 11(5).

Thus, this requirement of filing application is mandatory and without those particulars, the assessing authority cannot entertain the claim of the assessee under section 11. In case the statement in Form 10 is not submitted on or before the due date of filing return of income under section 139(1), then, the benefit of accumulation would not be available and such income would be taxable at the applicable rate. Further, the benefit of accumulation would also not be available if return of income is not furnished on or before the due date of filing of return of income under section 139(1). Therefore, the action of the Assessing Officer in this case is valid.

Question 3

An institution operating for promotion of education claiming exemption under section 11 since 1994 furnishes the following data for the assessment year 2020-21:

S. No.	*Particulars*	*₹ in crores*
(i)	*Fees collected from students*	*14*
(ii)	*Construction of a new computer science laboratory*	*0.50*
(iii)	*Land acquired to be used as a cricket field for the students*	*2*
(iv)	*Amount earmarked and set apart for construction of an arts block within the next 4 years.*	*4*

Compute the total income of the institution for the A.Y.2020-21.

Answer

Computation of total income of the institution for the A.Y. 2020-21

Particulars	₹ (in crores)
Fees received	14.00
Less : 15% (exempt even if not spent for the objects of the institution)	2.10
	11.90
Less : Accumulated for specified purpose **(See Note 2)**	4.00
Balance to be spent	7.90
Actual amount spent on construction of computer science lab **(See Note 1)**	0.50
Actual amount spent on purchase of land for cricket field **(See Note 1)**	2.00
Total Income	**5.40**

Notes:

(1) The institution must utilise 85% of its income within the previous year for the objects of the institution. The institution can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the institution. Land acquired and meant for use as cricket field for students is a capital expenditure incurred for promoting the objects of the institution and hence, eligible for deduction. Likewise, the amount spent on construction of computer science laboratory is also eligible for deduction.

(2) Section 11(2) provides that a trust/institution can accumulate or set apart its income for a specified purpose by furnishing statement in prescribed format to the concerned Assessing Officer. However, the period for which the funds can be accumulated cannot exceed 5

years. The amount so accumulated should be invested in the specified forms and modes. In this case, the institution has to furnish statement in Form 10 on or before the due date of filing return of income to the Assessing Officer, stating the purpose for which the income is being accumulated or set apart and the period for which the income is being accumulated or set apart, which shall, in no case, exceed five years. Further, the institution has to invest ₹ 4 crore in the specified forms and modes.

Question 4

A public charitable trust registered under section 12AA, for the previous year ending 31.3.2020, derived gross income of ₹ 21 lakhs, which consists of the following:

		(₹ in Lacs)
(a)	*Income from properties held by trust (net)*	*10*
(b)	*Income (net) from business (incidental to main objects)*	*4*
(c)	*Voluntary contributions from public*	*7*

The trust applied a sum of ₹ 11.60 lacs towards charitable purposes during the year which includes repayment of loan taken for construction of orphanage ₹ 3.60 lacs.

Determine the taxable income of the trust for the assessment year 2020-21..

Answer

Computation of taxable income of public charitable trust

	Particulars	₹
(i)	Income from property held under trust (net)	10,00,000
(ii)	Income (net) from business (incidental to main objects)	4,00,000
(iii)	Voluntary contributions from public	7,00,000
	Voluntary contribution made with a specific direction towards corpus are alone to be excluded under section 11(1)(d). In this case, there is no such direction and hence, included.	
		21,00,000
	Less: 15% of the income eligible for retention / accumulation without any conditions	3,15,000
		17,85,000
	Less: Amount applied for the objects of the trust	
	(i) Amount spent for charitable purposes (₹ 11,60,000 - ₹ 3,60,000)	8,00,000
	(ii) Repayment of loan for construction of orphan home	3,60,000
	Taxable Income	**6,25,000**

Question 5

A charitable trust registered under section 12AA of the Income-tax Act, 1961 has, out of its income of ₹ 3,90,000 for the year ending 31.3.2020 and sale proceeds of a capital asset, held by it for less than 24 months, amounting to ₹ 9,60,000, purchased a building during the year ending 31.3.2020 for ₹ 13,50,000. The capital asset was sold during the year ending 31.3.2020. The building is held only for charitable purposes. The trust claims that the purchase of the building amounts to application of its income for charitable purposes and that the capital gain arising on the sale of the capital asset is deemed to have been applied to charitable purposes. Is the claim made by the charitable trust valid in law?

Answer

Section 11(1)(a) stipulates that in order to avail exemption of income derived from property held under trust wholly for charitable or religious purposes, the trust is required to apply for charitable or religious purposes, 85% of its income from such property. In this case, the trust has earned income of ₹ 3,90,000 for the year ended 31.3.2020. It has also earned short term capital gain from sale of capital asset for ₹ 9,60,000. The trust had utilized the entire amount of ₹ 13,50,000 for the purchase of a building meant for charitable purposes.

The Supreme Court, in *S.RM. M. CT. M. Tiruppani Trust v. CIT (1998) 230 ITR 636,* ruled that the assessee-trust, which applied its income for charitable purposes by purchasing a building for use as a hospital, was entitled to exemption under section 11(1) in respect of such income.

The ratio of the decision squarely applies to the case of the charitable trust in question. Therefore, the charitable trust is justified in claiming that the purchase of the building amounted to application of its income for charitable purposes.

Under section 11(1A), where the whole of the sale proceeds of a capital asset held by a charitable trust is utilised by it for acquiring another capital asset, the capital gain arising therefrom is deemed to have been applied to charitable purposes and would be exempt. Section 11(1A) does not make any distinction between a long-term capital asset and a short-term capital asset. The claim of the charitable trust to the effect that the capital gain is deemed to have been applied to charitable purposes is tenable in law.

Question 6

Work out, from the following particulars, the amount of capital gain which shall be deemed to have been applied for charitable or religious purpose arising out of sale of a capital asset utilized for the purposes of trust to the extent of 60%:

Particulars	*₹*
Cost of transferred asset	*2,40,000*
Sale consideration	*3,60,000*
Cost of new asset purchased	*3,00,000*

Answer

In this case, since the asset which is transferred is utilized for the purposes of the trust only to the extent of 60%, only the proportionate amount (i.e. 60%) of the capital gain would be regarded as having been applied for charitable or religious purposes.

As per section 11(1A), where a capital asset held under trust is transferred, and only a part of the net consideration is utilized for acquiring a new capital asset, only so much of the capital gain as is equal to the amount, if any, by which the amount so utilized exceeds the cost of the transferred asset shall be considered to have been applied for the objects of the trust.

In this case, only a part of the net consideration of ₹ 3,60,000 is utilized for acquiring the new capital asset costing ₹ 3,00,000. The amount utilized in acquiring the new asset (i.e. ₹ 3,00,000) exceeds the cost of the transferred asset (i.e. ₹ 2,40,000) by ₹ 60,000.

Therefore, only 60% of (₹ 3,00,000 – ₹ 2,40,000) = 60% of ₹ 60,000 = ₹ 36,000 is deemed to be applied for the objects of the trust.

Question 7

An electoral trust approved by the CBDT is not liable to income-tax in respect of voluntary contribution received and other income - Examine the correctness of the statement.

Answer

Section 13B provides exemption in respect of voluntary contribution received by an electoral trust approved by the CBDT in accordance with the scheme to be made by the Central Government.

Voluntary contribution received by an electoral trust would be treated as its income under section 2(24), but shall be exempt under section 13B if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year along with surplus brought forward from any earlier years. Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules framed by the Central Government.

It may be noted that the exemption under section 13B will be available only in respect of voluntary contribution received by an electoral trust. The exemption cannot be claimed in respect of any other income of the electoral trust.

Therefore, the given statement is not correct.

SIGNIFICANT SELECT CASES

1. **Where an institution engaged in imparting education incidentally makes profit, would it lead to an inference that it ceases to exist solely for educational purposes?**

Queen's Educational Society v. CIT (2015) 372 ITR 699 (SC)

Facts of the case: The assessee, an educational institution, showed a net surplus of ₹ 6.59 lakhs and ₹ 7.83 lakhs, respectively, for the assessment years 2000-01 and 2001-02. Since it was established with the sole object of imparting education, it claimed exemption under section 10(23C)(iiiad). The Assessing Officer rejected the claim of exemption on the ground that the assessee has made profits and did not exist solely for educational purposes. The Commissioner (Appeals) allowed the assessee's claim and the Tribunal dismissed the Revenue's appeal holding that the assessee was engaged undoubtedly in imparting education and the profit was only incidental to the main object of spreading education. However, the High Court restored the order of the Assessing Officer on the reasoning that the institution made profit, year on year, and hence, was not eligible for tax exemption.

Supreme Court's Observations: The Supreme Court observed that the provisions of section 10(23C)(iiiad) provide for three requirements, namely,

(i) the education institution must exist solely for educational purposes;

(ii) it should not be for purposes of profit; and

(iii) the aggregate annual receipts of such institution should not exceed the amount as may be prescribed. Such monetary limit is ₹ 1 crore as per Rule 2BC.

The Supreme Court concurred with the Tribunal's reasoning that profit is only incidental to the main object of spreading education. If there is no surplus arising out of the difference between receipts and outgoings, the trust will not be able to achieve the objectives. Any education institution cannot be run in rented premises for all the times and without necessary equipment and without paying to the staff engaged in imparting education. The assessee is not getting any financial aid/assistance from the Government or other philanthropic agency and, therefore, to achieve the objective, it has to raise its own funds. However, such surplus would not come within the ambit of denying exemption under section 10(23C)(iiiad).

Further, the Apex Court made reference to the tests culled out in its own decisions in the case of *Addl. CIT v. Surat Art Silk Cloth Manufacturers Association [1980] 121 ITR 1, Aditanar Educational Institution v. Addl. CIT [1997] 224 ITR 310 and American Hotel and Lodging Association Educational Institute v. CBDT [2008] 301 ITR 86*, which would apply for determining whether an educational institution exists solely for education purposes and not for purposes of profit.

The Apex Court, after analyzing the legal provisions and precedents, summed up the law common to section 10(23C)(iiiad)/(vi):

(a) Where an educational institution carries on the activity of education primarily for educating persons, the fact that it makes a surplus does not lead to the conclusion that it ceases to exist solely for educational purposes and becomes an institution for the purpose of making profit;

(b) The predominant object test must be applied – the purpose of education should not be submerged by a profit making motive;

(c) A distinction must be drawn between the making of surplus and an institution being carried on "for profit". Merely because imparting of education results in making a profit, it cannot be inferred that it becomes an activity for profit;

(d) If after meeting expenditure, surplus arises incidentally from the activity carried on by the educational institution, it will not cease to be one existing solely for educational purposes; and

(e) The ultimate test is whether on an overall view of the matter in the concerned assessment year, the object is to make profit as opposed to educating persons.

Apex Court's Decision: Based on the above principles and tests, the Apex Court upheld the Tribunal's view that the assessee was engaged in imparting education and the profit was only incidental to the main object of spreading education. Hence, it satisfies the conditions laid down in section 10(23C)(iiiad) for claim of exemption thereunder.

2. Would imparting education/training in specialized field like communication, advertising etc. and awarding diplomas/certificates constitute an "educational purpose" for grant of exemption under section 10(23C)(vi)?

CIT v. St. Peter's Educational Society (2016) 385 ITR 66 (SC)

Facts of the case: The assessee-society registered under the Societies Registration Act, 1860 as well as under the provisions of the Bombay Public Trust Act, 1950 was engaged in imparting higher and specialized education. It imparted education in the field of communication including advertising and its related subjects. It was granted registration under section 12A of the Act originally.

The assessee later submitted an application for exemption under section 10(23C)(vi) and for which after calling for details, the CIT refused to grant exemption under section 10(23C)(vi). The reasons for refusal were (i) the society was not having education as the sole purpose; (ii) it is engaged in conducting coaching / training courses for and on behalf of industry, trade and commercial organizations; (iii) it is engaged in various social activities of general public utility; and (iv) it was not conducting educational courses as charitable activity but for the purpose of making profit.

High Court's view: The Court noted that the object clause of the society which indicated that the institution was awarding diplomas, certificates etc after providing training in communication, advertising and related subjects. The memorandum of the assessee showed that the fee collected shall not exceed the cost of training, hostel expenses etc and it is not precluded from subsidizing such costs. It observed that providing training to the individuals as well as those persons who have been sponsored by the companies to meet the needs of Indian industry and commerce, would not make the assessee-society as carrying on activity of service in relation to any trade, commerce and industry.

It held that teaching does not mean teaching the students only in the manner and method, the regular schools or colleges adopt to teach. In the progressive world, it is expected from certain institutions that they educate, teach and train persons so that those persons can compete with similar experts worldwide. It thus rejected the argument of the Revenue and held that providing latest information and training to persons to become super specialists in a particular field would still be treated as education.

Supreme Court's Observations: The Apex Court took note of the observations of the High Court and made reference to its own precedent in the case of *Queen's Educational Society v. CIT (2015) 372 ITR 699 (SC)* where it had summarized the legal position as under:

"The law common to sections 10(23C)(iiiad) and (vi) may be summed up as follows:

(i) Where an educational institution carries on the activity of education primarily for educating persons, the fact that it makes a surplus does not lead to the conclusion that it ceases to exist solely for educational purposes and becomes an institution for the purpose of making profit;

(ii) The predominant object test must be applied – the purpose of education should not be submerged by a profit making motive;

(iii) A distinction must be drawn between making of a surplus and the institution being carried on 'for profit'. No inference arises that merely because imparting education results in making a profit, it becomes an activity for profit;

(iv) If after meeting the expenditure, a surplus arises incidentally from the activity carried on by the educational institution, it will not cease to be one existing solely for educational purposes;

(v) The ultimate test is whether on an overall view of the matter in the concerned assessment year, the object is to make profit as opposed to educating persons".

The Apex Court, in *Queen's Educational Society's* case, noted the divergence of opinion among various High Courts on this issue. In that case, it had approved the decision of Delhi, Bombay and Punjab & Haryana High Courts and set aside the judgement of Uttarakhand High Court.

The Apex Court held that the correct tests for determining whether an institution exists solely for educational purposes and not for the purposes of profit were laid down in the Supreme Court decisions in *CIT (Addl.) v. Surat Art Silk Mfg. Association (1980) 121 ITR 1; Aditanar Educational Institution v. Addl. CIT (1997) 224 ITR 310; and American Hotel & Lodging Assn. Educational Institute v. CBDT (2008) 301 ITR 86.*

It further observed that the Thirteenth proviso to section 10(23C) is of great importance to the assessing authorities who must continuously monitor from assessment year to assessment year to know whether such institutions continues to apply their income and invest or deposit their funds in accordance with the law laid down. The activities of such institutions must be looked at carefully. If they are not genuine or are not being carried out in accordance with all or any of the conditions subject to which approval was given earlier, such approval and exemption must forthwith be withdrawn.

Supreme Court's Decision: Applying the rationale of the Supreme Court ruling in *Queen's Educational Society's* case, the Apex Court, in this case, held that the institution is established for the sole purpose of imparting education in a specialized field. The Supreme Court, thus, allowed the petition and set aside the order of the Chief Commissioner of Income-tax refusing exemption under section 10(23C)(vi).

Note: *Institutions engaged in providing specialized training in certain fields and awarding diplomas and certificates are also eligible for tax exemption in terms of section 10(23C)(vi). It is not mandatory for such institutions to impart education in formalized manner or conduct only recognized educational courses. Further, when corporates depute employees for gaining specialized knowledge, such imparting of knowledge by the institution would not mean that the institution is engaged in the activity of general public. Making of profit incidentally will not make the institution as existing for making profit. This is the jist of the above Supreme Court ruling.*

3. In a case where the charitable trust is deemed to be registered under section 12A due to non-disposal of application within the period of 6 months, as stipulated under section 12AA(2), from when would such deemed registration take effect?

CIT v. Society for the Promotion of Education (2016) 382 ITR 6 (SC)

Facts of the case: In the present case, the Allahabad High Court held that once an application for registration of the trust is made under section 12A and in case the same is not responded to within six months, the trust would be deemed to be registered under section 12AA. The High Court opined that non-consideration of the application for registration within the time fixed by the legal provision would lead to deemed grant of registration and there is no reason to make the assessee suffer merely because the Income Tax Department is not able to keep its officers under check and control so as to take timely decisions on the matter.

The Revenue appealed against this decision and raised an apprehension that since the date of application was February 24, 2003, the deemed registration would operate only after six months from the date of application.

Supreme Court's Decision: The Apex Court clarified that deemed registration would commence only after 6 months from the date of application. Therefore, the registration of the application under section 12AA of the Income-tax Act, in the case of the assessee trust shall take effect from August 24, 2003.

Note:

This decision is based on the provisions of section 12A prior to insertion of clause (aa) in sub-section (1) of section 12A and sub-section (2) in section 12A by the Finance Act, 2007 with effect from 1st June, 2007. The position prior to the amendment by the Finance Act, 2007 was that an application for registration has to be made before the expiry of one year from the date of creation of the trust. However, where an application for registration was made thereafter, the exemption provisions under sections 11 and 12 would apply from the date of creation of the trust, if the Principal Commissioner or Commissioner, for reasons to be recorded in writing, is satisfied that the person in receipt of the income was prevented from making the application before the expiry of one year. If he is not so satisfied, the exemption would apply from 1st day of the financial year in which the application was made.

The Finance Act, 2007 has inserted sub-section (2) in section 12A to provide that where an application has been made on or after 01.06.2007, the provisions of section 11 and 12 shall apply in relation to the income of such trust from the assessment year immediately following the financial year in which ***such application is made****.*

In Society for the Promotion of Education's case, the Supreme Court has decided that the deemed registration would be effective only after six months from the date of application, in the sense, that it would not have retrospective application. The Supreme Court ruling assumes significance in the current context, since it affirms that non-consideration of application within the time period of six months from the end of the month in which application is received would tantamount to deemed registration. However, in the light of the current provisions of section 12A(2), the exemption provisions of sections 11 and 12 would apply in relation to the income of the trust from the assessment year immediately following the financial year in which such application is made, even though the effective date of deemed registration would be after expiry of the six month period as per the above Supreme Court ruling.

4. **Where a charitable trust applied for issuance of registration under section 12A within a short time span (nine months, in this case) after its formation, can registration be denied by the concerned authority on the ground that no charitable activity has been commenced by the trust?**

DIT (Exemptions) v. Meenakshi Amma Endowment Trust (2013) 354 ITR 219 (Kar.)

Facts of the case: In the present case, the assessee, being a trust, made an application under section 12A for issuance of registration within nine months of its formation. The registration authority issued a show cause notice to the assessee-trust to furnish its audited accounts as also material indicating the actual activities undertaken by the trust. In response to the said notice, the assessee-trust furnished the details, wherein it indicated that it has not yet commenced any charitable activity. The concerned registration authority, not being satisfied with the reply, refused to grant registration to the trust on the ground that it has not commenced any charitable activity.

Issue: The issue under consideration is whether registration under section 12AA can be denied on the ground of non-commencement of charitable activity, where an application for registration has been made within a short-time span after the formation of the trust.

High Court's Observations: On this issue, the Karnataka High Court opined that an application under section 12A for registration of the trust can be sought even within a week of its formation. The activities carried on by the trust are to be seen in case the registration is sought much later after formation of the trust.

The High Court further observed that, in this case, the corpus fund included contribution made by the trustees only, which indicated that the trustees were contributing the funds by themselves in a humble way and were intending to commence charitable activities. Also, it was not the Revenue's contention that the assessee-trust had collected lots of donations for the activities of the trust, by the time its application came up for consideration before them. When the application for registration was made, the trust, therefore, did not have sufficient funds for commencement of its activities.

High Court's Decision: The High Court observed that, with the money available with the trust, it cannot be expected to carry out activity of charity immediately. Consequently, in such a case, it cannot be concluded that the trust has not intended to do any activity of charity. In such a situation, the objects of the trust as mentioned in the trust deed have to be taken into consideration by the authorities for satisfying themselves about the genuineness of the trust and not the activities carried on by it. Later on, if it is found from the subsequent returns filed by the trust, that it is not carrying on any charitable activity, it would be open to the concerned authorities to withdraw the registration granted or cancel the registration as per the provisions of section 12AA(3).

5. In a case where properties bequeathed to a trust could not be transferred to it due to ongoing court litigation and pendency of probate proceedings, can violation of the provisions of section 11(5) be attracted?

DIT (Exemption) v. Khetri Trust (2014) 367 ITR 723 (Del)

Facts of the case: As per the 'will' of Late Raja Bahadur Sardar Singh, the entire property, including immovable property and shares in foreign companies, were bequeathed to the trust. However, the properties could not be transferred to or acquired by the trust because of ongoing litigation in the Court. In the probate proceedings, the 'will' was challenged and the probate proceedings are still pending.

The trustees paid ₹ 1,10,000 for raising a memorial for late Raja Bahadur Sardar Singh and the said amount was given to a business entity for this purpose, but due to the ongoing dispute, such project was not completed. The business entity, however, paid interest on the said amount. The Assessing Officer denied the benefit of exemption under section 11, on the ground that the asset held in the form of shares of foreign company and the advance given to business entity were contrary to the mandate of section 11(5) and thus, the condition specified in section 13(1)(d) has been violated.

Appellate Authorities' views: The Commissioner (Appeals) observed that the validity of the will has been challenged in the probate proceedings; therefore, till the 'will' is probated and affirmed as genuine, the trust would not acquire the legal right on the property for the purpose of Income-tax Act, 1961. In case the probate is denied, the properties would not devolve on the trust. The shares in foreign company were still in the name of the donor, Late Raja Bahadur Sardar Singh, and its acquisition by the trust is dependent upon the adjudication of the probate.

Further, with regard to the advance given to the business entity, the Commissioner (Appeals) found that the said amount cannot be treated as an investment which was covered and regulated by section 11(5), since the intent and purpose behind the payment was not investment.

These views of the Commissioner (Appeals) were confirmed by the Tribunal.

High Court's Decision: Based on the above factual findings, elucidated and affirmed by the Commissioner (Appeals) and the Tribunal, the High Court held that there was no violation of section 11(5) in this case.

6. Is the cancellation of registration of a trust under section 12AA, on the basis of search conducted in the premises of its Secretary General and the statement recorded by him under section 132(4), valid?

U.P. Distillers Association (UPDA) v. CIT [2017] 399 ITR 143 (Del)

Facts of the case: A search and seizure operation took place in the premises of the Secretary General of the assessee, that is, Uttar Pradesh Distillers Association, in February 2006. During the search, the Secretary General's statement was recorded under section 132(4) of the Act. The statement was retracted after two years. In the meanwhile, the Commissioner of Income-tax (CIT) cancelled the assessee's registration under section 12AA(3) on the basis of the search operation and the statement made. The order was upheld by the Appellate Tribunal. The assessee contended that Secretary General's statement was made in the course of search in respect of his premises and not those of the assessee. Hence, the Secretary General's statement was not attributable to the assessee nor could the materials indicated by him be the basis for cancellation of registration of the trust under section 12AA

Issue: The issue under consideration is whether the cancellation of registration under section 12AA as a charitable trust on the basis of search conducted in the premises of the Secretary General of the assessee-trust and the statement recorded by him under section 132(4) is valid.

Delhi High Court's Observations: The Court dismissed the appeal to hold that although the premises, in which the search under section 132 took place, belonged to the Secretary General, he virtually ran the assessee-trust's activities from the same premises. The information which he provided in the course of the search pointed out to the activities of the assessee-trust and not to his own activities. Further, the Tribunal had expressly recorded that the search proceedings took place in the context of section 153A, in the very premises of the Secretary General, with respect to the assessee-trust.

Delhi High Court's Decision: The Delhi High Court, accordingly, held that cancellation of the trust's registration under section 12AA on the basis of search conducted in the premises of the Secretary General and the statement recorded under section 132(4) from him, is valid.

Note: *The special leave petition filed against the aforementioned decision of the Delhi High Court was dismissed by the Supreme Court.*

7. Is the approval of Civil Court mandatory for amendment of trust deed, even in a case where the settler has given power to the trustees to alter the trust deed?

DIT (Exemptions) v. Ramoji Foundation (2014) 364 ITR 85 (AP)

Facts of the case: The settler gave power to the trustees to amend, alter, change or modify the objects of the trust deed with the approval of two-third majority. Such additional or altered object, however, must be of charitable nature falling within the definition thereof under the relevant provisions of the Income-tax Act, 1961. Based on these provisions of the trust deed and referring to the Supreme Court decision in *CIT v. Kamla Town Trust (1996) 217 ITR 699,* the Tribunal held that the trust deed can be amended without approaching the Civil Court. Therefore, the Tribunal directed the DIT (Exemptions) to grant registration to the assessee-trust under section 12AA on the basis of the amended trust deed.

Issue: The issue under consideration before the High Court is whether the Tribunal was correct in holding that the amendment to the trust deed can be made without approaching the Civil Court, on the basis of the decision in the case of *Kamla Town Trust (Supra)*.

High Court's Observations: The High Court observed that the power has been given to the trustees by the settler to amend the trust deed without approaching the Civil Court, provided all the conditions laid down by the settler are fulfilled. The sanction of Civil Court is required only when there is no such power. When the power has been specifically given to the trustees by the settler, no further power from the Civil Court is required.

The High Court made reference to the *Kamla Town Trust's* case and observed that it has not been stated anywhere in the Supreme Court's decision that in spite of the power given to them by settler to amend the trust deed, the trustees have to approach the Civil Court to get the trust deed rectified.

High Court's Decision: Accordingly, in this case, the High Court held that the Tribunal has correctly dealt with the matter and the trust deed amended by the trustees can be relied upon by the Revenue authorities for the purpose of granting registration under section 12AA.

CHAPTER 14

TAX PLANNING, TAX EVASION AND TAX AVOIDANCE

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **distinguish** between tax planning, tax avoidance and tax evasion;
- **analyse** whether a specified activity resulting in reduction of tax liability would be considered as tax planning, tax avoidance or tax evasion;
- **examine** the doctrine of form and substance in the context of tax planning;
- **advise** salaried individuals and HUFs to plan their investments/ payments to minimise tax liability;
- **advise** corporates and businesses to plan their activities/structures in a tax-efficient manner.

14.1 TAX PLANNING, TAX EVASION AND TAX AVOIDANCE – AN OVERVIEW

Tax planning involves an intelligent application of the various provisions of the direct tax laws to practical situations in such a manner as to reduce the tax impact on the assessee to the minimum. A thorough understanding of the principles, practices and procedures of tax laws and the ability to apply such knowledge to various practical situations is expected at the final level.

(1) Method of study of tax planning: A thorough up-to-date knowledge of tax laws is a pre-requisite for a successful study of tax planning techniques. Not only an up-to-date knowledge of the statute is necessary, but one must also be aware of the contents of the various circulars issued by the CBDT and also of case laws in the form of various decisions of the Courts. One of the best methods to study tax planning in action is to analyze the case laws. In view of this position, students should realise the importance and usefulness of keeping track of the judgments of Supreme Court and of various High Courts reported in tax law journals from time to time. Students should make it a point to go through the relevant cases and understand the issues involved and the rationale of the judgments. Of course, tax planning in a particular case would depend on the facts and circumstances of that particular case.

Apart from the above, students are advised to go through the articles on tax laws published in tax journals and financial papers. With this brief introduction, let us go into the basic concepts of tax planning.

(2) Concept of tax planning: Planning is the formulation of a system which in its implementation is designed to achieve a specific result. Economic planning is the privilege of the State; tax planning is that of the subject. Men, material and money are the resources available at the disposal of a nation and to conserve the same, the State resorts to economic planning. Tax planning aims to reduce the outflow of cash resources made available to the Government by way of taxes so that the same may be effectively utilised for the benefit of the individual or the business, as the case may be. Just as sound economic planning is indispensable for a welfare State, a sound tax planning is equally indispensable for the welfare of the citizen.

Before entering into a transaction or before starting a business, one normally considers its profitability and other aspects. Amongst other aspects, the tax implications of the transactions of the business have to be thought out before actually embarking on the deal. Otherwise one may be caught unwittingly in huge tax liability. Planning from the point of view of taxation helps in generating greater savings of investible surplus.

Tax planning may be defined as an arrangement of one's financial affairs in such a way that, without violating in any way the legal provisions, full advantage is taken of all tax exemptions, deductions, concessions, rebates, allowances and other reliefs or benefits permitted under the Act so that the burden of taxation on the assessee is reduced to the minimum.

It involves arranging one's financial affairs by intelligently anticipating the effects which the tax laws will have on the arrangements now being adopted. As such it is a very stimulating intellectual exercise.

Any tax planning scheme should be a natural one and should not give an appearance of an artificial arrangement on the face of it. The tax planner or the tax adviser should exercise great care and caution in designing any tax planning scheme as its failure will result in great difficulties and heavy burden of tax on the assessee for whom the scheme is evolved.

(3) Tax planning, tax evasion and tax avoidance: Three methods of saving taxes have been developed in most countries of the world in the past few decades: tax evasion, tax avoidance and tax planning.

Reduction of taxes by legitimate means may take two forms — tax planning and tax avoidance. 'Tax planning' is wider in range. At this stage, the distinction between 'tax avoidance' and 'tax evasion' may be noted. The dividing line between tax evasion and tax avoidance is very thin. The Direct Taxes Enquiry Committee (Wanchoo Committee) has tried to draw a distinction between the two items in the following words.

"The distinction between 'evasion' and 'avoidance', therefore, is largely dependent on the difference in methods of escape resorted to. Some are instances of merely availing, strictly in accordance with law, the tax exemptions or tax privileges offered by the Government. Others are maneuvers involving an element of deceit, misrepresentation of facts, falsification of accounting calculations or downright fraud. The first represents what is truly tax planning, the latter tax evasion. However, between these two extremes, there lies a vast domain for selecting a variety of methods which, though technically satisfying the requirements of law, in fact, circumvent it with a view to eliminate or reduce tax burden. It is these methods which constitute "tax avoidance".

Thus, tax evasion refers to any attempt to avoid payment of taxes by using illegal means. Some of the common forms of tax evasion are:

- misrepresentation or suppression of facts;
- failure to record investments in books of account;
- claim of expenditure not substantiated by any evidence;
- recording of any false entry in books of account;
- failure to record any receipt in books of account having a bearing on total income; and
- failure to report any international transaction or deemed international transaction or specified domestic transaction under Chapter X.

These constitute misreporting of income attracting penalty @ 200% under section 270A.

(4) Judicial thinking—A brief study: The judicial attitude towards tax avoidance schemes is very strict and the landmark judgment of the Supreme Court in *M/s. Mc Dowell and Co. Ltd. vs.*

Commercial Tax Officer 1985 Taxman 77(3) (1985) 154 I.T.R. 148 (SC) is proof of the same. Though this decision was rendered in the context of A.P. General Sales Tax Act, the principles emerging out of this decision will have relevance to direct taxes also.

Before discussing the relevant observations of the Supreme Court in relation to tax avoidance scheme it will be instructive to have an idea of the development in judicial thinking in England since our own judicial thinking on the subject has been largely derived from English thinking.

English Scene: In *Inland Revenue Commissioner vs. Duke of Westminster 1936 AC 1* it was held "Every man is entitled if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."

After the World War II and the consequent huge profiteering and racketeering the attitude of the courts towards the avoidance of tax perceptibly changed and hardened. Commenting on a tax avoidance scheme, the court observed that it scarcely lies in the mouth of the taxpayer who plays with fire to complain of burnt fingers.

It was felt that there must be some limit to the devices which courts can put up with in order to defeat the fiscal intentions of the legislature. A very significant departure from the Westminster Principle was made in *Ramsay vs. Inland Revenue Commissioners (1982) AC 300*. It was felt in that case that even though the doctrine that courts could not go behind a given genuine document or transaction to some supposed underlying substance was a cardinal principle, it must not be overstated or over-extended. While obliging the courts to accept documents or transactions, found to be genuine, as such, the doctrine did not compel the court to look at the document or transaction in blinkers isolated from any context to which it properly belonged. If it could be seen that a document or transaction was intended to have effect as a part of a nexus or series of transactions or as an ingredient of a wider transaction intended as a whole, there was nothing in the doctrine to prevent it being so regarded. To do so was not to prefer form to substance or substance to form. It was the task of the court to ascertain the legal nature of any transaction to which it was sought to attach a tax consequence and if that emerged from a series or combination of transactions, intended, apart as such, as was that series or combination which might be regarded.

Thus, two points were established. The first was a significant change in the approach adopted by the court with regard to its judicial role towards tax avoidance scheme. The second was that it was crucial when considering any such scheme to take the analysis far enough to determine where the profit, gain or loss was really to be found. It was also stated that the fact that the court accepted that each step in a transaction was a genuine step producing its intended legal results did not confine the court to consider each step in isolation for the purpose of assessing the fiscal results. Thus, we can say that the true principle of the decision in Ramsey was that the fiscal consequence of a preordained series of transactions intended to operate as such, are generally to be ascertained by considering the result of the series as a whole and not by dissecting the scheme and considering each transaction separately.

In *I.R.C. vs. Burmah Shell Co. Ltd. (1982) STC 30 (Burmah)* and *Furniss (Inspector of Taxes) vs. Dawson (1984) 1 All E.R.530*, it was held that where tax avoidance was targeted through a series of transactions with no commercial or substantial value but with the only aim of avoiding tax, the Courts have to ignore the transactions and the tax liability has to be determined as if these transactions never took place.

Indian Scenario: In *CIT vs. A. Raman & Co. 1 SCR 10,* the Supreme Court followed the dictum of the Westminster's case. It observed that avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. The tax payer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon consideration of morality but on the operation of the Income-tax Act, 1961. Legislative injunction in taxing statutes may not, except on pain of penalty, be violated but it may lawfully be circumvented. The same view was expressed in *CIT vs. Kharwar (1969) 72 ITR 603 (SC)* as follows:

"The taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction, if the parties have chosen to conceal by a device the legal relation, it is open for the taxing authorities to unravel the device and to determine the true character of relationship. The legal effect of a transaction, however, cannot be displaced by probing into the substance of the transaction."

However, the Supreme Court in *Mc Dowell's* case clearly departed from the above views and expressly disassociated itself with the earlier observations of the Supreme Court echoing the sentiments of Westminster principle. The court enumerated the evil consequences of tax avoidance as follows:

(1) Substantial loss of much needed public revenue.

(2) Serious disturbance caused to the economy of the country by the piling up of mountains of black money, directly causing inflation.

(3) Large hidden loss to the community by some of the best brains of the country involved in perpetual litigation.

(4) Sense of injustice and inequality which tax avoidance arouses in the minds of those who are unwilling or unable to profit by it.

(5) The unethical practice of transferring the burden of tax liability to the shoulders of the guileless, good citizens from those of the 'artful dodgers'.

The court felt that there was as much moral sanction behind taxation laws as behind any other welfare legislation and avoidance of taxation was not ethical.

In the view of the Court, the proper way to construe a taxing statute while considering a device to avoid tax was not to ask whether the provisions should be construed literally or liberally, nor whether the transaction was not unreal and not prohibited by the statute, but whether the transaction was as device to avoid tax and whether the transaction was such that the judicial process might record its approval to it.

The court felt that it was neither fair nor desirable to expect the legislature to intervene and take care of every device to avoid taxation. It was up to the court to take stock to determine the nature of the new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices could be related to the existing legislation with the aid of emerging techniques of interpretation as was done in Ramsey's case to expose the devices for what they are really worth and to refuse to give judicial benediction.

The Supreme Court emphasised that tax planning may be legitimate provided it is within the framework of law and colourable devices cannot be part of tax planning. It is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. The Supreme Court also recommended that it is the obligation of every citizen to pay the taxes honestly without resorting to subterfuge.

It is significant to note that in deciding *Mc Dowell's case*, the Supreme Court was not content in merely adjudicating the dispute as to whether sales tax was leviable on the Central Excise paid by the purchaser on behalf of the seller and not exhibited in the bill. It also stated in this case that it decided to break away from the long tradition of earlier cases holding that tax avoidance is both legitimate and legal.

Another significant case decided by the Supreme Court, though involving a dispute relating to payment of bonus, is worthy of reference at this stage as it also reflects the same thinking as in *Mc Dowell's* case. In *Associated Rubber Industries case (1986) 157 ITR 77(SC)*, a new wholly owned subsidiary company was created with no asset of its own except investments transferred by the holding company with no business income, except receiving dividend from the transferred investments. The Supreme Court held that on facts, the purpose of such a transfer of investments was nothing but to reduce the gross profits of the holding company and thereby to reduce the payment of bonus. There was no direct evidence that the subsidiary was formed as a device to reduce the gross profits of the principal company for whatever purpose. But Justice Chinnappa Reddy in passing his judgment was following the principles earlier laid down by him in *Mc Dowell's* case and was of the opinion that the transfer of shares was nothing but a device like tax evasion to avoid a welfare legislation like the Payment of Bonus Act. It was observed that it is the duty of the Court in every case where ingenuity is expended to avoid liability to taxation and welfare legislation, to get behind the smoke screen and discover the true state of affairs.

The above decision seems to have introduced a new doctrine that it is upto the court to take stock, weigh out sophisticated legal devices and expose the devices for what they really are. The fact that this new doctrine has started gaining ground very fast is seen from a quick succession of decisions, after *Mc Dowell* in *Kartikeya vs. Sarabhai* and in *Associated Rubber's* case. The above change in the trend of judicial thinking clearly shows that the line of demarcation between Tax Planning and Tax avoidance.

In order to curb tax avoidance, provisions such as applicability of transfer pricing provisions in respect of specified domestic transactions, treating any transaction with the person located in the notified jurisdiction areas to be treated as international transaction, General Anti-avoidance Rules, provisions relating to furnishing of Tax Residency Certificate for claiming benefit of double tax avoidance agreements have been introduced.

The decision in *Mc Dowell's* case and the subsequent developments have evoked lot of debate in all legal and tax circles.

The Gujarat High Court in *CIT vs. Smt. Minal Rameshchandra (1987) 61 CTR (Guj) 80* had occasion to consider the impact of *Mc Dowell's* case. The following propositions appear to emerge from the same.

(1) *Mc Dowell's* case and observations therein cannot be ignored and these are binding on all courts.

(2) *Mc Dowell's* case and observation therein should be understood in the context of questioning the legitimacy of use of artificial and transparent device and sham practices to circumvent the law.

(3) Where the arrangement cannot be dismissed as an artificial tax device (and not as a legitimate transaction), the subject can be taxed only having "regard to strict letter of the law and not merely to the spirit of the statute or the substance of the law" and had been consistently laid down earlier. In this sense there is no radical departure from law, prior to Mc Dowell case.

In *C.W.T. vs. Arvind Narottam 173 ITR 479 (SC)* judge Sabyasachi Mukerji made the following significant observations:

1. Where the language of the deed of settlement is plain and admits of no ambiguity there is no scope for considerations of tax avoidance.

2. One would wish as noted by Chinnappa Reddy in Mc Dowell's case that one could get the enthusiasm of Justice Holmes that taxes are the price of civilization and one would like to pay that price to buy civilization. But the question which many ordinary tax payers very often in a country of shortages (with ostentatious consumption and deprivation for the large masses) ask is does he with taxes buy civilization or does he facilitate the waste and ostentation of the few. Unless waste and ostentation in government spending are avoided or eschewed no amount of moral sermons would change people's attitude to tax avoidance.

3. Where the true effect on the construction of the deeds is clear, appeal to discourage tax avoidance is not a relevant consideration".

In the light of the above development we have to ascribe a proper meaning to the concept of tax-planning. We can take a cue from the structure of our tax laws.

Our tax laws tend to serve a dual purpose of collecting revenue and of achieving certain social objectives. There are in-built tax incentives which promote savings and investments in new enterprises and facilitate development of backward areas. A lot of exemptions and incentives are provided in all the direct taxes. If an assessee takes maximum advantage of these incentives, exemptions etc. and enlarges the scope of his disposable resources, there can be no objection because the legislature wants the optimum utilisation of these incentives to promote economic activity in the country. The complexity of our tax-laws makes it impossible for even an intelligent assessee to comprehend them properly and avail all the reliefs which may be genuinely provided by such laws. Moreover, the interaction of other laws such as MRTP Act, FERA, Companies Act etc. make the exercise much more complicated. It requires, therefore, meticulous planning to bring down the tax commitments keeping in view not only the statutes but also the judge-made law. We may say that the above area properly belongs to tax-planning. In this sense there is nothing unethical about tax-planning.

Due to constant changes in the law and new court decisions, it is always necessary to have a continuous review in relation to all matters of tax planning so that appropriate changes are introduced without delay.

It may be noted that the scope of the three English cases of Ramsay, Burmah Oil Company and Dawson have been substantially narrowed by a more balanced view on tax planning in the case of 'Craven vs. White'

(5) **Doctrine of form and substance:** One of the reasons which prompts a tax payer to resort to tax planning is the existence of the doctrine of form and substance. The principle involved in this doctrine is simple. How far Court may stretch the wording of a Statute to cover a particular set of facts, where those facts have clearly been created by a tax payer in order to avoid or minimise his tax and the literal interpretation of the Statute is not, at first sight apt to cover them? Is it possible to ignore the form of a transaction and determine the substance thereof?

In *Commissioner of Income tax vs. Motor and General Stores (P) Ltd. (1967) 66 ITR 692 (SC.)* the Supreme Court had observed that in the absence of any suggestion of bad faith or fraud the true principle is that the taxing statute has to be applied in accordance with the legal rights of the parties to the transaction. According to the court, when the transaction is embodied in a document the liability to tax depends upon the-meaning and content of the language used in accordance with the ordinary rules of construction. The House of Lords in *Duke of Westminster vs. ICR (1936) 19 ATC 498* held that in considering the substance of the transaction, the legal form cannot be disregarded.

It was held in *CIT vs. B.M. Kharwar (1969) 72 ITR 603 (SC)* that the taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by device the legal relation, it is open to the taxing authority to unravel the device and to determine the true character of the relationship. However, the legal effect of a transaction cannot be displaced by probing into 'the substance of the transaction'. This principle applies alike to cases in which the legal relation is recorded in a formal document and to cases where it has to be gathered from the evidence - oral and documentary - and the conduct of the parties to the transaction. However, this view of the Supreme Court has now been expressly disapproved by the Supreme Court in *Mc Dowell & Co. Ltd's case.*

Justice Shah, in *Ram Laxman Sugar Mills vs. CIT (1967) 66 ITR 613, 617 (SC),* has stated that to ascertain the legal effect of a transaction, the court seeks, in the first instance, to determine the intention of the parties and if ambiguous expressions are used, the court may normally adopt such interpretation consistent with the parties thereto having acted on the assumption of its validity. Thus, any claim made by a tax-payer will be scrutinized from the point of view of his intention and if there was any intention to defraud the revenue, the court will consider the transaction or the claim as fraud.

Thus, we can say that unless there is clear evidence of *malafide* intention resulting in a form which is a "colourable device" or "mere legal facade" or "non-genuine" form the tax authorities are not justified in disregarding the legal form and probing into the substance of the transaction.

Principles governing the form and substance: Theory of interpretation of a taxing statute:

(i) It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability while, if it is entered into in another form which is equally lawful, it may not. In considering, therefore, whether a transaction attracts tax or not, the form of the transaction put through by the assessee is to be considered and not the substance thereof.

(ii) The above rule cannot naturally apply where the transaction, as put through by the assessee, is not genuine but colourable or is a mere device. For here, the question is not one between 'form' and 'substance' but between appearance and truth.

(iii) In deciding whether the transaction is a genuine or colourable one, it will be open to the authorities to pierce the corporate veil and look behind the legal facade at the reality of the transaction.

(iv) Where the authorities are charged under the Act with the duty of determining the nature or purpose of and payment or receipt on the facts of a case, it is open to them to work at the substance of the matter and the formal aspect may be ignored.

(v) Where the terms of a transaction are embodied in a document, it should not be construed only in its formal or technical aspect. While the words used should be looked at, too much importance should not be attached to the name or label given by the parties and the document should be interpreted so as to accord with the real intention of the parties as appearing from the instrument.

As noted earlier, the decisions of the Supreme Court in the cases of *Mc Dowell, Karthikeya Sarabhai and Associated Rubber Industries,* clearly show a preference for the 'substance' over the 'form', if the circumstances of the case warrant such a preference. Where the transactions are genuine, perfectly authentic and not sham, the mere fact that the transaction results in less liability or no liability to tax should not put the transaction to a legal scrutiny questioning the substance of the transaction, attributing a motive behind it. It is up to the Court to take stock of the situation, weigh out sophisticated legal devices and expose the devices for what they really are.

(6) Successful tax planning — tests to be satisfied: Tax planning in any case will entirely depend on the individual facts and circumstances. It is a tool in the hands of the taxpayer and tax practitioners for selective use. It is essential to comprehend (a) that the facts bearing on the issue are evidenced by proof; (b) that the associated legal consequences, both under the personal and under the tax laws, are fully borne in mind; and (c) that the situation warrants implementation of "tax planning". Successful tax planning must conform to two outstanding tests viz, (a) conformity with the current law and (b) flexibility.

In order to satisfy the first test, the essential requisite is a *comprehensive knowledge* of the law, rules and regulations on the part of the tax planner. This knowledge of law extends not only to the provisions of the taxing statutes and the case law that has developed on those statutes, but also to other branches of law, both civil and personal, so that the tax planner's device does not get defeated by the universal principles of jurisprudence.

The second test of flexibility seeks to ensure that the success of the *tax planning device is not nullified* by statutory negation. Though the tax planner may be successful in seeking out a device which in his opinion is in conformity with law, the subsequent statutory negation may nullify his success. In order to counter this exigency, his tax plan must be flexible. Flexibility essentially means that the device provides for suitable changes in accepted forms. Flexibility is a practical concept. Its introduction and utilisation depend upon the circumstances of the case. Under certain circumstances, flexibility may be of no avail. As a matter of fact, flexibility may invalidate the tax plan. But when flexibility is permissible, the tax planner will do well to remember to keep this test in mind to counter the measures of statutory negation. In view of this position wherever possible, tax planning schemes should be flexible, designed so as to avoid irretrievable situations. The tax planner should, therefore, be watchful of all significant developments related to his field.

In order to be a successful venture, efforts at tax planning should not ignore the legislative intent; they should be directed in every case to see that not only the tax benefits are obtained but also the tax obligations are discharged without fail so that the penal provisions are not attracted.

(7) Retrospective Legislation: Every tax planner will inevitably have to face the question of retrospective legislation and the specific problems arising from the retrospective application of tax rates and tax amendments. Tax planning often flounders on the rock of retrospective legislation. The cardinal principle of construction is that a statute must always be interpreted prospectively unless the language of the statute makes it retrospective either expressly or by necessary implication. A retrospective operation is not to be given to a statute so as to impair vested rights or the legality of past transactions.

Unless the terms of statute expressly so provide or unless there is a necessary implication, retrospective operation should not be given to the statute so as to affect, alter or destroy any right already acquired or to revive any remedy already lost by efflux of time. If the law is amended so as to make it applicable retrospectively to any assessment year, the question at issue in respect of the assessment year will have to be decided in the light of the law so amended and it shall be so even if the matter is at the appellate, revisional or reference stage.

The history of tax laws of our country is replete with instances of retrospective amendment of law. It is obviously competent for the Legislature, in its wisdom, to make the provisions of an Act of Parliament retrospective and no one denies the competency of the Legislature to pass retrospective statutes if they think fit and many time they have done so, but, before giving such a construction to an Act of Parliament one would require that it should either appear very clearly in the terms of the Act or arise by necessary and distinct interpretation. A retrospective operation is not to be given to a statute as to impair existing right or obligation otherwise than as regards matters of procedure unless that effect cannot be avoided without doing violence to the language of the enactment. If the enactment is expressed in language which is fairly capable of either interpretation, it ought to be construed as prospective only.

In our country, the Government generally follows the principle that the changes in the rates of tax, as also the other amended provisions of tax laws, should ordinarily be made operative prospectively in relation to current incomes and not in relation to incomes of the past year. However, there are cases where the Government have thought it fit to introduce retrospective amendments in tax laws. The Supreme Court has upheld the validity of such retrospective laws. Any retrospective legislation has two aspects. For pending assessments, the amended provision would be applied. The difficulty would arise in the case of completed assessments. The effect of a retrospective legislative amendment is that the provisions as amended, shall, for all legal purposes be deemed to have been included in the statute from the date on which the amendment came into force. All orders relating to periods subsequent to the date of retrospective amendment must be in consonance with the specific and clear provisions, as amended retrospectively. Therefore, the case will be construed as if there is mistake apparent from the record which can be rectified under section 154 *[M.K. Venkatachalam vs. Bombay Dyeing and Manufacturing Co. Ltd. (1958) 34 I.T.R. 143 (S.C.)]*. Conversely, by virtue of a retrospective amendment, an order which was inconsistent with the clear terms of a provision at the time when the order was made, may become one in consonance with that provision and thereafter, there remains no scope for passing a rectification order *[SAL. Narayana Rao vs. Ishwarlal Bhawan Das (1965) 57 L T.R. 149 (S.C.)]*.

For instance, the Finance Act, 2012 had introduced amendments to certain provisions of income-tax law, which were stated to be clarificatory and, accordingly, introduced with retrospective effect from the date of insertion of the respective provisions. Subsequently, considering the severity of the consequences of such retroactive amendments, the CBDT issued a clarification directing the tax authorities not to reopen completed tax assessments on account of the clarificatory amendments made by the Finance Act, 2012. However, the clarification does not extend to assessment orders which are pending adjudication before a judicial authority or if reassessment proceedings have already been initiated before 1st April 2012.

(8) Systems and methods of tax planning: The systems and methods of tax-planning in any case will depend upon the result sought to be achieved. Broadly, the various methods of tax-planning will either be short-range tax-planning or long-range tax-planning.

The short-range tax planning has limited objective. An assessee whose income is likely to register unusual growth in a particular year on account of say, sale of capital asset like house property, as compared to the preceding year might plan to invest the same in notified bonds, bonds of National Highway Authority of India or Rural Electrification Corporation Limited to claim exemption under section 54EC. This has a lock-in period of 5 years. Such a plan does not involve any permanent or long-term commitment and yet it results in substantial tax saving. This is an example of short-range tax planning.

The long-range tax planning, on the other hand, may not even confer immediate tax benefits. However, it may pay-off in none too distant a future. For instance, in a case where an assessee transfers certain shares to his spouse, the income arising from the shares will, of course, be clubbed with the transferor's income. However, if the company subsequently issues bonus shares in respect of those shares the income arising from the bonus shares will not be clubbed with the transferor's income. Similarly, the income arising out of the investment of the income from the transferred assets will not also be clubbed with the transferor's income. Long range tax planning may be resorted to even for domestic or family reasons.

In relation to income-tax, the following may be noted as illustrative instances of tax-planning measures:

(a) Varying the residential status taking into consideration the number of days of stay in India to be a resident, in case of an individual.

(b) Choosing the suitable form of assessable entity (individual, HUF, Firm, Co-operative society, Association of persons, Company, Trust, etc. to obtain optimal tax concessions)

(c) Choosing suitable forms of investment (share capital, loan capital, lease, mortgages, tax exempt investments, priority sector, etc.), considering deductions available in respect of interest, exemption available in respect of dividend etc.

(d) Programmed replacement of assets to take free advantage of the provisions governing depreciation.

(e) Diversification of the business activities (hotel industry, agro-based industry etc.) considering the various profit-linked and investment-linked benefits available under the provisions of the Act.

(f) The use of the concept of commercial expediency to claim deduction in respect of expenditure, in computing business income.

(9) Tax planning in the context of administrative legislation: It is a common feature of modern legislative enactment to lay down in the section of the Act, the principles and the policy of the Legislature leaving out details to be filled in or worked out by rules or regulations made either by the Government or by some other authority as may be empowered in the legislation. This kind of subordinate or administrative legislation is justified and even necessitated by the fact that the Legislature has neither the time nor the material to consider and enact rules relating to various details as they may not be acquainted fully with the facts and circumstances relating to the subject matter and may have no time to consider such details. Section 295(1) of the Income-tax Act, 1961 vests with the CBDT, the power to make rules for carrying out the requirements of these Acts. This power also enables the Board to give retrospective effect to any of the rules in such a way as not to prejudicially affect the interests of any taxpayer.

The various matters in respect of which the rules may be framed are specified in the relevant sections. Rules are made by the appropriate authority in exercise of the powers conferred on it under the provisions of the Act. Therefore, they have statutory force and fall within the scope of the law made by the Legislature itself. Thus, they are a part of the enactment which imposes the tax. Since the Rules are meant only for the purpose of carrying out the provisions of the Act, they cannot take away what is conferred by the Act nor whittle down its effect. Therefore, rules can only be made in consonance with the provisions of the Act. They must be interpreted in the light of the section under which they are made. If there is an irreconcilable conflict between a rule and a provision in the Act, the provision in the Act is to prevail and the rule which is subordinate to the Act must give way.

Similarly, notifications are also issued in exercise of a valid authority bestowed under the statutes. Such notifications, when validly made in exercise of the authority provided for in the law, are binding on all concerned and may be enforced.

The following principles emerging from various rulings are relevant in this context.

1. The rule making authority *cannot* frame a rule which is *contrary to the object* and provisions of the Act from which its rule making power is derived.
2. A rule *cannot over-reach the subject-matter* relevant to the particular provision in the Act.
3. A rule *cannot whittle down, negate* or take away (directly or by implication or causation) the right, privilege, advantage or benefit granted by the section or the enactment relevant to it.
4. A rule cannot *create any disability, limitation* or other condition not sanctioned by the Act to which it is relevant or not consistent with the Act.
5. A subordinate authority cannot *seek to sit in judgement over the rights of the subject nor decide questions of law* and fact or otherwise usurp the functions of a Court.
6. No rule can be framed nor regulation promulgated *contrary to the rules of natural justice*.
7. A rule cannot seek to *impose a tax which the Legislature has not thought it fit* or expedient to impose.
8. A rule has to strictly confine itself to the subject-matter for which the rule-making authority has been empowered by the enactment.
9. In providing for a rule-making power, however wide the terms of that power be, as long as the Legislature has laid down the necessary guidelines for exercise of such rule-making power of the subordinate authority and as long as the Legislature has clearly laid down in the enactment the legislative object and policy and has retained in itself the ultimate legislative

power, the enactment delegating power to a subordinate authority cannot be said to be ultra vires the Legislature or the enactment.

10. Both a rule and a provision of law are equally bound to respect the constitutional protection and fundamental right of the citizen enshrined in *Article 14 of the Constitution*.

11. Merely because a rule is subsequently laid before the Parliament, it cannot be given the status of a law of Parliament.

12. As in the case of an enactment, if a rule classifies persons and objects into identifiable classes and such classification is relevant to the purpose of the enactment and for carrying out the provisions of the Act, it cannot be called in question.

13. A rule has no retrospective operation unless the Act to which it is relevant specifically provides for the making of rules having retrospective operation.

14. The power to notify or to exempt also carries with it necessarily the power to denotify, rescind or withdraw the notification or exemption.

The above principles may be kept in mind while deciding about embarking on tax-planning.

Section 119(1) enacts that all officers and other persons employed in the execution of that Act shall observe and follow the orders and instruction or direction of the Board, provided that no such orders, instructions or directions shall be given so as to interfere with the discretion of the Commissioner (Appeals) 'in the exercise of his appellate functions. It is judicially settled that the Circulars issued by the Board would be binding under Section 119 on all the officers and persons employed in the execution of the Act *[Navnilal vs. Sen (1965) 56 I.T.R. (198 SC)]*. Consequently, if the Assessing Officer contravenes any circular issued by the Board in respect of, say, non-eligibility to tax of a certain item of receipt, he can be called upon by the appellate authority [the Commissioner (Appeals) or the Appellate Tribunal] to obey such a circular. The circular is not such a law that it should be taken judicial notice of; but after the circular has been brought to the notice of appellate authority, it would be competent to the appellate authority to direct the Assessing Officer to correct his mistakes in his not giving effect to the circular. However, it may be noted that opinions expressed by the CBDT in its individual communication to the assessee on issues affecting (for example, as to when the new industrial undertaking eligible for deduction under section 80-IC established by the assessee began to manufacture or produce articles in specified States) cannot be considered as directions binding on the Income-tax authorities under section 119. The CBDT is not competent to give directions regarding the exercise of any judicial power by its subordinate authorities *[J.K. Synthetics Ltd. and other vs. CBDT (1972) 83 ITR 335 (SC)].*

The various judicial rulings which have considered the legal aspects of Circulars under the Income-tax Act, 1961 point out the following:

(i) The instructions of the Board are binding on the Department but *not on the assessee.*

(ii) The instructions *in favour of the assessee should be followed by the Department*, irrespective of the question of their legality; but the instructions adverse to the assessee can be challenged by the assessee.

(iii) Instructions adverse to the assessee cannot be issued with retrospective effect, while instructions favourable to the assessee can be so issued.

(iv) Instruction withdrawn subsequently should be given effect to by the Assessing Officer for the assessment year for which they were in force even though they are withdrawn at the a time he makes the assessment.

(v) In the exercise of its power, the Board cannot impose a burden or put the assessee in a worse position but the Board can grant relief or relax the rigour of the law.

(vi) No instruction or circular can go against the provisions of the Act. While the Board can relax the rigours of the law or grant relief which is not to be found in the terms of the statute, it cannot issue any instruction which will be ultra vires of the provisions of the statute.

(vii) No such orders, instructions or directions shall be issued — (a) so as to require any income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner or (b) so as to interfere with the discretion of the Deputy Commissioner (Appeals) or the Commissioner (Appeals) in the exercise of his appellate functions.

In making an assessment or levying a penalty, the Assessing Officer exercises a quasi-judicial power conferred on him by the Statute and has to act independently. He cannot act on advice of a stranger even though that person may be an authority superior to him in official hierarchy — Sheo Shankar Sitaram (1974) 95 ITR 523 (All).

(viii) Administrative instructions cannot also override the statutory rules.

In view of this position, the tax planner, while planning his affairs or that of his clients must take into account not only the relevant legal provisions which affect him but also all relevant rules, notifications, circulars, etc. As for circulars, since they are in the nature of administrative or executive instructions, the possibility that they might be withdrawn by the Board at any time, should also be taken into account. They may be challenged in the Courts although, otherwise they are binding at the administrative level (i.e., below thee High Court or the Tribunal). In case where the circulars are based on erroneous and untenable footings, they are also liable to be quashed by the Court/Government.

(10) System of advance rulings: A ruling is a statement in writing to a taxpayer from the prescribed tax administering authority which interprets and applies the law and regulation to a specific set of facts and states a conclusion as to the tax consequences of that particular transaction. As the rulings are given in advance of the concerned transactions they are called advance rulings. The advance rulings given are binding on the tax authorities and the applicant who had sought such ruling, with reference to the particular cases in respect of which they are given. A change in the facts can affect the basis of the rulings because the law often pivots on a date, an amount, type of tax payer and so on. Likewise, a ruling issued with respect to one transaction may not be good to the same tax payer for a subsequent transaction even on what might appear to be identical facts.

Advance rulings are an excellent device for fostering and encouraging the self-assessment system and would contribute to good relations between the administration and tax paying public. From the tax payer's point of view, these rulings are most desirable because they give more assurance of certainty prior to entering into a transaction and guarantee more uniformity in the application of the tax legislation. They are desirable for the administration also as they minimise the scope for controversy and litigation, reduce the time spent in answering question from tax payers and help to achieve a fair and co-ordinated tax administration.

Advance Ruling means written opinion or authoritative decision by an Authority empowered to render it with regard to the tax consequences of a transaction or proposed transaction or an assessment in regard thereto. The term has been defined in section 245N(a) of the Income-tax Act, 1961.

Chapter XIX-B of the Income-tax Act, 1961, provides for a scheme of advance rulings. For detailed reading, students may refer to **Chapter 4 of Part II: International Taxation**.

(11) Construction and Interpretation: No tax can be imposed on the subject without words in the Act clearly showing an intention to lay a burden upon him. In other words, the subject cannot be taxed unless he comes within the letter of the law.

(a) Natural Justice: This, however, does not mean that there is no scope for natural justice. Tax laws have to be interpreted reasonably and in consonance with justice. Where a literal construction would defeat the obvious intention of the legislation and produce a wholly unseasonable result, the court must achieve that obvious intention and produce a rational construction. If the interpretation of a fiscal enactment is open to doubts, the construction most beneficial to the subject should be adopted, even if it results in his obtaining "a double advantage". A provision for exemption of relief should be construed liberally and in favour of the assessee. Likewise, a provision for appeal should be liberally construed. In cases of doubt regarding the construction, assistance may be sought from previous judicial interpretation or from previous legislation or by adverting to the mischief intended to be suppressed. A subsequent enactment affords no useful guide to the interpretation of earlier law, unless it is on the same subject and the earlier law is ambiguous.

Generally speaking, the sections in the Act do not overlap one another and each section completely covers the matter with which it deals. As far as possible the Act should be construed in such a way as to reconcile the various provisions and unravel apparent conflict into harmony bearing in mind that a general provision cannot derogate from a special provision regarding a certain class of cases. If a case appears to be governed by either of two provisions, it is clearly the right of the assessee to claim that he should be assessed under that one which leaves him with a lighter burden.

Those sections which impose the change of levy should be strictly construed but those which deal merely with the machinery of assessment and collection should not be subjected to a rigorous construction but should be construed in a way that makes the machinery workable.

The draft of a Bill which is afterwards enacted in the form of a statute and the report of a Commission or Select Committee appointed to deal with the subject are not admissible as aids in construing the provisions of the Act but the statement of objects and reasons may be referred to for the limited purpose of ascertaining the conditions prevailing at the time and the extent and urgency of the defect sought to be remedied.

(b) **Definition clause and undefined words:** A definition or interpretation clause which extends the meaning of a word should not be construed as taking away its ordinary meaning. Further, such a clause should be so interpreted as not to destroy the basic concept or essential meaning of the expression defined, unless there are competing words to the contrary. Words used in the sections of the Act are presumed to have been used correctly and exactly as defined in the Act and it is for those who assert the contrary to show that there is something repugnant in the subject or context. Words which are not specifically defined must be taken in their legal sense or their dictionary meaning or their popular or commercial sense as distinct from their scientific or technical meaning unless a contrary intention appears.

(c) **Legal fiction:** The word "deemed" may include the obvious, the uncertain and the impossible. A legal fiction has to be carried to its logical conclusion but only within the field of definite purpose for which the fiction is created. As far as possible, a legal fiction should not be so interpreted as to work injustice.

(d) **Marginal Notes:** Marginal notes to the sections cannot control the construction of the statute but they may throw light on the intention of the legislature.

(e) **Provisos:** A proviso cannot be held to control the substantial enactment or to withdraw by mere implication any part of what the main provision has given. A proviso is not applicable unless the substantive clause is applicable to the facts of the case. The proper function of a proviso is to provide an exception to a case which would otherwise fall within the general language of the main enactment and its effect as confined to that case. However, a proviso may be read as an independent substantive enactment where the context warrants such construction. Whether a proviso is construed as restricting the main provision or as a substantive clause, it cannot be divorced from the provision to which it stands as a proviso. It must be construed harmoniously with the main enactment.

(12) Doctrine of Precedence: Doctrine of Precedence would be applicable in case of tax laws. The following principles which govern the rule of precedence may be noted.

- **Supreme Court:**

    (i) The Supreme Court judgments are *absolutely binding* on all the courts, Tribunals and authorities.

(ii) Not only the *ratio decidendi*, but also *obiter dicta* of the Supreme Court are binding on all the Courts.

(iii) When there are two irreconcilable decisions of the Supreme Court on some point of law, the decision of a larger Bench shall prevail.

(iv) When there are two irreconcilable decisions of two Benches of similar strength, the decision later in time will have to be followed by the lower courts.

(v) The Supreme Court judgments cannot be ignored by the lower courts though such judgments are *per incuriam.*

(vi) The Supreme Court, though expected to follow its own judgments, is not bound to follow them and in appropriate cases it can review its earlier judgment.

♦ **High Courts:**

(i) A Division Bench of a High Court is generally bound by its earlier decision, but it may refuse to follow the same if the earlier judgment is *per incuriam*.

(ii) If the Division Bench of a High Court does not agree with its earlier judgment it will have to either follow the same or refer the issue to a Full Bench.

(iii) A Division Bench of High Court is bound to follow a decision of the Full Bench of the same High Court.

(iv) A single judge of a High Court is bound by a decision of a Division Bench or of the Full Bench of the same High Court.

(v) A single judge of a High Court is not bound to follow the decision of another single judge, though he is expected to follow the same.

(vi) All the lower authorities, courts and tribunals are absolutely bound to follow the decision of a High Court within whose jurisdiction they function. Here, the High Court decisions include decision of a single judge.

(vii) The lower authorities and courts can ignore a decision of a High Court only if it is overruled by a larger Bench of the same High Court, or by the Supreme Court or by a later enactment.

♦ **Others:**

(i) The Assessing Officer and the Commissioner, while acting under section 263, cannot refuse to follow the decision of High Court. They cannot pass orders which are inconsistent with the decisions of the High Court within whose jurisdiction they function, even for the purpose of keeping the issue alive.

(ii) In all Indian Acts like the Income-tax Act, 1961, to keep the uniformity of law, a High Court should normally follow the decision of another High Court, unless it finds an overriding reason not to follow the same.

(iii) The lower appellate authorities are bound to follow the decision of another High Court, though they do not function within the jurisdiction of the said High Court, if there is no contrary decision of any other High Court.

(iv) The Assessing Officer or the Commissioner need not follow the decision of another High Court if the department has not accepted the said decision and has taken the matter to Supreme Court.

(v) The Bench of the Appellate Tribunal, should generally follow the orders of other Benches of the Tribunal, unless those orders of the Tribunal are *per incuriam.*

(vi) An order of a Full Bench of a Tribunal is binding on the ordinary Bench of the Tribunal.

(vii) If an ordinary bench of a Tribunal does not agree with an order of another Bench of the Tribunal, and that order of the another Bench of the Tribunal is not *per incuriam*, the Bench cannot differ from the view taken by the other Bench. It can only get the matter referred to a larger Bench. But this is subject to the general rule that as far as possible, the Bench should try to follow the orders of the Benches.

(viii) The Tribunal orders are binding on the Commissioner (Appeals) falling within the territorial jurisdiction of the Tribunal passing the order in question.

(ix) The Assessing Officer and the Commissioner are bound by the order of the Tribunal (falling within the jurisdiction of the Tribunal unless the Department has not accepted the decision of the Tribunal.)

(13) Diversion of income by overriding title and application of income: The concept of 'diversion of income by overriding title' signifies diversion of income at source by an overriding title before it reaches an assessee. Such a diversion can take place either under a legal compulsion or under a contractual obligation or otherwise. An obligation to apply the income in a particular way before it has accrued or arisen to the assessee results in the diversion of the income. On the other hand, an obligation to apply income which has accrued or arisen or has been received amounts merely to the apportionment or application of the income and not to its diversion. Sometimes the dividing line between diversion by overriding title and the application of income after it has accrued is somewhat thin.

When income or a portion of income is diverted at the source by an overriding title before it started flowing into the channel which was to reach the assessee concerned it could be excluded from his assessable income. Wherever there is such diversion of income, such diverted income, cannot be included in the total income of the assessee who claims that there has been a diversion. On the other hand, where income has accrued or arisen in the hands of the assessee, its subsequent application in any way will not affect the tax liability.

In order to decide whether a particular disbursement amounts to diversion or application of income, the true test is to probe into and decide whether the amount sought to be deducted, in truth, did not reach the assessee as his own income. It is the nature of the obligation that is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of his income. It is the nature of the obligation that is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of his income. Where, by obligation, income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. In order that there is diversion at source of the income, the obligation is to attach to the source which yields income and not to the income only. This was so held in *CIT vs. Sital Doss Twath 41 ITR 367 (SC), M.K. Brothers Pvt. Ltd. vs. CIT 86 ITR 38 (SC)*. In many cases, it would really be a matter of proper drafting of the document creating the obligation, though, in substance, the result in both the situations may appear similar.

For the purpose of tax planning, the concept of 'diversion by overriding title' would have better scope for exploitation than the concept of 'application of income'. This is because, as pointed out above, where income is diverted by overriding title such diverted income is not taxed in the hands of the person who claims such diversion. On the other hand, the concept of application of income envisages first the accruing or arising of income and when once it has come within the grasp of the Income-tax Act, 1961 it is liable to income-tax whatever may be its destination or whomever it may be applied for. Therefore, if an overriding charge is created by the assessee either voluntarily or in pursuance of an obligation, whether pre-existing or not, the assessee may be able to invoke the principle of diversion of income by overriding charge. This is, of course, subject to the provisions of sections 60 to 64, which have the effect of getting over this principle in some situations.

14.2 TAX PLANNING CONSIDERATIONS IN RESPECT OF SALARY INCOME

The scope for tax planning from the angle of employees is limited. The definition of salary is very wide and includes not only monetary salary but also benefits and perquisites in kind. The only deductions available in respect of salary income are the deduction for entertainment allowance and deduction for professional tax. Therefore, the scope for tax planning in respect of salary income is severely limited. However, the following are some ideas of tax planning in regard to salary income.

(1) Salary Structure: The employer should not pay a consolidated amount as salary to the employee. If it is so paid, the entire amount of salary will become taxable without any exemption. Therefore, he can split the same and pay it as basic salary plus various allowances and perquisites.

For example, the employer should include allowances as part of the salary structure of the employees for which exemption can be claimed under Rule 2BB, eg. Children education allowance, hostel allowance, house rent allowance etc. The employer will get a deduction of all the above amounts paid in his assessment.

Further, the employer can give such allowances like special compensatory allowance, border area allowance or remote area allowance or difficult area allowance or disturbed area allowance depending upon the posting of the employee. Some exemptions are available in respect of these allowances. In this connection, Rule 2BB specifies the exempt allowances. The employer has to make a careful study and fix the salary structure in such a manner that it will include allowances which are exempt.

Standard deduction of ***₹ 50,000*** or the amount of gross salary, whichever is less, is allowed as deduction under section 16(ia).

(2) Employees' welfare schemes: There are several employees' welfare schemes such as recognised provident fund, approved superannuation fund, gratuity fund. Payments received from such funds by the employees are totally exempt or exempt upto significant amounts.

For example, gratuity received by an employee covered under the Payment of Gratuity Act, 1972 is exempt upto ₹ 20 lakh. The entire provident fund received by the employee from recognised provident fund is exempt. The employer is well advised to institute such welfare schemes for the benefit of the employees. Such amount contributed by the employer towards the above funds are deductible. However, a note of caution is necessary here in view of the restrictive provisions of section 40A(9) which disallows any contribution made to any welfare funds except where such contributions are covered by section 36(1)(iv)/(iva)/(v) or as required by or under any other law for the time being in force. In this connection, it may be noted that section 10(23AAA) exempts any income of a staff welfare fund subject to the satisfaction of certain conditions. However, in the absence of an amendment to section 40A(9), contribution to such welfare trusts can be disallowed by the Assessing Officer. Further, the employer can contribute to recognized provident fund account of the employee upto 12% of salary, and the same would not be taxable in the hands of the employees.

(3) Insurance policies: Any payment made by an employer on behalf of an employee to maintain a life policy will be treated as perquisite in the hands of the employee. Further, payments received from the employer in respect of keyman insurance policies constitute income in the hands of the employees. However, the payment of premium by the employer on behalf of the employee will not be treated as a perquisite in the case of accident insurance policies. This is due to the fact that the employer has a vested interest in the safety of the life of his employee who is engaged in such dangerous occupations. *[CIT v Lala Shri Dhar (1972) 84 ITR 192 (Del) and CIT v Vinay Bharat Ram (1981) 129 ITR 128 (Del)].* Further, any sum paid by the employer in respect of any mediclaim premium paid by the employee to keep in force an insurance on his health or the health of any member of his family under any scheme approved by the Central Government or IRDA for the purpose of section 80D is not a perquisite in the hands of the employee.

(4) **Dearness allowance, dearness pay:** The employer should ensure that dearness allowance and dearness pay should form part of "salary". This is because certain items like entertainment allowance, gratuity, commuted pension and the employer's contribution to the recognised provident fund etc. are calculated on the basis of salary. Therefore, if dearness allowance, dearness pay etc. are included in salary, the above benefits will also increase leading to higher exemption in the hands of the employee.

(5) **Commission:** The Supreme Court, in *Gestetner Duplicators Pvt. Ltd. v. CIT 117 ITR 1,* has held that if, under the terms of employment, commission is payable at a fixed percentage of turnover achieved by an employee such commission should be taken into account for calculating "salary" for the purpose of gratuity etc. The employer will be well advised to provide for such commission.

(6) **Leave travel facility :** The employer should extend leave travel facility to the employees at all levels. Under section 10(5) of the Income-tax Act, 1961, exemption is provided in the hands of the employee in respect of leave travel concession. Such exemption is available for the employee, spouse, children (to a maximum of 2 children), dependent parents, dependent brothers and dependent sisters.

(7) **Rent free accommodation / House Rent Allowance (HRA):** An employee should analyse the tax incidence of a perquisite and an allowance, whenever he is given an option, in order to choose the one which is more beneficial to him. In the case of Rent Free Accommodation vs. HRA, it must be noted that the perquisite of rent free accommodation is taxed as per Rule 3(1) of the Income-tax Rules, 1962 and HRA is exempt to the extent mentioned in section 10(13A) read with Rule 2A. The employee should therefore work out his tax liability and net cash flow under both the options and then, decide on whether to receive HRA or choose a rent free accommodation.

(8) **Uncommuted/Commuted pension:** Uncommuted pension is fully taxable. Therefore, the employees should get their pension commuted. Commuted pension is fully exempt from tax in the case of government employees and partly exempt from tax in the case of non-government employees.

(9) **Provident Fund:** Where an employee who is a member of a recognised provident fund and who resigns before completing five years of continuous service should ensure that he joins a firm which maintains a recognised provident fund. The accumulated balance of the provident fund with the previous employer will be exempt from tax provided the same is transferred to the new employer who also maintains a recognised provident fund.

(10) **Retirement benefits:** Incidence of tax on retirement benefits like gratuity, commuted pension, accumulated balance of unrecognized provident fund is lower if they are paid in the beginning of the financial year.

The employer and the employees should mutually plan their affairs in such a way that retirement takes place in the beginning of a financial year.

(11) Pension received by non-residents: Pension received in India by a non-resident assessee from abroad is taxable in India. If, however, such pension is first received by or on behalf of the employee in a foreign country and later on remitted to India, it will be exempt from tax.

(12) Accident insurance: In respect of accident insurance policies, the decision of the Supreme Court in *CIT v. L.W.Russel (1964) 53 ITR 91* points out that the term perquisite applied to only such sums in regard to which there was an obligation on the part of the employer to pay and a vested right on the part of the employee. If the employee has no vested interest in the policy, it cannot be considered as a perquisite. In view of this position, in cases where an employer takes out accident insurance policy covering all workmen and staff members and pays insurance premium and whenever any worker/staff member meets with an accident and the amount of claim is received from the insurance company and the same is paid away by the employer to the said worker or his family members, the premium paid by the employer in respect of group accident policies could not be considered as a perquisite, under section 17 to be added in the salary income of any employee [*CIT v. Lala Shri Dhar (1972) 84 ITR 192(Delhi)]*. The amount received from insurance company on accident or death by employee or his dependents will not also be in the nature of income but a capital receipt and therefore the same will not be taxable.

(13) Exempt perquisites: The following are the perquisites which are exempt from tax–

(i) Use of computers and laptop by employee;

(ii) Medical facility in employer's own hospital or a public hospital or Government or other approved hospital;

(iii) Educational benefit in a school run by employer provided value of benefit does not exceed ₹ 1,000 per month per child.

(14) Considerations for salary structuring: The perquisite valuation rules prescribe the method for valuing the various perquisites provided by the employer to his employees on the basis of the cost of such perquisites to the employee. For a detailed study, students are advised to refer to the chapter on 'Salaries'. Accordingly, the entire salary structuring for employees will have to be done after carefully weighing the pros and cons of paying cash salary or allowing the benefit of perquisites in kind to the employees.

14.3 TAX PLANNING CONSIDERATIONS IN RELATION TO BUSINESS

The scope of income liable to tax under the head "Profits and gains of business or profession" covered by Section 28 to 44D of the Income-tax Act, 1961 has been discussed earlier. The object of this part of the study material is to discuss from the angle of tax planning the various areas in which tax payer will have to take appropriate decisions to ensure that the incidence of tax in respect of his income chargeable under this head is reduced to the extent possible, by taking advantage of the various allowances, deductions and other tax concessions provided under the law.

For a new business, the spheres in which the question of tax planning is relevant are as follows:

(i) Form of the organisation

(ii) Nature of the business

(iii) Financial Structure

(iv) Acquisition of plant and machinery and other fixed assets

(v) Setting up and commencement of business

Each of these aspects will be considered briefly in the following paragraphs. In addition, there is lot of scope for planning with reference to the method of accounting to be employed and the various deductions and special incentives provided under the Income-tax Act, 1961. Certain special tax planning considerations relevant to specific management decisions, foreign collaboration agreements and other related matters are also discussed.

(1) Form of Business Organisation: The choice of the appropriate form of business organisation will have to be thought of and decided by the person who intends to carry on business or profession at the beginning itself, because a change in the form of business organisation after the commencement of the business, may attract liability to tax.

A new business can be organised under any of the following forms:

(i) Sole proprietorship

(ii) Hindu undivided family

(iii) Association of persons or Body of Individuals

(iv) Partnership firm/LLP

(v) Company

(vi) Co-operative society

The selection of a particular form of organisation would depend not only on the tax aspect but on other considerations also, e.g., financial requirements and resources, requirement of limited liability and many other practical considerations.

However, depending upon the taxable status and level of tax liability of the owners, a selection can be made from the various forms available for setting up a new unit.

♦ ***Sole Proprietorship:*** In the case of a sole proprietorship concern, one of the important tax disadvantages would be that no allowance or relief would be available to the tax payer in computing his income from business in respect of even a reasonable amount of remuneration attributable to the services rendered by him for carrying on the business. As a result, the taxable income arrived at would be a larger amount than what it would have been if it had been the case of, say, a firm paying remuneration to partners, such remuneration is allowable subject to the limits specified in section 40(b)(v). The taxable income from business would get reduced and correspondingly, the incidence of tax would also be reduced.

Under sole proprietorship, the entire income of a business unit gets assessed in the hands of the same person along with other income, while the entire loss and other allowances shall be available for set off in his hands against other income. This may have some advantage in the initial years, after which the possibility of converting it into company/firm may be considered; on such conversion, the questions of possible capital gains tax, etc., will have to be considered.

- ***Hindu Undivided Family:*** The Hindu undivided family as a unit of taxation continues to exist for the purpose of carrying on business as well and there is a large number of cases where business is carried on by the members of the family on behalf on the family. Since the law does not specifically provide for the disallowance of such expenses, it is advantageous to carry on a business through the HUF wherever possible. The income of the family is computed and first taxed in the hands of the family at the rates applicable to it. The income of the family may, thereafter, be divided amongst the members of the family and the members, in such cases, do not attract any liability to tax in view of the specific exemption granted under section 10(2) of the Income-tax Act, 1961. Thus, if a business is carried on by a Hindu undivided family, the advantages which are available in the case of a company could be fully availed of and in addition, the members of the family would not become liable to tax when they receive any portion of the family's income.

- ***Partnership Firm/LLP:*** All firms and LLPs will be taxed at a flat rate of **30%**. If the total income exceeds ₹ 1 crore, surcharge @ **12%** would be attracted. Further, health and education cess @**4%** would be applicable. There will be no initial exemption and the entire income will be taxed. In computing the taxable income of a firm, certain prescribed deductions in respect of interest and remuneration have to be allowed. The share income of a firm in the hands of the partners of the firm which is separately assessed as such is fully exempt under section 10(2A).

Note: An Individual, HUF or a partnership firm (but not an LLP), who is a resident carrying on eligible business can declare income on presumptive basis as per the provisions of section 44AD @ **8%** of gross receipts (**6%** in case gross receipts are received by an account payee cheque/bank draft/use of ECS through bank account/***through any other electronic mode as may be prescribed***).

An assessee, being a resident in India, carrying on notified profession can declare income on presumptive basis@ **50%** of gross receipts as per the provisions of section 44ADA. In such a case, they need not get their books of account audited as per section 44AB.

- ***Company:*** For any large venture requiring substantial investment and recourse to borrowed funds from banks and institutions, ordinarily the form of a limited company will have to be adopted. Within the company form of organisation, however, several alternatives exist. On the basis of the ownership and control, a company can either be organised as a widely held company, i.e. a company in which the public are substantially interested within the meaning of section 2(18) of the Income-tax Act, 1961. Alternatively, it can be organised as a closely held company. Depending upon the choice of the form of organisation of the company, the following important tax consequences would have to be considered from the view point of tax planning:

(i) The provisions of section 79 regarding restrictions on carry forward of losses in the event of substantial change in the shareholding of the company also become applicable if the company is one in which the public are not substantially interested. This aspect would assume particular significance in the case of closely held companies where losses are made and shareholdings are transferred before such losses are fully absorbed.

(ii) It is significant to note that domestic companies have to pay tax @ 17.472% (15% plus surcharge @ 12% plus cess @ 4%) on dividend declared, distributed or paid by applying grossing up. In case deemed dividend under section 2(22)(e), the rate of dividend distribution tax is 34.944% (i.e., tax @ 30% plus surcharge @ 12% plus cess @ 4% without grossing up).

For further details students may refer to Chapter 12 on "*Assessment of Various Entities*".

(iii) Also, MAT provisions are applicable to companies. It so happens that in case of companies enjoying tax holiday benefits still have to pay tax under MAT provisions, credit of which also cumulated for number of years without being used causing significant outflow of funds in the initial years.

Thus, it can be seen that the concept of deemed dividend under section 2(22)(e) and the provisions of section 79 do not apply to a widely held company.

Place of Effective Management (PoEM) framework is introduced to determine the tax payable by a foreign company that for all purposes is managed from India and yet does not pay tax domestically. Many Indian companies that have traditionally used holding companies and subsidiaries overseas for various reasons are assessing how they may be affected and are racing to put new structures in place before they come under scrutiny. These provisions provide for a foreign company to be a resident of India, if the company's place of effective management is in India. If a company's POEM is situated in India; it will be treated as Indian resident. Its global income will be taxable in India. It will have to file its tax returns, audit reports etc. with income tax department in India.

Rate of tax: The income-tax rate on foreign companies is higher at 40% *plus* surcharge @ *2%* (if total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore) and @ 5%, if the total income exceeds ₹ 10 crore as against 30% (plus surcharge @ 7%, if total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore and @ 12%, if total income exceeds ₹ 10 crore) on domestic companies. This is so because distributions by the former are generally not liable to tax in India.

Note *– The Taxation Laws (Amendment) Ordinance, 2019 was promulgated by the President of India on 20.9.2019 to amend the Income-tax Act, 1961 and the Finance (No.2) Act, 2019 and is in force*[1]*. This Ordinance has inserted two new sections, section 115BAA and 115BAB, in the Income-tax Act, 1961 to be applicable from A.Y.2020-21.*

Section 115BAA provides for concessional rate of tax@22% (plus surcharge@10% and HEC@4%) for domestic companies, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction (weighted or otherwise) for contribution to research and development, additional depreciation etc.

Section 115BAB provides for concessional rate of tax@15% (plus surcharge@10% plus HEC@4%) to new manufacturing domestic companies set up and registered on or after 1.10.2019, and commences manufacturing on or before 31.3.2023, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction (weighted or otherwise) for contribution to research and development, additional depreciation etc.

Domestic Companies have to exercise the option to be governed by these special provisions of the Act. The option for section 115BAB has to be exercised in the very first year in which the eligible company is set up, failing which it cannot exercise such option in the future years. However, a company eligible to exercise option u/s 115BAA can defer exercise of such option to a future year, if it is availing sizable profit-linked or investment-linked deductions or additional depreciation in the P.Y.2019-20. However, once the company exercises such option in any year, it would continue to be governed by the special provisions u/s 115BAA thereafter and cannot opt for regular provisions in any subsequent year.

It may be noted that companies exercising option under section 115BAA or section 115BAB are not liable to minimum alternate tax under section 115JB.

These two sections, namely sections 115BAA and 115BAB have been detailed in Annexure. These sections would come into effect from A.Y.2020-21 after passing of the Taxation Laws (Amendment) Ordinance, 2019 by the Parliament.

Also, certain tax incentives available to domestic companies are not available to foreign companies like amortisation of preliminary expenses. It is advantageous, from tax angle, for

[1] At the time of publication of the Study Material

foreign corporations intending to do business in India to do so through a subsidiary instead of directly through a branch.

- ***Co-operatives:*** The co-operative form of business organisation, i.e., a co-operative society would also be advantageous from the tax angle and, in addition to the general benefits flowing from the co-operative form the society, can claim deduction in respect of the reasonable amount of remuneration payable to the members of the society for their services rendered, including the amount of commission, if any, payable to them and the interest on the deposits or loans given by them. The co-operative society is entitled to a further tax benefit arising from section 80P under which the income of a co-operative society is exempted from tax under different circumstances depending upon the nature of the income and/or the amount thereof. In addition to the various tax concessions which are available to all assessees, the co-operative society stands to gain substantially by virtue of the special benefits available to it under section 80P. The profits of the society remaining after payment of tax would be distributed by it amongst its members in the form of dividends subject to the relevant legislation.

However, it may be noted that benefit under section 80P has been withdrawn w.e.f. A.Y.2007-08 in respect of all co-operative banks, other than primary agricultural credit societies (i.e. as defined in Part V of the Banking Regulation Act, 1949) and primary co-operative agricultural and rural development banks (i.e. societies having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities). This is for the purpose of treating co-operative banks at par with other commercial banks, which do not enjoy similar tax benefits.

From the above analysis of various forms of the organisation and their treatment for income-tax purposes, it may be appreciated that the provisions of the taxation laws have a considerable influence on the entrepreneurs in their choice of particular form of the organisation that they should establish.

For a detailed discussion students are advised to refer to **Chapter 12** on **“*Assessment of Various Entities*”**.

ILLUSTRATION 1

Mr. Gavaskar sought voluntary retirement from a Government of India Undertaking and received compensation of ₹ 40 lacs on 31st January, 2019. He is planning to use the money as capital for a business dealership in electronic goods. The manufacturer of the product requires a security deposit of ₹ 15 lacs, which would carry interest at 8% p.a. Gavaskar’s wife is a graduate and has worked as marketing manager in a multinational company for 15 years. She now looks for a change in employment. She is willing to join her husband in running the business. She expects an annual income of ₹ 5 lacs. Mr. Gavaskar would like to draw a monthly remuneration of ₹ 40,000 and also interest @ 10% p.a. on his capital in the business. Mr. Gavaskar has approached you for a tax efficient structure of the business.

Discuss the various issues, which are required to be considered for formulating your advice. Computation of income or tax liability is not required.

SOLUTION

The selection of the form of organisation to carry on any business activity is essential in view of the differential tax rates prescribed under the Income-tax Act, 1961 and specific concessions and deductions available under the Act in respect of different entities. For the purpose of formulating advice as to the tax efficient structure of the business, it is necessary for the tax consultant to consider the following issues:

(i) In the case of sole proprietary concern, interest on capital and remuneration paid to the proprietor is not allowable as deduction under section 37(1) as the expenditure is of personal nature. On the other hand, in the case of partnership firm, both interest on capital and remuneration payable to partners are allowable under section 37(1) subject to the conditions and limits laid down in section 40(b). The partnership should be evidenced by an instrument and the individual share of partners should be specified in the instrument. Remuneration and interest should however, be authorised by the instrument of partnership and paid in accordance with such instrument. Such interest and salary shall be taxable in the hands of partners to the extent the same is allowed as deduction in the hands of the firm under section 40(b). Interest to partners can be allowed up to 12% on simple interest basis, while the limit for allowability for partners' remuneration is based on book profit under section 40(b). As per section 40(b)(v), partners' remuneration shall be allowed to the extent of aggregate of -

(a) On the first ₹ 3,00,000 of book profit or in case of loss – ₹ 1,50,000 or at the rate of 90% of book profits, whichever is more

(b) On the balance of book profit – at the rate of 60%

Note – *However, if the firm is eligible to opt for presumptive taxation under section 44AD, 8% of gross receipts or 6% of gross receipts, as the case may be, would be deemed as its income. All deductions under section 30 to 37 are deemed to be allowed. No deduction is allowable, including deduction for partner's remuneration and interest on capital.*

(ii) Partner's share in the profits of firm is not taxed in the hands of the partners by virtue of section 10(2A).

(iii) If a proprietary concern is formed, the salary of Mrs. Gavaskar shall be allowed as deduction under section 37(1).

(iv) The possibility of invoking section 40A(2) cannot be ruled out as salary is payable to a relative, who is an interested person within the meaning of section 40A(2). However, it can be argued successfully that salary of ₹ 5 lacs is justified in view of her long experience as marketing manager of a multinational company and the fair market value of services to be rendered by her to the concern.

(v) An issue arises as to whether remuneration of Mrs. Gavaskar would be includible in the total income of Mr. Gavaskar. Under section 64(1)(ii), remuneration of the spouse of an individual working in a concern in which the individual is having a substantial interest shall be included in the total income of the individual. However, the clubbing provision does not apply if the spouse possesses technical or professional qualification and the income is solely attributable to the application of his or her technical or professional knowledge and experience. Further, technical or professional qualification would not necessarily mean the qualifications obtained by degree or diploma of any recognized body [*Batta Kalyani vs. CIT (1985) 154 ITR 0059 (AP)*]. The experience of Mrs. Gavaskar as a marketing manager in a multinational company for 15 years may reasonably be considered as a professional qualification for this purpose.

(vi) If Mrs. Gavaskar joins the proprietary concern or partnership concern of her husband as employee, remuneration of ₹ 5 lacs shall be taxed in her hands under the head "salary".

(vii) If she joins as partner in the business, remuneration shall be taxed in her hand as business income under section 28 to the extent such remuneration is allowed in the hands of the firm under section 40(b).

(viii) The tax rate applicable to an individual depends on the level of his/her income, whereas for partnership firms it is flat rate at 30%. Surcharge @ 12% would be attracted only if total income exceeds ₹ 1 crore. For individuals, the rate of tax is 5% on income exceeding ₹ 2.50 lakhs but not exceeding ₹ 5 lakhs; 20% for total income exceeding ₹ 5 lakhs but not exceeding ₹ 10 lakhs and @ 30% in respect of income exceeding ₹ 10 lakhs for the assessment year 2020-21. The surcharge for total income exceeding ₹ 50 lakhs but not exceeding ₹ 1 crore is 10% of tax payable; for total income exceeding ₹ 1 crore but not exceeding ₹ 2 crore is 15% of tax payable; for total income exceeding ₹ 2 crore but not exceeding ₹ 5 crore is 25% of tax payable and for total income exceeding ₹ 5 crore is 37% of tax payable . Health and Education cess @ 4% on income-tax plus surcharge, if applicable, is attracted in all the cases.

(2) Nature of the business: Besides the form of organisation, the choice of the nature of the business also calls for appropriate planning with reference to the various special benefits available under the taxation laws to the particular kinds of industries which are not available to other kinds. Some of these benefits are of such a substantial nature that they constitute one of the major factors in the determination of the nature of the business.

Broadly, business for this purpose may be divided into two categories - trading and manufacturing business. There could be a third category involving combination of both. Deduction is available under section 10AA to newly established units in Special Economic Zones.

A taxpayer carrying on manufacturing or industrial activities would be in a position to avail of the various concessions such as depreciation allowance, benefit of amortisation under sections 32, 35ABA, 35ABB, 35D and 35E.

Tax holiday benefit under section 80-IAC would be available in case of eligible start-up, under section 80-IBA in case of developing and building housing projects and under section 80LA in case of offshore banking unit and IFSC located in Special Economic Zone.

While deciding the nature of the business, the benefit of tax exemption or concessional treatment available in respect of certain types of income such as agricultural income, new industrial undertakings, ships, business of repairs to ocean going vessels, business of exploration, etc. of mineral oils, etc. should also be taken into account.

(3) Sources of Funds or Financial Structure: Broadly speaking, the choice in the matter of financing a new unit or business would be between capital and borrowings. New units being set up by existing units or companies would have the possibility of using retained profits. In the case of a company, the means of finance are as follows:

(i) Share capital.

(ii) Debentures.

(iii) Other borrowed moneys.

(iv) Generation of funds through profits.

While the return on share capital is a charge on the profits after tax, the return on loans to the lenders is a charge on the profits before tax. Thus, recourse to borrowings would offer a tax advantage which will be reflected in a higher rate of return on the owner's capital.

(4) Acquisition of 'Fixed Assets': Apart from other considerations relevant in the context, the consequences may require a careful choice between buying or leasing some or more of the fixed assets. Assets can be bought or hired. If these are bought and are depreciable, e.g. building, plant and machinery and furniture, the assessee can claim depreciation on the cost and over the years. The entire cost can be claimed as deduction against the profit. If hired, however, the charge for hire becomes an admissible deduction. Having regard to the fact that the acquisition of an asset requires a larger immediate outlay than what is necessary in the case of hiring, the company may opt for hiring in some cases rather than for straight acquisition. For example, taking the business premises on rent rather than purchasing the same may be a better proposition.

But in the case of plant and machinery, two additional considerations may arise. New plant and machinery in certain industries may enable a company to claim deduction on account of depreciation and additional depreciation which may outweigh other considerations. Similarly, if there can be a new industrial undertaking, substantial tax benefits may be available by way of tax holiday benefit, etc. but that would require employment of new plant and machinery to a large extent. These considerations are out and out tax considerations which may prompt an assessee to make two choices—(i) not to hire plant and machinery but to purchase them and (ii) not to purchase second hand plant and machinery but to purchase them new.

In appropriate cases, the assessee may go in for second hand imported plant and machinery, satisfying the conditions laid down. In cases where an assessee opts to go for old plant and machinery, the limit regarding the use of old plant and machinery, as laid down in Section 80-IAC should be taken into consideration. Difficulties may arise in applying the 20% limit for the value of old plant or machinery for the purpose of section 80-IA etc. since the concept of value to be adopted for this purpose has not been spelt out in the law and it is not clear whether such value should refer to the cost or market value or the written down value as per books or as per income-tax records. Particular care will have to be taken while planning for such a situation.

The assessee engaged in the specified business mentioned in section 35AD can avail the benefit of deduction of capital expenditure incurred wholly and exclusively of the purpose of such specified business. Capital expenditure incurred prior to commencement of business shall be allowed as deduction during the previous year in which the assessee commences operation of the specified business if, such expenditure incurred is capitalized in the books of accounts of the assessee on the date of commencement of its operation. However, such deduction is not available in respect of capital expenditure incurred on acquisition of any land, goodwill or financial instrument. In case the deduction under this section is claimed, no deduction shall be allowed under Chapter VI-A under "Deduction in respect of certain incomes" in relation to the specified business for the same or any other assessment year.

(5) Setting up and commencement of production: Setting up of business in the context of the Income-tax Act, 1961 is a concept entirely confined to that Act. It is not the same as the commencement of the business and these two concepts have been clearly distinguished for income-tax purpose. Between the date of the setting up and date of commencement, there may be an interregnum during which the assessee may be incurring expenses of a revenue nature.

Under the taxation laws, the expenditure incurred prior to the date of setting up is not normally admissible for income-tax purposes. But if those are incurred on and from the date of setting up, but before commencement of the business, they may be allowed as deduction for tax purposes provided of course they are revenue in nature and are incurred wholly and exclusively for the purposes of business.

It is now practically well settled by various judicial rulings that a business is set up as soon as it is ready to commence production and it is not necessary that actual production should be so commenced. Thus, in the case of a company established for manufacturing cement, the business is set up as soon as acquiring of limestone is commenced even if at that time the plant and machinery may not have been installed so that actual manufacturing operations may commence.

A tax planner should accordingly fix the setting up date in such a manner that the company gets the maximum scope for allowability of expenses incurred contemporaneously to the date of setting up remembering that if those are incurred prior to the setting up date those are inadmissible as direct deductions while, if such expenses are of a revenue nature and they are wholly and exclusively incurred for business purpose, and are incurred subsequent to the date of setting up, they will be admissible as normal deductions. The following examples may be noted:

(a) Such expenditure may be allowed as revenue expenditure. Expenditure by way of brokerage, legal charges, etc. for arranging long term loans, interest on borrowing— *India Cement Ltd. vs. CIT 60 ITR 52 (SC).*

(b) Such expenditure may form part of the cost of assets on which depreciation may be available - *Challapalli Sugars Ltd. vs. CIT 98 ITR 167 (SC).*

In this context, the provisions of *Explanation 8* to Section 43(1) to the effect that any interest paid or payable in connection with the acquisition of an asset, which is relatable to any period after such asset is first put to use cannot be capitalised, are relevant.

(c) Such expenditure may constitute preliminary expenditure and may be eligible for amortisation over a five year period under section 35D.

(d) Such expenditure, if being of a capital nature and if not falling under any of the three categories noted above may be disallowed and there may not be relief either on account of depreciation or amortisation.

(6) Tax planning for business deductions — Some general considerations: There are several matters which affect the assessee's ability to deduct various expenses for income-tax purposes. Some of the principal considerations to be borne in mind planning for business deductions, are given below:

Successful tax planning for business deductions pre-supposes a clear and thorough understanding of the various statutory provisions governing the deductions and an awareness of the statutory rights as well as various restrictions and conditions governing such rights. The general considerations applicable to tax planning in the field of business deductions, revolve round their-

(a) allowability.

(b) year of allowability.

(c) extent of allowability (disallowing provisions if any), and

(d) carry-forward to future years.

Often, the question of expenditure being capital or revenue and the consequences attaching to the likely treatment eventually may also be an important part of the tax planning exercise. This aspect has been discussed at a later stage.

One of the important aspects of tax planning would be to see that the maximum deduction or allowance is obtained in the earliest possible time for the purpose of determination of taxable income. Therefore, while deciding about incurring of capital and revenue expenditure, the assessee should consider the tax treatment of such expenditures and the period within which the benefit of deduction or amortisation would be obtained so that he can estimate and work out cash flow position over a period of time. While tax considerations play a major role in investment decisions, the general principles of financial management and their effect on investment decisions should not be ignored.

The tax planner should keep in mind the advantage arising out of minimising the expenditure, especially in the initial years of a business, so that the profits may be maximised and the assessee may be in a position to avail of the various tax incentives like depreciation as also the tax holiday provisions.

Normally, deductions of expenditure is allowable in the year in which it is incurred or paid depending on the method of accounting followed, viz, mercantile or cash. In other words, the expenditure to be claimed as deduction should be claimed in the relevant year. Where the assessee follows the cash system of accounting, the allowance in respect of expenses would be available only when the moneys in respect of them are actually paid by the assessee. Whereas in the case of mercantile system of accounting, if a business liability has definitely arisen in the accounting year, a deduction should be allowed. Where accounts are kept on a mercantile basis, if an expenditure is claimed on the ground that it is legally deductible, it can be claimed in the year in which the liability for the expenditure is incurred even though the payment itself is made in a subsequent year. If an assessee following mercantile system fails to claim an expense in the year in which it accrues he loses the right to claim it as a deduction altogether. He cannot claim or make any attempt to reopen the accounts of the earlier year to which the expense relates.

The Supreme Court's decision in *C.I.T. vs. Gemini Cashew Sales Corporation (1967) 65 ITR 643* emphasizes the principle that if the liability to make the payment has arisen during the previous year, it must be appropriately regarded as the expenditure of that year and merely because the payment in respect of the expenditure is made in the subsequent year, the assessee would not be entitled to claim deduction in respect thereof in the subsequent year. As pointed out earlier, this is subject to the provisions of section 43B.

Normally, deduction can be claimed by the assessee only in respect of those expenses and losses which have been actually incurred by the assessee during the previous year, i.e. after the business is set up. However, there are some exceptions to this rule and a tax planner should be aware of the exceptions and make use of them in appropriate cases. For example, expenditure incurred on scientific research before the commencement of the business — capital or revenue during the three years immediately preceding the commencement of the business and coming within the scope of the *Explanation* to sections 35(1)(i) and 35(1)(ii), capital expenditure incurred prior to commencement of specified business allowed as deduction in the year of commencement of business, in case capitalized under section 35AD, preliminary expenses incurred before commencement of the business and coming within the scope of section 35D, expenditure on prospecting for minerals coming within the scope of section 35E, are cases where the assessee could claim deduction in respect of the expenditure even though the expenditure was not incurred during the previous year.

Similarly, the expenditure in respect of which deduction is claimed by the assessee should not be in the nature of capital expenditure. This is again subject to the statutory exceptions contained in provisions like section 35 and 35AD. Again, subject to the statutory exceptions, the expenditure should be incurred wholly and exclusively for the purpose of the business.

Various other expenses incurred prior to the commencement of commercial operations may, in appropriate cases, be accumulated and capitalised by being spread over the cost of various assets constructed or acquired during the pre-production period. If this is done on a proper basis, the cost of the various assets including the indirect expenses capitalised can be depreciated for tax purposes to the extent that the cost relates to assets which are themselves depreciable for income-tax purposes. This is a matter which the tax planner should bear in mind in order to ensure that expenses incurred during the construction period are properly accounted and allocated.

Interest on borrowed capital

Under clause (iii) of section 36(1), deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession". As per the proviso to section 36(1)(iii), any amount of interest paid, in respect of capital borrowed for acquisition of an asset for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.

ICDS IX on Borrowing Costs deals with the treatment of borrowing costs. It requires borrowing costs which are directly attributable to the acquisition, construction or production of a qualifying asset to be capitalized as part of the cost of that asset.

Qualifying asset has been defined to mean –

- land, building, machinery, plant or furniture, being tangible assets;
- know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;
- inventories that require a period of twelve months or more to bring them to a saleable condition.

This ICDS requires capitalization of specific borrowing costs (in respect of funds borrowed specifically for the purpose of acquisition, construction or production of a qualifying asset) and general borrowing costs. In case of qualifying assets being tangible and intangible assets, the capitalization shall commence from the date on which funds were borrowed and cease when such asset is first put to use.

This ICDS also provides the formula for capitalization of borrowing costs when funds are borrowed generally and used for the purpose of acquisition, construction or production of a qualifying asset. For this restricted purpose, a qualifying asset shall be such asset that necessarily require a period of 12 months or more for its acquisition, construction or production. In this case, the capitalization of borrowing costs shall commence from the date on which funds were utilized.

Thin Capitalisation Rules

Equity and debt are the two ways through which a company can source its funding. 'Thin capitalisation' refers to a situation where a company is financed through a substantially higher amount of debt than equity. The capital structure of a company has consequential effects on the amount of profit it reports for tax purposes. The Act allows a deduction on interest paid or payable for arriving at taxable profit while dividend paid on equity is not deductible. Therefore, a higher level of debt entails lower levels of taxable profit, thereby providing an incentive to finance operations with debt rather than equity. Companies structure their mix of finance in such a way that they maximise the benefit of claims of deduction of interest. The Finance Act, 2017 has sought to restrict interest expenses claimed by an Indian company or a permanent establishment of a foreign company on payments to its non-resident associated enterprises (or a permanent establishment thereof) to 30% of earnings before interest, taxes, depreciation and amortization. With a view to targeting only large interest payments, this provision would be applicable only in cases where the interest expense exceeds ₹ 1 crore. Banks and insurance companies have been exempted from these provisions.

Specific deductions under the Income-tax Act, 1961

The Income-tax Act, 1961 lists several specific deductions. A deduction falling under each category is allowable subject to the conditions and limitations, if any which may be specified. At times the restrictive conditions apply to expenditure which is prima facie suspect as, for example, transactions with relatives or associates or within the same group coming within the scope of section 40A(2). While planning for business deductions, due regard must be had to these limitations.

In addition to the specific provisions the omnibus provision in section 37 also enables an assessee to claim deduction in respect of expenditure laid out 'wholly and exclusively for the purpose of the business' the tax planner has to take into consideration the principles emerging from the innumerable relevant judicial rulings while availing of the facility of deduction under this provision. Any expenditure incidental to business, may be deducted except those prohibited by any provision of the Act.

Ordinarily, an expenditure which is specifically provided for should be claimed under the relevant section rather under the omnibus provision. To justify the deduction under the residual clause, all that is required is that the expenditure must have been incurred wholly and exclusively and it is not necessary to prove that the expenditure was also incurred 'necessarily' or 'reasonably". The expenditure must have been incurred 'for the purpose of business'. These words are wider than the phrase "for the purpose of earning profits". A specific quid *pro quo* is not essential. It is not necessary to show that the expenditure resulted in commensurate benefit or advantage either during the same year or subsequently.

An expenditure is liable to be disallowed if it is either of a personal nature or of a capital nature. The question whether a particular expenditure is of a personal nature must be judged by reference to the assessee himself and not any other person.

- ***Capital or Revenue**:* Generally speaking, an expenditure is regarded as being of a capital nature, if it results in the acquisition of an asset or of an advantage or benefit of an enduring nature.

The test with regard to the nature of the expenditure-capital or revenue - is to be applied with reference to its purpose rather than its effect. The test must be applied by reference to the assessee himself and not any other person. For instance, a company must be obliged to construct pipelines for the purpose of its business but under conditions whereby the pipelines ultimately become the property of a municipal corporation rather than the company itself. In such a case, although the pipelines undoubtedly constitute tangible assets the expenditure may not be regarded as of a capital nature, since the assets do not belong to the company but to some other person. There are many judicial rulings to support this view. A leading case that maybe referred to in this context is *Lakshmiji Sugar Mills Co. P. Ltd. vs. CIT (1971) 82 ITR 376 (SC)].*

If the purpose of the expenditure is to secure a commercial advantage, rather than acquisition of a capital asset, it is likely to be allowed as revenue expenditure even though the advantage may endure for an indefinite period. However, this rule is by no means inflexible or capable of universal application. Conversely, if the purpose of the expenditure is the acquisition of an advantage or benefit of an enduring nature the expenditure is liable to be treated as capital expenditure even if the period or durability of the asset acquired as the result of the expenditure is very short. For example, if a company making shoes acquires knives and lasts, whose life is only three years, the expenditure may nevertheless be regarded as capital expenditure.

In applying the various case laws on the subject of distinction between capital and revenue, it should be recognised that circumstances do change and the law normally keeps pace with such changing circumstances. The expenditure that was regarded as capital expenditure resulting in long-term benefit during the relatively *laissez faire* days of the 19th century may not perhaps, be regarded as capital expenditure in the context of the rapid technological changes which are the feature of industrial life today. The decision of the Supreme Court in *Shahzada Nund & Sons vs. CIT 108 ITR 358* also supports this view. A tax planner would do well to keep track of the various cases reported from time to time so as to keep himself informed of the trend of judicial thinking in this regard.

In this context, the requirements spelt out in the various income computation and disclosure standards have also to be kept in mind while considering the point in time of deductibility of expenditure.

♦ ***Expenditure specifically allowed:*** The Income-tax Act, 1961 specifically allows many types of expenditure such as depreciation, expenditure on scientific research, expenditure on know-how, preliminary expenses, bad debts etc. The Act prescribes several conditions and restrictions for the allowance of such expenditure. The tax-planner should take care to see that all the prescribed conditions are complied with so that deductions may not be denied.

Note - *A company opting for the special provisions under section 115BAA or 115BAB would, however, not be eligible to claim deduction on account of, inter alia, additional depreciation and expenditure on scientific research. See Annexure at the end of Chapter 12.*

- ***Other business expenses**:* As already explained earlier, section 37(1) deals with the various items of expenses which are otherwise not covered by the provisions of Section 30 to 36 of the Income-tax Act, 1961 and specifically provides that all expenses which are incurred wholly and exclusively (though not necessarily) for the purpose of the business or profession carried on by the assessee would be deductible in computing the assessee's business income. In order to qualify for deduction under this provision, the following important conditions will have to be fulfilled:

  (i) The expenditure should have been incurred by the assessee in the ordinary course of his business or profession;

  (ii) The expenditure should be of a revenue nature and should not be of capital nature;

  (iii) The expenditure should not be of a personal nature;

  (iv) The expenditure should not be covered by any other provisions of sections 30 to 36 for purposes of allowance and it should not also be covered by any of the provisions of disallowance contained in sections 40 to 44D; and

  (v) The expenditure should not be one which is in the nature of an appropriation of income or diversion of profits by an overriding title. It should not also be one in respect of which deduction is permissible under Chapter VI-A of the Income-tax Act, 1961 from the gross total income of the assessee.

- ***Commercial expediency**:* The concept of 'commercial expediency' helps a tax payer in insisting that a reasonable view is taken of his right to deduct normal expenditure. The trend in judicial thinking has also recognised this concept. This concept reflects the fact that it is virtually impossible for the legislation to list all possible deductions to which an assessee would be entitled in computing his taxable income and therefore the fact that a business has to be run by the assessee himself under normal commercial conditions must be recognised in determining the allowability of certain expenditure. The test of commercial expendiency should be applied from the point of view of a normal prudent businessman, by reference to modern concepts of business responsibility and not by reference to the subjective standards of the revenue department.

  A claim on the ground of commercial expediency is subject to the under-noted conditions and limitations:

  (a) If the expenditure is covered by one of the express provisions in the Act, it must conform to the requirements stipulated therein.

  (b) An expenditure which is expressly disallowed under the Act cannot be claimed on grounds of commercial expediency.

  (c) An expenditure cannot be claimed on grounds of commercial expediency if it is improper or illegal. It may be commercially expedient to pay a bribe or incur a penalty but this does not mean that the bribe or penalty would be normally deductible for tax purposes.

There is also a distinction between a payment made for a violation or breach of law and payment made for a breach of contract. Courts have taken the view that where the payments are not in the nature of penalties for infraction of any law but made in pursuance of the exercise of an option given in a particular scheme and where the assessee opts for it out of commercial expediency and business consideration, it could be allowed as deduction.

(7) **Tax consideration governing Management/Investment decision:** Though management/ investment decisions are not based on the tax factor alone, yet it has become imperative to consider tax factors before adopting any course of action because the effect of this factor is not only significant but it may also differ from one alternative to another. To illustrate this point, tax implications that are relevant while taking some specific management decisions are explained below:

- ***Make or buy decision:*** In making 'make or buy' decisions, the variable cost of making the product or part/component of product is compared with its purchase price in the market. The article is brought if the former is greater than the latter. Alternatively, if the decision to make involves establishment of a separate industrial unit for this purpose, a decision may be taken on the basis of total cost rather than variable cost. In such an event, the assessee would also be in a position to get the tax benefits arising from allowances such as depreciation, tax holiday benefit and deduction in respect of profits from new industrial undertakings, wherever they are applicable.

  There are many other costing and non-costing considerations which are kept in mind at the time of taking the decision, like capacity utilisation, supply position of the article to be bought, terms of purchase, etc. The basis of taking make or buy decision should be 'saving after tax'. The net saving can be ascertained after deducting from gross savings, income-tax payable on the amount of saving. The long-term advantages arising out of a decision to make should also be given due weightage in arriving at a decision.

  At the time of ascertaining variable cost of the product (for taking make or buy decision) all taxes such as GST, customs duty etc., payable in the process of manufacture should be taken into account and in determining purchase price of the product. All taxes to be borne by the purchaser should be added for the purpose of comparison and cost of purchasing.

- ***Own or lease:*** Another important area of decision making is whether to own or lease (or sale and lease back). There are advantages as well as disadvantages in leasing. Leasing avoids ownership and with it, the accompanying risks of obsolescence and terminal value losses. In leasing, immediate payment of capital costs is avoided but fixed rental obligation arises. There are many factors which are required to be considered before making 'own or lease' decision such as cost of asset to be owned, rent of the asset to be taken on lease, source of financing the asset, risk involved in the alternatives, impact of tax concessions such as depreciation, tax holiday benefit, etc.

Leasing can also provide important tax advantages. If the asset is taken on lease, the firm can deduct for income-tax purposes, the entire rental payment. If the rate of tax is 30%, then, the effective rent obligation is reduced to that extent. Another tax advantage of the lease is that the life of the lease can be shortened compared to the depreciable life otherwise allowed if the assessee purchased the asset. Thus, there is a delay in paying taxes and in effect an interest free loan by the Government to the extent of the delay in taxes. There is one more tax advantage arising out of lease which arises from the opportunity to depreciate otherwise non-depreciable assets. The principal asset of this type is land. The lease rental covers the cost of the land which thus becomes deductible. This arrangement may prove particularly attractive where the land value constitutes a high percentage of the total value of the real estate or where the building is already fully depreciated. Leasing is becoming popular in India.

Wherever possible or appropriate, the concept of sale and lease back can also be made use of as a tool for tax planning with its attendant advantages.

♦ ***Lease rent paid:*** As regards the consideration for the lease, there could be two types of receipts in the hands of the lessor-receipt on capital account termed 'premium' or 'salami' in respect of the transfer of rights and receipts on revenue account termed 'rent' for the right or liberty to use the property for a term of years.

The lease rental paid is chargeable to revenue every year. The lease rental may be split into three components—the recovery of principal, cost, the interest chargeable and an element of profit. It is generally believed that the interest rate in-built into the rent would be more than the going market interest rate for term loans for purchase of equipment. Since the entire lease rental is chargeable to revenue the lessee could claim tax benefits on even the principal investment in the equipment. Tax advantage in such cases is reported to be more in a leasing transaction than in a similar loaning transaction.

♦ ***Retain or Replace Decision****:* One of the important decisions which involves alternative choice is whether or not to buy new capital equipment. Both have their own merits and demerits. Generally, replacement offers cost saving which results in increase in profit. However, replacement requires investment of large funds resulting in extra cost. The decision is based on the relative profitability and other financial and non-financial considerations. Tax considerations should also be taken into account in this context. Some of the important considerations from the tax angle to which attention will have to be paid relate to the allowance of depreciation, as also the allowance on account of expenditure on scientific research. The applicability of the provisions for allowances should be considered and their impact ascertained before any decision is taken.

(8) Tax Planning with reference to Foreign Collaborations: Very often, Indian concerns enter into foreign collaboration agreements. The tax implications of these agreements both on the foreign party and on the Indian concern are required to be known in advance. The foreign collaborator wants to make sure about his tax liabilities in India and unless assured of involvement with a not too high amount of tax, the foreign party is not very eager to conclude an agreement with an Indian party. In such a case, the foreign collaborator can seek advance ruling under the provisions of Chapter XIX-B of the Income-tax Act, 1961, for determination of tax implication of the transaction to be undertaken by the non-resident applicant. The Indian party must examine all the tax angles and devise a method which will saddle the foreign collaborator with the minimum amount of tax in India. The aim should be to arrange the affairs in such a way within the four corners of the law so as to attract the minimum amount of tax.

♦ ***Double Taxation Avoidance Agreements****:* For the determination of the taxability of foreign collaborators, the provisions of section 90 are very relevant. This provision empowers the Central Government to enter into double taxation avoidance agreement with foreign countries. In exercise of this power, the Government has entered into such agreements with a number of foreign countries.

Where there is an agreement between the Government of India and the Government of a foreign country, the tax liability of the foreign participant is determined in accordance with and subject to the provisions of the agreement and the Income-tax Act, 1961, to that extent, stands superseded by such agreement. In fact, *Circular No. 333 dated 2.4.1982*, issued by the CBDT clarifies that where a double taxation avoidance agreement provides for a particular mode of computation of income the same should be followed irrespective of the provision of the Income-tax Act, 1961. Where there is no specific provision in the agreement, it is the basic law, i.e., the Income-tax Act, 1961 which will govern the taxation of income.

Generally, the foreign party happens to be a non-resident for tax purposes. The status in which the chargeability to tax usually arises in the hands of the foreign party is either that of a company, or of an association of persons or of an individual. Body corporates incorporated outside India are treated as 'companies' for the purposes of section 2(17)(ii).

***Note** - The Multi-lateral Instrument (MLI) helps fight against base erosion and profit shifting (BEPS) by implementing tax treaty-related measures developed through the BEPS Project in existing bilateral treaties in a synchronized and efficient manner to –*

- prevent treaty abuse,

- improve dispute resolution

- prevent the artificial avoidance of PE status

- neutralize the effects of hybrid mismatch arrangements.

*The MLI is flexible instrument which modifies tax treaties that are "**Covered Tax Agreements**". A Covered Tax Agreement is an agreement for the avoidance of double taxation that is in force between Parties to the MLI and for which both Parties have made a notification that they wish to modify the agreement using the MLI.*

The Multilateral Convention to implement tax treaty related measures to prevent Base Erosion and Profit Shifting (BEPS) was signed by India at Paris, France on 7th June, 2017. India had ratified the said Convention and had deposited the instrument of ratification along-with the list of Covered Tax Agreements, reservations and notifications (India's Position under the said Convention) to the Depositary on 25th June, 2019. The date of entry into force of the *said Convention for India is 1st October, 2019, being the first day of the month following the expiry of a period of three calendar months beginning on 25th June, 2019, being the date of deposit by India of the instrument of ratification. The earliest date when the provisions of this Convention can take effect in India is 1st April, 2020 (six months from 1st October, 2019, the date of entry into force for India). Since the provisions of this Convention takes effect only from F.Y.2020-21, the same have not been discussed in detail in this Study Material.*

- ***Advance Rulings:*** In appropriate cases, the facility of getting Advance Rulings, envisaged by section 245N-245V could also be availed of.

- ***Double taxation relief:*** Taxpayers deriving income chargeable to tax both in India and in a foreign country by virtue of their business being carried on in more countries than one or otherwise, should avail of the benefit of double taxation relief granted under sections 90, 90A and 91 of the Income-tax Act, 1961 subject to GAAR provisions in Chapter X-A of the Act. In order to get the benefit of relief, before starting to carry on business operations in a foreign country, the assessee should be certain whether India has entered into a double taxation avoidance agreement with the foreign country and, if so, the extent to which and the manner in which the relief has to be availed of. Taxpayers should prefer to derive income from those countries with which India has entered into agreement for granting relief from double taxation as compared to those countries with which no such agreement exists. Even in cases where the income is derived from a country with which India has not entered into double taxation avoidance agreement, the assessee should claim the unilateral relief available under section 91 by proving that he has paid tax in that country on the income which accrued or arose there during the previous year. In such a case, he would be entitled to a deduction from the Indian-tax-payable by him, of a sum calculated on such doubly taxed income at the Indian rate of tax or at the rate of tax of the concerned country, whichever is the lower, or at the Indian rate of tax, if both the rates are equal. The claiming of this statutory relief would help to reduce the total incidence of tax on such doubly taxed income. However the arrangement's main purpose should not be to obtain a tax benefit, thus, not void of commercial substance and should not result in abuse/misuse of the provisions of the Act.

  Another aspect which will require consideration is the effect of double taxation avoidance agreements wherever they exist. To the extent specific provisions exist in such agreements, the corresponding provisions in the national law will not have application. Therefore, in understanding the tax liability in respect of technical tie-ups with foreign parties, attention will have to be paid to the relevant provisions of the double taxation avoidance agreements vis-à-vis the provisions of the Income-tax Act, 1961.

(9) **Tax planning in case of losses:** The provisions of sections 70, 71 and 72 of the Income-tax Act, 1961 regulate the manner in which losses incurred in the business carried on by any tax payer will have to be dealt with for tax purposes. The consideration to be given by tax payers in the matter of taking the full benefit of set-off of losses permissible under the law is as important as the considerations for tax planning which are taken into account in regard to business expenses or claiming the maximum allowances and deductions particularly in view of the fact that the provisions of set-off of losses offer valuable scope for planning.

Under section 73, losses incurred in speculation business are to be set off only against the income from the business of speculation, if any, which the assessee may derive in the same year or in the subsequent four years. In view of the prohibition in the matter of set-off of losses incurred in speculation business, it would be in the interest of the assessee to avoid indulging in the business of speculation if it is likely to result in losses and there is no possibility of setting it off against future speculation profits within the specified period. Where the business of speculation carried on by the assessee is not profitable, he could discontinue the business of speculation in the same line so that the quantum of losses could be reduced and the assessee could resort to speculation in any other profitable field thereby taking the benefit of exception provided under the law.

Loss from specified business referred to in section 35AD can be carried forward indefinitely under section 73A for set-off against income from the same or any other specified business. Such loss cannot, however, be set-off against income from non-specified business or income under any other head.

The Supreme Court, in *CIT vs. Shantilal P. Ltd. (1983) 144 ITR 57,* held that a transaction cannot be described as a 'speculative transaction' within the meaning of section 43(5), where there is a breach of a contract and on a dispute between the parties, damages are awarded as compensation by an arbitration award. However, where there is no dispute and damages on a pre-determined basis are payable under the contract, without actual delivery of the goods contracted for, the transaction would be a speculative one. If any loss arises out of such a speculative transaction, such speculation loss would not be available for adjustment against other business profits, if any.

The assessee should exercise his right of set off of brought forward loss at the first available opportunity. The Madras High Court, in *Tyresoles (India) vs. CIT [1963] 49 ITR 515,* held that where losses sustained are not set off against the profits of the immediately succeeding year or years, they cannot be set off against profits at a later date. This has been followed by the Punjab and Haryana High Court in *B.C.S. Kartar Chit Fund and Finance Co. (P.) Ltd. vs. CIT [1989] 79 CTR (P & H) 232.* Hence, as a matter of proper tax planning, the assessee should exercise the right under section 72 in the immediately succeeding year/years when the profits allow such a set off.

It is also significant to note that, under section 79, a closely held company will be entitled to claim the benefit of carry forward and set-off of losses, only if shares carrying at least 51% of the voting power is held on the last day of the previous year by the same persons who held such shares on the last day of the previous year in which the loss was incurred. ***In case of a closely held company, being an eligible start up referred to in section 80-IAC, the loss incurred in any year prior to the previous year (say, in P.Y.2016-17) can be carried forward for set-off against the income of the relevant previous year (i.e., P.Y.2019-20), if shares carrying at least 51% of the voting power is held on the last day of the previous year (i.e., as on 31.3.2020) by the same persons who held such shares on the last day of the previous year in which the loss was incurred (i.e., as on 31.3.2017). In the alternative, all shareholders of such company holding shares carrying voting power on the last day of the previous year in which the loss was incurred (i.e., as on***

31.3.2017), should continue to hold those shares on the last day of the previous year in which the loss is to be set-off (i.e., as on 31.3.2020) and such loss should have been incurred during the seven years beginning from the date of incorporation of such company. This benefit will not be denied, if the change has occurred on account of death of a shareholder or on account of transfer by a shareholder to his relative by way of a gift. This benefit will also not be denied if the change in shareholding of an Indian company, which is a subsidiary of a foreign company, is the result of an amalgamation or demerger. However, this is subject to the condition that 51% shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or resulting foreign company. Further, the benefit of carry forward and set-off would not be denied to accompany, where a change in the shareholding takes place in a previous year pursuant to a resolution plan approved under the Insolvency and Bankruptcy Code, 2016, after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.

It should be kept in mind that section 79 applies to carry forward and set off of losses and not to the benefit of deduction in respect of unabsorbed depreciation.

Loss Returns: In the context of discussion on losses it would be relevant to point out that the tax planner would do well to keep in mind the implications of the provisions of section 139(3) read with section 80.

If an assessee is to get the benefit of the determination of the loss and its carry forward under section 72(1) or 73(2) or 73A(2) or 74(1) or 74A(3), he should file a return voluntarily within the period specified in section 139(1).

However, filing of return within the period specified in section 139(1) is not necessary for carry forward of loss from house property under section 71B and unabsorbed depreciation.

The profits and gains allowed as deduction under section 10AA or under any provision of Chapter VI-A under the heading "C.-Deductions in respect of certain incomes" in any assessment year, shall not be allowed as deduction, if the deduction has not been claimed in the return of income.

14.4 GENERAL ANTI-AVOIDANCE RULES

There is a growing concern amongst the revenue in many countries that taxpayers structure transactions to reduce the tax costs. The Base Erosion and Profits Shifting (BEPS) project of the Organization for Economic Cooperation and Development ("OECD") along with G-20 countries sort to tackle this issue. The BEPS Action plans have come out with various recommendations on the issue, both to address it within the international treaty framework (for example, introducing the principle purpose test, limitation of benefits clause, amending the permanent establishment clause, etc.) and in the domestic tax law context (for example, controlled foreign corporation rules, equalization levy, etc.).

Tax avoidance is not defined in taxing statutes. Tax avoidance is, nevertheless, the outcome of actions taken by the assessee, none of which or no combination of which is illegal or forbidden by the law as such. International literature on the subject tends to describe it in the following ways:

- Tax avoidance involves the legal exploitation of tax laws to one‘s own advantage.
- Every attempt by legal means to prevent or reduce tax liability which would otherwise be incurred, by taking advantage of some provisions or lack of provisions in the law.
- An arrangement entered into solely or primarily for the purpose of obtaining a tax advantage.

Taxpayers consider it their legitimate right to arrange their affairs in a manner as to pay the least tax possible. However, tax authorities internationally consider aggressive tax planning schemes by taxpayers to erode the tax base unnaturally, particularly when effective rates of tax diminish significantly. Several countries have, therefore, legislated to prevent tax avoidance in various ways

The General Anti-Avoidance Rules (GAAR) provisions aim at combating 'impermissible tax avoidance'. Many countries, like United Kingdom, China, South Africa, Australia, Canada, Brazil have incorporated General Anti-Avoidance Rules in their domestic tax laws to deal with aggressive tax planning.

The Indian GAAR

In India, the GAAR concept was initially introduced in the Direct Taxes Code Bill, 2009 [DTC Bill, 2009]. Later, a Revised Discussion Paper was released. The Direct Taxes Code Bill, 2010 [DTC Bill, 2010] proposed to introduce GAAR from 1st April 2012 onwards. The GAAR provisions were introduced in the Income-tax Act, 1961 vide the Finance Act, 2012 by insertion of new Chapter X-A. Chapter X-A was substituted by the Finance Act, 2013.

The Government subsequently set up a panel under Parthasarathy Shome to review the proposals. The Committee suggested that the rules be deferred by three years to 2016-17, arguing that more time is needed to create administrative machinery for its implementation and called for intensive training of officials.

The Shome Committee Report explains the need for and rationale of GAAR as under:

(i) GAAR has been enacted as a codification of the proposition that, while interpreting the tax legislation, substance should be selected over a legal form.

(ii) Transactions have to be real and are not to be looked at in isolation.

(iii) The fact that the transactions are legal, does not imply that they are acceptable with reference to the underlying meaning embedded in the fiscal statute.

(iv) Thus, where there is no business purpose except to obtain a tax benefit, the GAAR provisions would not allow such a tax benefit to be availed through the tax statute. These propositions have comprised part of jurisprudence in direct tax laws as reflected in various judicial decisions.

(v) The GAAR provisions codify this 'substance over form' basis of the tax law.

The CBDT, vide Press Release dated January 27, 2017, clarified that the GAAR provisions shall be effective from A.Y.2018-19 onwards, i.e., financial year 2017-18 onwards. The provisions of GAAR are contained in Chapter X-A of the Income-tax Act, 1961. The necessary procedures for application of GAAR and conditions under which it shall not apply, have been enumerated in Rules 10U to 10UC of the Income-tax Rules, 1962.

Prior to A.Y. 2018-19, the Act contained only Specific Anti-Avoidance Rules (SAARs) to prevent tax avoidance. SAAR targets known tax planning schemes which are commonly used by taxpayers but are not acceptable owing to misuse or abuse of tax laws, or they result in a consequence unintended in the law. In the Act, the following may, inter alia, be considered specific examples of SAAR -

(i) Section 40A(2) on excessive or unreasonable payments to related parties not deductible

(ii) Section 80-IA(8) on transactions with tax exempt entities to be valued at market value.

(iii) Sections 92 to 92F on transfer pricing regulations applicable to international transactions. These provisions also made applicable to specified domestic transactions by the Finance Act, 2012.

(iv) Section 93 on avoidance of tax by transfer of income to non-residents through transfer of assets, rights or interest.

(v) Section 94 on avoidance of tax by certain transactions in securities.

(vi) Section 94A on transactions with persons located in notified jurisdictions.

(vii) Section 2(22)(e) on deemed dividend.

(viii) Section 40(a)(i) and (ia) on disallowance of expenses for non-deduction of tax at source.

(ix) Section 9 on scope of 'income deemed to accrue or arise in India'. The Finance Act, 2012 had widened its scope to overcome the Supreme Court's ruling in Vodafone and some other cases.

(x) Explanations 1 to 13 to section 43(1) on determination of actual cost of assets ignoring agreements, etc., in certain cases.

Tax treaties also provide certain anti-avoidance rules for instance, Limitation of Benefit (LOB) Clause and concept of Beneficial Ownership.

Applicability of General Anti-Avoidance Rule [Section 95]

(1) Section 95 of the Act with regard to the applicability of GAAR provides that an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement and the consequence in relation to tax arising there from may be determined subject to the provisions of this Chapter.

(2) The section further clarifies that the provisions of this Chapter may be applied to any step in, or a part of, the arrangement as they are applicable to the arrangement.

(3) The section starts with a non-obstante clause which means, if there is a conflict with provisions in other sections, then this section shall prevail over other conflicting provisions.

(4) The term arrangement referred to in section 95 of the Act, has been defined in section 102 under clause (1) and means any step in, or a part or whole of, any transaction, operation, scheme, agreement or understanding, whether enforceable or not, and includes the alienation of any property in such transaction, operation, scheme, agreement or understanding;

The term 'Step' has been defined in section 102 under clause (9) to include a measure or an action, particularly one of a series taken in order to deal with or achieve a particular thing or object in the arrangement.

Example 1

Facts:

M/s India Chem Ltd. is a company incorporated in India. It sets up a unit in a Special Economic Zone (SEZ) in F.Y. 2018-19 for manufacturing of chemicals. It claims 100% deduction of profits earned from that unit in F.Y. 2020 -21 and subsequent years as per section 10AA of the Act. Is GAAR applicable in such a case?

Interpretation:

There is an arrangement of setting up of a unit in SEZ which results in a tax benefit. However, this is a case of tax mitigation where the tax payer is taking advantage of a fiscal incentive offered to him by complying with the conditions imposed and economic consequences of the provisions in the legislation e.g., setting up the business unit in SEZ area. Hence, the Revenue would not invoke GAAR as regards this arrangement.

Example 1A

Facts:

In the above example 1, let us presume M/s India Chem Ltd. has another unit for manufacturing chemicals in a non-SEZ area. It then diverts its production from such manufacturing unit and shows the same as manufactured in the tax exempt SEZ unit, while doing only the process of packaging there. Is GAAR applicable in such a case?

Interpretation:

This is a case of misrepresentation of facts by showing production of non-SEZ unit as production of SEZ unit. Hence, this is an arrangement of tax evasion and not tax avoidance.

Tax evasion, being unlawful, can be dealt with directly by establishing correct facts. GAAR provisions will not be invoked in such a case.

Example 1B

Facts:

In the above example 1A, let us presume that M/s India Chem Ltd. does not show production of non-SEZ unit as a production of SEZ unit but transfers the product of non-SEZ unit at a price lower than the fair market value and does only some insignificant activity in SEZ unit. Thus, it is able to show higher profits in SEZ unit than in non-SEZ unit, and consequently claims higher deduction in computation of income. Can GAAR be invoked to deny the tax benefit?

Interpretation:

As there is no misrepresentation of facts or false submissions, it is not a case of tax evasion. The company has tried to take advantage of tax provisions by diverting profits from non-SEZ unit to SEZ unit. This is not the intention of the SEZ legislation. However, such tax avoidance is specifically dealt with through transfer pricing regulations that deny tax benefits. Hence, the Revenue need not invoke GAAR in such a case, though GAAR and SAAR can co-exist as per clarification given in the CBDT Circular.

Example 1C

Facts:

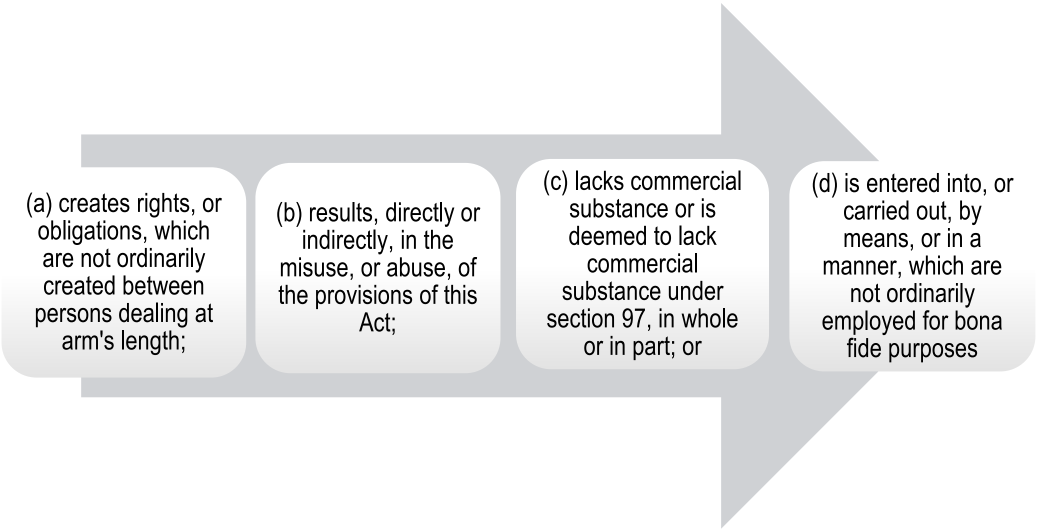
In the above example 1B, let us presume, that both units in SEZ area (say A) and non-SEZ area (say B) work independently. M/s India Chem Ltd. started taking new export orders from existing as well as new clients for unit A and gradually, the export from unit B declined. There has not been any shifting of equipment from unit B to unit A. The company offered lower profits from unit B in computation of income. Can GAAR be invoked on the ground that there has been shifting or reconstruction of business from unit B to unit A for the main purpose of obtaining tax benefit?

Interpretation:

The issue of tax avoidance through shifting/reconstruction of existing business from one unit to another has been specifically dealt with in section 10AA of the Act. Hence, the Revenue need not invoke GAAR in such a case, though GAAR and SAAR can co-exist as per clarification given in the CBDT Circular.

Impermissible Avoidance Agreement [Section 96]

(1) An impermissible avoidance arrangement (IAA) means an arrangement, the main purpose or one of the main purposes of which is to obtain a tax benefit and also any of the following tests is satisfied:



(a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

(b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;

(c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or

(d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes

(2) The **purpose test of obtaining tax benefit and tainted element test as under clauses (a) to (d)** above are **twin conditions** that satisfy an impermissible avoidance arrangement. The purpose test requires that the main purpose or one of the main purposes is to obtain tax benefit. The term "tax benefit" has been defined in section 102 clause (10) as under -

(a) a reduction or avoidance or deferral of tax or other amount payable under this Act; or

(b) an increase in a refund of tax or other amount under this Act; or

(c) a reduction or avoidance or deferral of tax or other amount that would be payable under this Act, as a result of a tax treaty; or

(d) an increase in a refund of tax or other amount under this Act as a result of a tax treaty; or

(e) a reduction in total income or

(f) an increase in loss,

in the relevant previous year or any other previous year.

(3) **The first tainted element** refers to non-arm's length dealings where an arrangement creates rights and obligations, which are not normally created between parties dealing at arm's length. As there are specific transfer pricing regulations (SAAR) applicable to international transactions and certain specified domestic transactions, this tainted element is to be examined only in those transactions which are not covered by Transfer Pricing regulations and where the main purpose of the arrangement is to obtain tax benefit.

Example -2

Facts:

Y Tech Ltd. is a company resident of country C1. It enters into an agreement with Z Energy Ltd., an Indian company for setting up a power plant in India. It is a composite contract for *an agreed price of US$ 100 million. The payment has been split in the following parts as per separate agreements*

(i) US$ 10 million for design of power plant outside India (payment for which is taxable at 10% on gross basis)

(ii) US$ 70 million for offshore supplies of equipment etc (not taxable as no role is played by any PE in India. These are not subject to import duty)

(iii) US$ 20 million for local supplies and installation charges (taxable on net income basis)

It is found that the fair market value of offshore design is about USD 30 million; therefore, it is under invoiced. On the other hand, offshore supplies were over invoiced. The arrangement resulted in significant tax benefit to the taxpayer. Can GAAR be invoked in such a case?

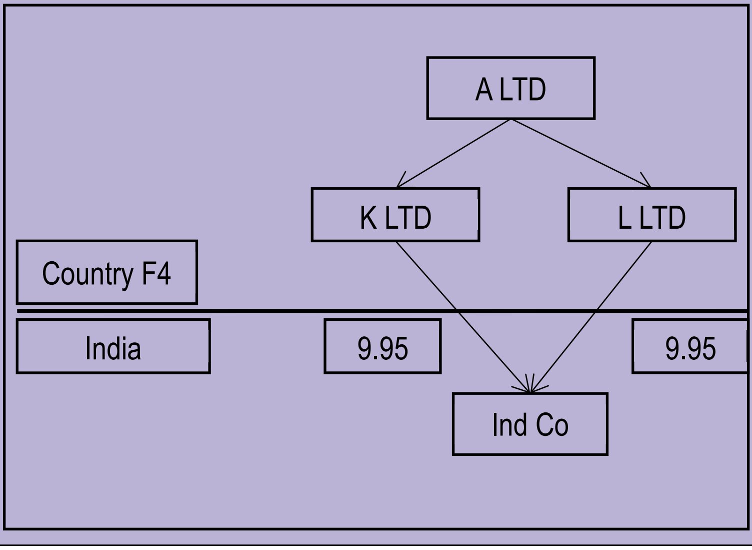
Interpretation:

The allocation of price to different parts of the contract has been decided in such a manner as to reduce tax liability of the foreign company in India. Both conditions for declaring an arrangement as impermissible are satisfied. (1) The main purpose of this arrangement is to obtain tax benefit; and (2) the transactions are not at arm's length. Consequently, GAAR may be invoked and prices would be reallocated. However, determination of arm's length price should be based on transfer pricing regulations under the Act.

(4) **The second tainted** element refers to an arrangement which results in misuse or abuse of the provisions of the Act. It implies cases where the law is followed in letter or form but not in spirit or substance, or where the arrangement results in consequences which are not intended by the legislation, revealing an intent to misuse or abuse the law.

Example-3

Facts:



Under the provisions of a tax treaty between India and country F4, any capital gains arising from the sale of shares of Indco, an Indian company would be taxable only in F4 if the transferor is a resident of F4 except where the transferor holds more than 10% interest in the capital stock of Indco. A company, A Ltd., being resident in F4, makes an investment in Indco through two wholly owned subsidiaries (K Ltd. and L Ltd.) located in F4. Each subsidiary holds 9.95% shareholding in the Indian Company, the total adding to 19.9% of equity of Indco. The subsidiaries sell the shares of Indco and claim exemption as each is holding less than 10% equity shares in the Indian company. Can GAAR be invoked to deny treaty benefit?

***Interpretation**:*

The above arrangement of splitting the investment through two subsidiaries appears to be with the intention of obtaining tax benefit under the treaty. Further, there appears to be no commercial substance in creating two subsidiaries as they do not change the economic condition of investor A Ltd. in any manner (i.e. on business risks or cash flow), and reveals a tainted element of abuse of tax laws. Hence, the arrangement can be treated as an impermissible avoidance arrangement by invoking GAAR. Consequently, treaty benefit would be denied by ignoring K and L, the two subsidiaries, or by treating K and L as one and the same company for tax computation purposes.

*(5) **The third tainted** element refers to an arrangement which lacks commercial substance or is deemed to lack commercial substance**. [Dealt with in detail below]***

*(6) **The fourth element** refers to an arrangement which is entered into, or carried out, by means of, or in a manner which is normally not employed for a bona fide purpose. In other words, it means an arrangement that possesses abnormal features. This is not a purpose test but a manner test.*

Arrangement to lack commercial substance [Section 97]

Another alternate condition of an impermissible avoidance arrangement is that the arrangement lacks commercial substance or is deemed to lack commercial substance in whole or in part.

(1) Under section 97, certain arrangements have been deemed to lack commercial substance as under –

(a) the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or

(b) it involves or includes—

(i) round trip financing;

(ii) an accommodating party;

(iii) elements that have effect of offsetting or cancelling each other; or

(iv) a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of such transaction; or

(c) it involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit (but for the provisions of this Chapter) for a party.

(d) it does not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained (but for the provisions of this Chapter)

(2) Clause (a) is the codification of **substance v. form doctrine**. It implies that where substance of an arrangement is different from what is intended to be shown by the form of the arrangement, then tax consequence of a particular arrangement should be assessed based on the ―substance of what took place. In other words, it reflects the inherent ability of the law to **remove the corporate veil and look beyond form**.

(3) Sub-clause (i) of clause (b) deems an arrangement, which includes round tripping of funds, to lack commercial substance. For this purpose, the phrase round trip financing has been further defined. Round trip financing includes any arrangement in which, through a series of transactions—

(a) funds are transferred among the parties to the arrangement; and

(b) such transactions do not have any substantial commercial purpose other than obtaining the tax benefit (but for the provisions of this Chapter),

without having any regard to—

(A) whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;

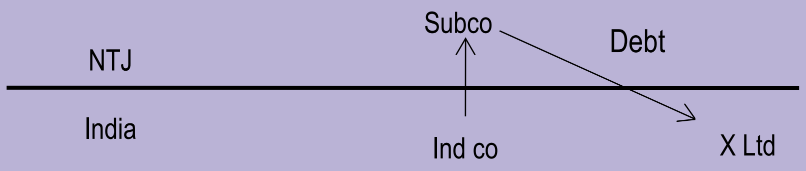
(B) the time, or sequence, in which the funds involved in the round trip financing are transferred or received; or

(C) the means by, or manner in, or mode through, which funds involved in the round trip financing are transferred or received.

Example-4

Facts:

Indco incorporates a Subco in a NTJ (Low Tax Jurisdiction) with equity of US $100. Subco gives a loan of US $ 100 to another Indian company (X Ltd.) at the rate of 10% p.a. X Ltd. claims deduction of interest payable to Subco from the profit of business. There is no other activity in Subco. Can GAAR be invoked in such a case?



Interpretation:

The arrangement appears to be to avoid payment of tax on interest income by Indco in case loan is directly provided by Indco to X Ltd. The arrangement involves round tripping of funds even though the funds emanating from Indco are not traced back to Indco in this case. Hence, the arrangement may be deemed to lack commercial substance.

Consequently, in the case of Indco, Subco may be disregarded and the interest income may be taxed in the hands of Indco.

(4) Sub-clause (ii) of clause (b) deems an arrangement which includes an accommodating party to lack commercial substance. For this, the phrase “accommodating party” has been further defined. A party to an arrangement shall be an accommodating party, if the main purpose of the direct or indirect participation of that party in the arrangement, in whole or in part, is to obtain, directly or indirectly, a tax benefit (but for the provisions of this Chapter) for the assessee whether or not the party is a connected person in relation to any party to the arrangement.

It means that where a party is included in an arrangement mainly for obtaining tax benefit to the taxpayer, then such party may be treated as an accommodating party and consequently the arrangement shall be deemed to lack commercial substance. Also, it is not necessary that such party should be connected to the taxpayer.

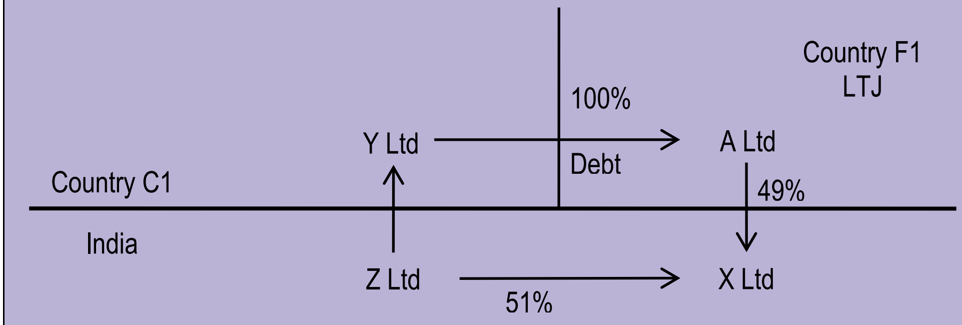
(5) Sub-clause (iii) of clause (b) deems an arrangement, which includes elements that have effect of offsetting or cancelling each other to lack commercial substance.

(6) Sub-clause (iv) of clause (b) deems an arrangement, which disguises value, source or location etc. of funds, to lack commercial substance. In other words, such arrangements have an element of deceit as regards funds.

(7) Clause (c) deems an arrangement to lack commercial substance where it involves the location of an asset or of a transaction or of the place of residence of any party and such location is without any substantial commercial purpose. It means if a particular location is selected for an asset or transaction or residence, and such selection has no substantial commercial purpose, then such arrangement shall be deemed to lack commercial substance.

Example 5

Facts:



(i) *Y Ltd. is a company incorporated in country C1. It is a non-resident in India.*

(ii) *Z Ltd. is a company resident in India.*

(iii) *A Ltd. is a company incorporated in country F1 and it is a 100% subsidiary of Y Ltd.*

(iv) *A Ltd. and Z Ltd. form a joint venture company X Ltd. in India after the date of commencement of GAAR provisions. There is no other activity in A Ltd.*

(v) *The India-F1 tax treaty provides for non-taxation of capital gains in the source country and country F1 charges no capital gains tax in its domestic law.*

(vi) *A Ltd. is also designated as a permitted transferee of Y Ltd. Permitted transferee means that though shares are held by A Ltd, all rights of voting, management, right to sell etc., are vested in Y Ltd.*

(vii) *As per the joint venture agreement, 49% of X Ltd's equity is allotted to A Ltd. and 51% is allotted to Z Ltd..*

(viii) *Thereafter, the shares of X Ltd. held by A Ltd. are sold to C Ltd., a company connected to the Z Ltd. group.*

As per the tax treaty with country F1, capital gains arising to A Ltd. are not taxable in India. Can GAAR be invoked to deny the treaty benefit?

Interpretation:

The arrangement of routing investment through country F1 results in a tax benefit. Since there is no business purpose in incorporating company A Ltd. in country F1 which is a LTJ, it can be said that the main purpose of the arrangement is to obtain a tax benefit. The alternate course available in this case is direct investment in X Ltd. joint venture by Y Ltd. The tax benefit would be the difference in tax liabilities between the two available courses.

The next question is, does the arrangement have any tainted element? It is evident that there is no commercial substance in incorporating A Ltd. as it does not have any effect on *the business risk of Y Ltd. or cash flow of Y Ltd. As the twin conditions of main purpose being tax benefit and existence of a tainted element are satisfied, GAAR may be invoked.*

Additionally, as all rights of shareholders of X Ltd. are being exercised by Y Ltd instead of A Ltd, it again shows that A Ltd lacks commercial substance.

Hence, it is possible to invoke GAAR, in this case.

(8) In section 97(4), the following factors are considered relevant but not sufficient for determining whether an arrangement lacks commercial substance or not, namely—

(i) the period or time for which the arrangement (including operations therein) exists;

(ii) the fact of payment of taxes, directly or indirectly, under the arrangement;

(iii) the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement.

Consequence of impermissible avoidance arrangement [Section 98]

(1) If an arrangement is declared to be an impermissible avoidance arrangement, then the consequences may include denial of tax benefit or a benefit under a tax treaty. The consequence may be determined in such manner as is deemed appropriate in the circumstances of the case. Certain illustrations of the manner have been provided, namely:—

(a) disregarding, combining or re-characterizing any step in, or a part or whole of, the impermissible avoidance arrangement;

(b) treating the impermissible avoidance arrangement as if it had not been entered into or carried out;

(c) disregarding any accommodating party or treating any accommodating party and any other party as one and the same person;

(d) deeming persons who are connected persons in relation to each other to be one and the same person for the purposes of determining tax treatment of any amount;

(e) reallocating amongst the parties to the arrangement—

(i) any accrual, or receipt, of a capital or revenue nature; or

(ii) any expenditure, deduction, relief or rebate;

(f) treating—

(i) the place of residence of any party to the arrangement; or

(ii) the situs of an asset or of a transaction,

at a place other than the place of residence, location of the asset or location of the transaction as provided under the arrangement; or

(g) considering or looking through any arrangement by disregarding any corporate structure.

(2) It has also been provided that –

(i) any equity may be treated as debt or vice versa;

(ii) any accrual, or receipt, of a capital nature may be treated as of revenue nature or vice versa; or

(iii) any expenditure, deduction, relief or rebate may be recharacterised.

Treatment of connected persons and accommodating party [Section 99]

(1) As per section 99, for the purposes of Chapter X-A, in determining whether a tax benefit exists—

(i) the parties who are connected persons in relation to each other may be treated as one and the same person;

(ii) any accommodating party may be disregarded;

(iii) such accommodating party and any other party may be treated as one and the same person;

(iv) the arrangement may be considered or looked through by disregarding any corporate structure.

(2) The term 'connected person' is defined in section 102(4). Connected person means any person who is connected directly or indirectly to another person and includes –

If Connected Person is an				A Company/Firm/AOP/BOI/HUF having substantial interest in the business of the person or any director/partner/member or any relative of such director/partner/member	A Company/Firm/AOP/BOI/HUF whose director/partner/member has substantial interest in the business of the person or family or any relative of such director/partner/member	Any person who carries on business – being an individual or any relative of such person has substantial interest in the business of that other person – being a company/ Firm/AOP/BOI/HUF or any director /partner/member or any relative of such
Individual: any relative or who has substantial interest in the business of the person or any relative of such individual	**Company:** any director or relative of such director	**Firm/ AOP/ BOI:** any partner/ member or relative of such partner/ member	**HUF:** Any member or relative of such member			

						director/partner/ member has substantial interest in the business of that other person

Framing of guidelines under Income-tax Rules [Section 101]

The provisions of Chapter XA shall be applied in accordance with such guidelines and subject to such conditions as may be prescribed. These guidelines are contained in Rules 10U to 10UC.

(1) As per Rule 10U, the provisions of General Anti Avoidance Rule are not applicable to

(a) an arrangement where the tax benefit in the relevant assessment year arising, in aggregate, to all the parties to the arrangement does not exceed a sum of rupees three crores.

(b) a Foreign Institutional Investor -

(i) who is an assessee under the Act;

(ii) who has not taken benefit of an agreement referred to in section 90 or section 90A as the case may be; and

(iii) who has invested in listed securities, or unlisted securities, with the prior permission of the competent authority, in accordance with the Securities and Exchange Board of India (Foreign Institutional Investor) Regulations, 1995 and such other regulations as may be applicable, in relation to such investments.

(c) a person, being a non-resident, in relation to investment made by him by way of offshore derivative instruments or otherwise, directly or indirectly, in a Foreign Institutional Investor.

(d) any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received by, any person from transfer of investments made before the 1st day of April, 2017 by such person.

However, the provisions of GAAR shall apply to any arrangement [other than specified in (d) above], irrespective of the date on which it has been entered into, in respect of the tax benefit obtained from the arrangement on or after the 1st day of April, 2017.

(2) Where a part of an arrangement is declared to be an impermissible avoidance arrangement, the consequences in relation to tax shall be determined with reference to such part only [Rule 10UA].

(3) The Assessing Officer shall, before making a reference to the Commissioner under section 144BA(1), issue a notice in writing to the assessee seeking objections, if any, to the applicability of provisions of GAAR in his case [Rule 10UB(1)].

Implementation of GAAR Provisions under the Income Tax Act, 1961

Clarifications on certain queries about implementation of GAAR [Circular No.7 of 2017 dated 27-1-2017]

The provisions of Chapter X-A of the Income Tax Act, 1961 relating to General Anti-Avoidance Rule will come into force from 1st April, 2017. Certain queries have been received by the Board about implementation of GAAR provisions. The Board constituted a Working Group in June, 2016 for this purpose. The Board has considered the comments of the Working Group and the following clarifications are issued:

Question no. 1: *Will GAAR be invoked if SAAR applies?*

Answer: *It is internationally accepted that specific anti avoidance provisions may not address all situations of abuse and there is need for general anti-abuse provisions in the domestic legislation. The provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in the facts and circumstances of the case.*

Question no. 2: *Will GAAR be applied to deny treaty eligibility in a case where there is compliance with LOB test of the treaty?*

Answer: *Adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is sufficiently addressed by LOB in the treaty, there shall not be an occasion to invoke GAAR.*

Question no. 3: *Will GAAR interplay with the right of the taxpayer to select or choose method of implementing a transaction?*

Answer: *GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction.*

Question no. 4: *Will GAAR provisions apply where the jurisdiction of the FPI is finalised based on non-tax commercial considerations and such FPI has issued P-notes referencing Indian securities? Further, will GAAR be invoked with a view to denying treaty eligibility to a Special Purpose Vehicle (SPV), either on the ground that it is located in a tax friendly jurisdiction or on the ground that it does not have its own premises or skilled professional on its own roll as employees.*

Answer: *For GAAR application, the issue, as may be arising regarding the choice of entity, location etc., has to be resolved on the basis of the main purpose and other conditions provided under section 96 of the Act. GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient jurisdiction. If the jurisdiction of FPI is finalized based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply.*

Question no. 5: *Will GAAR provisions apply to (i) any securities issued by way of bonus issuances so long as the original securities are acquired prior to 01 April, 2017 (ii) shares issued* *post 31 March, 2017, on conversion of Compulsorily Convertible Debentures, Compulsorily Convertible Preference Shares (CCPS), Foreign Currency Convertible Bonds (FCCBs), Global Depository Receipts (GDRs), acquired prior to 01 April, 2017; (iii) shares which are issued consequent to split up or consolidation of such grandfathered shareholding?*

Answer: *Grandfathering under Rule 10U(1)(d) will be available to investments made before 1st April 2017 in respect of instruments compulsorily convertible from one form to another, at terms finalized at the time of issue of such instruments. Shares brought into existence by way of split or consolidation of holdings, or by bonus issuances in respect of shares acquired prior to 1st April 2017 in the hands of the same investor would also be eligible for grandfathering under Rule 10U(1)(d) of the Income Tax Rules.*

Question no. 6: *The expression "investments" can cover investment in all forms of instrument - whether in an Indian Company or in a foreign company, so long as the disposal thereof may give rise to income chargeable to tax. Grandfathering should extend to all forms of investments including lease contracts (say, air craft leases) and loan arrangements, etc.*

Answer: *Grandfathering is available in respect of income from transfer of investments made before 1st April, 2017. As per Accounting Standards, 'investments' are assets held by an enterprise for earning income by way of dividends, interest, rentals and for capital appreciation. Lease contracts and loan arrangements are, by themselves, not 'investments' and hence grandfathering is not available.*

Question no. 7: *Will GAAR apply if arrangement held as permissible by Authority for Advance Ruling?*

Answer: *No. The AAR ruling is binding on the PCIT / CIT and the Income Tax Authorities subordinate to him in respect of the applicant.*

Question no. 8: *Will GAAR be invoked if arrangement is sanctioned by an authority such as the Court, National Company Law Tribunal or is in accordance with judicial precedents etc.?*

Answer: *Where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement.*

Question no. 9: *Will a Fund claiming tax treaty benefits in one year and opting to be governed by the provisions of the Act in another year attract GAAR provisions? An example would be where a Fund claims treaty benefits in respect of gains from derivatives in one year and in another year sets-off losses from derivatives transactions against gains from shares under the Act.*

Answer: *GAAR provisions are applicable to impermissible avoidance arrangements as under section 96. In so far as the admissibility of claim under treaty or domestic law in different years is concerned, it is not a matter to be decided through GAAR provisions.*

Question no. 10: *How will it be ensured that GAAR will be invoked in rare cases to deal with highly aggressive and artificially pre-ordained schemes and based on cogent evidence and not on the basis of interpretation difference?*

Answer: *The proposal to declare an arrangement as an impermissible avoidance arrangement under GAAR will be vetted first by the Principal Commissioner / Commissioner and at the second* *stage by an Approving Panel, headed by judge of a High Court. Thus, adequate safeguards are in place to ensure that GAAR is invoked only in deserving cases.*

Question no. 11: *Can GAAR lead to assessment of notional income or disallowance of real expenditure? Will GAAR provisions expand the scope of charging provisions or scope of taxable base and/or disallow the expenditure which is actually incurred and which otherwise is admissible having regard to diverse provisions of the Act?*

Answer: *If the arrangement is covered under section 96, then the arrangement will be disregarded by application of GAAR and necessary consequences will follow.*

Question no. 12: *A definite timeline may be provided such as 5 to 10 years of existence of the arrangement where GAAR provisions will not apply in terms of the provisions in this regard in section 97(4) of the IT Act.*

Answer: *Period of time for which an arrangement exists is only a relevant factor and not a sufficient factor under section 97(4) to determine whether an arrangement lacks commercial substance.*

Question no. 13: *It may be ensured that in practice, the consequences of a transaction being treated as an 'impermissible avoidance arrangement' are determined in a uniform, fair and rational basis. Compensating adjustments under section 98 of the Act should be done in a consistent and fair manner. It should be clarified that if a particular consequence is applied in the hands of one of the participants, there would be corresponding adjustment in the hands of another participant.*

Answer: *Adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner. In the event of a particular consequence being applied in the hands of one of the participants as a result of GAAR, corresponding adjustment in the hands of another participant will not be made. GAAR is an anti-avoidance provision with deterrent consequences and corresponding tax adjustments across different taxpayers could militate against deterrence.*

Question no. 14: *Tax benefit of INR 3 crores as defined in section 102(10) may be calculated in respect of each arrangement and each taxpayer and for each relevant assessment year separately. For evaluating the main purpose to be obtaining of tax benefit, the review should extend to tax consequences across territories. The tax impact of INR 3 crores should be considered after taking into account impact to all the parties to the arrangement i.e. on a net basis and not on a gross basis (i.e. impact in the hands of one or few parties selectively).*

Answer: *The application of the tax laws is jurisdiction specific and hence what can be seen and examined is the Tax Benefit' enjoyed in Indian jurisdiction due to the 'arrangement or part of the arrangement'. Further, such benefit is assessment year specific. Further, GAAR is with respect to an arrangement or part of the arrangement and therefore limit of Rs. 3 crores cannot be read in respect of a single taxpayer only.*

Question no. 15: *Will a contrary view be taken in subsequent years if arrangement held to be permissible in an earlier year?*

Answer: *If the PCIT/Approving Panel has held the arrangement to be permissible in one year and facts and circumstances remain the same, as per the principle of consistency, GAAR will not be invoked for that arrangement in a subsequent year.*

Question no. 16: *No penalty proceedings should be initiated pursuant to additions made under GAAR at least for the initial 5 years.*

Answer: *Levy of penalty depends on facts and circumstances of the case and is not automatic. No blanket exemption for a period of five years from penalty provisions is available under law. The assessee, may at his option, apply for benefit u/s 273A if he satisfies conditions prescribed therein.*

EXERCISE

Question 1

Distinguish between Tax planning and Tax Evasion

Answer

Tax planning is carried out within the framework of law by availing the deductions and exemptions permitted by law and thereby minimizing tax liability. Tax planning is an arrangement by which full advantage is taken of the concessions and benefits conferred by the statute, without violation of legal provisions. Tax evasion on the other hand is an attempt to reduce tax liability by dubious or artificial methods or downright fraud. It is illegal and denies the State its legitimate share of tax.

Question 2

Specify with reason, whether the following acts can be considered as (i) Tax planning; or (ii) Tax management; or (iii) Tax evasion.

(i) *Mr. P deposits ₹ 1,00,000 in PPF account so as to reduce his total income from ₹ 5,90,000 to ₹ 4,90,000.*

(ii) *SQL Ltd. maintains register of tax deduction at source effected by it to enable timely compliance.*

(iii) *An individual tax payer making tax saver deposit of ₹ 1,00,000 in a nationalised bank.*

(iv) *A partnership firm obtaining declaration from lenders/depositors in Form No. 15G/15H and forwarding the same to income-tax authorities.*

(v) *A company installed an air-conditioner costing ₹ 75,000 at the residence of a director as per terms of his appointment but treats it as fitted in quality control section in the factory. This is with the objective to treat it as plant for the purpose of computing depreciation.*

(vi) *RR Ltd. issued a credit note for ₹ 80,000 as brokerage payable to Mr. Ramana who is the son of the managing director of the company. The purpose is to increase the total income of Mr. Ramana from ₹ 4,20,000 to ₹ 5,00,000 and reduce the income of RR Ltd. correspondingly.*

(vii) *A company remitted provident fund contribution of both its own contribution and employees' contribution on monthly basis before due date.*

Answer

Tax Planning / Tax Management / Tax Evasion

	Answer	Reason
1.	Tax planning	Depositing money in PPF and claiming deduction under section 80C is as per the provisions of law.

2.	Tax management	Maintaining register of payments subject to TDS helps in complying with the obligations under the Income-tax Act, 1961.
3.	Tax planning	Making a tax saver deposit of ₹ 1,00,000 in a nationalized bank for claiming deduction under section 80C by an individual is a permitted tax planning measure under the provisions of income-tax law.
4.	Tax management	Obtaining declaration from lenders/depositors in Form No. 15G/15H by a partnership firm and forwarding the same to Income-tax authorities is in the nature of compliance of statutory obligation under the Income-tax Act, 1961.
5.	Tax evasion	An air conditioner fitted at the residence of a director as per the terms of his appointment would be a furniture qualifying for depreciation @10%, whereas an air conditioner fitted in a factory would be a plant qualifying for a higher depreciation @15%. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit and consequent tax liability. Treatment of air-conditioner fitted at the residence of a director as a plant fitted at the factory would tantamount to furnishing of false particulars with an attempt to evade tax.
6.	Tax evasion	Issuance of a credit note for ₹ 80,000 by RR Ltd. as brokerage payable to Mr. Ramana, the son of the Managing Director, to increase his total income from ₹ 4.2 lakh to ₹ 5.00 lakh and to correspondingly reduce the company's total income is a method of reducing the tax liability of the company by recording a fictitious transaction. The company is liable to tax at a flat rate of 30%/25%, as the case may be, whereas Mr. Ramana would not be liable to pay any tax, since his total income does not exceed ₹ 5,00,000, consequent to which he would be eligible for tax rebate of ₹ 12,500 under section 87A. Reducing tax liability by recording a fictitious transaction would tantamount to tax evasion.
7.	Tax management	Remitting of own contribution to provident fund and employees contribution to provident fund on a monthly basis before due date is proper compliance of the statutory obligations.

Question 3

Examine the doctrine of form and substance in the context of tax planning.

Answer

The following are certain principles enunciated by the Courts on the question as to whether it is the form or substance of a transaction, which will prevail in income-tax matters:

(i) **Form of transaction is to be considered in case of genuine transactions -** It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability whereas, if it is entered into in another form which is equally lawful, it may not. Therefore, in considering whether a transaction attracts tax or not, the form of the transaction put through is to be considered and not the substance. **However, this rule applies only to genuine transactions.** [*CIT v. Motor and General Stores (P) Ltd. v. CIT (1967) 66 ITR 692(SC).* Moreover, with General Anti Avoidance Rules coming into force with effect from A.Y.2017-18.

(ii) **True legal relation is the crucial element for taxability -** It is open for the authorities to pierce the corporate veil and look behind the legal facade at the reality of the transaction. The taxing authority is entitled as well as bound to determine the true legal relation resulting from a transaction. The true legal relation arising from a transaction alone determines the taxability of a receipt arising from the transaction *[CIT v. B.M. Kharwar (1969) 72 ITR 603 (SC)]*

(iii) **Substance (i.e. actual nature of expense) is relevant and not the form –**

(a) In the case of an expenditure, the mere fact that the payment is made under an agreement does not preclude the department from enquiring into the actual nature of the payment [*Swadeshi Cotton Mills Co. Ltd. v. CIT (1967) 63 ITR 57(SC)*].

(b) In order to determine whether a particular item of expenditure is of revenue or capital nature, the substance and not merely the form should be looked into. [*Assam Bengal Cement Co. Ltd. v. CIT (1955) 27 ITR 34 (SC)*].

Question 4

(a) The merger of a loss making company with a profit making one results in losses setting off profits, a lower net profit and lower tax liability for the merged company. Would the losses be disallowed by applying GAAR?

(b) In the above facts, let us presume, the profit making company merges with a loss making one. This results in losses setting off profits, a lower net profit and lower tax liability for both companies taken together. Can this be examined under GAAR?

Answer

(a) As regards setting off of losses, the provisions relating to merger and amalgamation already contain specific anti-avoidance safeguards. Therefore, GAAR need not be invoked when SAAR is applicable, though as per *CBDT Circular No. 7/2017 dated 27.01.2017,* GAAR and SAAR can co-exist.

(b) In case of merger of a profit-making company with loss making company, there is no specific anti-avoidance safeguards. However, since such merger would be under the order of High Court, GAAR would not be invoked if the High Court has explicitly and adequately considered the tax implication while sanctioning the merger scheme.

Question 5

A choice is made by a company by acquiring an asset on lease over outright purchase. The company claims deduction for lease rentals in case of acquisition through lease rather than depreciation as in *the case of purchase of the asset. Would the lease rent payment, being higher than the depreciation, be disallowed as expense under GAAR?*

Answer

GAAR provisions would not apply in this case as the taxpayer merely makes a selection out of the options available to him.

Question 6

M/s Global Architects Inc is a company incorporated in country F1. It is engaged in the business of providing architectural design services all over the world. It receives an offer from Lovely Resorts Pvt Ltd, an Indian company, for design and development of resorts all over India.

India-F1 tax treaty provides that architectural services are technical services and payment for the same to a company may be taxed in India. However, if such professional services are provided by a firm or individual, then payment for such services are taxable only if the firm has a fixed base in India or stay of partners/ employees in India exceed 180 days.

M/s Global Architects Inc forms a partnership firm with a third party (director of the company) having only a nominal share in the F1. The firm enters into an agreement to carry out the services in India. The company seconded its trained manpower to the firm.

Thus, the partnership firm claimed the treaty benefit and no tax was paid in India. Can such an arrangement be examined under GAAR?

Answer

It is obvious that there was no commercial necessity to create a separate firm except to obtain the tax benefit. The firm was only on paper as the manpower was drawn from the company. The firm did not have any commercial substance. Moreover, it is a case of treaty abuse. Hence, GAAR may be invoked to disregard the firm and tax payment for architectural services as fee for technical services. However, the rate of tax on such payment shall be as applicable under the treaty, if more beneficial.

Question 7

An Indian holding company Holdco borrows ₹ 10 crore for acquisition of shares of Subco which then became subsidiary of Holdco. Holdco and Subco amalgamate so that the interest payable on the monies borrowed to acquire the shares can be deducted in computing the income from the business of the amalgamated company.

Answer

The borrowing by Holdco followed by the amalgamation by Subco is not abusive and GAAR would not apply in the case of merger which is carried out under the orders of High Court.

Final Course

(Revised Scheme of Education and Training)

Study Material

(Modules 1 to 4)

Paper 7

Direct Tax Laws and International Taxation

Part – I: Direct Tax Laws

[As amended by the Finance (No. 2) Act, 2019]

Assessment Year 2020-21

Module – 3

(Relevant for May, 2020 and
November, 2020 Examinations)

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This study material has been prepared by the faculty of the Board of Studies. The objective of the study material is to provide teaching material to the students to enable them to obtain knowledge in the subject. In case students need any clarifications or have any suggestions for further improvement of the material contained herein, they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the study material has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

Permission of the Institute is essential for reproduction of any portion of this material.

© *The Institute of Chartered Accountants of India*

All rights reserved. No part of this book may be reproduced, stored in a retrieval system, or transmitted, in any form, or by any means, electronic, mechanical, photocopying, recording, or otherwise, without prior permission, in writing, from the publisher.

Edition	:	October, 2019
Website	:	www.icai.org
E-mail	:	bosnoida@icai.in
Committee/ Department	:	Board of Studies
ISBN No.	:	
Price (All Modules)	:	₹
Published by	:	The Publication Department on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi 110 002, India.
Printed by	:	

CONTENTS

PART I : DIRECT TAX LAWS

MODULE – 1

Chapter 1 : Basic Concepts

Chapter 2 : Residence and Scope of Total Income

Chapter 3 : Incomes which do not form part of Total Income

Chapter 4 : Salaries

Chapter 5 : Income from House Property

Chapter 6 : Profits and Gains of Business or Profession

Chapter 7 : Capital Gains

Chapter 8 : Income from Other Sources

MODULE – 2

Chapter 9 : Income of Other Persons included in assessee's Total Income

Chapter 10 : Aggregation of income; set-off, or carry forward and set-off, of Losses

Chapter 11 : Deductions from Gross Total Income

Chapter 12 : Assessment of Various Entities

Chapter 13: Assessment of Charitable or Religious Trusts or Institutions, Political Parties and Electoral Trusts

Chapter 14 : Tax Planning, Tax Avoidance & Tax Evasion

MODULE – 3

Chapter 15 : Deduction, Collection and Recovery of tax

Chapter 16 : Income-tax Authorities

Chapter 17 : Assessment Procedure

Chapter 18 : Appeals and Revision

Chapter 19 : Settlement of Tax Cases

Chapter 20 : Penalties

Chapter 21 : Offences and Prosecution

Chapter 22 : Liability in Special Cases

Chapter 23 : Miscellaneous Provisions

PART II: INTERNATIONAL TAXATION

MODULE - 4

Chapter 1 : Transfer Pricing & Other Anti-Avoidance Measures

Chapter 2: Non-resident Taxation

Chapter 3 : Double Taxation Relief

Chapter 4 : Advance Rulings

Chapter 5 : Equalisation levy

Chapter 6 : Application and Interpretation of Tax Treaties

Chapter 7 : Fundamentals of Base Erosion and Profit Shifting

Chapter 8 : Overview of Model Tax Conventions

DETAILED CONTENTS : MODULE - 3

CHAPTER 15: DEDUCTION, COLLECTION AND RECOVERY OF TAX

Learning Outcomes ... 15.1

Contents:

15.1 Deduction at source and advance payment [Section 190] ... 15.2

15.2 Direct payment [Section 191] ... 15.2

15.3 Deduction of tax at source ... 15.3

15.4 Certificate for deduction of tax at a lower rate [Section 197) ... 15.58

15.5 No deduction in certain cases [Section 197A] ... 15.59

15.6 Miscellaneous provisions ... 15.62

15.7 Tax collection at source [Section 206C] ... 15.77

15.8 Processing of TCS Statements [Section 206CB] ... 15.87

15.9 PAN quoting mechanism in the TCS Regime [Section 206CC] ... 15.88

15.10 Advance payment of tax [Section 207 to 219] ... 15.88

15.11 Interest chargeable in certain cases ... 15.92

15.12 Collection and recovery of tax - Other Methods ... 15.99

15.13 Refunds ... 15.108

Exercise ... 15.114

Significant Select Cases ... 15.133

CHAPTER 16: INCOME TAX AUTHORITIES

Learning Outcomes ... 16.1

Contents:

16.1 Appointment and Control [Section 116 to 119] ... 16.2

16.2 Jurisdiction ... 16.5

16.3 Powers of Income-tax Authorities [Section 131 to 136] ... 16.8

Exercise ... 16.25

Significant Select Cases ... 16.32

CHAPTER 17: ASSESSMENT PROCEDURE

Learning Outcomes 17.1

Contents:

17.1 Return of income 17.2
17.2 Compulsory filing of return of income [Section 139(1)] 17.2
17.3 Interest for default in furnishing return of income [Section 234A] 17.5
17.4 Option to furnish return of income to employer [Section 139(1A)] 17.6
17.5 Specified class or classes of persons to be exempted from filing return of income [Section 139(1C)] 17.6
17.6 Return of Loss [Section 139(3)] 17.7
17.7 Belated Return [Section 139(4)] 17.7
17.8 Return of Income of Charitable Trusts and Institutions [Section 139(4A)] 17.8
17.9 Return of Income of Political Parties [Section 139(4B)] 17.8
17.10 Mandatory filing of returns by Scientific Research Associations, News-Agency, Trade Unions, etc. [Section 139(4C)] 17.9
17.11 Mandatory filing of returns by Universities, Colleges etc. [Section 139(4D)] 17.10
17.12 Filing of return of income by a Business Trust [Section 139(4E)] 17.10
17.13 Filing of Return of Income by Investment Fund [Section 139(4F)] 17.10
17.14 Revised return [Section 139(5)] 17.10
17.15 Particulars to be furnished with the return [Section 139(6)] 17.11
17.16 Particulars to be furnished with return of income in the case of an assesse engaged in business or profession [Section 139(6A)] 17.11
17.17 Defective return [Section 139(9)] 17.11
17.18 Permanent Account Number (PAN) [Section 139A] 17.14
17.19 Quoting of Aadhar Number [Section 139AA] 17.21
17.20 Scheme for submission of returns through Tax Return preparers [Section 139B] 17.22

17.21 Power of CBDT to dispense with furnishing documents etc. with the return and filing of return in electronic form [Sections 139C & 139D]……...17.24

17.22 Persons authorized to verify return of income [Section 140] 17.25

17.23 Self assessment [Section 140A] 17.27

17.24 Inquiry before assessment [Section 142] 17.29

17.25 Audit under section 142 .... 17.29

17.26 Power of Assessing Officer to make a reference to the valuation officer [Section142A] 17.32

17.27 Assessment [Section 143]... 17.33

17.28 Power of Joint Commissioner to issued direction in certain cases [Section 144A] 17.39

17.29 Reference to Principal Commissioner or Commissioner in certain cases [Section 144BA]... 17.39

17.30 Provision for constitution of Alternate Dispute Resolution Mechanism [Section 144C] 17.42

17.31 Income escaping assessment [Sections 147 to 149] 17.44

17.32 Sanction for issue of notice [Section 151] 17.49

17.33 Other provisions [Section 152] 17.50

17.34 Time limit for completion of assessments and reassessments [Section 153]... 17.50

17.35 Assessment procedure in case of search or requisition [Section153A/153B/153C] 17.57

17.36 Rectification of mistakes [Section 154] 17.71

17.37 Other amendments [Section 155] 17.73

17.38 Notice of demand [Section 156].. 17.76

17.39 Intimation of loss [Section 157]... 17.76

Exercise 17.77

Significant Select Cases 17.95

Annexure 17.113

CHAPTER 18: APPEALS AND REVISION

Learning Outcomes 18.1

Contents:

18.1 Appeals before Commissioner (Appeals) 18.2

18.2 Appeals to the Appellate Tribunal [Sections 252 to 255] 18.7

18.3 Appeals to High Court [Sections 260A & 260B] 18.13

18.4 Appeals to the Supreme Court [Section 261] 18.14

18.5 Provision for avoiding Repetitive Appeals [Section 158A] 18.15

18.6 Procedure for appeal by revenue when an identical question of law is pending before Supreme Court [Section 158AA] 18.17

18.7 Revision by the Principal Commissioner or Commissioner [Sections 263 and 264] 18.17

18.8 Monetary limits for filing of appeals by the department before Income Tax Appellate Tribunal, High courts and SLPs/appeals before Supreme Court 18.22

18.9 Doctrine of partial merger and doctrine of total merger 18.26

Exercise 18.28

Significant Select Cases 18.39

CHAPTER 19: SETTLEMENT OF TAX CASES

Learning Outcomes 19.1

Contents:

19.1 Introduction 19.2

19.2 Definition of 'Case' [Section 245A(B)] 19.2

19.3 Application for settlement of cases [Section 245C] 19.3

19.4 Procedure on receipt of Application [Section 245D] 19.8

19.5 Power of Settlement Commission to order provisional attachment to protect revenue [Section 245DD] 19.11

19.6 Re-opening of completed proceedings [Section 245E] 19.12

19.7 Jurisdiction and powers of the Settlement Commission [Section 245BA] 19.12

19.8 Power to grant immunity from prosecution and penalty [Section 245H].. 19.14

19.9 Abatement of proceeding before the Settlement Commission [Section 245HA & 245HAA] 19.15

19.10 Order of Settlement Commission to be conclusive [Section 245-I].. 19.16

19.11 Recovery of settled amount [Section 245J] 19.17

19.12 Bar on subsequent application for settlement [Section 245K].. 19.17

19.13 Proceedings to be judicial proceedings [Section 245L] 19.18

Exercise 19.19

Significant Select Cases.. 19.26

CHAPTER 20: PENALTIES

Learning Outcomes..20.1

Contents:

20.1 Introduction 20.2

20.2 Penalties 20.2

20.3 Penalty leviable for under-reporting of income [Section 270A]..20.12

20.4 Immunity from imposition of penalty and prosecution [Section 270AA]..20.22

20.5 Penal provisions on undisclosed income found during the course of search [Section 271AAB]..20.24

20.6 Commencement of limitation for penalty proceedings under sections 271D and 271E. [Circular No. 9/2016 Dated 26.4.2016]..20.25

20.7 Limitation for penalty proceedings under sections 271D and 271E - Whether to be determined u/s 275(1)(a) or u/s 275(1)(c) [Circular No. 10/2016 Dated 26.4.2016]..20.26

20.8 Penalty for failure to furnish Statement of Financial Transaction Reportable Account [Section 271FA] 20.26

20.9 Penalty for furnishing Inaccurate Statement of Financial Transaction or Reportable Account [Section 271FAA]..20.28

20.10 Penalty not leviable in certain cases [Section 273B] 20.28

20.11 Procedure for assessment of penalties [Section 274]..20.28

20.12 Reduction or waiver of penalty and interest [Section 273A] 20.29

20.13 Power of Principal Commissioner or Commissioner to grant immunity from penalty [Section 273AA] 20.30

20.14 Time limit for passing an order for waiver of interest and penalty [Sections 220(2A), 273A, 273AA] 20.31

20.15 Time limit for imposition of penalty [Section 275] 20.32

Exercise 20.35

Significant Select Cases 20.42

CHAPTER 21: OFFENCES AND PROSECUTION

Learning Outcomes 21.1

Contents:

21.1 Summary of offences and prosecution 21.2

21.2 Power of Principal Commissioner or Commissioner to grant immunity from prosecution [Section 278AB] 21.5

21.3 Presumption with regard to assets, books of account [Section 278D] 21.6

21.4 Presumption as to culpable mental state [Section 278E] 21.6

21.5 Prosecution to be made at the instance of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner [Sections 279 and 279A] 21.7

21.6 Proof of entries in records or documents [Section 279B] 21.7

21.7 Disclosure of particulars by Public Servants [Section 280] 21.8

21.8 Constitution of Special Courts & Offences triable by Special Court [Sections 280A & 280B] 21.8

21.9 Trial of offences as summons case [Section 280C] 21.9

21.10 Application of Code of Criminal Procedure, 1973 to proceedings before Special Court [Section 280D] 21.9

Exercise 21.10

Significant Select Cases 21.13

CHAPTER 22: LIABILITY IN SPECIAL CASES

Learning Outcomes 22.1

Contents:

22.1 Legal Representatives [Section 159] 22.2

22.2 Representative Assessee 22.3

22.3 Taxation of discretionary trusts [Section 164(1)] 22.7

22.4 Direct assessment or recovery not barred [Section 166] 22.11

22.5 Remedies against property in cases of representative Assessees [Section 167] 22.11

22.6 Executors and Administrators [Sections 168 and 169] 22.11

22.7 Liability of successor to business in respect of tax chargeable from the predecessor [Section 170] 22.13

22.8 Income earned in a financial year assessed in the same financial year-exceptions to the general rule [Section 174 to 176] 22.14

22.9 Liabilities arising when an association carrying on business is dissolved or business is discontinued [Section 177] 22.17

22.10 Companies under liquidation [Sections 178 and 179] 22.18

Exercise 22.21

CHAPTER 23: MISCELLANEOUS PROVISIONS

Learning Outcomes 23.1

Contents:

23.1 Mode of taking or accepting certain loans, deposits and specified sum [Section 269SS] 23.2

23.2 Mode of undertaking transactions [Section 269ST] 23.3

23.3 Acceptance of payment through prescribed electronics modes [Section 269SU] 23.5

23.4 Mode of repayment of certain loans or deposits [Section 269T] 23.6

23.5 Transfers to defraud revenue void [Section 281] 23.7

23.6 Provisional attachment to protect the interest of the revenue [Section 281B] 23.8

23.7 Service of Notice [Sections 282, 283 & 284] 23.10

23.8 Authentication of notices and other documents [Section 282A].................................. 23.11

23.9 Obligation to furnish Statement of Financial
Transaction or Reportable Account [Section 285BA] 23.11

23.10 Publication of information [Section 287].. 23.17

23.11 Appearance by registered valuers [Section 287A]... 23.17

23.12 Appearance by authorized representative [Section 288].. 23.17

23.13 Rounding off of income, tax etc. [Sections 288A & 288B].. 23.22

23.14 Receipt [Section 289]... 23.23

23.15 Indemnity [Section 290].. 23.23

23.16 Power to tender immunity from prosecution [Section 291] 23.23

23.17 Cognizance of offences and Bar of suits in Civil Courts [Section 292 and 293] 23.23

23.18 Certain laws not to apply [Section 292A].. 23.24

23.19 Return of income etc. not to become invalid [Section 292B] 23.24

23.20 Notice deemed to be valid in certain circumstances [Section 292BB] 23.24

23.21 Presumption as to assets, books of account, etc. [Section 292C] 23.24

23.22 Authority empowered to grant an approval under
the Income-tax Act, 1961 deemed to have power to
withdraw the approval granted [Section 293C]... 23.26

23.23 Act to have effect pending legislative provision
for charge of tax [Section 294].. 23.26

23.24 Rules [Section 295 and 296] 23.26

23.25 Schedules to the Income-tax Act. 1961.. 23.27

Exercise 23.28

Significant Select Cases... 23.34

CHAPTER 15

DEDUCTION, COLLECTION AND RECOVERY OF TAX

LEARNING OUTCOMES

After studying this chapter, you would be able to -

❑ **examine** the provisions relating to deduction and collection of tax at source to determine whether tax needs to be deducted/collected at source;

❑ **compute** the amount of tax to be deducted/collected at source;

❑ **analyse and apply** the provisions relating to deduction and collection of tax at source to address related issues;

❑ **examine** the provisions relating to advance tax obligations, the instalments and due dates, and interest and penal consequences of non-payment or delayed payment of advance tax; **analyse and apply** such provisions to determine the quantum of advance tax payment and interest liability, if any, and address related issues;

❑ **examine** the provisions relating to chargeability of interest for defaults in furnishing return of income, for non-payment of advance tax and deferral of advance tax; **analyse and apply** such provisions to compute interest and address related issues;

❑ **analyse and apply** the provisions relating to refunds to compute the refund due and address related issues.

15.1 DEDUCTION AT SOURCE AND ADVANCE PAYMENT [SECTION 190]

The total income of an assessee for the previous year is taxable in the relevant assessment year. For example, the total income for the P.Y. 2019-20 is taxable in the A.Y. 2020-21. However, income-tax is recovered from the assessee in the previous year itself through –

(1) Tax deduction at source (TDS)

(2) Tax collection at source (TCS)

(3) Payment of advance tax

Another mode of recovery of tax is from the employer through tax paid by him under section 192(1A) on the non-monetary perquisites provided to the employee.

These taxes are deductible from the total tax due from the assessee. The assessee, while filing his return of income, has to pay self-assessment tax under section 140A, if tax is due on the total income as per his return of income after adjusting, *inter alia*, TDS, TCS, ***relief of tax claimed under section 89,*** relief of tax claimed under section 90, 90A or 91 on account of tax paid in a country outside India or specified territory outside India, tax credit claimed to be set off in accordance with the provisions of section 115JAA or section 115JD and advance tax.

15.2 DIRECT PAYMENT [SECTION 191]

Section 191 provides that in the following cases, tax is payable by the assessee directly –

(1) in the case of income in respect of which tax is not required to be deducted at source; and

(2) income in respect of which tax is liable to be deducted but is not actually deducted.

In view of these provisions of section 191, the proceedings for recovery of tax necessarily had to be taken against the assessee whose tax was liable to be deducted, but not deducted.

In order to overcome this difficulty, the *Explanation* to this section provides that if any person, including the principal officer of the company –

(1) who is required to deduct tax at source; or

(2) an employer paying tax on non-monetary perquisites under section 192(1A),

does not deduct the whole or part of the tax, or after deducting fails to pay such tax deducted, then, such person shall be deemed to be an assessee-in-default.

However, if the assessee himself has paid the tax, this provision will not apply.

15.3 DEDUCTION OF TAX AT SOURCE

15.3.1 Salary [Section 192]

(1) Applicability of TDS under section 192

This section casts an obligation on every person responsible for paying any income chargeable to tax under the head 'Salaries' to deduct income-tax on the amount payable.

(2) Manner of deduction of tax

(i) Such income-tax has to be calculated at the average rate of income-tax computed on the basis of the rates in force for the relevant financial year in which the payment is made, on the estimated total income of the assessee. Therefore, the liability to deduct tax at source in the case of salaries arises only at the time of payment.

(ii) Average rate of income-tax means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.

(iii) The concept of payment of tax on non-monetary perquisites has been provided in sections 192(1A) and (1B). These sections provide that the employer may pay this tax, at his option, in lieu of deduction of tax at source from salary payable to the employee. Such tax will have to be worked out at the average rate applicable to aggregate salary income of the employee and payment of tax will have to be made every month along with tax deducted at source on monetary payment of salary, allowances etc.

(iv) In cases where an assessee is simultaneously employed under more than one employer or the assessee takes up a job with another employer during the financial year after his resignation or retirement from the services of the former employer, he may furnish the details of the income under the head "Salaries" due or received by him from the other employer, the tax deducted therefrom and such other particulars to his current employer. Thereupon, the subsequent employer should take such information into consideration and then deduct the tax remaining payable in respect of the employee's remuneration from both the employers put together for the relevant financial year.

(v) For purposes of deduction of tax out of salaries payable in a foreign currency, the value of salaries in terms of rupees should be calculated at the prescribed rate of exchange as specified in Rule 26 of the Income-tax Rules, 1962.

(vi) In respect of salary payments to employees of Government or to employees of companies, co-operative societies, local authorities, universities, institutions, associations or bodies, deduction of tax at source should be made after allowing relief under section 89(1), where eligible.

(vii) A tax payer having salary income in addition to other income chargeable to tax for that financial year, may send to the employer, the following:

(a) particulars of such other income;

(b) particulars of any tax deducted under any other provision;

(c) particulars of the loss, if any, under the head 'Income from house property'.

The employer shall take the above particulars into account while calculating tax deductible at source.

(viii) It is also provided that except in cases where loss from house property has been adjusted against salary income, the tax deductible from salary should not be reduced as a consequence of making the above adjustments.

(3) Furnishing of statement of particulars of perquisites or profits in lieu of salary by employer to employee

Sub-section (2C) provides that the employer shall furnish to the employee, a statement in Form No. 12BA giving correct and complete particulars of perquisites or profits in lieu of salary provided to him and the value thereof. The statement shall be in the prescribed form and manner. This requirement is applicable only where the salary paid/payable to an employee exceeds ₹ 1,50,000. For other employees, the particulars of perquisites/profits in lieu of salary shall be given in Form 16 itself.

(4) Circular issued by CBDT

Every year, the CBDT issues a circular giving details and direction to all employers for the purpose of deduction of tax from salaries payable to the employees during the relevant financial year. These instructions should be followed.

(5) Requirement to obtain evidence/ proof/ particulars of claims from the employee by the employer

Sub-section (2D) casts responsibility on the person responsible for paying any income chargeable under the head "Salaries" to obtain from the assessee, the evidence or proof or particulars of prescribed claims (including claim for set-off of loss) under the provisions of the Act in the prescribed form and manner, for the purposes of –

(1) estimating income of the assessee; or

(2) computing tax deductible under section 192(1).

Rule 26C has been inserted in the Income-tax Rules, 1962, with effect from 1st June, 2016, to require furnishing of evidence of the following claims by an employee to the person responsible for making payment under section 192(1) in Form No.12BB for the purpose of estimating his income or computing the tax deduction of tax at source:

S. No.	Nature of Claim	Evidence or particulars
1.	House Rent Allowance	Name, address and PAN of the landlord(s) where the aggregate rent paid during the previous year exceeds ₹ 1 lakh.
2.	Leave Travel Concession or Assistance	Evidence of expenditure
3.	Deduction of interest under the head "Income from house property"	Name, address and PAN of the lender
4.	Deduction under Chapter VI-A	Evidence of investment or expenditure.

Section 192(1) requires any person responsible for paying any income chargeable under the head "Salaries" to deduct tax at source at the time of payment. If an employee receives income chargeable under a head other than "Salaries", section 192 does not get attracted at all.

In the case of ITC Ltd v. CIT (2016) 384 ITR 14, the issue under consideration before the Supreme Court was whether "tips" received by the hotel-company from its customers and distributed to the employees fell within the meaning of "Salaries" to attract tax deduction at source under section 192.

The Supreme Court observed that in respect of tips collected by the company from the customers and distributed to the employees, the person responsible for paying the employee was not the employer at all, but a third person, namely the customer. As income from tips would be chargeable in the hands of the employees as "Income from Other Sources", on account of such tips being received from customers and not from the employer, section 192 would not get attracted at all.

The Supreme Court further observed that there was no vested right in the employee to claim any amount of tip from his employer. Tips are purely voluntary amounts that may or may not be paid by customers for services rendered to them, and hence, would not fall within the meaning and scope of section 15. Further, the amount of tips collected from the customers by the employer and paid to the employees has no reference to the contract of employment at all. Tips were received by the employer in a fiduciary capacity as trustee for payments that were received from customers which they disbursed to their employees for service rendered to the customer. There was, therefore, no reference to the contract of employment when these amounts were paid by the employer to the employee. Due to this reason the tips received by the employees could not be regarded as profits in lieu of salary in terms of section 17(3). The payments of collected tips included and paid by way of a credit card by a customer, would not be payments made "by or on behalf of" an employer. The contract of employment not being the proximate cause for the receipt of tips by the employee from a customer, such payments would be outside the scope of sections 15 and 17.

ILLUSTRATION 1

LL Limited paid leave travel facility to its employees and considered exemption under section 10(5), based on the self-declaration furnished by the employees. The Assessing Officer held that the company as an employer ought to have verified the genuineness of the claim of exemption by obtaining from them, the proof of actual expenditure incurred by availing leave travel facility. Accordingly, the Assessing Officer treated the assessee company as assessee in default. Decide the correctness of action.

SOLUTION

Section 192 casts liability on the employer to deduct tax at source from the salary paid to its employees.

In this case, the employer has paid leave travel concession / facility to its employees and the said concession / facility would be eligible for exemption subject to the conditions laid down in section 10(5) read with Rule 2B of the Income-tax Rules, 1962.

Section 192(2D) casts responsibility on the person responsible for paying any income chargeable under the head 'Salaries' to obtain from the assessee, the evidence or proof or particulars of prescribed claims under the provisions of the Act in the prescribed form and manner for the purposes of –

(1) estimating income of the assesses; or

(2) computing tax deductible under section 192(1).

Rule 26C of the Income-tax Rules, 1962 mandates a salaried assessee claiming, *inter alia*, leave travel concession or assistance to furnish evidence of expenditure incurred in relation thereto to the person responsible for making such for payment under section 192(1), for the purpose of estimating his income for computing the tax deductible under section 192.

Thus, the action of the Assessing Officer is correct in law.

15.3.2 Premature withdrawal from Employees Provident Fund [Section 192A]

(1) Compliance with Rule 9 of Part A of the Fourth Schedule: Certain Concerns

(i) Under the Employees Provident Fund and Miscellaneous Provisions Act, 1952 (EPF & MP Act, 1952), certain specified employers are required to comply with the Employees Provident Fund Scheme, 1952 (EPFS). However, these employers are also permitted to establish and manage their own private provident fund (PF) scheme subject to fulfillment of certain conditions.

(ii) The provident funds established under a scheme framed under EPF & MP Act, 1952 or Provident Fund exempted under section 17 of the said Act and recognised under the Income-tax Act, 1961 are termed as Recognised Provident fund (RPF) under the Act.

(iii) Part A of the Fourth Schedule to the Income-tax Act, 1961 contains the provisions relating to RPFs. Under the existing provisions of Rule 8 of Part A of the Fourth Schedule, the withdrawal of accumulated balance by an employee from the RPF is exempt from taxation.

(iv) For the purpose of discouraging pre-mature withdrawal and promoting long term savings, if the employee makes withdrawal before continuous service of five years (other than the cases of termination due to ill health, contraction or discontinuance of business, cessation of employment etc.) and does not opt for transfer of accumulated balance to new employer, the withdrawal would be subject to tax.

(v) Rule 9 of Part A of the Fourth Schedule provides the manner of computing the tax liability of the employee in respect of such pre-mature withdrawal. In order to ensure collection of tax in respect of such pre-mature withdrawals, Rule 10 of Part A of the Fourth Schedule casts responsibility on the trustees of the RPF to deduct tax as computed in Rule 9 at the time of payment.

(vi) Rule 9 provides that the tax on withdrawn amount is required to be calculated by re-computing the tax liability of the years for which the contribution to RPF has been made by treating the same as contribution to unrecognized provident fund. The trustees of private provident fund schemes, are generally a part of the employer group and hence, have access to or can easily obtain the information regarding taxability of the employee making pre-mature withdrawal for the purposes of computation of the amount of tax liability under Rule 9. However, it may not always be possible for the trustees of EPFS to get the information regarding taxability of the employee such as year-wise amount of taxable income and tax payable for the purposes of computation of the amount of tax liability under Rule 9.

(2) Applicability and Rate of TDS

Section 192A provides for deduction of tax **@10%** on premature taxable withdrawal from employees provident fund scheme. Accordingly, in a case where the accumulated balance due to an employee participating in a recognized provident fund is includible in his total income owing to the provisions of Rule 8 of Part A of the Fourth Schedule not being applicable, the trustees of the Employees Provident Fund Scheme, 1952 or any person authorised under the scheme to make payment of accumulated balance due to employees are required to deduct income-tax@**10%**.

(3) Time of tax deduction at source

Tax should be deducted **at the time of payment** of accumulated balance due to the employee.

(4) Non-applicability of TDS under section 192A

No tax deduction is to be made under this section, if the amount of such payment or aggregate amount of such payment to the payee is less than **₹ 50,000**.

(5) Deduction at maximum marginal rate in case of non-submission of PAN

Any person entitled to receive any amount on which tax is deductible under this section has to furnish his PAN to the person responsible for deducting such tax. In case he fails to do so, tax would be deductible at the maximum marginal rate.

ILLUSTRATION 2

Mr. Sharma, an employee of M/s. ABC Ltd. since 10-04-2016 resigned on 31-03-2020 and withdrew ₹ 60,000 being the balance in his EPF account. Discuss with reasons whether the provisions of Chapter XVII-B are attracted and if so, what is the net amount receivable by the payee, Mr. Sharma?

SOLUTION

As per section 192A, in a case where the accumulated balance due to an employee participating in a recognized provident fund is includible in his total income owing to the provisions of Rule 8 of Part A of the Fourth Schedule not being applicable, the trustees of the Employees Provident Fund Scheme, 1952 or any person authorised under the scheme to make payment of accumulated balance due to employees are required to deduct income-tax@10% at the time of payment of accumulated balance due to the employee. Tax deduction at source has to be made only if the amount of such payment or aggregate amount of such payment of the payee is ₹ 50,000 or more.

Rule 8 of Part A of the Fourth Schedule, *inter alia*, provides that only if an employee has rendered continuous service of five years or more with the employer, then accumulated balance in a recognized provident fund payable to an employee would be excluded from the total income of that employee.

In the present case, Mr. Sharma has withdrawn an amount exceeding ₹ 50,000 on his resignation after rendering a continuous service of four years with M/s. ABC Ltd. Therefore, tax has to be deducted at source@10% under section 192A on ₹ 60,000, being the amount withdrawn on his resignation without rendering continuous service of a period of five years with M/s. ABC Ltd.

The net amount receivable by Mr. Sharma is ₹ 54,000 [i.e., ₹ 60,000 – ₹ 6,000, being tax deducted at source].

Note – *It is assumed that Mr. Sharma has furnished his permanent account number (PAN) to the person responsible for deducting tax at source. Otherwise, tax would be deductible at the maximum marginal rate. It may be noted that with effect from 1.6.2015 such employee can furnish declaration in Form No.15G for non-deduction of tax at source under section 192A by virtue of section 197A(1A).*

15.3.3 Interest on securities [Section 193]

(1) Person responsible for deduction of tax at source

This section casts responsibility on every person responsible for paying to a resident any income by way of interest on securities.

(2) Rate of TDS

Such person is vested with the responsibility to deduct income-tax at the rates in force from the amount of interest payable.

The rate at which tax is deductible under section 193 is **10%**, both in the case of domestic companies and resident non-corporate assessees.

(3) Time of tax deduction at source

Tax should be deducted at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

Where any income by way of interest on securities is credited to any account in the books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and tax has to be deducted at source. The account to which such interest is credited may be called “Interest Payable account” or “Suspense account” or by any other name.

(4) Non-applicability of TDS under section 193

No tax deduction is to be made from any interest payable:

(i) on 4¼% National Defence Bonds 1972, where the bonds are held by an individual not being a non-resident;

(ii) on 4¼% National Defence Loan, 1968 or 4¾% National Defence Loan, 1972, where the interest is payable to an individual;

(iii) on National Development Bonds;

(iv) on 7-year National Savings Certificates (IV Issue);

(v) on debentures issued by any institution or authority or any public sector company or any co-operative society (including a co-operative land mortgage bank or a co-operative land development bank), as notified by the Central Government;

Accordingly, the Central Government has, vide Notification No. 27 & 28/2018, dated 18-06-2018, notified-

(i) “Power Finance Corporation Limited 54EC Capital Gains Bond” issued by Power Finance Corporation Limited {PFCL} and

(ii) “Indian Railway Finance Corporation Limited 54EC Capital Gains Bond” issued by Indian Railway Finance Corporation Limited {IRFCL}

Thus, no tax is required to be deducted at source on interest payable on “Power Finance Corporation Limited 54EC Capital Gains Bond” and “Indian Railway Finance Corporation Limited 54EC Capital Gains Bond”.

> *The benefit of this exemption would, however, be admissible in the case of transfer of such bonds by endorsement or delivery, only if the transferee informs PFCL/IRFCL by registered post within a period of sixty days of such transfer.*

(vi) on 6½% Gold Bonds, 1977 or 7% Gold Bonds, 1980, where the bonds are held by an individual (other than a non-resident), provided that the holders of the bonds make a written declaration that the total nominal value of the bonds held by him or on his behalf did not in either case exceed ₹10,000 at any time during the period to which the interest relates;

(vii) on any security of the Central Government or a State Government;

Note – It may be noted that tax has to be deducted at source in respect of interest payable on 8% Savings (Taxable) Bonds, 2003, or 7.75% Savings (Taxable) Bonds, 2018, only if such interest payable exceeds ₹ 10,000 during the financial year.

(viii) on any debentures (whether listed or not listed on a recognized stock exchange) issued by the company in which the public are substantially interested to a resident individual or HUF. However,

(a) the interest should be paid by the company by an account payee cheque;

(b) the amount of such interest or the aggregate thereof paid or likely to be paid during the financial year by the company to such resident individual or HUF should not exceed ₹ 5,000.

(ix) on securities to LIC, GIC, subsidiaries of GIC or any other insurer, provided –

(a) the securities are owned by them or

(b) they have full beneficial interest in such securities.

(x) on any security issued by a company, where such security is in dematerialised form and is listed on a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956 and the rules made thereunder.

15.3.4 Interest other than interest on securities [Section 194A]

This section deals with the scheme of deduction of tax at source from interest other than interest on securities. The main provisions are the following:

(1) Applicability of TDS under section 194A

This section applies only to interest, other than "interest on securities", credited or paid by assessees other than individuals or Hindu undivided families whose total sales, gross receipts or turnover from the business or profession carried on by him do not exceed the monetary limits of ₹ 1 crore and ₹ 50 lakhs, respectively, under section 44AB during the immediately preceding financial year.

These provisions apply only to interest paid or credited to residents.

(2) Time of tax deduction at source

The deduction of tax must be made at the time of crediting such interest to the payee or at the time of its payment in cash or by any other mode, whichever is earlier.

Where any such interest is credited to any account in the books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and the tax has to be deducted at source. The account to which such interest is credited may be called "Interest Payable account" or "Suspense account" or by any other name.

The CBDT has, vide Circular No.3/2010 dated 2.3.2010, given a clarification regarding deduction of tax at source on payment of interest on time deposits under section 194A by banks following Core-branch Banking Solutions (CBS) software.

It has been clarified that *Explanation* to section 194A is not meant to apply in cases of banks where credit is made to provisioning account on daily/monthly basis for the purpose of macro monitoring only by the use of CBS software. It has been further clarified that since no constructive credit to the depositor's/ payee's account takes place while calculating interest on time deposits on daily or monthly basis in the CBS software used by banks, tax need not be deducted at source on such provisioning of interest by banks for the purposes of macro monitoring only. In such cases, tax shall be deducted at source on accrual of interest at the end of financial year or at periodic intervals as per practice of the bank or as per the depositor's/ payee's requirement or on maturity or on encashment of time deposits, whichever event takes place earlier, whenever the aggregate of amounts of interest income credited or paid or likely to be credited or paid during the financial year by the banks exceeds the limits specified in section 194A.

Note - The time for making the payment of tax deducted at source would reckon from the date of credit of interest made constructively to the account of the payee.

(3) Rate of TDS

The rate at which the deduction is to be made is given in Part II of the First Schedule to the Annual Finance Act. The rate at which tax is to be deducted is **10%** both in the case of resident non-corporate assessees and domestic companies.

(4) Non-applicability of TDS under section 194A

No deduction of tax shall be made in the following cases:

(a) If the aggregate amount of interest paid or credited during the financial year does not exceed **₹ 5,000**.

This limit is ***₹ 40,000*** in respect of interest paid on –

(i) time deposits with a banking company;

(ii) time deposits with a co-operative society engaged in banking business; and

(iii) deposits with post office under notified schemes.

In respect of (i), (ii) and (iii) above, the limit is **₹ 50,000, in case of payee, being a resident senior citizen**.

The limit will be calculated with respect to income credited or paid by a branch of a banking company or a co-operative society or a public company in case of:

(i) time deposits with a banking company

(ii) time deposits with a co-operative society carrying on the business of banking; and

(iii) deposits with housing finance companies, provided:

- they are public companies formed and registered in India
- their main object is to carry on the business of providing long-term finance for construction or purchase of houses in India for residential purposes
- they are eligible for deduction under section 36(1)(viii).

In the case of income credited or paid in respect of time deposits with a banking company or a co-operative bank or a public company with the main object of providing long-term finance for construction or purchase of houses in India for residential purposes, the threshold limit for deduction of tax at source (i.e., ₹ 50,000***, ₹ 40,000*** or ₹ 5,000, as the case may be) shall be computed with reference to the income credited or paid by a branch of the banking company or the co-operative society or the public company.

The threshold limit will be reckoned with reference to the total interest credited or paid by the banking company or the co-operative society or the public company, as the case may be, (and not with reference to each branch), where such banking company or co-operative society or public company has adopted core banking solutions.

(b) Interest paid or credited by a firm to any of its partners;

(c) Income paid or credited by a co-operative society (other than a co-operative bank) to a member thereof or to such income credited or paid by a co-operative society to any other co-operative society;

(d) Interest paid or credited in respect of deposits under any scheme framed by the Central Government and notified by it in this behalf;

(e) Interest income credited or paid in respect of deposits (other than time deposits made on or after 1.7.1995) with

(i) a bank to which the Banking Regulation Act, 1949 applies; or

(ii) a co-operative society engaged in carrying on the business of banking.

(f) Interest credited or paid in respect of deposits with primary agricultural credit society or a primary credit society or a co-operative land mortgage bank or a co-operative land development bank.

(g) Interest credited or paid in respect of deposits (other than time deposits) with a co-operative society, other than a co-operative society or bank referred to in (f) above, engaged in carrying on the business of banking.

(h) Interest income credited or paid by the Central Government under any provisions of the Income-tax Act, 1961, the Estate Duty Act, the Wealth-tax Act, 1957, the Gift-tax Act, the Companies (Profits) Surtax Act or the Interest Tax Act.

(i) Interest paid or credited to the following entities:

(i) banking companies, or co-operative societies engaged in the business of banking, including co-operative land mortgage' banks;

(ii) financial corporations established under any Central, State or Provincial Act.

(iii) the Life Insurance Corporation of India.

(iv) companies and co-operative societies carrying on the business of insurance.

(v) the Unit Trust of India; and

(vi) notified institution, association, body or class of institutions, associations or bodies (National Skill Development Fund ***and Housing and Urban Development Corporation Ltd.(HUDCO)*** has been notified by the Central Government for this purpose)

(j) income credited by way of interest on the compensation amount awarded by the Motor Accidents Claims Tribunal;

(k) income paid by way of interest on the compensation amount awarded by the Motor Accidents Claims Tribunal where the amount of such income or, as the case may be, the aggregate of the amounts of such income paid during the financial year does not exceed ₹ 50,000.

(l) income paid or payable by an infrastructure capital company or infrastructure capital fund or public sector company or scheduled bank in relation to a zero coupon bond issued on or after 1.6.2005.

Note - The expression "time deposits" [for the purpose of (4)(a), (e) and (g) above] means the deposits, including recurring deposits, repayable on the expiry of fixed periods.

No tax to be deducted at source under section 194A, in case of Senior Citizens if the aggregate amount of interest does not exceed ₹ 50,000 [Notification No. 6/2018, dated 6-12-2018]

As per the third proviso to section 194A(3), no tax is required to be deducted at source in the case of senior citizens where the amount of interest or the aggregate of the amount of interest credited or paid during the financial year by a banking company, co-operative society engaged in banking business or post office does not exceed ₹ 50,000. However, it has come to the notice of the CBDT, that, some tax deductors/banks are making tax deductions even when the amount of interest does not exceed ₹ 50,000.

Under Rule 31A(5) of the Income-tax Rules, 1962, the DGIT (Systems) is authorized to specify the procedures, formats and standards for the purposes of furnishing and verification of the statements or claim for refund and shall be responsible for the day-to-day administration in relation to furnishing and verification of the statements or claim for refund in the manner so specified.

Accordingly, the Principal Director General of Income-tax (Systems) has, in exercise of the powers delegated by the CBDT under Rule 31A(5), clarified that no tax deduction *at source* under section 194A shall be made in the case of senior citizens where the amount of such income or the aggregate of the amounts of such income credited or paid during the financial year does not exceed ₹ 50,000.

Applicability of provisions for deduction of tax at source under section 194A on interest on fixed deposit made in the name of the Registrar General of Court or the depositor of the Fund on directions of Courts [*Circular No.23/2015, dated 28-12-2015*]

Section 194A stipulates deduction of tax at source (TDS) on interest other than interest on securities if the aggregate of amount of such interest credited or paid to the account of the payee during the financial year exceeds the specified amount.

In the case of UCO Bank in *Writ Petition No. 3563 of 2012 and CM No. 7517/2012 vide judgment dated 11/11/2014*, the Hon'ble Delhi High Court has held that the provisions of section 194A do not apply to fixed deposits made in the name of Registrar General of the Court on the directions of the Court during the pendency of proceedings before the Court. In such cases, till the Court passes the appropriate orders in the matter, it is not known who the beneficiary of the fixed deposits will be. Amount and year of receipt is also unascertainable. The Delhi High Court, thus, held that the person who is ultimately granted the funds would be determined by orders that are passed subsequently. At that stage, undisputedly, tax would be required to be deducted at source to the credit of the recipient. The High Court has also quashed Circular No.8/2011.

The CBDT has accepted the aforesaid judgment. Accordingly, it is clarified that interest on FDRs made in the name of Registrar General of the Court or the depositor of the fund on the directions of the Court, will not be subject to TDS till the matter is decided by the Court. However, once the Court decides the ownership of the money lying in the fixed deposit, the provisions of section 194A will apply to the recipient of the income.

Deduction of tax at source on interest income accrued to minor child, where both the parents have deceased [Notification No. 05/2017, dated 29.05.2017]

Under Rule 31A(5) of the Income-tax Rules, 1962, the Director General of Income-tax (Systems) is authorized to specify the procedures, formats and standards for the purposes of furnishing and verification of, *inter alia*, the statements and shall be responsible for the day-to-day administration in relation to furnishing and verification of the statements in the manner so specified.

The Principal Director General of Income-tax (Systems) has, in exercise of the powers delegated by the CBDT under Rule 31A(5), specified that in case of minors where both the parents have deceased, TDS on the interest income accrued to the minor is required to be deducted and reported against PAN of the minor child unless a declaration is filed under Rule 37BA(2) that credit for tax deducted has to be given to another person.

Deduction of tax at source on interest on deposits made under Capital Gains Accounts Scheme, 1988 where depositor has deceased [Notification No. 08/2017, dated 13.09.2017]

The Principal Director General of Income-tax (Systems) has, in exercise of the powers delegated by the CBDT under Rule 31A(5), vide this notification, specified that in case of deposits under the Capital Gains Accounts Scheme, 1988 where the depositor has deceased:

(i) TDS on the interest income accrued for and upto the period of death of the depositor is required to be deducted and reported against PAN of the depositor, and

(ii) TDS on the interest income accrued for the period after death of the depositor is required to be deducted and reported against PAN of the legal heir,

unless a declaration is filed under Rule 37BA(2) that credit for tax deducted has to be given to another person.

ILLUSTRATION 3

Examine the TDS implications under section 194A in the cases mentioned hereunder –

(i) On 1.10.2019, Mr. Harish, aged 40 years, made a six-month fixed deposit of ₹ 10 lakh @9% p.a. with ABC Co-operative Bank. The fixed deposit matures on 31.3.2020.

(ii) On 1.6.2019, Mr. Ganesh, aged 45 years, made three nine month fixed deposits of ₹ 3 lakh each carrying interest@9% with Dwarka Branch, Janakpuri Branch and Rohini Branch of XYZ Bank, a bank which has adopted CBS. The fixed deposits mature on 28.2.2020.

(iii) On 1.4.2019, Mr. Rajesh, aged 35 years, started a 1 year recurring deposit of ₹ 80,000 per month@8% p.a. with PQR Bank. The recurring deposit matures on 31.3.2020.

SOLUTION

(i) ABC Co-operative Bank has to deduct tax at source@10% on the interest of ₹ 45,000 (9% × ₹ 10 lakh × ½) under section 194A. The tax deductible at source under section 194A from such interest is, therefore, ₹ 4,500.

(ii) XYZ Bank has to deduct tax at source@10% under section 194A, since the aggregate interest on fixed deposit with the three branches of the bank is ₹ 60,750 [₹ 3,00,000 × 3 × 9% × 9/12], which exceeds the threshold limit of ₹ 40,000. Since XYZ Bank has adopted CBS, the aggregate interest credited/paid by all branches has to be considered. Since the aggregate interest of ₹ 60,750 exceeds the threshold limit of ₹ 40,000, tax has to be deducted@10% under section 194A.

(iii) Tax has to be deducted under section 194A by PQR Bank on the interest of ₹ 41,600 falling due on recurring deposit on 31.3.2020 to Mr. Rajesh, since –

(1) "recurring deposit" is included in the definition of "time deposit"; and

(2) such interest exceeds the threshold limit of ₹ 40,000.

ILLUSTRATION 4

Maya Bank credited ₹ 73,50,000 towards interest on the deposits in a separate account for macro-monitoring purposes by using Core-branch Banking Solutions (CBS) software. No tax was deducted at source in respect of interest on deposits so credited even where the interest in respect of some depositors exceeded the limit of ₹ 40,000.

The Assessing Officer disallowed 30% of interest expenditure, where the interest on time deposits credited exceeded the limit of ₹ 40,000 and also levied penalty under section 271C.

Decide the correctness of action of the Assessing Officer.

SOLUTION

The *Explanation* below section 194A(1) provides that where any income by way of interest other than interest on securities is credited to any account, whether called 'interest payable account' or 'suspense account' or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and provisions of section 194A, shall, thus, apply.

However, the CBDT has, vide *Circular No.3/2010 dated 2.3.2010*, clarified that *Explanation* to section 194A will not apply in cases of banks where credit is made to provisioning account on daily/monthly basis for the purpose of macro monitoring only by the use of CBS software.

Since no constructive credit to the depositor's / payee's account takes place while calculating interest on daily / monthly basis in the CBS software used by banks, tax need not be deducted at source on such provisioning of interest by banks for the purposes of macro monitoring only.

In such cases, tax shall be deducted at source on accrual of interest at the end of the financial year or at periodic intervals as per practice of the bank or as per the depositor's or payee's requirement or on maturity or on encashment of time deposit, whichever event takes place earlier and wherever the aggregate amount of interest income credited or paid or likely to be credited or paid during the financial year by the bank exceeds the limits specified in section 194A i.e., ₹ 40,000.

In view of the above, the action of the Assessing Officer in disallowing the interest expenditure credited in a separate account for macro monitoring purpose is not valid and consequent initiation of penalty proceedings under section 271C is not tenable in law.

15.3.5 Winnings from lotteries, crossword puzzles and horse races [Sections 194B and 194BB]

(1) Rate of tax on casual income

Any income of a casual and non-recurring nature of the type of winnings from lotteries, crossword puzzles, card game and other game of any sort, races including horse races, etc. will be charged to income-tax at a flat rate of **30%** [Section 115BB].

(2) TDS on winning from lotteries, crossword puzzles etc.

According to the provisions of section 194B, every person responsible for paying to any person, whether resident or non-resident, any income by way of winnings from lottery or crossword puzzle or card game and other game of any sort, is required to deduct income-tax therefrom at the rate of **30%** if the amount of payment exceeds **₹ 10,000**.

(3) Cases where winnings are partly in kind and partly in cash

In a case where the winnings are wholly in kind or partly in cash and partly in kind but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of the winnings, the person responsible for paying shall, before releasing the winnings, ensure that tax has been paid in respect of the winnings.

(4) Person responsible for deduction of tax under section 194BB

Section 194BB casts responsibility on the following persons to deduct tax at source -

(i) a bookmaker; or

(ii) a person to whom a license has been granted by the Government under any law for the time being in force -

(a) for horse racing in any race course; or

(b) for arranging for wagering or betting in any race course.

(5) Threshold limit and rate of TDS under section 194BB

The obligation to deduct tax at source under section 194BB arises when the abovementioned persons make payment to any person of any income by way of winnings from any horse race in excess of **₹ 10,000**. The rate applicable for deduction of tax at source is **30%**.

Tax will have to be deducted at source from winnings from horse races even though the winnings may be paid to the person concerned in instalments of less than **₹ 10,000**. Similarly, in cases where the book-maker or other person responsible for paying the winnings, credits such winnings and debits the losses to the individual account of the punter, tax has to be deducted **@30%** on winnings before set-off of losses. Thereafter, the net amount, after deduction of tax and losses, has to be paid to the winner.

(6) *Meaning of the expression "horse race"*

In the context of the provisions of section 194BB, the expression 'any horse race' used therein must be taken to include, wherever the circumstances so necessitate, more than one horse race. Therefore, winnings by way of jack pot would also fall within the scope of section 194BB.

ILLUSTRATION 5

Mr. Govind won the first prize in a lottery ticket and the prize was a Maruti car worth ₹ 5 lacs. What is the procedure to be adopted before handing over the Maruti Car to Mr. Govind?

SOLUTION

Section 194B provides that the person responsible for paying to any person, any income by way of winnings from any lottery or crossword puzzle, card game or any other game of any sort and the amount of winning exceeds ₹ 10,000, tax shall be deducted at source @30%.

However, in case where the winning is wholly in kind, the person responsible for paying the prize shall before releasing the winning, ensure that the tax has been paid in respect of such winning.

The Karnataka High Court in the case of *CIT v. Hindustan Lever Ltd. (2014) 361 ITR 1* has held that where the winnings are wholly in kind, the responsibility cast under section 194B is to ensure that the tax is paid by the winner of the prize before the prize is released in his favour. In this regard, the *CBDT Circular No.763 dated 18/2/1998* clarifies that the person responsible for paying the winnings shall, before releasing such winnings, ensure that the tax is paid by the winner. He can do so, for example, by collecting from the winner a sum equal to the tax deductible at source on the winnings in kind, before releasing the winnings. For this purpose, the value of the winnings in kind shall be taken as the cost incurred by the payer in acquiring the said winnings in kind.

Therefore, in this case since the entire winning is in kind, it must be ensured that the sum equal to the tax deductible at source (i.e., ₹ 1,50,000, being @ 30% of ₹ 5 lacs) is paid by Mr. Govind, before the car is released in his favour. This can be done by collecting ₹ 1,50,000 from Mr. Govind before releasing the Maruti car to him and remitting the said sum to the Government account or verifying the tax payment by the winner and thereafter releasing the prize.

15.3.6 Payments to contractors and sub-contractors [Section 194C]

(1) *Applicability of TDS under section 194C*

Section 194C provides for deduction of tax at source from the payment made to resident contractors and sub-contractors.

Any person responsible for paying any sum to a resident contractor for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor and the Central Government, a State Government, local authority, statutory corporation, a company, co-operative society, any statutory authority dealing with housing accommodation, any society registered under the Societies Registration Act, 1860, any trust or any university or any firm or any Government of a foreign State or foreign enterprise or any association or body established outside India or an individual, HUF, AOP or BOI subject to tax audit under section 44AB(a)/(b) in the immediately preceding financial year must deduct tax at source at the prescribed rate from such sum.

(2) Time of deduction

Tax has to be deducted at the time of payment of such sum or at the time of credit of such sum to the account of the contractor, whichever is earlier.

Where any such sum is credited to any account in the books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and the tax has to be deducted at source. The account to which such sum is credited may be called "Suspense account" or by any other name.

However, no tax has to be deducted at source in respect of payments made by individuals/ HUF to a contractor exclusively for personal purposes.

(3) Rate of TDS

The rate of TDS under section 194C on payments to contractors would be **1%**, where the payee is an individual or HUF and **2%** in respect of other payees. The same rates of TDS would apply for both contractors and sub-contractors.

The applicable rates of TDS under section 194C are as follows –

Payee	TDS rate
Individual / HUF contractor/sub-contractor	1%
Other than individual / HUF contractor/sub-contractor	2%
Contractor in transport business (if PAN is furnished)	Nil
Sub-contractor in transport business (if PAN is furnished)	Nil

(4) Threshold limit for deduction of tax at source under section 194C

No deduction will be required to be made if the consideration for the contract does not exceed **₹ 30,000**. However, to prevent the practice of composite contracts being split up into contracts valued at less than **₹ 30,000** to avoid tax deduction, it has been provided that tax will be required to be deducted at source where the amount credited or paid or likely to be credited or paid to a contractor or sub-contractor exceeds **₹ 30,000** in a single payment or **₹ 1,00,000** in the aggregate during a financial year.

Therefore, even if a single payment to a contractor does not exceed **₹ 30,000**, TDS provisions under section 194C would be attracted where the aggregate of the amounts of such sums credited or paid or likely to be credited or paid to the contractor during the financial year exceeds **₹ 1,00,000**.

ILLUSTRATION 6

ABC Ltd. makes the following payments to Mr. X, a contractor, for contract work during the P.Y.2019-20–

₹ 20,000 on 1.5.2019

₹ 25,000 on 1.8.2019

₹ 28,000 on 1.12.2019

On 1.3.2020, a payment of ₹ 30,000 is due to Mr. X on account of a contract work.

Discuss whether ABC Ltd. is liable to deduct tax at source under section 194C from payments made to Mr. X.

SOLUTION

In this case, the individual contract payments made to Mr. X does not exceed ₹ 30,000. However, since the aggregate amount paid to Mr. X during the P.Y.2019-20 exceeds ₹ 1,00,000 (on account of the last payment of ₹ 30,000, due on 1.3.2020, taking the total from ₹ 73,000 to ₹ 1,03,000), the TDS provisions under section 194C would get attracted. Tax has to be deducted@1% on the entire amount of ₹ 1,03,000 from the last payment of ₹ 30,000 and the balance of ₹ 28,970 (i.e., ₹ 30,000 – ₹ 1,030) has to be paid to Mr. X.

(5) Definition of work

Work includes –

(a) advertising;

(b) broadcasting and telecasting including production of programmes for such broadcasting or telecasting;

(c) carriage of goods or passengers by any mode of transport other than by railways;

(d) catering;

(e) manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer.

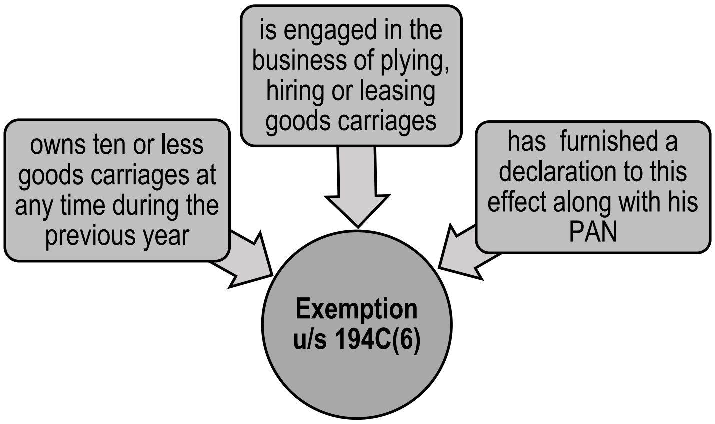
However, "work" shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer, as such a contract is a contract for 'sale'. However, this will not be applicable to a contract which does not entail manufacture or supply of an article or thing (e.g. a construction contract).

It may be noted that the term "work" would include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. In such a case, tax shall be deducted on the invoice value excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. Where the material component has not been separately mentioned in the invoice, tax shall be deducted on the whole of the invoice value.

(6) Non-applicability of TDS under section 194C

No deduction is required to be made from the sum credited or paid or likely to be credited or paid during the previous year to the account of a contractor, during the course of the business of plying, hiring or leasing goods carriages, if he furnishes his PAN to the deductor.

In order to convey the true intent of law, it has been clarified that this relaxation from the requirement to deduct tax at source shall only be applicable to the payment in the nature of transport charges (whether paid by a person engaged in the business of transport or otherwise) made to a contractor, who fulfills the following three conditions cumulatively -


is engaged in the business of plying, hiring or leasing goods carriages
owns ten or less goods carriages at any time during the previous year
has furnished a declaration to this effect along with his PAN
Exemption u/s 194C(6)

Meaning of Goods carriage:

Goods carriage means -

(i) any motor vehicle constructed or adapted for use solely for the carriage of goods; or

(ii) any motor vehicle not so constructed or adapted, when used for the carriage of goods.

The term "motor vehicle" does not include vehicles having less than four wheels and with engine capacity not exceeding 25cc as well as vehicles running on rails or vehicles adapted for use in a factory or in enclosed premises.

(7) Important points

(i) The deduction of income-tax at source from payments made to non-resident contractors will be governed by the provisions of section 195.

(ii) The deduction of income-tax will be made from sums paid for carrying out any work or for supplying labour for carrying out any work. In other words, the section will apply only in relation to 'works contracts' and 'labour contracts' and will not cover contracts for sale of goods.

(iii) Contracts for rendering professional services by lawyers, physicians, surgeons, engineers, accountants, architects, consultants etc., cannot be regarded as contracts for carrying out any "work" and, accordingly, no deduction of income-tax is to be made from payments relating to such contracts under this section. Separate provisions for fees for professional services have been made under section 194J.

(8) Deduction of tax at source on payment of gas transportation charges by the purchaser of natural gas to the seller of gas [Circular No. 9/2012 dated 17.10.2012]

In case the Owner/Seller of the natural gas sells as well as transports the gas to the purchaser till the point of delivery, where the ownership of gas to the purchaser is simultaneously transferred, the manner of raising the sale bill (whether the transportation charges are embedded in the cost of gas or shown separately) does not alter the basic nature of such contract which remains essentially a 'contract for sale' and not a 'works contract' as envisaged in section 194C. Therefore, in such circumstances, the provisions of Chapter XVIIB are not applicable on the component of Gas Transportation Charges paid by the purchaser to the Owner/Seller of the gas. Further, the use of different modes of transportation of gas by Owner/Seller will not alter the position.

However, transportation charges paid to a third party transporter of gas, either by the Owner/Seller of the gas or purchaser of the gas or any other person, shall continue to be governed by the appropriate provisions of the Act and tax shall be deductible at source on such payment to the third party at the applicable rates.

(9) Applicability of TDS provisions on payments by broadcasters or Television Channels to production houses for production of content or programme for telecasting [Circular No. 04/2016, dated 29-2-2016]

The issue under consideration is whether payments made by the broadcaster/telecaster to production houses for production of content/programme are payments under a 'work contract' liable for tax deduction at source under section 194C or a contract for 'professional or technical services' liable for tax deduction at source under section 194J.

In this regard, the CBDT has clarified that while applying the relevant provisions of TDS on a contract for content production, a distinction is required to be made between:

(i) a payment for production of content/programme as per the specifications of the broadcaster/telecaster; and

(ii) a payment for acquisition of broadcasting/ telecasting rights of the content already produced by the production house.

In the first situation where the content is produced as per the specifications provided by the broadcaster/ telecaster and the copyright of the content/programme also gets transferred to the telecaster/ broadcaster, such contract is covered by the definition of the term `work' in section 194C and, therefore, subject to TDS under that section.

However, in a case where the telecaster/broadcaster acquires only the telecasting/ broadcasting rights of the content already produced by the production house, there is no contract for ''carrying out any work", as required in section 194C(1). Therefore, such payments are not liable for TDS under section 194C. However, payments of this nature may be liable for TDS under other sections of Chapter XVII-B of the Act.

ILLUSTRATION 7

Bharathi Cements Ltd. purchased jute bags from Raj Kumar & Co. The latter has to supply the jute bags with the logo and address of the assessee, printed on it. From 01.09.2019 to 20.03.2020, the value of jute bags supplied is ₹ 8,00,000, for which the invoice has been raised on 20.03.2020. While effecting the payment for the same, is the assessee bound to deduct tax at source, assuming that the value of the printing component involved is ₹ 1,10,000. You are informed that the assessee has not sold any material to Raj Kumar & Co. and that the latter has to manufacture the jute bags in its plant using raw materials purchased by it from outsiders.

SOLUTION

As per the definition under section 194C, "work" shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer. This is regardless of the quantum of expenditure incurred towards printing or processing comprised in the bill amount.

The problem clearly states that Raj Kumar & Co. has to manufacture the jute bags using raw materials purchased from outsiders and that the assessee Bharathi Cements Ltd has not sold any material to them. Therefore, in this case, it is a contract of sale. Hence, the provisions of section 194C are **not** attracted and no liability to deduct tax at source would arise.

ILLUSTRATION 8

Alap Ltd. has made following payments on various dates in financial year 2019-20 to Vilambit Ltd. towards work done under different contracts:

Contract Number	*Date of payment*	*Amount (₹)*
1.	*5.5.2019*	*20,000*
2.	*6.6.2019*	*15,000*
3.	*8.8.2019*	*25,000*
4.	*10.12.2019*	*25,000*
5.	*29.01.2020*	*17,000*

Alap Ltd. claims that it is not liable for deduction of tax at source under section 194C. Examine the correctness of the claim made by the company. What would be the position if the value of the contract no. 5 is ₹ 14,000 only and there was no further contract during the year?

SOLUTION

As per section 194C(5), tax has to be deducted at source where the amount credited or paid or likely to be credited or paid to a contractor or sub-contractor exceeds ₹ 30,000 in a single payment or ₹ 1,00,000 in aggregate during the financial year.

Therefore, in the given case, even though the value of each individual contract does not exceed ₹ 30,000, the aggregate amount exceeds ₹ 1,00,000. Hence, Alap Ltd's contention is not correct and tax is required to be deducted at source on the whole amount of ₹ 1,02,000 from the last payment of ₹17,000 towards Contract No.5 on account of which the aggregate amount exceeded ₹ 1,00,000.

However, no tax deduction is to be made if the value of the last contract is ₹ 14,000 as the aggregate amount in such case would only be ₹ 99,000, which is below the aggregate monetary limit of ₹ 1,00,000.

15.3.7 Insurance Commission [Section 194D]

(1) Applicability of TDS under section 194D

Section 194D casts responsibility on any person responsible for paying to a resident any income by way of remuneration or reward, whether by way of commission or otherwise, for soliciting or procuring insurance business (including the business relating to the continuance, renewal or revival of policies of insurance) to deduct tax at source.

(2) Rate of TDS

Such person is required to deduct income-tax at the rate of **5%**.

(3) Time of deduction

The deduction is to be made at the time of the credit of the income to the account of the payee or at the time of making the payment (by whatever mode) to the payee, whichever is earlier.

(4) Threshold limit

The tax under this section has to be deducted at source only if the amount of such income or the aggregate of the amounts of such income credited or paid during the financial year to the account of the payee exceeds **₹ 15,000**.

15.3.8 Payment in respect of life insurance policy [Section 194DA]

(1) Taxability of sum received under a life insurance policy

Under section 10(10D), any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy is exempt subject to fulfillment of conditions specified under the said section.

Consequently, the sum received under a life insurance policy which does not fulfill the conditions specified under section 10(10D) is taxable.

(2) Rate of TDS

For ensuring a proper mechanism for reporting of transactions and collection of tax in respect of sum paid under life insurance policies which are not exempt under section 10(10D), section 194DA provides for deduction of tax at the rate of **1%** on any sum paid to a resident under a life insurance policy, including the sum allocated by way of bonus, which are not exempt under section 10(10D). ***However, with effect from 1.9.2019, tax is to be deducted at source @5% on the amount of income comprised therein i.e., after deducting the amount of insurance premium paid by the resident assessee from the total sum received.***

(3) Threshold limit

Tax deduction is required only if the payment or aggregate payment in a financial year to an assessee is **₹ 1,00,000 or more**. This is for alleviating the compliance burden on the small tax payers.

ILLUSTRATION 9

Examine the applicability of the provisions for tax deduction at source under section 194DA in the following cases -

(i) Mr. X, a resident, is due to receive ₹ 4.50 lakhs on 31.3.2020, towards maturity proceeds of LIC policy taken on 1.4.2017, for which the sum assured is ₹ 4 lakhs and the annual premium is ₹ 1,10,000.

(ii) Mr. Y, a resident, is due to receive ₹ 3.25 lakhs on 31.3.2020 on LIC policy taken on 31.3.2012, for which the sum assured is ₹ 3 lakhs and the annual premium is ₹ 35,000.

(iii) Mr. Z, a resident, is due to receive ₹ 95,000 on 1.8.2019 towards maturity proceeds of LIC policy taken on 1.8.2013 for which the sum assured is ₹ 90,000 and the annual premium is ₹ 12,000.

SOLUTION

(i) Since the annual premium exceeds 10% of sum assured in respect of a policy taken after 31.3.2012, the maturity proceeds of ₹ 4.50 lakhs due on 31.3.2020 are not exempt under section 10(10D) in the hands of Mr. X. Therefore, tax is required to be deducted@5% under section 194DA on the amount of income comprised therein i.e., on ₹ 1,20,000 (₹ 4,50,000, being maturity proceeds - ₹ 3,30,000, being the entire amount of insurance premium paid).

(ii) Since the annual premium is less than 20% of sum assured in respect of a policy taken before 1.4.2012, the sum of ₹ 3.25 lakhs due to Mr. Y would be exempt under section

10(10D) in his hands. Hence, no tax is required to be deducted at source under section 194DA on such sum payable to Mr. Y.

(iii) Even though the annual premium exceeds 10% of sum assured in respect of a policy taken after 31.3.2012, and consequently, the maturity proceeds of ₹ 95,000 due on 1.8.2019 would not be exempt under section 10(10D) in the hands of Mr. Z, the tax deduction provisions under section 194DA are not attracted since the maturity proceeds are less than ₹ 1 lakh.

15.3.9 Payments to non-resident sportsmen or sports association [Section 194E]

(1) Applicability

This section provides for deduction of tax at source in respect of any income referred to in section 115BBA payable to a non-resident sportsman (including an athlete) or an entertainer who is not a citizen of India or a non-resident sports association or institution.

(2) Rate of TDS

Deduction of tax at source **@20.8%** should be made by the person responsible for making the payment. Health and education cess @4% on TDS rate of 20% would be leviable, since payment is made to a non-resident.

(3) Time of deduction of tax

Such tax deduction should be at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(4) Income referred to in section 115BBA

(i) income received or receivable by a non-resident sportsman (including an athlete) by way of-

(a) participation in any game or sport in India (However, games like crossword puzzles, horse races etc. taxable under section 115BB are not included herein); or

(b) advertisement; or

(c) contribution of articles relating to any game or sport in India in newspapers, magazines or journals.

(ii) Guarantee amount paid or payable to a non-resident sports association or institution in relation to any game or sport played in India. However, games like crossword puzzles, horse races etc. taxable under section 115BB are not included herein.

(iii) income received or receivable by a non-resident entertainer (who is not a citizen of India) from his performance in India.

ILLUSTRATION 10

Calculate the amount of tax to be deducted at source (TDS) on payment made to Ricky Ponting, an Australian cricketer, by a newspaper for contribution of articles ₹ 25,000.

SOLUTION

Under section 194E, the person responsible for payment of any amount to a non-resident sportsman for contribution of articles relating to any game or sport in India in a newspaper shall deduct tax @20%. Further, since Ricky Ponting is a non-resident, health and education cess@4% on TDS would also be added.

Therefore, tax to be deducted = ₹ 25,000 x 20.80% = ₹ 5,200.

15.3.10 Payments in respect of deposits under National Savings Scheme etc. [Section 194EE]

(1) Rate of TDS

The person responsible for paying to any person any amount from National Savings Scheme Account shall deduct income-tax thereon at the rate of **10%** at the time of payment.

(2) Threshold limit

No such deduction shall be made where the amount of payment or the aggregate amount of payments in a financial year is less than **₹ 2,500**.

(3) Non-applicability of TDS under section 194EE

The provisions of this section shall not apply to the payments made to the heirs of the assessee.

15.3.11 Repurchase of units by Mutual Fund or Unit Trust of India [Section 194F]

A person responsible for paying to any person any amount on account of repurchase of units covered under section 80CCB(2)[1] shall deduct tax at source at the rate of **20%** at the time of payment of such amount.

15.3.12 Commission etc. on the sale of lottery tickets [Section 194G]

(1) Applicability and Rate of TDS

Under section 194G, the person responsible for paying to any person, who is or has been stocking, distributing, purchasing or selling lottery tickets, any income by way of commission, remuneration or prize (by whatever name called) on lottery tickets in an amount exceeding **₹ 15,000** shall deduct income-tax thereon at the rate of **5%**.

[1] Deduction u/s 80CCB was available in respect of investment made in notified units of UTI or Mutual Funds during the PYs 1990-91 and 1991-92

(2) Time of deduction of tax

Such deduction should be made at the time of credit of such income to the account of the payee or at the time of payment of such income by cash, cheque, draft or any other mode, whichever is earlier.

Where any such income is credited to any account, whether called "Suspense Account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

15.3.13 Commission or brokerage [Section 194H]

(1) Applicability and Rate of TDS

Any person who is responsible for paying any income by way of commission (other than insurance commission) or brokerage to a resident shall deduct income tax at the rate of **5%**.

However, an individual or HUF whose total sales, gross receipts or turnover from the business or profession carried on by him do not exceed the monetary limits of **₹ 1 crore** and **₹ 50 lakhs**, respectively, specified under section 44AB during the immediately preceding financial year is not liable to deduct tax at source.

(2) Time of deduction

The deduction shall be made at the time such income is credited to the account of the payee or at the time of payment in cash or by issue of cheque or draft or by any other mode, whichever is earlier.

Even where income is credited to some other account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit to the account of the payee for the purposes of this section.

(3) Threshold limit

No deduction is required if the amount of such income or the aggregate of such amount does not exceed **₹ 15,000** during the financial year.

(4) Meaning of "Commission or brokerage"

"Commission or brokerage" includes any payment received or receivable, directly or indirectly, by a person acting on behalf of another person for services rendered, or for any services in the course of buying or selling of goods, or in relation to any transaction relating to any asset, valuable article or thing, other than securities.

(5) Non-applicability of TDS under section 194H

This section is not applicable to professional services. "Professional Services" means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or such other profession as notified by the CBDT for the purpose of compulsory maintenance of books of account under section 44AA.

Further, there would be no requirement to deduct tax at source on commission or brokerage payments by BSNL or MTNL to their public call office (PCO) franchisees.

(6) Applicability of TDS provisions on payments by television channels and publishing houses to advertisement companies for procuring or canvassing for advertisements [Circular No. 05/2016, dated 29-2-2016]

There are two types of payments involved in the advertising business:

(i) Payment by client to the advertising agency, and

(ii) Payment by advertising agency to the television channel/newspaper company

The applicability of TDS on these payments has already been dealt with in Circular No. 715 dated 8-8-1995, where it has been clarified in Question Nos. 1 & 2 that while TDS under section 194C (as work contract) will be applicable on the first type of payment, there will be no TDS under section 194C on the second type of payment e.g. payment by advertising agency to the media company.

However, another issue has been raised in various cases as to whether the fees/charges taken or retained by advertising companies from media companies for canvasing/booking advertisements (typically 15% of the billing) is 'commission' or 'discount' for attracting the provisions of section 194H.

The CBDT has clarified that no TDS is attracted on payments made by television channels/newspaper companies to the advertising agency for booking or procuring of or canvassing for advertisements. It is also further clarified that 'commission' referred to in Question No.27 of the *CBDT's Circular No. 715 dated 8-8-1995* does not refer to payments by media companies to advertising companies for booking of advertisements but to payments for engagement of models, artists, photographers, sportspersons, etc. and, therefore, is not relevant to the issue of TDS referred to in this Circular.

ILLUSTRATION 11

B. Airways Ltd. sold tickets to the travel agents in India at a minimum fixed commercial price. The agents were permitted to sell the tickets at a higher price but not exceeding the maximum published price. Commission at the rate of 9% of minimum fixed commercial price was deducted under section 194H by the company. The Assessing Officer contended that the liability for tax deduction at source is attracted on the difference between the minimum fixed commercial price and the maximum published price by treating it as "additional special commission" in the hands of the agents.

Is the contention of Assessing Officer tenable in law?

SOLUTION

As per the provisions of section 194H, a person is liable to deduct tax at source at the time of credit or payment of commission to any resident, whichever is earlier.

In the present case, B. Airways Ltd. correctly deducted tax at source under section 194H from the commission@9% of the minimum fixed commercial price paid to the travel agents, who were allowed to sell the air tickets at any price higher than the minimum fixed commercial price subject to a maximum published price. However, the Assessing Officer contented that the airline company was required to deduct tax at source on the difference between the minimum fixed commercial price and the maximum published price by treating it as "additional special commission" in the hands of the agents.

The facts of the case are similar to the case of *CIT v. Qatar Airways (2011) 332 ITR 253,* where the Bombay High Court held that the difference between the maximum published price and the minimum fixed commercial price cannot be taken as "additional special commission" in the hands of the agents. This is because the maximum published price is the maximum price and the airline company has granted permission to the agents to sell the tickets at a price lower than the maximum published price**.** Further, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents. In order to deduct tax at source on the difference between actual sale price and minimum fixed commercial price, the exact income in the hands of the agents must be ascertainable by the airline company. However, it is not so ascertainable in this case, since the agents are given discretion to sell the tickets at any rate between the minimum fixed commercial price and the maximum published price. **It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of the price at which the tickets were sold by them.**

Applying the rationale of the above case to the case on hand, B. Airways Ltd. is not liable to deduct tax at source under section 194H on the difference between the maximum published price and the minimum fixed commercial price, even though the amount earned by the agent over and above the minimum fixed commercial price is taxable as income in their hands.

Therefore, the contention of the Assessing Officer is not tenable in law.

ILLUSTRATION 12

Moon TV, a television channel, made payment of ₹ 50 lakhs to a production house for production of programme for telecasting as per the specifications given by the channel. The copyright of the programme is also transferred to Moon TV. Would such payment be liable for tax deduction at source under section 194C? Discuss.

Also, examine whether the provisions of tax deduction at source under section 194C would be attracted if the payment was made by Moon TV for acquisition of telecasting rights of the content already produced by the production house.

SOLUTION

In this case, since the programme is produced by the production house as per the specifications given by Moon TV, a television channel, and the copyright is also transferred to the television channel, the same falls within the scope of definition of the term 'work' under section 194C. Therefore, the payment of ₹ 50 lakhs made by Moon TV to the production house would be subject to tax deduction at source under section 194C.

If, however, the payment was made by Moon TV for acquisition of telecasting rights of the content already produced by the production house, there is no contract for ''carrying out any work", as required in section 194C(1). Therefore, such payment would not be liable for tax deduction at source under section 194C.

15.3.14 Rent [Section 194-I]

(1) Applicability and Rate of TDS

Any person who is responsible for paying to a resident any income by way of rent shall deduct income tax at the rate of:

(i) **2%** in respect of rent for plant, machinery or equipment;

(ii) **10%** in respect of other rental payments (i.e., rent for use of any land or building, including factory building, or land appurtenant to a building, including factory building, or furniture or fixtures).

However, an individual or HUF whose total sales, gross receipts or turnover from the business or profession carried on by him do not exceed the monetary limits of ₹ 1 crore and ₹ 50 lakhs, respectively, specified under section 44AB during the immediately preceding financial year is not liable to deduct tax at source.

Further, no deduction shall be made under this section from rent credited or paid to a business trust, being a REIT, in respect of any real estate asset owned directly by it.

(2) Time of deduction

This deduction is to be made at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of cheque or draft or by any other mode, whichever is earlier.

Where any such income is credited to any account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section will apply accordingly.

(3) Threshold limit

No deduction need be made where the amount of such income or the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year to the account of the payee does not exceed ***₹ 2,40,000***.

(4) Meaning of Rent

"Rent" means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any –

(a) land; or

(b) building (including factory building); or

(c) land appurtenant to a building (including factory building); or

(d) machinery; or

(e) plant; or

(f) equipment; or

(g) furniture; or

(h) fittings,

whether or not any or all of the above are owned by the payee.

(5) Applicability of TDS provisions under section 194-I to payments made by the customers on account of cooling charges to the cold storage owners

CBDT *Circular No.1/2008 dated 10.1.2008* provides clarification regarding applicability of provisions of section 194-I to payments made by the customers on account of cooling charges to the cold storage owners.

The main function of the cold storage is to preserve perishable goods by means of a mechanical process, and storage of such goods is only incidental in nature. The customer is also not given any right to use any demarcated space/place or the machinery of the cold store and thus does not become a tenant. Therefore, the provisions of 194-I are not applicable to the cooling charges paid by the customers of the cold storage.

However, since the arrangement between the customers and cold storage owners are basically contractual in nature, the provision of section 194-C will be applicable to the amounts paid as cooling charges by the customers of the cold storage.

(6) No requirement to deduct tax at source under section 194-I on remittance of Passenger Service Fees (PSF) by an Airline to an Airport Operator [Circular No. 21/2017, dated 12.06.2017]

Section 194-I requires deduction of tax at source at specified percentage on any income payable to a resident by way of rent. *Explanation* to this section defines the term "rent" as any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of any (a) land; or (b) building; or (c) land appurtenant to a building; or (d) machinery; (e) plant; (f) equipment (g) furniture; or (h) fitting, whether or not any or all of them are owned by the payee.

On the issue of whether payment of PSF by an airline to an Airport Operator qualifies as rent to attract TDS under section 194-I, the Bombay High Court relied on the Apex Court ruling in *Japan Airlines and Singapore Airlines* case, wherein it was observed that the primary requirement for any payment to qualify as rent is that the payment must be for the use of land and building and mere incidental/minor/insignificant use of the same while providing other facilities and service would not make it a payment for use of land and buildings so as to attract section 194-I. Accordingly, the Bombay High Court declined to admit the ground relating to applicability of the provisions of section 194-I on PSF charges holding that no substantial question of law arises.

The CBDT, accepting the view of the Bombay High Court, has clarified that the provisions of section 194-I shall **not** be applicable on payment of PSF by an airline to Airport Operator.

***(7) Applicability of TDS provisions under section 194-I to* service tax component of rental income**

CBDT *Circular No.4/2008 dated 15.4.2008* provides clarification on deduction of tax at source (TDS) on service tax component of rental income under section 194-I.

As per the provisions of 194-I, tax is deductible at source on income by way of rent paid to any resident. Further, rent has been defined in 194-I to mean any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any,-

(a) land; or

(b) building (including factory building); or

(c) land appurtenant to a building (including factory building); or

(d) machinery; or

(e) plant; or

(f) equipment; or

(g) furniture; or

(h) fittings,

whether or not any or all of the above are owned by the payee.

Service tax paid by the tenant doesn't partake the nature of income of the landlord. The landlord only acts as a collecting agency for Government for collection of service tax. Therefore, tax deduction at source under section 194-I would be required to be made on the amount of rent paid/payable without including the service tax.

Note- *It may be noted that the clarification in respect of applicability of TDS provisions under section 194-I to GST component of rental income on similar lines is yet to be issued. Pending such clarification, it is possible to take a view that the clarification given in Circular No.4/2008 would apply in the GST regime also.*

Clarification regarding TDS on Goods and Services Tax (GST) component comprised in payments made to residents [Circular No. 23/2017 dated 19.07.2017]

The CBDT had, vide Circular No. 1/2014 dated 13.01.2014, clarified that wherever in terms of the agreement or contract between the payer and the payee, the service tax component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source on the amount paid or payable without including such service tax component.

In order to harmonize the same treatment with the new system for taxation of services under the GST regime w.e.f. 01.07.2017, the CBDT has, vide this circular, clarified that wherever in terms of the agreement or contract between the payer and the payee, the component of 'GST on services' comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source on the amount paid or payable without including such 'GST on services' component.

GST shall include Integrated Goods and Services Tax, Central Goods and Services Tax, State Goods and Services Tax and Union Territory Goods and Services Tax.

Further, for the purposes of this Circular, any reference to “service tax” in an existing agreement or contract which was entered into prior to 01.07.2017 shall be treated as “GST on services” with respect to the period from 01.07.2017 onward till the expiry of such agreement or contract.

(8) Clarification on applicability of TDS provisions of section 194-I on lumpsum lease premium paid for acquisition of long term lease [Circular No.35/2016, dated 13-10-2016]

The issue of whether or not TDS under section 194-I is applicable on 'lump sum lease premium' or 'one-time upfront lease charges" paid by an assessee for acquiring long-term leasehold rights for land or any other property has been examined by the CBDT.

Accordingly, the CBDT has, vide this clarified that lump sum lease premium or one-time upfront lease charges, which are not adjustable against periodic rent, paid or payable for acquisition of long-term leasehold rights over land or any other property are not payments in the nature of rent within the meaning of section 194-I. Therefore, such payments are not liable for TDS under section 194-I.

The issue as to whether the charges fixed by the Airport Authority of India (AAI) for landing and parking facility for the aircraft are for the "use of the land" by the airline company came up before the Supreme Court in Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372.

The Supreme Court observed that the charges which are fixed by the AAI for landing and take-off services as well as for parking of aircrafts are not for the "use of the land". These charges are for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport.

There are various international protocols which mandate all authorities manning and managing these airports to construct the airport of desired standards which are stipulated in the protocols. The services which are required to be provided by these authorities, like AAI, are aimed at passengers' safety as well as for safe landing and parking of the aircrafts. Therefore, the services are not restricted to merely permitting "use of the land" of airport. On the contrary, it encompasses all the facilities that are to be compulsorily offered by the AAI in tune with the requirements of the protocol.

The Supreme Court observed that the charges levied on air-traffic includes landing charges, lighting charges, approach and aerodrome control charges, aircraft parking charges, aerobridge charges, hangar charges, passenger service charges, cargo charges, etc. Thus, when the airlines pay for these charges, treating such charges as charges for "use of the land" would tantamount to adopting a totally simplistic approach which is far away from the reality.

The Supreme Court opined that the substance behind such charges has to be considered and when the issue is viewed from this angle, keeping the larger picture in mind, it becomes very clear that the charges are not for use of the land per se and, therefore, it cannot be treated as "rent" within the meaning of section 194-I. The Supreme Court, thus, concurred with the view taken by the Madras High Court in Singapore Airlines case and overruled the view taken by the Delhi High Court in United Airlines/Japan Airlines case.

ILLUSTRATION 13

ABC Ltd. took on sub-lease a building from J, an individual, with effect from 1.9.2019 on a rent of ₹ 25,000 per month. It also took on hire machinery from J with effect from 1.10.2019 on hire charges of ₹ 15,000 per month. ABC Ltd. entered into two separate agreements with J for sub-lease of building and hiring of machinery. The rent of building and hire charges of machinery for the financial year 2019-20 were ₹ 1,75,000 and ₹ 90,000, respectively, which were credited by ABC Ltd. to the account of J in its books of account on 31.3.2020. Examine the obligation of ABC Ltd. with regard to deduction of tax at source in respect of the rent and hire charges.

SOLUTION

As per section 194-I dealing with deduction of tax at source from payment of rent, the rate of TDS applicable is 2% for machinery hire charges and 10% for building lease rent. The scope of the section includes within its ambit, rent for machinery, plant and equipment. Tax is required to be deducted at source from payment of rent, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of building and machinery, irrespective of whether such assets are owned or not by the payee.

The limit of ₹ 2,40,000 for tax deduction at source will apply to the aggregate rent of all the assets. Even if two separate agreements are entered into, one for sub-lease of building and another for hiring of machinery, rent and hire charges under the two agreements have to be aggregated for the purpose of application of the threshold limit of ₹ 2,40,000. In this case, since the payment for rent and hire charges credited to the account of J, the payee, aggregates to ₹ 2,65,000 (₹ 1,75,000 + ₹ 90,000), tax is deductible at source under section 194-I. Tax is deductible@10% on ₹ 1,75,000 (rent of building) and @2% on ₹ 90,000 (hire charges of machinery).

15.3.15 Payment on transfer of certain immovable property other than agricultural land [Section 194-IA]

(1) Applicability and Rate

Every transferee responsible for paying any sum as consideration for transfer of immovable property (land, other than agricultural land, or building or part of building) to a resident transfer shall deduct tax, at the rate of **1%** of such sum.

(2) Time of deduction

The deduction is to be made at the time of credit of such sum to the account of the resident transferor or at the time of payment of such sum to a resident transferor, whichever is earlier.

(3) Threshold limit

Tax is not required to be deducted at source where the total amount of consideration for the transfer of immovable property is less than **₹ 50 lakh**.

(4) Non-applicability of TDS under section 194-IA

Since tax deduction at source for compulsory acquisition of immovable property is covered under section 194LA, the provisions of section 194-IA do not get attracted in the hands of the transferee in such cases.

(5) No requirement to obtain TAN

The provisions of section 203A containing the requirement of obtaining Tax deduction account number (TAN) shall not apply to the person required to deduct tax in accordance with the provisions of section 194-IA.

(6) Meaning of consideration for transfer of any immovable property

Consideration for transfer of any immovable property includes all charges of the nature of club membership fee, car parking fee, electricity or water facility fee, maintenance fee, advance fee or any other charges of similar nature, which are incidental to transfer of the immovable property.

Time and mode of payment of tax deducted at source under section 194-IA to the credit of Central Government, furnishing challan-cum-statement and TDS Certificate [Rules 30, 31A & 31]

(i) Such sum deducted under section 194-IA shall be paid to the credit of the Central Government within a period of 30 days from the end of the month in which the deduction is made and shall be accompanied by a challan-cum-statement in Form No.26QB [Rule 30].

(ii) The amount so deducted has to be deposited to the credit of the Central Government by electronic remittance within the above mentioned time limit, into RBI, SBI or any authorized bank [Rule 30].

(iii) Every person responsible for deduction of tax under section 194-IA shall also furnish to the DGIT (Systems) or any person authorized by him, a challan-cum-statement in Form No.26QB electronically within 30 days from the end of the month in which the deduction is made [Rule 31A].

(iv) Every person responsible for deduction of tax under section 194-IA shall furnish the TDS certificate in Form No.16B to the payee within 15 days from the due date for furnishing the challan-cum-statement in Form No.26QB under Rule 31A, after generating and downloading the same from the web portal specified by the DGIT (Systems) or the person authorized by him [Rule 31].

ILLUSTRATION 14

Mr. X sold his house property in Bangalore as well as his rural agricultural land for a consideration of ₹ 60 lakh and ₹ 15 lakh, respectively, to Mr. Y on 1.8.2019. He has purchased the house property and the land in the year 2018 for ₹ 40 lakh and ₹ 10 lakh, respectively. The stamp duty value on the date of transfer, i.e., 1.8.2019, is ₹ 85 lakh and ₹ 20 lakh for the house property and rural agricultural land, respectively. Determine the tax implications in the hands of Mr. X and Mr. Y and the TDS implications, if any, in the hands of Mr. Y, assuming that both Mr. X and Mr. Y are resident Indians.

SOLUTION

(i)	**Tax implications in the hands of Mr. X**
	As per section 50C, the stamp duty value of house property (i.e. ₹ 85 lakh) would be deemed to be the full value of consideration arising on transfer of property since stamp duty value exceeds 105% of the actual consideration. Therefore, ₹ 45 lakh (i.e.,

	₹ 85 lakh – ₹ 40 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y.2020-21. Since rural agricultural land is not a capital asset, the gains arising on sale of such land is not taxable in the hands of Mr. X.
(ii)	**Tax implications in the hands of Mr.Y**
	In case immovable property is received for inadequate consideration, the difference between the stamp value and actual consideration would be taxable under section 56(2)(x), if such difference exceeds higher of ₹ 50,000 or 5% of the consideration. Therefore, in this case ₹ 25 lakh (₹ 85 lakh – ₹ 60 lakh) would be taxable in the hands of Mr. Y under section 56(2)(x). Since agricultural land is not a capital asset, the provisions of section 56(2)(x) are not attracted in respect of receipt of agricultural land for inadequate consideration, since the definition of "property" under section 56(2)(x) includes only capital assets specified thereunder.
(iii)	**TDS implications in the hands of Mr. Y**
	Since the sale consideration of house property exceeds ₹ 50 lakh, Mr. Y is required to deduct tax at source under section 194-IA. The tax to be deducted under section 194-IA would be ₹ 60,000, being 1% of ₹ 60 lakh. TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

15.3.16 Payment of rent by certain individuals or Hindu undivided family [Section194-IB]

(1) Applicability and Rate of TDS

Section 194-IB requires any person, being an individual or a HUF, other than those individual or HUF whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits of ₹ 1 crore and ₹ 50 lakhs, respectively, specified under section 44AB in the immediately preceding financial year, responsible for paying to a resident any income by way of rent, to deduct income tax at the rate of **5%**.

(2) Threshold limit

Under this section, tax has to be deducted at source only if the amount of such rent exceeds **₹ 50,000** for a month or part of a month during the previous year.

(3) Time of deduction

This deduction is to be made at the time of credit of such rent, for the last month of the previous year or the last month of tenancy, if the property is vacated during the year, as the case may be, to the account of the payee or at the time of payment thereof in cash or by issue of cheque or draft or by any other mode, whichever is earlier.

(4) No requirement to obtain TAN

The provisions of section 203A containing the requirement of obtaining Tax deduction account number (TAN) shall not apply to the person required to deduct tax in accordance with the provisions of section 194-IB.

(5) Meaning of "Rent"

"Rent" means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of any land or building or both.

(6) Deduction not to exceed rent for last month

Section 206AA requires providing of Permanent Account Number (PAN) of the deductee to the deductor, failing which tax shall be deducted at a higher rate (i.e., higher of the rate provided in the relevant section, rates in force and 20%). Where the tax is required to be deducted as per the provisions of section 206AA, such deduction shall not exceed the amount of rent payable for the last month of the previous year or the last month of the tenancy, as the case may be.

ILLUSTRATION 15

Mr. X, a salaried individual, pays rent of ₹ 55,000 per month to Mr. Y from June, 2019. Is he required to deduct tax at source? If so, when is he required to deduct tax? Also, compute the amount of tax to be deducted at source.

Would your answer change if Mr. X vacated the premises on 31st December, 2019?

Also, what would be your answer if Mr. Y does not provide his PAN to Mr. X?

SOLUTION

Since Mr. X pays rent exceeding ₹ 50,000 per month in the F.Y. 2019-20, he is liable to deduct tax at source @5% of such rent for F.Y. 2019-20 under section 194-IB. Thus, ₹ 27,500 [₹ 55,000 x 5% x 10] has to be deducted from rent payable for March, 2020.

If Mr. X vacated the premises in December, 2019, then tax of ₹ 19,250 [₹ 55,000 x 5% x 7] has to be deducted from rent payable for December, 2019.

In case Mr. Y does not provide his PAN to Mr. X, tax would be deductible @20%, instead of 5%.

In case 1 above, this would amount to ₹ 1,10,000 [₹ 55,000 x 20% x 10] but the same has to be restricted to ₹ 55,000, being rent for March, 2020.

In case 2 above, this would amount to ₹ 77,000 [₹ 55,000 x 20% x 7] but the same has to be restricted to ₹ 55,000, being rent for December, 2019.

15.3.17 Payment under specified agreement [Section 194-IC]

(1) Applicability and Rate

This section casts responsibility on any person responsible for paying to a resident any sum by way of consideration, not being consideration in kind, under a specified agreement under section 45(5A), to deduct income-tax at the rate of **10%**.

(2) Time of deduction

This deduction is to be made **at the time of credit of such sum to the account of the payee or at the time of payment** thereof in cash or by issue of cheque or draft or by any other mode, **whichever is earlier**.

(3) Non-applicability of section 194-IA

Since tax deduction at source for specified agreement under section 45(5A) is covered under section 194-IC, the provisions of section 194-IA do not get attracted in the hands of the transferee in such cases.

(4) Meaning of specified agreement

Specified agreement under section 45(5A):

- It means a registered agreement in which a person owning land or building or both, agrees to allow another person to develop a real estate project on such land or building or both.
- The consideration, in this case, is a share, being land or building or both in such project; Part of the consideration may also be in cash.

15.3.18 Fees for professional or technical services [Section 194J]

(1) Applicability and Rate of TDS

Every person, who is responsible for paying to a resident any sum by way of –

(i) fees for professional services; or

(ii) fees for technical services; or

(iii) any remuneration or fees or commission, by whatever name called, other than those on which tax is deductible under section 192, to a director of a company; or

(iv) royalty, or

(v) non-compete fees referred to in section 28(va)

shall deduct tax at source at the rate of **10%**.

However, in case of a payee, engaged only in the business of operation of call centre, the tax shall be deducted at source @**2%**

(2) Time of deduction

The deduction is to be made at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

Where any sum referred to in (1) is credited to any account, whether called suspense account or by any other name, in the books of accounts of the person liable to pay such sum, such crediting shall be deemed to be credit of such sum to the account of the payee and tax has to be deducted accordingly.

(3) Threshold limit

No tax deduction is required if the amount of fees or the aggregate of the amounts of fees credited or paid or likely to be credited or paid during a financial year does not exceed **₹ 30,000** in the case of fees for professional services, **₹ 30,000** in the case of fees for technical services, **₹ 30,000** in the case of royalty and **₹ 30,000** in the case of non-compete fees.

The limit of ₹ 30,000 under section 194J is applicable separately for fees for professional services, fees for technical services, royalty and non-compete fees referred to in section 28(va). It implies that if the payment to a person towards each of the above is less than ₹ 30,000, no tax is required to be deducted at source, even though the aggregate payment or credit exceeds ₹ 30,000. However, there is no such exemption limit for deduction of tax on any remuneration or fees or commission payable to director of a company.

ILLUSTRATION 16

XYZ Ltd. makes a payment of ₹ 28,000 to Mr. Ganesh on 2.8.2019 towards fees for professional services and another payment of ₹ 25,000 to him on the same date towards fees for technical services. Discuss whether TDS provisions under section 194J are attracted.

SOLUTION

TDS provisions under section 194J would not get attracted, since the limit of ₹ 30,000 is applicable for fees for professional services and fees for technical services, separately. It is assumed that there is no other payment to Mr. Ganesh towards fees for professional services and fees for technical services during the P.Y.2019-20.

(4) Non-applicability of TDS under section 194J

(i) An individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him do not exceed the monetary limit of ₹ 1 crore and ₹ 50 lakhs, respectively, specified under section 44AB during the immediately preceding the financial year is not liable to deduct tax at source.

However, an individual or HUF, whose total sales, gross receipts or turnover from business or profession carried by him exceeds the above monetary limits under section 44AB in the immediately preceding financial year is required to deduct tax on fees for professional services or fees for technical services credited or paid.

(ii) Further, an individual or Hindu Undivided family, shall not be liable to deduct income-tax on the sum payable by way of fees for professional services, **in case such sum is credited or paid exclusively for personal purposes**.

(5) Meaning of "Professional services"

"Professional services" means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or advertising or such other profession as is notified by the CBDT for the purposes of section 44AA or of this section.

Other professions notified for the purposes of section 44AA are as follows:

(a) Profession of "authorised representatives";

(b) Profession of "film artist";

(c) Profession of "company secretary".

The CBDT has notified the services rendered by following persons in relation to the sports activities as Professional Services for the purpose of the section 194J:

(i) Sports Persons,

(ii) Umpires and Referees,

(iii) Coaches and Trainers,

(iv) Team Physicians and Physiotherapists,

(v) Event Managers,

(vi) Commentators,

(vii) Anchors and

(viii) Sports Columnists.

Accordingly, the requirement of TDS as per section 194J would apply to all the aforesaid professions. The term "profession", as such, is of a very wide import. However, the term has been defined in this section exhaustively. For the purposes of TDS, therefore, all other professions would be outside the scope of section 194J. For example, this section will not apply to professions of teaching, sculpture, painting etc. unless they are notified.

(6) Meaning of "Fees for technical services"

Explanation (b) to section 194J provides that the term 'fees for technical services' shall have the same meaning as in *Explanation 2* to section 9(1)(vii). The term 'fees for technical services' as defined in *Explanation 2* to section 9(i)(vii) means any consideration (including any lump sum consideration) for rendering of any of the following services:

(i) Managerial services;

(ii) Technical services;

(iii) Consultancy services;

(iv) Provision of services of technical or other personnel.

It is expressly provided that the term 'fees for technical services' will not include following types of consideration:

(i) Consideration for any construction, assembly, mining or like project, or

(ii) Consideration which is chargeable under the head 'Salaries'.

(7) TPAs liable to deduct tax under section 194J on payment to hospitals on behalf of insurance companies

The CBDT has, through *Circular No.8/2009 dated 24.11.2009*, clarified that TPAs (Third Party Administrator's) who are making payment on behalf of insurance companies to hospitals for settlement of medical/insurance claims etc. under various schemes including cashless schemes are liable to deduct tax at source under section 194J on all such payments to hospitals etc. This is because the services rendered by hospitals to various patients are primarily medical services and, therefore, the provisions of section 194J are applicable to payments made by TPAs to hospitals etc.

Consequently, all such past transactions between TPAs and hospitals would fall within the provisions of section 194J and consequence of failure to deduct tax or after deducting tax failure to pay on all such transactions would make the deductor (TPAs) deemed to be an assessee-in-default in respect of such tax and also liable for charging of interest under section 201(1A).

However, no proceedings under section 201 may be initiated after the expiry of six years from the end of the financial year in which payments have been made without deducting tax at source etc. by the TPA's. Further, the tax demand arising out of section 201(1) in situations arising above, may not be enforced if the deductor (TPA) satisfies the officer in charge of TDS that the relevant taxes have been paid by the deductee-assessee (hospitals etc.). A certificate from the auditor of the deductee-assessee stating that the tax and interest due from deductee-assessee has been paid for the assessment year concerned would be sufficient compliance for the above purpose. However, this will not alter the liability to charge interest under section 201(1A) till payment of taxes by the deductee-assessee or liability for penalty under section 271C, as the case may be.

In the case of CIT v. Kotak Securities Ltd (2016) 383 ITR 1 (SC) the Supreme Court dealt on whether transaction charges paid by the members of the stock exchange for availing fully automated online trading facility, being a facility provided by the stock exchange to all its members, constitute fees for technical services to attract the provisions of tax deduction at source under section 194J.

It observed that technical services like managerial and consultancy service are in the nature of specialised services made available by the service provider to cater to the special needs of the customer-user as may be felt necessary. It is the above feature that would distinguish or identify a service provider from a facility offered

The Apex Court, accordingly, held that the service provided by the BSE for which transaction charges are paid failed to satisfy the test of specialized, exclusive and individual requirement of the user or the consumer who may approach the service provider for such assistance or service.

Therefore, the transaction charges paid to BSE by its members are not for technical services but are in the nature of payments made for facilities provided by the stock exchange. Such payments would, therefore, not attract the provisions of tax deduction at source under section 194J.

(8) Consideration for use or right to use of computer software is royalty within the meaning of section 9(1)(vi)

As per section 9(1)(vi), any income payable by way of royalty in respect of any right, property or information is deemed to accrue or arise in India. The term "royalty" means consideration for transfer of all or any right in respect of certain rights, property or information.

The consideration for use or right to use of computer software is royalty by clarifying that, transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Consequently, the provisions of tax deduction at source under section 194J and section 195 would be attracted in respect of consideration for use or right to use computer software since the same falls within the definition of royalty.

Note - The Central Government has, vide *Notification No.21/2012 dated 13.6.2012*, effective from 1st July, 2012, exempted certain software payments from the applicability of tax deduction under section 194J. Accordingly, where payment is made by the transferee for acquisition of software from a resident-transferor, the provisions of section 194J would not be attracted if -

(1) the software is acquired in a subsequent transfer without any modification by the transferor;

(2) tax has been deducted either under section 194J or under section 195 on payment for any previous transfer of such software; and

(3) the transferee obtains a declaration from the transferor that tax has been so deducted along with the PAN of the transferor.

ILLUSTRATION 17

East Bengal Club, a renowned football club, has engaged Raghu, a resident in India, as its coach at a remuneration of ₹ 6 lacs per annum. The club wants to know from you whether it is liable to deduct tax at source from such remuneration.

SOLUTION

Section 194J requires deduction of tax at source @10% from the amount credited or paid by way of fees for professional services, where such amount or aggregate of such amounts credited or paid to a person exceeds ₹ 30,000 in a financial year. As per *Explanation (a)* to section 194J, professional services includes services rendered by a person in the course of carrying on such other profession as is notified by the CBDT for the purposes of section 194J.

Accordingly, the CBDT has, vide *Notification No.88 dated 21.8.2008*, in exercise of the powers conferred by clause (a) of the *Explanation* to section 194J notified the services rendered by coaches and trainers in relation to the sports activities as professional services for the purposes of section 194J.

Therefore, the club is liable to deduct tax at source under section 194J from the remuneration payable to the Coach, Raghu.

15.3.19 Payment of compensation on acquisition of certain immovable property [Section 194LA]

(1) Applicability

Section 194LA provides for deduction of tax at source by a person responsible for paying to a resident any sum in the nature of –

(i) compensation or the enhanced compensation or

(ii) the consideration or the enhanced consideration

on account of compulsory acquisition, under any law for the time being in force, of any immovable property (other than agricultural land).

Immovable property means any land (other than agricultural land) or any building or part of a building.

(2) Rate of TDS

The amount of tax to be deducted is **10%** of such sum mentioned in (1) above.

(3) Time of deduction

The tax should be deducted at the time of payment of such sum in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(4) Threshold limit

No tax is required to be deducted where the amount of such payment or, as the case may be, the aggregate amount of such payments to a resident during the financial year does not exceed **₹ 2,50,000**.

(5) Non-applicability of TDS under section 194LA

No tax is required to be deducted where payment is made in respect of any award or agreement which has been exempted from levy of income tax under section 96 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013.

15.3.20 Income by way of interest from Infrastructure Debt Fund [Section 194LB]

(1) Special rate of tax on interest received by non-residents from notified infrastructure debt funds

Interest income received by a non-corporate non-resident or a foreign company from notified infrastructure debt funds set up in accordance with the prescribed guidelines would be subject to tax at a concessional rate of **5%** under section 115A on the gross amount of such interest income as compared to tax @20% on other interest income of non-resident. The concessional rate of tax is expected to give a fillip to infrastructure and encourage inflow of long-term foreign funds to the infrastructure sector.

(2) Rate of TDS

Accordingly, tax would be deductible @**5%** on interest paid/credited by such fund to a non-resident/foreign company.

(3) Time of deduction

The person responsible for making the payment shall, **at the time of credit of such income to the account of the payee or at the time of payment thereof** in cash or by issue of a cheque or draft or by any other mode, **whichever is earlier**, deduct income-tax @5%.

15.3.21 Income by way of interest from an Indian company [Section 194LC]

(1) Concessional rate of tax on interest on foreign currency borrowings by an Indian company or business trust

Interest paid by an Indian company or business trust[2] to a foreign company or a non-corporate non-resident in respect of borrowing made in foreign currency from sources outside India between 1.7.2012 and 30.6.2020 would be subject to tax at a concessional rate of 5% on gross interest (as against the rate of 20% of gross interest applicable in respect of other

[2] *Business trust means a trust registered as an Infrastructure Investment Trust or a Real Estate Investment Trust, the units of which are required to be listed on a recognized stock exchange, in accordance with the regulations made under the SEBI Act, 1992 and notified by the Central Government in this behalf.*

Note - TDS provisions under section 194LBA relating to income from units of a business trust and section 194LBB relating to income in respect of units of investment fund have been discussed in Chapter 12 on Assessment of various entities.

interest received by a non-corporate non-resident or foreign company from Government or an Indian concern on money borrowed or debt incurred by it in foreign currency).

To avail this concessional rate, the borrowing should be from a source outside India

- under a loan agreement at any time between 1.7.2012 and 30.6.2020 or
- by way of issue of long-term infrastructure bonds during the period between 1.7.2012 and 30.9.2014 or
- by way of issue of any long-term bond, including long-term infrastructure bonds during the period between 1.10.2014 and 30.6.2020 and approved by the Central Government in this behalf.

The interest to the extent the same does not exceed the interest calculated at the rate approved by the Central Government, taking into consideration the terms of the loan or the bond and its repayment, will be subject to tax at a concessional rate of 5%.

(2) Rate of TDS

Such interest paid by an Indian company to a non-corporate non-resident or a foreign company would be subject to TDS@**5%** under section 194LC.

(3) Extension of applicability of concessional rate of TDS

The benefit of concessional rate of TDS under section 194LC is extended to interest payable in respect of monies borrowed by an Indian company or business trust from a source outside India by way of issue of rupee denominated bond issued before 1st July, 2020.

However, interest payable by an Indian company or a business trust to a non-resident, including a foreign company, in respect of rupee denominated bond issued outside India during the period from 17.9.2018 to 31.3.2019, shall be exempt from tax, and consequently, no tax shall be deducted on the payment of interest in respect of the said bond.

(4) Non-applicability of higher rate of TDS under section 206AA for non-furnishing of PAN

Levy of higher rate of TDS@20% under section **206AA in the absence of PAN would not be attracted** in respect of payment of interest on long-term bonds, as referred to in section 194LC, to a non-corporate non-resident or to a foreign company.

15.3.22 Interest on Government securities or rupee-denominated bonds of an Indian company payable to a Foreign Institutional Investor (FII) or a Qualified Foreign Investor (QFI) [Section 194LD]

(1) Applicability and Rate of TDS

Section 194LD provides that any income by way of interest payable during the period between 1.6.2013 and 30.6.2020 in respect of investment made by an FII or QFI in a rupee denominated bond of an Indian company or a Government security, shall be subject to tax deduction at source at a concessional rate of 5% (as against the rate of 20% of interest applicable in respect of other interest received by a QFI or FII).

The interest to the extent the same does not exceed the interest calculated at the rate notified by the Central Government in this behalf will be subject to tax deduction at a concessional rate of **5%**.

(2) Time of deduction

Any person who is responsible for paying to a person being a FII or a QFI, any such interest shall, at the time of credit of such income to the account of the payee or at the time of payment of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon@5%.

(3) Meaning of FII and QFI

S.No.	Term	Meaning
(i)	FII	Foreign Institutional Investors specified by the Central Government by notification in the Official Gazette.
(ii)	QFI	Qualified Foreign Investor (QFI) shall mean a person resident in a country that is compliant with Financial Action Task Force (FATF) standards and that is a signatory to International Organization of Securities Commission's (IOSCO's) Multilateral Memorandum of Understanding. Such person is, however, not resident in India These Qualified Foreign Investors i.e., Foreign Investors, being non-residents, who meet certain KYC requirements under SEBI laws and are hence permitted to invest in equity and debt schemes of Mutual Funds, either through direct route i.e., holding MF units in demat account through a SEBI registered depository participant (DP) or indirect route i.e., holding MF units via Unit Confirmation Receipt (UCR). **QFI does not include FII.**

15.3.23 Payment made by an individual or a HUF for contract work or by way of fees for professional services or commission or brokerage [Section 194M]

(1) Applicability and rate of TDS

Section 194M, inserted with effect from 1.9.2019, provides for deduction of tax at source ***@5%*** *by an individual or a HUF responsible for paying any sum during the financial year to any resident –*

(i) for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract; or

(ii) by way of commission (not being insurance commission referred to in section 194D) or brokerage; or

(iii) by way of fees for professional services.

It may be noted that only individuals and HUFs (other than those who are required to deduct income-tax as per the provisions of section 194C or 194H or 194J) are required to deduct tax in respect of the above sums payable during the financial year to a resident.

(2) Time of deduction

The tax should be deducted at the time of credit of such sum or at the time of payment of such sum, whichever is earlier.

(3) Threshold limit

No tax is required to be deducted where such sum or, as the case may be, aggregate amount of such sums credited or paid to a resident during the financial year does not exceed **₹ 50,00,000.**

(4) Non-applicability of TDS under section 194M

An individual or a Hindu undivided family is not liable to deduct tax at source under section 194M, if –

(i) they are required to deduct tax at source under section 194C for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract i.e., an individual or a HUF who is subject to tax audit under section 44AB(a)/(b) in the immediately preceding financial year and such amount is not exclusively credited or paid for personal purposes of such individual or HUF.

(ii) they are required to deduct tax at source under section 194H on commission (not being insurance commission referred to in section 194D) or brokerage i.e., an individual or a HUF whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits of ₹ 1 crore and ₹ 50 lakhs, respectively, specified under section 44AB during the immediately preceding financial year.

(iii) they are required to deduct tax at source under section 194J on fees for professional services i.e., an individual or a HUF whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits of ₹ 1 crore and ₹ 50 lakhs, respectively, specified under section 44AB during the immediately preceding financial year and such amount is not exclusively credited or paid for personal purposes of such individual or HUF.

(5) No requirement to obtain TAN

The provisions of section 203A containing the requirement of obtaining Tax deduction account number (TAN) shall not apply to the person required to deduct tax in accordance with the provisions of section 194M.

Note - *For the meaning of the terms "Work", "Professional services" and "Commission or brokerage" refer sub-heading "15.3.6 Payments to contractors and sub-contractors [Section 194C]", "15.3.18 Fees for professional or technical services [Section 194J]" and "15.3.13 Commission or brokerage [Section 194H]", respectively.*

ILLUSTRATION 18

Examine whether TDS provisions would be attracted in the following cases, and if so, under which section. Also, specify the rate of TDS applicable in each case. Assume that all payments are made to residents.

	Particulars of the payer	***Nature of payment***	***Aggregate of payments made in the F.Y.2019-20***
1	*Mr. Ganesh, an individual carrying on retail business with turnover of ₹ 2.5 crores in the P.Y.2018-19*	*Contract Payment for repair of residential house*	*₹ 5 lakhs*
		Payment of commission to Mr. Vallish for business purposes	*₹ 80,000*
2.	*Mr. Rajesh, a wholesale trader who declares profits under section 44AD for P.Y.2018-19 and P.Y.2019-20.*	*Contract Payment for reconstruction of residential house (made during the period January-March, 2020)*	*₹ 20 lakhs in January, 2020, ₹ 15 lakhs in Feb 2020 and ₹ 20 lakhs in March 2020.*
3.	*Mr. Satish, a salaried individual*	*Payment of brokerage for buying a residential house in March, 2020*	*₹ 51 lakhs*
4.	*Mr. Dheeraj, a pensioner*	*Contract payment made during October-November 2019 for reconstruction of residential house*	*₹ 48 lakhs*

SOLUTION

	Particulars of the payer	Nature of payment	Aggregate of payments in the F.Y.2019-20	Whether TDS provisions are attracted?
1	Mr. Ganesh, an individual carrying on retail business with turnover of ₹ 2.5 crores in the P.Y.2018-19	Contract Payment for repair of residential house	₹ 5 lakhs	No, TDS u/s 194C is not attracted since the payment is for personal purpose and TDS u/s 194M is not attracted as aggregate of contract payment to the payee in the P.Y.2019-20 does not exceed ₹ 50 lakh.
		Payment of commission to Mr. Vallish for business purposes	₹ 80,000	Yes, u/s 194H, since the payment exceeds ₹ 15,000, and Mr. Ganesh's turnover exceeds ₹ 1 crore in the P.Y.2018-19.
2.	Mr. Rajesh, a wholesale trader who declares profits under section 44AD for P.Y.2018-19 and P.Y.2019-20.	Contract Payment for reconstruction of residential house	₹ 55 lakhs	Yes, u/s 194M, since the aggregate of payments (i.e., ₹ 55 lakhs) exceed ₹ 50 lakhs, and the payments are made after 1.9.2019. Since he declares profits on presumptive basis u/s 44AD, he is not subject to tax audit in the P.Y.2018-19. Hence, TDS provisions u/s 194C are not attracted in respect of payments made in the P.Y.2019-20.
3.	Mr. Satish, a salaried individual	Payment of brokerage for buying a residential house	₹ 51 lakhs	Yes, under section 194M, since the payment of ₹ 51 lakhs made in March 2020 exceeds the threshold of ₹ 50 lakhs. Since Mr. Satish is a salaried individual, the provisions of section 194H are not applicable in this case.
4.	Mr. Dheeraj, a pensioner	Contract payment for reconstruction of residential	₹ 48 lakhs	TDS provisions u/s 194C are not attracted since Mr. Dheeraj is a pensioner and hence, not subject to tax audit. TDS provisions u/s

		house		194M are also not applicable in this case, since the payment of ₹ 48 lakhs, even though made after 1.9.2019, does not exceed the threshold of ₹ 50 lakhs.

15.3.24 TDS on cash withdrawal [Section 194N]

(1) Applicability and rate of TDS

Section 194N, inserted with effect from 1.9.2019, provides that every person, being

- *a banking company to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred under section 51 of that Act)*
- *a co-operative society engaged in carrying on the business of banking or*
- *a post office*

who is responsible for paying, in cash, any sum or aggregate of sums exceeding ₹ 1 crore during the previous year to any person from one or more accounts maintained by such recipient-person with it, shall deduct tax at source ***@2% of sum exceeding ₹ 1 crore.***

(2) Time of deduction

This deduction is to be made at the time of payment of such sum.

(3) Non-applicability of TDS under section 194N

Liability to deduct tax at source under section 194N shall not be applicable to any payment made to –

- *the Government*
- *any banking company or co-operative society engaged in carrying on the business of banking or a post-office*
- *any business correspondent of a banking company or co-operative society engaged in carrying on the business of banking, in accordance with the RBI guidelines*
- *any white label ATM operator of a banking company or co-operative society engaged in carrying on the business of banking, in accordance with the authorisation issued by the RBI under the Payment and Settlement Systems Act, 2007*
- *such other person or class of persons notified by the Central Government in consultation with the RBI.*

Accordingly, the Central Government has, in consultation with the RBI, notified the following class of persons, payment to whom would not attract liability to deduct tax at source u/s 194N –

(i) ***Cash Replenishment Agencies (CRAs) and franchise agents of White Label Automated Teller Machine Operators (WLATMO's) –*** *For availing exemption from applicability of TDS u/s 194N, CRAs and franchise agents of WLATMOs should maintain a separate bank account from which withdrawal is made only for the purposes of replenishing cash in the Automated Teller Machines (ATMs) operated by such WLATMOs. Further, the WLATMO should furnish a certificate every month to the bank certifying that the bank account of the CRAs and the franchise agents of the WLATMOs have been examined and the amounts being withdrawn from their bank accounts has been reconciled with the amount of cash deposited in the ATM's of the WLATMO's.*

(ii) ***Commission agent or trader, operating under Agriculture Produce Market Committee (APMC), and registered under any law relating to Agriculture Produce Market of the concerned State*** - *For availing exemption from the applicability of TDS u/s 194N, the commission agent/trader should intimate to the banking company or co-operative society or post office, his account number through which he wishes to withdraw cash in excess of ₹ 1 crore in the previous year along with his Permanent Account Number (PAN) and the details of the previous year. Also, he should certify to the banking company or co-operative society or post office that the withdrawal of cash from the account in excess of ₹ 1 crore during the previous year is for the purpose of making payments to the farmers on account of purchase of agriculture produce. Further, the banking company or co-operative society or post office has to ensure that the PAN quoted is correct and the commission agent or trader is registered with the APMC, and for this purpose, collect necessary evidences and place the same on record.*

(4) ***Person to whom credit is to be given for tax deducted and paid:*** *Rule 37BA provides the manner of giving credit for tax deducted and remitted to the Central Government i.e., it specifies the person to whom credit for tax deducted is to be given and also the assessment year for which the credit may be given. Accordingly, sub-rule (3A) has been inserted in Rule 37BA, to provide that, for the purposes of section 194N, credit for tax deducted at source shall be given to the person from whose account tax is deducted and paid to the Central Government account for the assessment year relevant to the previous year in which such tax deduction is made.*

15.3.25 Other sums (payable to non-residents) [Section 195]

(1) Applicability

Any person responsible for paying interest (other than interest referred to in section 194LB or section 194LC or section 194LD*)* or any other sum chargeable to tax (other than salaries) to a non-corporate non-resident or to a foreign company is liable to deduct tax at source at the rates prescribed by the relevant Finance Act. Such persons are also required to furnish the information relating to payment of any sum in such form and manner as may be prescribed by the CBDT.

Payee to be a non-resident - In order to subject an item of income to deduction of tax under this section the payee must be a non-corporate non-resident or a foreign company.

Payer may be a resident or non-resident - Under section 195(1), the obligation to deduct tax at source from interest and other payments to a non-resident, which are chargeable to tax in India, is on "any person responsible for paying to a non-resident or to a foreign company". The words "any person" used in section 195(1) is intended to include both residents and non-residents. Therefore, a non-resident person is also required to deduct tax at source before making payment to another non-resident, if the payment represents income of the payee non-resident, chargeable to tax in India. Therefore, if the income of the payee non-resident is chargeable to tax, then tax has to be deducted at source, whether the payment is made by a resident or a non-resident.

Explanation 2 clarifies that the obligation to comply with section 195(1) and to make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident, whether or not the non-resident has:-

(a) a residence or place of business or business connection in India; or

(b) any other presence in any manner whatsoever in India.

(2) Time of deduction

The tax is to be deducted at source at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

Where any interest or other sum as aforesaid is credited to any account, whether called "Interest payable account" or "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee.

However, in the case of interest payable by the Government or a public sector bank within the meaning of section 10(23D) or a public financial institution within the meaning of section 10(23D), deduction of tax shall be made only at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode.

(3) Payments subject to tax deduction

The statutory obligation imposed under this section would apply for the purpose of deduction of tax at source from any sum being income assessable to tax (other than salary income) in the hands of the non-resident/foreign company. However, no deduction shall be made in respect of any dividends declared/distributed/paid by a domestic company, which is exempt in the hands of the shareholders under section 10(34).

Payment to a non-resident by way of royalties and payments for technical services rendered in India are common examples of sums chargeable under the provisions of the Act to which the liability for deduction of tax at source would apply.

(4) Certificate of non-deduction of tax at source

(i) Any person entitled to receive any interest or other sum on which income-tax has to be deducted under section 195(1) may make an application in the prescribed form to the Assessing Officer for grant of certificate authorizing him to receive such interest or other sum without deduction of tax thereunder.

(ii) Where any such certificate is granted, every person responsible for paying such interest or other sum to the person to whom certificate is granted make payment of such interest or other sum without deduction of tax at source under section 195(1), so long as the certificate in force.

(iii) Such certificate shall remain in force till the expiry of the period specified therein. However, if it is cancelled by the Assessing Officer before the expiry of such period, the certificate shall remain in force till such cancellation.

(iv) The CBDT is empowered to make rules specifying the cases in which, and the circumstances under which, an application may be made for the grant of certificate. While doing so, it should take into account the convenience of the assessees and the interests of the revenue.

(v) Such Rules would provide for the conditions subject to which such certificate may be granted and any other matter connected therewith.

(5) Person responsible for paying any sum to non-resident to furnish prescribed information

Section 195(6) provides that the person responsible for paying any sum, whether or not chargeable to tax under the provisions of the Act, to a non-corporate non-resident or to a foreign company, shall be required to furnish the information relating to payment of such sum in the prescribed form and prescribed manner.

(6) Specified class or classes of persons, making payment to the non-resident, to mandatorily make application to Assessing Officer to determine the appropriate proportion of sum chargeable to tax

(i) Under section 195(1), any person responsible for paying to a non-corporate non-resident or to a foreign company, any interest or any other sum chargeable under the provisions of the Act (other than salary), has to deduct tax at source at the rates in force.

(ii) Under section 195(2), where the person responsible for paying any such sum chargeable to tax under the Act (other than salary) to a non-resident, considers that the whole of such sum would not be income chargeable in the hands of the recipient, he may make an application ***in such form and manner to the Assessing Officer, to determine in such manner, as may be prescribed***, the appropriate proportion of such sum so chargeable. When the Assessing Officer so determines, the appropriate proportion, tax shall be deducted under section 195(1) only on that proportion of the sum which is so chargeable.

(iii) Consequent to the retrospective amendments in section 2(47), section 2(14) and section 9(1) by the Finance Act, 2012, sub-section (7) in section 195 provides that, notwithstanding anything contained in sections 195(1) and 195(2), the CBDT may, by notification in the Official Gazette, specify a class of persons or cases, where the person responsible for paying to a non-corporate non-resident or to a foreign company, any sum, **whether or not chargeable under the provisions of this Act**, shall make an application ***in such form and manner to the Assessing Officer, to determine in such manner, as may be prescribed***, the appropriate proportion of sum chargeable to tax. Where the Assessing Officer determines the appropriate proportion of the sum chargeable, tax shall be deducted under sub-section (1) on that proportion of the sum which is so chargeable.

(iv) Consequently, where the CBDT specifies a class of persons or cases, the person responsible for making payment to a non-corporate non-resident or a foreign company in such cases has to mandatorily make an application to the Assessing Officer, whether or not such payment is chargeable under the provisions of the Act.

(7) Procedure for refund of TDS under section 195 to the person deducting tax in cases where tax is deducted at a higher rate prescribed in the DTAA

(i) The CBDT has, through *Circular No.7/2011 dated 27.9.2011*, modified Circular No.07/2007, dated 23.10.2007 which laid down the procedure for refund of tax deducted at source under section 195 of the Income-tax Act, 1961 to the person deducting tax at source from the payment to a non-resident. The said Circular allowed refund to the person making payment under section 195 in the circumstances indicated therein as the income does not accrue to the non-resident or if the income is accruing, no tax is due or tax is due at a lesser rate. The amount paid to the Government in such cases to that extent does not constitute tax.

(ii) The said Circular, however, did not cover a situation where tax is deducted at a rate prescribed in the relevant DTAA which is higher than the rate prescribed in the Income-tax Act, 1961. Since the law requires deduction of tax at a rate prescribed in the relevant DTAA or under the Income-tax Act, 1961, whichever is lower, there is a possibility that in such cases excess tax is deducted relying on the provisions of relevant DTAA.

(iii) Accordingly, in order to remove the genuine hardship faced by the resident deductor, the CBDT has modified *Circular No. 07/2007, dated 23-10-2007* to the effect that the beneficial provisions under the said Circular allowing refund of tax deducted at source under section 195 to the person deducting tax at source shall also apply to those cases where deduction of tax at a higher rate under the relevant DTAA has been made while a lower rate is prescribed under the domestic law.

15.3.26 Non-applicability of TDS provisions on payments made to Corporations whose income is exempt under section 10(26BBB) [*Circular No.7/2015, dated 23-04-2015]*

The CBDT had earlier issued *Circular No.4/2002 dated 16.07.2002* which laid down that there would be no requirement for tax deduction at source in respect of payments made to such entities, whose income is unconditionally exempt under section 10 of the Income-tax Act, 1961 and who are statutorily not required to file return of income as per the section 139. The said Circular also lists the entities which are unconditionally exempt under section 10 and who are statutorily not required to file return of income as per section 139.

Subsequently, section 10(26BBB) was inserted in the Income-tax Act, 1961 vide Finance Act, 2003 w.e.f. 1.4.2004 to provide that any income of a corporation established by a Central, State or Provincial Act for the welfare and economic upliftment of ex-service-men being the citizens of India does not form part of the total income. The corporations covered under section 10(26BBB) are also statutorily not required to file return of income as per the section 139.

The corporations covered under section 10(26BBB) satisfy the two conditions of Circular No. 4/2002 i.e., such corporations are statutorily not required to file return of income as per section 139 and their income is also unconditionally exempt under section 10 of the Income-tax Act, 1961. Accordingly, the CBDT has examined the matter and extended the benefit of the said Circular to such corporations whose income is exempt under section 10(26BBB). Hence, there would be no requirement for tax deduction at source from the payments made to such corporations, since their income is anyway exempt under the Income-tax Act, 1961.

15.3.27 Income payable net of tax [Section 195A]

(1) Where, under an agreement or other arrangement, the tax chargeable on any income referred to in the foregoing provisions of this Chapter is to be borne by the person by whom the income is payable, then, for the purposes of deduction of tax under those provisions such income shall be increased to such amount as would, after deduction of tax thereon, be equal to the net amount payable under such agreement or arrangement.

(2) However, no grossing up is required in the case of tax paid [under section 192(1A)] by an employer on the non-monetary perquisites provided to the employee.

ILLUSTRATION 19

'X' while making payment "net of tax" to a non-resident for providing technical services on a world bank aided project had deducted tax out of such payments as per rates prescribed but says that the payee is not entitled for the TDS certificate. Examine.

SOLUTION

As per section 198, any sum deducted in accordance with the provisions of Chapter XVII-B of the Income-tax Act, 1961 is deemed to be income received while computing the income of the payee.

As per section 203, every person deducting tax at source shall furnish to the payee a certificate in the prescribed form within the prescribed time.

Even in a case where ‘X undertakes to pay the tax on the grossed up amount, the non-resident shall be entitled for issue of certificate for tax deducted at source in respect of payment made ‘net of tax’ in terms of section 195A. This has been clarified vide CBDT *Circular No.785 dated 24.11.1999.*

Therefore, X has a legal obligation to issue TDS certificate to the non-resident, even if he has made payment of income “net of tax” to him.

15.3.28 Interest or dividend or other sums payable to Government, Reserve Bank or certain corporations [Section 196]

(1) No deduction of tax shall be made by any person from any sums payable to -

(i) the Government; or

(ii) the Reserve Bank of India; or

(iii) a corporation established by or under a Central Act, which is, under any law for the time being in force, exempt from income-tax on its income; or

(iv) a Mutual Fund specified under section 10(23D).

(2) This provision for non-deduction is when such sum is payable to the above entities by way of -

(i) interest or dividend in respect of securities or shares -

(a) owned by the above entities; or

(b) in which they have full beneficial interest or

(ii) any income accruing or arising to them.

15.4 CERTIFICATE FOR DEDUCTION OF TAX AT A LOWER RATE [SECTION 197]

(1) This section applies where, in the case of any income of any person or sum payable to any person, income-tax is required to be deducted at the time of credit or payment, as the case may be at the rates in force as per the provisions of sections 192, 193, 194, 194A, 194C, 194D, 194G, 194H, 194-I, 194J 194K, 194LA, 194LBB, 194LBC, ***194M*** and 195.

(2) In such cases, the assessee can make an application to the Assessing Officer for deduction of tax at a lower rate or for non-deduction of tax.

(3) If the Assessing Officer is satisfied that the total income of the recipient justifies the deduction of income-tax at lower rates or no deduction of income-tax, as the case may be, he may give to the assessee such certificate, as may be appropriate.

(4) Where the Assessing Officer issues such a certificate, then the person responsible for paying the income shall deduct income-tax at such lower rates specified in the certificate or deduct no tax, as the case may be, until such certificate is cancelled by the Assessing Officer.

(5) Enabling powers have been conferred upon the CBDT to make rules for prescribing the procedure in this regard.

15.5 NO DEDUCTION IN CERTAIN CASES [SECTION 197A]

(1) Enabling provision for filing of declaration for receipt of dividend and NSS payment without deduction of tax [Sub-section (1)]

(i) This section enables an individual, who is resident in India and whose estimated total income of the previous year is less than the basic exemption limit, to receive dividends and any sum out of National Savings Scheme Account, without deduction of tax at source under sections 194 and 194EE, on furnishing a declaration in duplicate in the prescribed form and verified in the prescribed manner.

(ii) The declaration in the above form is to be furnished in writing in duplicate by the declarant to the person responsible for paying any income of the nature referred to in sections 194 or 194EE. The declaration will have to be to the effect that the tax on the estimated total income of the declarant of the previous year in which such income is to be included in computing his total income will be **Nil**.

(2) Enabling provision for filing of declaration for non-deduction of tax under section 192A or 193 or 194A or 194D or 194DA or 194-I by persons, other than companies and firms [Sub-section (1A)]

No deduction of tax shall be made under the above provisions of the Act, where a person, who is not a company or a firm, furnishes to the person responsible for paying any income of the nature referred to in these sections, a declaration in writing in duplicate in the prescribed form to the effect that the tax on his estimated total income of the previous year in which such income is to be included in computing his total income will be **Nil**

(3) Filing declaration not permissible if income/aggregate of incomes exceed basic exemption limit [Sub-section (1B)]

Declaration cannot be furnished as per the above provisions, where -

(i) payments in respect of deposits under National Savings Schemes, etc.; or

(ii) payment of premature withdrawal from Employee Provident Fund; or

(iii) income from interest on securities or interest other than "interest on securities" or units; or

(iv) insurance commission; or

(v) payment in respect of life insurance policy; or

(vi) rent; or

(vii) the aggregate of the amounts of such incomes in (i) to (vi) above

credited or paid or likely to be credited or paid during the previous year in which such income is to be included exceeds the basic exemption limit.

(4) Enabling provision for filing of declaration by resident senior citizens for non-deduction of tax at source [Sub-section (1C)]

For a resident senior citizen, who is of the age of 60 years or more at any time during the previous year, no deduction of tax shall be made under section 192A or section 193 or section 194 or section 194A or section 194D or section 194DA or section 194EE or section 194-I, if such individual furnishes a declaration in writing in duplicate in Form 15H to the payer, that tax on his estimated total income of the previous year in which such income is to be included in computing his total income is **Nil**. The restriction contained in sub-section (1B) will not apply to resident senior citizens.

Further, declaration in Form 15H can also be made in a case where income of the assessee, who is eligible for rebate of income-tax under section 87A, is higher than the basic exemption limit (after allowing for deduction(s) under Chapter VI-A, if any, or set off of loss, if any, under the head "Income from house property" for which, the declarant is eligible) but his tax liability would be nil after taking into account the rebate available to him under section 87A.

(5) Non-deduction of tax in certain cases

(i) Interest payments by an Offshore Banking Unit to a non-resident/not ordinarily resident in India [Sub-section (1D)]

No deduction of tax shall be made by an Offshore Banking Unit from the interest paid on -

(a) deposit made by a non-resident/not-ordinarily resident on or after 1.4.2005; or

(b) borrowing from a non-resident/not-ordinarily resident on or after 1.4.2005.

Applicability of section 197A(1D) and section 10(15)(viii) to interest paid by IFSC Banking Units (IBUs) [*Circular No 26/2016 dated 4.7.2016*]

The CBDT Circular clarifies that in accordance with the provisions of section 197A(1D), tax is not required to be deducted on interest paid by IFSC Banking Units, on deposit made on or after 1.4.2005 by a non-resident or a person who is not ordinarily resident in India, or on borrowings made on or after 1.4.2005 from such persons.

(ii) Payment to any person for, or on behalf of, the NPS Trust [Sub-section (1E)]

No deduction of tax at source shall be made from any payment to any person for, or on behalf of, the New Pension System Trust referred in section 10(44).

(iii) Specified payments to notified institutions/class of institutions etc. [Sub-section (1F)]

No deduction of tax shall be made from specified payments to such institution, association or body or class of institutions or associations or bodies as may be notified by the Central Government in the Official Gazette in this behalf. Therefore, in respect of such specified payments made to notified bodies, no tax is to be deducted at source.

Accordingly, the Central Government has notified that no deduction of tax shall be made from the payments of the nature specified below, in case such payment is made by a person to a bank listed in the Second Schedule to the Reserve Bank of India Act, 1934, excluding a foreign bank or to any payment systems company authorised by the Reserve Bank of India under section 4(2) of the Payment and Settlement Systems Act, 2007–

(a) bank guarantee commission,

(b) cash management service charges,

(c) depository charges on maintenance of DEMAT accounts,

(d) charges for warehousing services for commodities,

(e) underwriting service charges,

(f) clearing charges (MICR charges) including interchange fee or any other similar charges, by whatever name called, charged at the time of settlement or for clearing activities under the Payment and Settlement Systems Act, 2007 and

(g) credit card or debit card commission for transaction between the merchant establishment and acquirer bank,

(6) Time limit for delivery of one copy of declaration [Sub-section (2)]

On receipt of the declaration referred to in sub-sections (1), (1A) or (1C), the person responsible for making the payment will be required to deliver or cause to be delivered to the Chief Commissioner or Commissioner, one copy of the declaration **on or before the 7th of the month following the month in which the declaration is furnished** to him.

15.6 MISCELLANEOUS PROVISIONS

15.6.1 Tax deducted is income received [Section 198]

(1) All sums deducted in accordance with the foregoing provisions shall, for the purpose of computing the income of an assessee, be deemed to be income received.

(2) However, the following tax paid or deducted would not be deemed to be income received by the assessee for the purpose of computing the total income–

(i) the tax paid by an employer under section 192(1A) on non-monetary perquisites provided to the employees

(ii) ***tax deducted under section 194N.***

15.6.2 Credit for tax deducted at source [Section 199]

(1) Tax deducted at source in accordance with the above provisions and paid to the credit of the Central Government shall be treated as payment of tax on behalf of the-

(i) person from whose income the deduction was made; or

(ii) owner of the security; or

(iii) depositor; or

(iv) owner of property; or

(v) unit-holder; or

(vi) shareholder.

(2) Any sum referred to in section 192(1A) and paid to the Central Government, shall be treated as the tax paid on behalf of the person in respect of whose income, such payment of tax has been made.

(3) The CBDT is empowered to frame rules for the purpose of giving credit in respect of tax deducted or tax paid under Chapter XVII. The CBDT also has the power to make rules for giving credit to a person other than the persons mentioned in (1) and (2) above. Further, the CBDT can specify the assessment year for which such credit may be given.

(4) Rule 37BA – Credit for tax deducted at source for the purposes of section 199

Rule 37BA(1) provides that credit for tax deducted at source and paid to the Central Government shall be given to the person to whom the payment has been made or credit has been given (i.e., the deductee) on the basis of information relating to deduction of tax furnished by the deductor to the income-tax authority or the person authorized by such authority.

Rule 37BA(2)(i) provides that where under any provision of the Act, the whole or any part of the income on which tax has been deducted at source is assessable in the hands of a person other than the deductee, credit for the whole or any part of the tax deducted at source, as the case may be, shall be given to the other person and not to the deductee.

However, the deductee should file a declaration with the deductor and the deductor should report the tax deduction in the name of the other person in the information relating to deduction of tax referred to in sub-rule (1) of Rule 37BA.

15.6.3 Duty of person deducting tax [Section 200]

(1) The persons responsible for deducting the tax at source should deposit the sum so deducted to the credit of the Central Government within the prescribed time [Sub-section (1)].

(2) Further, an employer paying tax on non-monetary perquisites provided to employees in accordance with section 192(1A), should deposit within the prescribed time, the tax to the credit of the Central Government or as the Board directs [Sub-section (2)].

Rule 30 – Prescribed time and mode of payment to Government account of TDS or tax paid under section 192(1A)

(a) All sums deducted in accordance with Chapter XVII-B by an office of the Government shall be paid to the credit of the Central Government on

- the same day where the tax is paid without production of an income-tax challan and
- on or before seven days from the end of the month in which the deduction is made or income-tax is due under section 192(1A), where tax is paid accompanied by an income-tax challan.

(b) All sums deducted in accordance with Chapter XVII-B by deductors other than a Government office shall be paid to the credit of the Central Government

- on or before 30th April, where the income or amount is credited or paid in the month of March.
- In any other case, the tax deducted should be paid on or before seven days from the end of the month in which the deduction is made or income-tax is due under section 192(1A).

(c) In special cases, the Assessing Officer may, with the prior approval of the Joint Commissioner, permit quarterly payment of the tax deducted under section 192/

194A/194D/194H on or before 7th of the month following the quarter, in respect of first three quarters in the financial year and 30th April in respect of the quarter ending on 31st March. The dates for quarterly payment would, therefore, be 7th July, 7th October, 7th January and 30th April, for the quarters ended 30th June, 30th September, 31st December and 31st March, respectively.

(d) Tax deducted under sections 194-IA and 194-IB have to be remitted within 30 days from the end of the month of deduction. A challan-cum-statement in Form 26QB/26QC has to be furnished within 30 days from the end of the month of deduction.

(3) For the purpose of improving the reporting of payment of TDS made through book entry and to make existing mechanism enforceable, section 200(2A) provides that where the tax deducted or tax referred to in section 192(1A) has been paid without the production of a challan, the PAO/TO/CDDO or any other person, by whatever name called, who is responsible for crediting such sum to the credit of the Central Government, shall deliver or cause to be delivered within the prescribed time a statement in the prescribed form, verified in the prescribed manner and setting forth prescribed particulars to the prescribed income-tax authority or the person authorised by such authority.

(4) Sub-section (3) casts responsibility on the following persons for preparing such statements for such periods as may be prescribed, after paying the tax deducted to the credit of the Central Government within the prescribed time –

(i) any person deducting any sum on or after 1st April, 2005 in accordance with the foregoing provisions of this chapter; or,

(ii) any person being an employer referred to in section 192(1A).

(5) These persons are responsible for preparing such statements for such periods as may be prescribed, after paying the tax deducted to the credit of the Central Government within the prescribed time.

(6) Such statements have to be delivered or caused to be delivered to the prescribed income-tax authority or the person authorised by such authority.

(7) Such statements should be in the prescribed form and verified in the prescribed manner.

(8) It should set forth such particulars and should be delivered within such time as may be prescribed.

(9) The deductor may also deliver to the prescribed authority, a correction statement -

(a) for rectification of any mistake; or

(b) to add, delete or update the information furnished in the statement delivered under section 200(3).

(10) **Submission of quarterly statements:** Every person responsible for deduction of tax under Chapter XVII-B shall deliver, or cause to be delivered, the following quarterly statements to the DGIT (Systems) or any person authorized by him, in accordance with section 200(3):

(i) Statement of TDS under section 192 in Form No.24Q;

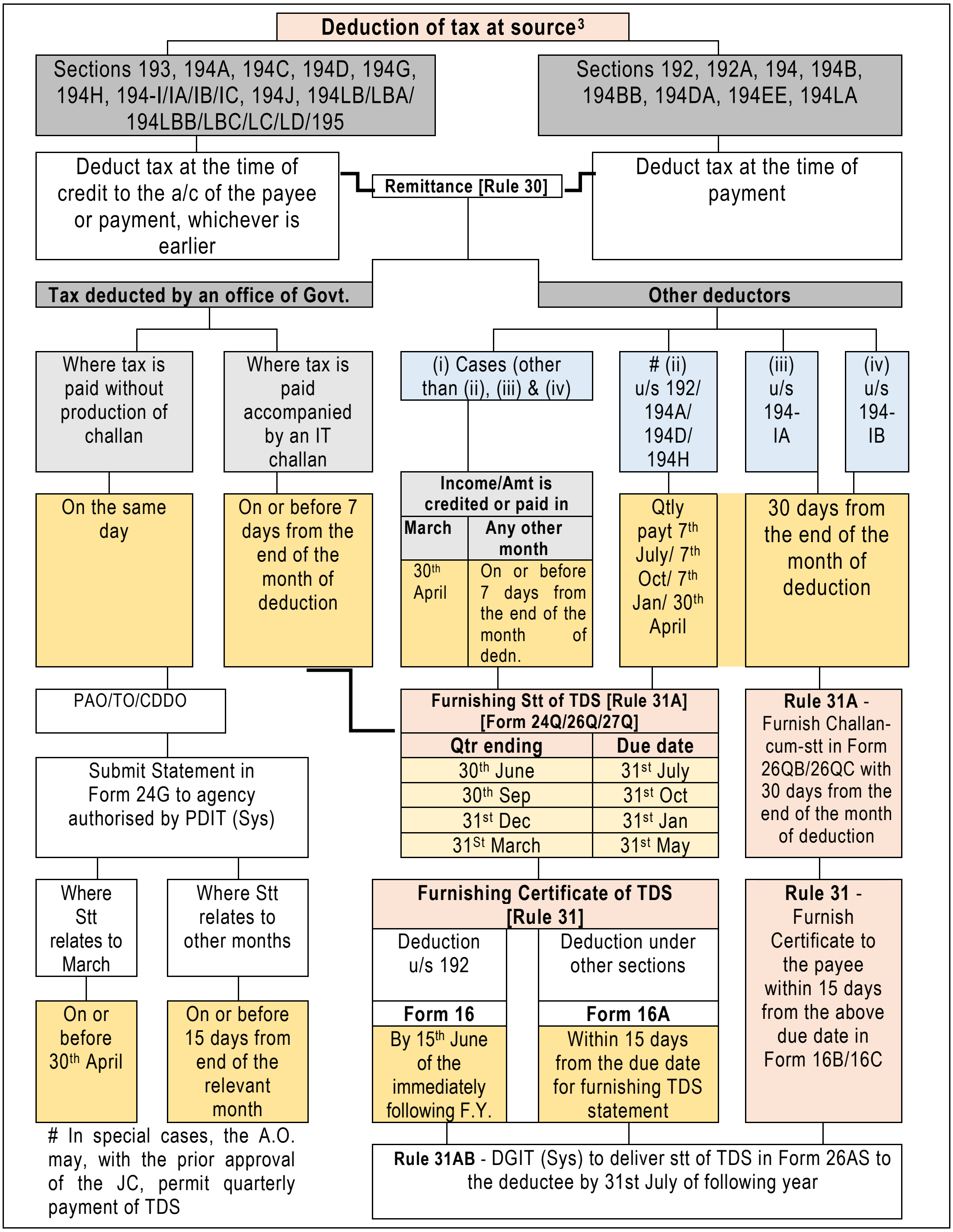
(ii) Statement of TDS under sections 193 to 196D in Form No.26Q in respect of all deductees other than a deductee being a non-corporate non-resident or a foreign company or resident but not ordinarily resident in which case the relevant form would be Form No.27Q.

Rule 31A - Time limit for submission of quarterly statements

Rule 31A requires every person responsible for deduction of tax under Chapter XVII-B to deliver, or cause to be delivered, quarterly statements to the Director General of Income-tax (Systems) or the person authorised by him within the due date for each quarter specified in Rule 31A(2). Rule 31A(2) prescribed differential due dates for Government deductors and other deductors. In order to ensure equity and give more time for other deductors, common due dates are now prescribed thereunder for Government deductors and other deductors. Accordingly, quarterly statements of TDS have to be furnished by the due dates specified in column (3) against the corresponding quarter –

Sl. No.	Date of ending of the quarter of the financial year	Due date
1.	30th June	31st July of the financial year
2.	30th September	31st October of the financial year
3.	31st December	31st January of the financial year
4.	31st March	31st May of the financial year immediately following the financial year in which the deduction is made.

However, every person responsible for deduction of tax under section 194-IA or 194-IB have to furnish to the Principal Director General of Income-tax (Systems) or Director General of Income-tax (System) or the person authorised by the Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems) a challan-cum-statement in Form No.26QB or 2QC, respectively, within thirty days from the end of the month of deduction of tax.



Deduction of tax at source[3]

Sections 193, 194A, 194C, 194D, 194G, 194H, 194-I/IA/IB/IC, 194J, 194LB/LBA/ 194LBB/LBC/LC/LD/195

Deduct tax at the time of credit to the a/c of the payee or payment, whichever is earlier

Sections 192, 192A, 194, 194B, 194BB, 194DA, 194EE, 194LA

Deduct tax at the time of payment

Remittance [Rule 30]

Tax deducted by an office of Govt.

Where tax is paid without production of challan – On the same day

Where tax is paid accompanied by an IT challan – On or before 7 days from the end of the month of deduction

PAO/TO/CDDO

Submit Statement in Form 24G to agency authorised by PDIT (Sys)

Where Stt relates to March – On or before 30th April

Where Stt relates to other months – On or before 15 days from end of the relevant month

# In special cases, the A.O. may, with the prior approval of the JC, permit quarterly payment of TDS

Other deductors

(i) Cases (other than (ii), (iii) & (iv)

Income/Amt is credited or paid in	
March	**Any other month**
30th April	On or before 7 days from the end of the month of dedn.

# (ii) u/s 192/ 194A/ 194D/ 194H – Qtly payt 7th July/ 7th Oct/ 7th Jan/ 30th April

(iii) u/s 194-IA; (iv) u/s 194-IB – 30 days from the end of the month of deduction

Furnishing Stt of TDS [Rule 31A] [Form 24Q/26Q/27Q]

Qtr ending	Due date
30th June	31st July
30th Sep	31st Oct
31st Dec	31st Jan
31St March	31st May

Furnishing Certificate of TDS [Rule 31]

Deduction u/s 192	Deduction under other sections
Form 16	**Form 16A**
By 15th June of the immediately following F.Y.	Within 15 days from the due date for furnishing TDS statement

Rule 31A - Furnish Challan-cum-stt in Form 26QB/26QC with 30 days from the end of the month of deduction

Rule 31 - Furnish Certificate to the payee within 15 days from the above due date in Form 16B/16C

Rule 31AB - DGIT (Sys) to deliver stt of TDS in Form 26AS to the deductee by 31st July of following year

[3] In respect of the newly inserted sections 194M and 194N, rules relating to remittance, furnishing of statement of TDS and certificate of TDS to the payee are yet to be prescribed as on the date of publication of this material. Hence, reference to these sections have not been given in the above diagram.

15.6.4 Correction of arithmetic mistakes and adjustment of incorrect claim during computerized processing of TDS statements [Section 200A]

(1) At present, all statements of tax deducted at source are filed in an electronic mode, thereby facilitating computerised processing of these statements. Therefore, in order to process TDS statements on computer, electronic processing on the same lines as processing of income-tax returns has been provided in section 200A.

(2) The following adjustments can be made during the computerized processing of statement of tax deducted at source or a correction statement –

(i) any arithmetical error in the statement; or

(ii) an incorrect claim, if such incorrect claim is apparent from any information in the statement.

(3) The term "an incorrect claim apparent from any information in the statement" shall mean such claim on the basis of an entry, in the statement, –

(i) of an item, which is inconsistent with another entry of the same or some other item in such statement;

(ii) in respect of rate of deduction of tax at source, where such rate is not in accordance with the provisions of the Act.

(4) The interest, if any, has to be computed on the basis of the sums deductible as computed in the statement;

(5) The fee, if any, has to be computed in accordance with the provision of section 234E. A fee of ₹ 200 for every day would be levied under section 234E for late furnishing of TDS statement from the due date of furnishing of TDS statement to the date of furnishing of TDS/ statement. However, the total amount of fee shall not exceed the total amount of tax deductible/collectible and such fee has to be paid before delivering the TDS statement.

(6) The sum payable by, or the amount of refund due to, the deductor has to be determined after adjustment of interest and fee against the amount paid under section 200 or section 201 or section 234E and any amount paid otherwise by way of tax or interest or fee.

(7) An intimation will be prepared and generated and sent to the deductor, specifying his tax liability or the refund due, within one year from the end of the financial year in which the statement is filed. The refund due shall be granted to the deductor.

For this purpose, the CBDT is empowered to make a scheme for centralized processing of statements of TDS to determine the tax payable by, or refund due to, the deductor.

15.6.5 Consequences of failure to deduct or pay [Section 201]

(1) Deemed assessee-in-default

The following persons shall be deemed to be an assessee in default if they do not deduct the whole or any part of the tax or after deducting fails to pay the tax -

(i) any person including the principal officer of a company, who is required to deduct any sum in accordance with the provisions of the Act; and

(ii) an employer paying tax on non-monetary perquisites under section 192(1A).

(2) Non-applicability of deeming provision

Any person (including the principal officer of the company) who fails to deduct the whole or any part of the tax on the amount credited or payment made to a ***payee*** shall not be deemed to be an assessee-in-default in respect of such tax if such ***payee*** –

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income,

and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

(3) No penalty under section 221

No penalty shall be charged under section 221 from such person unless the Assessing Officer is satisfied that such person has failed to deduct and pay the tax without good and sufficient reasons.

(4) Interest Liability

(i) A person deemed to be an assessee-in-default under section 201(1), for failure to deduct tax or to pay the tax after deduction, is liable to pay simple interest @1% for every month or part of month on the amount of such tax from the date on which tax was deductible to the date on which such tax was actually deducted and simple interest @1½% for every month or part of month from the date on which tax was deducted to the date on which such tax is actually paid [Section 201(1A)].

ILLUSTRATION 20

An amount of ₹ 40,000 was paid to Mr. X on 1.7.2019 towards fees for professional services without deduction of tax at source. Subsequently, another payment of ₹ 50,000 was due to Mr. X on 28.2.2020, from which tax @10% (amounting to ₹ 9,000) on the entire amount of ₹ 90,000 was deducted. However, this tax of ₹ 9,000 was deposited only on 22.6.2020. Compute the interest chargeable under section 201(1A).

SOLUTION

Interest under section 201(1A) would be computed as follows –

Particulars	₹
1% on tax deductible but not deducted i.e., 1% on ₹ 4,000 for 8 months	320
1½% on tax deducted but not deposited i.e. 1½% on ₹ 9,000 for 4 months[4]	540
	860

(ii) Such interest should be paid before furnishing the statements in accordance with section 200(3).

(iii) Where the payer fails to deduct the whole or any part of the tax on the amount credited or payment made to a ***payee*** and is not deemed to be an assessee-in-default under section 201(1) on account of payment of taxes by such ***payee***, interest under section 201(1A)(i) i.e., @1% p.m. or part of month, shall be payable by the payer from the date on which such tax was deductible to the date of furnishing of return of income by such ***payee***. The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the ***payee.***

(iv) Where the tax has not been paid after it is deducted, the amount of the tax together with the amount of simple interest thereon shall be a charge upon all the assets of the person or the company, as the case may be.

Guidelines for waiver of interest charged under section 201(1A) of the Income-tax Act, 1961 – [Circular No. 11/2017, dated 24.03.2017]

In exercise of the powers conferred under section 119(2)(a), the CBDT has directed that the Chief Commissioner of Income-tax and Director General of Income-tax may reduce or waive interest charged under section 201(1A)(i) in the classes of cases specified below for the period and to the extent the Chief Commissioner of Income-tax/Director General of Income-tax may deem fit. However, no reduction or waiver of such interest shall be ordered unless the principal demand under sections 200A, 201(1) or 234E, as the case may be, stands fully paid or satisfactory arrangements for payment of the principal demand under these sections have been made. The Chief Commissioner of Income-tax or Director General of Income-tax may also impose any other condition as deemed fit for the said reduction or waiver of interest.

The class of cases in which the reduction or waiver of interest under section 201(1A)(i) can be considered, are as follows:

(i) Where during the course of proceedings for search and seizure under section 132, or

[4] *TRACES, the TDS Centralised Processing Cell, however, calculates interest @1½% for 5 months in the above case.*

otherwise, the books of account and other documents necessary for making deduction under Chapter XVIIB of the Act were seized and the assessee was not able to, within the time specified, deduct tax at source from any sum credited to any account (whether called "suspense account" or by any other name) in his books of account.

(ii) Where any sum paid or payable was not liable for deduction of tax at source in the case of a deductor on the basis of any order passed by the jurisdictional High Court, and as a result, he did not deduct tax at source in relation to such sum, and subsequently, in consequence of any retrospective amendment of law or a decision of the Supreme Court of India or a decision of a Larger Bench of the jurisdictional High Court (which was not challenged before the Supreme Court and has become final) in any proceedings, as the case may be, tax was held to be deductible or the tax deducted by the deductor during such financial year was found to be less than the tax deductible on such sums paid or payable.

(iii) Where the default under section 201 relates to non-deduction or a lower deduction of tax under section 195 in respect of a payment made to a non-resident (including a foreign company) being a resident of a country or specified territory outside India with whom India has entered into an agreement referred to in section 90 or 90A of the Act, and where —

(a) a dispute regarding the tax payable in India in respect of the said payment had been referred to the Competent Authority in India mentioned in Rule 44H of the Income-tax Rules, 1962 under the said agreement under section 90 or 90A of the Act;

(b) such reference had been received by the Competent Authority in India within a period of two years of the date on which the notice of demand determining the tax payable was received by the person in default under section 201;

(c) the dispute has been settled by way of a resolution arrived at under the Mutual Agreement Procedure (MAP) provided in the said agreement; and

(d) the person in default under section 201 has given his acceptance to the resolution and has withdrawn his appeal(s) pending on the issue, within the meaning of Rule 44H(4) of the Income-tax Rules, within a period of one month of the date on which the resolution is communicated to him.

Even if the interest under section 201(1A)(i) has already been paid by the deductor, the same can be considered for waiver, subject to the conditions above and a refund may be given to the deductor, if waiver is ordered.

The Chief Commissioner of Income-tax or Director General of Income-tax examining an application for waiver of interest under this order shall pass a speaking order after providing adequate opportunity of being heard to the applicant.

The CBDT reserves the power to examine any grievance arising out of an order passed or not passed by Chief Commissioner of Income-tax or Director General of Income-tax, as the case may be, and issue suitable directions to these authorities for proper implementation of this order. However, no review of or appeal against the orders passed on merits by such authorities would be entertained by the CBDT.

(5) Time limit for deeming a person to be an assessee-in-default for failure to deduct tax at source

No order under section 201(1), deeming a person to be an assessee-in-default for failure to deduct the whole or any part of the tax from a person resident in India, shall be passed at any time after the expiry of

- seven years from the end of the financial year in which the payment is made or credit is given; or
- ***two years from the end of the financial year in which the correction statement is delivered under the proviso to section 200(3)***

whichever is later

Further, the exclusions from the time limit, as specified in *Explanation 1* to section 153, would also apply to the above time limit for passing an order deeming a person to be an assessee-in-default. Also, the time limit would not apply to an order passed consequent to the direction contained in an order of the Commissioner under sections 263 and 264, Commissioner (Appeals) under section 250, Appellate Tribunal under section 254, Supreme Court/National Tax Tribunal under section 260 and Supreme Court under section 262. Thus, the time limit would be extended where effect is to be given to various appellate proceedings or where proceedings are stayed.

(6) Non-specification of time limit where tax has been deducted but not paid

Section 201(1) deems a person to be an assessee-in-default if he –

(i) does not deduct tax; or

(ii) does not pay; or

(iii) after so deducting fails to pay

the whole or any part of the tax, as required by or under this Act.

Thus, section 201(1) contemplates three types of defaults. The default contemplated in (ii) is covered by the default contemplated in (iii). However, the time limit has been specified only for passing of orders relating to default contemplated in (i) above. There is no time limit specified in respect of the other defaults.

Therefore, no time-limits have been prescribed for the order under section 201(1) where –

(i) the deductor has deducted but not deposited the tax deducted at source, as this would be a case of defalcation of government dues,

(ii) the employer has failed to pay the tax wholly or partly, under sub-section (1A) of section 192, as the employee would not have paid tax on such perquisites,

(iii) the deductee is a non-resident as it may not be administratively possible to recover the tax from the non-resident.

15.6.6 Deduction only one mode of recovery [Section 202]

(1) Recovery of tax through deduction at source is only one method of recovery.

(2) The Assessing Officer can use any other prescribed methods of recovery in addition to tax deducted at source.

15.6.7 Certificate for tax deducted [Section 203]

(1) Every person deducting tax at source shall issue a certificate to the effect that tax has been deducted and specify the amount so deducted, the rate at which tax has been deducted and such other particulars as may be prescribed.

(2) Every person, being an employer, referred to in section 192(1A) shall, within such period, as may be prescribed, furnish to the person in respect of whose income such payment of tax has been made, a certificate to the effect that tax has been paid to the Central Government, and specify the amount so paid, the rate at which the tax has been paid and such other particulars as may be prescribed.

(3) **Certificate of TDS to be furnished under section 203 [Rule 31]**

The certificate of deduction of tax at source to be furnished under section 203 shall be in Form No.16 in respect of tax deducted or paid under section 192 and in any other case, Form No.16A.

Form No.16 shall be issued to the employee annually by **15th June** of the financial year immediately following the financial year in which the income was paid and tax deducted. Form No.16A shall be issued quarterly within 15 days from the due date for furnishing the statement of TDS under Rule 31A.

15.6.8 Common number for TDS and TCS [Section 203A]

(1) Persons responsible for deducting tax or collecting tax at source should apply to the Assessing Officer for the allotment of a “tax-deduction and collection-account number”.

(2) Section 203A(2) enlists the documents/certificates/returns/challans in which the “tax deduction account number” or “tax collection account number” or “tax deduction and collection account number” has to be compulsorily quoted. They are -

(i) challans for payment of any sum in accordance with the provisions of section 200 or section 206C(3);

(ii) certificates furnished under section 203 or section 206C(5);

(iii) statements prepared and delivered or caused to be delivered in accordance with the provisions of section 200(3) or section 206C(3);

(iv) returns delivered in accordance with the provisions of section 206 or section 206C(5A)/(5B); and

(v) in all other documents pertaining to such transactions as may be prescribed in the interests of revenue.

(3) The requirement of obtaining and quoting of TAN under section 203A shall not apply to such person, as may be notified by the Central Government in this behalf.

15.6.9 Furnishing of statement of tax deducted [Section 203AA]

(1) This section provides for furnishing of a statement of the tax deducted on or after 1st April, 2008 by the prescribed income-tax authority or the person authorised by such authority referred to in section 200(3)

(2) Such statement should be prepared and delivered to every person -

(a) from whose income, tax has been deducted or

(b) in respect of whose income, tax has been paid.

(3) Such statement should be in the prescribed form specifying the amount of tax deducted or paid and other prescribed particulars.

(4) Accordingly, the DGIT (Systems) has to deliver statement of TDS in Form 26AS by 31st July the following year.

15.6.10 Person responsible for paying taxes deducted at source [Section 204]

For purposes of deduction of tax at source the expression "person responsible for paying" means:

	Nature of income/payment	Person responsible for paying tax
(1)	Salary (other than payment of salaries by the Central or State Government)	(i) the employer himself; or (ii) if the employer is a company, the company itself, including the principal officer thereof.
(2)	Interest on securities (other than payments by or on behalf of the Central or State Government)	the local authority, corporation or company, including the principal officer thereof.
(3)	Any sum payable to a non-resident Indian, representing	the "Authorised Person" responsible for remitting such sum to the non-resident Indian or for

	consideration for the transfer by him of any foreign exchange asset, which is not a short term capital asset	crediting such sum to his Non-resident (External) Account maintained in accordance with the Foreign Exchange Management Act, 1999 and any rules made thereunder.
(4)	furnishing of information relating to payment to a non corporate non-resident, or to a foreign company, of any sum, whether or not chargeable under the provisions of this Act	(i) the payer himself; or (ii) if the payer is a company, the company itself including the principal officer thereof.
(5)	Credit/payment of any other sum chargeable under the provisions of the Act	(i) the payer himself; or (ii) if the payer is a company, the company itself including the principal officer thereof.
(6)	Credit/payment of any sum chargeable under the provisions of the Act made by or on behalf of the Central Government or the Government of a State.	(i) the drawing and disbursing officer; or (ii) any other person, by whatever name called, responsible for crediting, or as the case may be, paying such sum.

15.6.11 Bar against direct demand on assessee [Section 205]

Where tax is deductible at source under any of the aforesaid sections, the assessee shall not be called upon to pay the tax himself to the extent to which tax has been deducted from that income.

15.6.12 Furnishing of statements in respect of payment of any income to residents without deduction of tax [Section 206A]

(1) *This section casts responsibility on every banking company or co-operative society or public company referred to in the proviso to section 194A(3)(i) [i.e., a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of residential houses in India and which is eligible for deduction under section 36(1)(viii)] to prepare such statement, for such period as may be prescribed –*

— *if they are responsible for paying* ***to a resident****,*

— *the payment should be of any income* ***not exceeding ₹ 40,000****, where the payer is a banking company or a co-operative society, and* ***₹ 5,000*** *in any other case.*

— *such income should be by way of* ***interest (other than interest on securities)***

(2) *The statements have to be delivered or caused to be delivered to the prescribed income-tax authority or the person authorised by such authority.*

(3) *The statements have to be in the prescribed form, containing such particulars verified in the prescribed manner. The statement has to be filed within the prescribed time.*

(4) *The CBDT may cast responsibility on any person other than a person mentioned in (1) above, who is responsible for paying to a resident any income liable for deduction of tax at source.*

(5) *Such persons may be required to prepare statement for such period as may be prescribed in the prescribed form and deliver or cause to be delivered such statement within the prescribed time to the prescribed income-tax authority or the person authorized by such authority.*

(6) *Such statements should be in the prescribed form, containing such particulars and verified in the prescribed manner.*

(7) *Such person referred to in (1) and (4) above may also deliver to the prescribed authority, a correction statement -*

   (a) *for rectification of any mistake; or*

   (b) *to add, delete or update the information furnished in the statement delivered referred in (2) & (5) above.*

Note – *The above section has been substituted with effect from 1st September, 2019 to enable online filing of such statements (where tax has not been deducted on payment of interest to residents) in the prescribed form and manner. Prior to this date, the section provided for filing of such statements on a floppy, diskette, magnetic tape, CD-ROM or any other computer readable media. The new section also provides for correction of such statements to rectify a mistake or to add, delete or update the information furnished. Consequential amendment arising out of increased in threshold limit for TDS on payment of interest by a banking company or co-operative society to ₹40,000 has also been made.*

15.6.13 Mandatory requirement of furnishing PAN in all TDS statements, bills, vouchers and correspondence between deductor and deductee [Section 206AA]

(1) The non-quoting of PAN by deductees in many cases led to delay in issue of refund on account of problems in the processing of returns of income and in granting credit for tax deducted at source.

(2) With a view to strengthening the PAN mechanism, section 206AA provides that any person whose receipts are subject to deduction of tax at source i.e. the deductee, shall mandatorily furnish his PAN to the deductor failing which the deductor shall deduct tax at source at higher of the following rates –

   (i) the rate prescribed in the Act;

   (ii) at the rate in force i.e., the rate mentioned in the Finance Act; or

(iii) at the rate of 20%.

For instance, in case of rental payment for plant and machinery, where the payee does not furnish his PAN to the payer, tax would be deductible @20% instead of @2% prescribed under section 194-I. However, non-furnishing of PAN by the deductee in case of income by way of winnings from lotteries, card games etc., would result in tax being deducted at the existing rate of 30% under section 194B. Therefore, wherever tax is deductible at a rate higher than 20%, this provision would not have any impact.

(3) Tax would be deductible at the rates mentioned above also in cases where the taxpayer files a declaration in Form 15G or 15H (under section 197A) but does not provide his PAN.

(4) Further, no certificate under section 197 will be granted by the Assessing Officer unless the application contains the PAN of the applicant.

(5) Both the deductor and the deductee have to compulsorily quote the PAN of the deductee in all correspondence, bills, vouchers and other documents exchanged between them.

(6) If the PAN provided to the deductor is invalid or it does not belong to the deductee, it shall be deemed that the deductee has not furnished his PAN to the deductor. Accordingly, tax would be deductible at the rate specified in (ii) above.

(7) The provisions of section 206AA shall not apply in respect of payment of interest on long-term bonds, as referred to in section 194LC, to a non-corporate non-resident or to a foreign company.

(8) **Non-applicability of section 206AA to non-residents subject to fulfilment of certain conditions:**

For the purpose of reducing the compliance burden, section 206AA provides for non-applicability of the requirements contained in section 206AA to a non-corporate non-resident or a foreign company not having PAN in respect of payment in the nature of interest, royalty, fees for technical services and payments on transfer of any capital asset, subject to the deductee furnishing the following details and documents to the deductor, namely:-

a. name, e-mail id, contact number;

b. address in the country or specified territory outside India of which the deductee is a resident;

c. a certificate of his being resident in any country or specified territory outside India from the Government of that country or specified territory if the law of that country or specified territory provides for issuance of such certificate;

d. Tax Identification Number of the deductee in the country or specified territory of his residence and in case no such number is available, then a unique number on the basis of which the deductee is identified by the Government of that country or the specified territory of which he claims to be a resident. ***[Notification No. 53/2016 dated 24th June, 2016]***

(8) Both the deductor and the deductee have to compulsorily quote the PAN of the deductee in all correspondence, bills, vouchers and other documents exchanged between them.

15.7 TAX COLLECTION AT SOURCE [SECTION 206C]

(1) ***Applicability and Rate [Section 206C(1)/(1C)/(1F)]***

(i) Under section 206C(1), sellers of certain goods are required to collect tax from the buyers at the specified rates. The specified percentage for collection of tax at source is as follows:

	Nature of Goods	Percentage
(i)	Alcoholic liquor for human consumption	1%
(ii)	Tendu leaves	5%
(iii)	Timber obtained under a forest lease	2.5%
(iv)	Timber obtained by any mode other than (iii)	2.5%
(v)	Any other forest produce not being timber or tendu leaves	2.5%
(vi)	Scrap	1%
(vii)	Minerals, being coal or lignite or iron ore	1%

(ii) Section 206C(1C) provides for collection of tax by every person who grants a lease or a licence or enters into a contract or otherwise transfers any right or interest in any -

- parking lot or
- toll plaza or
- a mine or a quarry

to another person (other than a public sector company) for the use of such parking lot or toll plaza or mine or quarry for the purposes of business. The tax shall be collected as provided, from the licensee or lessee of any such licence, contract or lease of the specified nature, at the rate of 2%.

Note *– Mining and quarrying excludes mining and quarrying of mineral oil. Mineral oil includes petroleum and natural gas. Thus, mining and quarrying excludes mining and quarrying of petroleum and natural gas. Consequently, the oil exploration and incidental services are relieved from the applicability of TCS provisions, since these services are in the organized sector.*

(iii) Section 206C(IF) provides that every person, being a seller, who receives any amount as consideration for sale of a motor vehicle of the value exceeding ₹ 10 lakhs, shall collect tax from the buyer@1% of the sale consideration.

> **Note** - *The power to recover tax by collection under sub-section (1) or (1C) shall be without prejudice to any other mode of recovery [Sub-section (2)].*

(2) Meaning of certain terms [Explanation to section 206C]

	Term	Meaning
(i)	Buyer	**For sub-section (1) and (1C) of section 206C**: A person who obtains in any sale, by way of auction, tender, or any other mode, goods of the nature specified in the Table in sub-section (1) or the right to receive any such goods but does not include – (A) a public sector company, the Central Government, a State Government, and an embassy, a high commission, legation, commission, consulate and the trade representation, of a foreign State and a club, or (B) a buyer in the retail sale of such goods purchased by him for personal consumption **For sub-section (1F) of section 206C**: A person who obtains in any sale, goods of the nature specified therein, but does not include – (A) the Central Government, a State Government and an embassy, a High Commission, legation, commission, consulate and the trade representation of a foreign State; or (B) a local authority as defined in Explanation to section 10(20); or (C) a public sector company which is engaged in the business of carrying passengers.
(ii)	Seller	(i) The Central Government, (ii) a State Government or (iii) any local authority or (iv) corporation or (v) authority established by or under a Central, State or Provincial Act, or (vi) any company or (vii) firm or (viii) co-operative society Seller also includes an individual or a HUF whose total sales, gross

		receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which the goods of the nature specified in the Table in sub-section (1) are sold.
(iii)	Scrap	Waste and scrap from the manufacture or mechanical working of materials which is definitely not usable as such because of breakage, cutting up, wear and other reasons;

(3) CBDT Clarification relating to certain issues with respect to section 206C(1F)

These amendments in section 206C have given rise to certain issues relating to the scope and applicability of the provisions. Accordingly, the CBDT has, vide *Circular No. 22/2016 dated 8.6.2016* and *Circular No.23/2016 dated 24.6.2016*, clarified the following issues in "Question & Answer (Q&A)" format.

Q.1 ***Whether TCS@1% is on sale of motor vehicle at retail level or also on sale of motor vehicles by manufacturers to dealers/ distributors?***

A. To bring high value transactions within the tax net, section 206C has been amended to provide that the seller shall collect the tax @ 1% from the purchaser on sale of motor vehicle of the value exceeding ₹ 10 lakhs. This is brought to cover all transactions of retail sales and accordingly, it **will not apply on sale of motor vehicles by manufacturers to dealers/distributors.**

Q.2 ***Whether TCS@1% on sale of motor vehicle is applicable only to luxury cars?***

A. No,as per section 206C(1F), the seller shall collect tax@1% from the purchaser on sale of any motor vehicle of the value exceeding ₹ 10 lakhs.

Q.3 ***Whether TCS@1% is applicable in the case of sale to Government Departments, Embassies, Consulates and United Nation Institutions, of motor vehicle or any other goods or provision of services?***

A. Government, institutions notified under United Nations (Privileges and Immunities) Act 1947, and Embassies, Consulates, High Commission, Legation, Commission and trade representation of a foreign State shall not be liable to levy of TCS@1% under sub-section (IF) of section 206C.

Q.4 ***Whether TCS is applicable on each sale of motor vehicle or on aggregate value of sale during the year?***

A. Tax is to be collected at source@1% on sale consideration of a motor vehicle exceeding ₹ 10 lakhs. It is applicable to each sale and not to aggregate value of sale made during the year.

Q.5 ***Whether TCS@1% on sale of motor vehicle is applicable in case of an individual?***

A. The definition of "Seller" as given in clause (c) of the *Explanatio*n below sub-section (11) of section 206C shall be applicable in the case of sale of motor vehicles also.

Accordingly, an individual who is liable to audit as per the provisions of section 44AB during the financial year immediately preceding the financial year in which the motor vehicle is sold shall be liable for collection of tax at source on sale of motor vehicle by him.

Q.6 ***How would the provisions of TCS on sale of motor vehicle be applicable in a case where part of the payment is made in cash and part is made by cheque?***

A. The provisions of TCS on sale of motor vehicle exceeding ₹ 10 lakhs is not dependent on mode of payment. Any sale of motor vehicle exceeding ₹ 10 lakhs would attract TCS@1%.

(4) ***Time of Collection of tax [Section 206C(1)/(1C)/(1F)]***

The tax should be collected at the time of debiting of the amount payable by the buyer or licensee or lessee, as the case may be, to his account or at the time of receipt of such amount from the buyer or licensee or lessee, as the case may be, in cash or by the issue of a cheque or draft or any other made, whichever is earlier.

In case of sale of a motor vehicle of the value exceeding ₹ 10 lakhs, tax shall be collected at the time of receipt of such amount.

(5) ***Non-applicability of TCS [Section 206C(1A)]***

No collection of tax shall be made in the case of a resident buyer, if such buyer furnishes to the person responsible for collecting tax, a declaration in writing in duplicate in the prescribed form and verified in the prescribed manner to the effect that goods referred to in column (2) of the Table in (1)(i) above are to be utilised for the purpose of manufacturing, processing or producing articles or things or for the purposes of generation of power and not for trading purposes.

(6) ***Furnishing of copy of declaration within specified time [Section 206C(1B)]***

The person responsible for collecting tax under this section shall deliver or cause to be delivered to the Chief Commissioner or Commissioner one copy of the declaration referred to in sub-section (1A) on or before 7th of the month next following the month in which the declaration is furnished to him.

(7) ***TCS to be paid within prescribed time [Section 206C(3)]***

Any amount collected under sub-section (1) or (1C) shall be paid within the prescribed time to the credit of the Central Government or as the Board directs.

Time limit for paying tax collected to the credit of the Central Government [Rule 37CA]

	Person collecting sums in accordance with section 206C(1)/(1C)	Circumstance	Period within which such sum should be paid to the credit of the Central Government
(1)	An office of the Government	(i) where the tax is paid without production of an income-tax challan	on the same day
		(ii) where tax is paid accompanied by an income-tax challan	on or before 7 days from the end of the month in which the collection is made
(2)	Collectors other than an office of the Government		within one week from the last day of the month in which the collection is made

(8) Statement of TCS to be prepared and delivered within prescribed time

(i) A person collecting tax in accordance with the provisions of the section is vested with the responsibility of preparing such statements for such periods as may be prescribed after paying the tax collected to the credit of the Central Government within the prescribed time.

(ii) The statement should be delivered or caused to be delivered to the prescribed income-tax authority, i.e., DGIT (Systems) or the person authorised by such authority.

(iii) The statement should be in the prescribed form [Form No.27EQ] and verified in the prescribed manner.

(iv) The statement should set forth the prescribed particulars and should be filed within such time as may be prescribed. The time limit for furnishing such quarterly statements shall be 15th of the month following each quarter in respect of the first three quarters and 15th May for the last quarter ending on 31st March.

Due dates for furnishing statement of TCS [Rule 31AA]

	Quarter ending	Due Date
I	30th June	15th July

II	30th September	15th October
III	31st December	15th January
IV	31st March	15th May

(9) ***Enabling provision for improving the reporting of payment of TCS made through book entry and making the existing mechanism enforceable [Section 206C(3A)]***

Where the tax collected has been paid without the production of a challan, the PAO/TO/CDDO or any other person, by whatever name called, who is responsible for crediting such sum to the credit of the Central Government, shall furnish a statement in the prescribed form [Form No.24G] for the prescribed period to the agency authorised by the Principal Director of Income-tax (Systems) in respect of tax collected by the collectors and reported to him. Such statement has to be furnished within the prescribed time by verifying the same in the prescribed manner and setting forth prescribed particulars.

Relevant Rule	Period to which statement relates	Prescribed Time
37CA(3A)(a)	Where the statement relates to the month of March	On or before 30th April
37CA(3A)(b)	In any other case	On or before 15 days from the end of the relevant month

Such statement has to be furnished in the following manner:

(a) electronically under digital signature; or

(b) electronically along with verification of the statement in Form No.27A or verified through an electronic process

in accordance with the procedures, formats and standards for the purpose of furnishing and verification of the statements specified by the Principal Director General of Income-tax (Systems)

(10) Enabling provision for filing correction statement of TCS [Section 206C(3B)]

The person collecting tax at source who is required to prepare statements to be delivered to Director General of Income-tax (Systems) / NSDL after paying the tax collected to the credit of the Central Government, may also deliver to the said authority, a correction statement for rectification of any mistake or to add, delete or update the information furnished in the statement so delivered in the specified form and verified in the specified manner.

(11) Credit for TCS [Sub-section (4)]

Any amount collected in accordance with the provisions of this section and paid to the credit of the Central Government shall be deemed to be payment of tax on behalf of the person from whom the amount has been collected. The CBDT may prescribe the rules based on which credit shall be given to such person for the amount so collected in a particular assessment year.

Rule	Case	Manner of allowing credit
Rule 37-I(2)(i)	Where tax has been collected at source and paid to the Central Government	Credit for TCS shall be given for the A.Y. for which the income is assessable to tax.
Rule 37-I(2)(ii)	Where tax has been collected at source and paid to the Central Government and the lease or license is relatable to more than one year	Credit for TCS shall be allowed across those years to which the lease or license relates in the same proportion

(12) Furnishing of Certificate of TCS within prescribed time [Sub-section (5)]

(i) Every person collecting tax in accordance with the provisions of this section shall, within such period as may be prescribed from the date of debit or receipt of the amount, furnish to the buyer or licensee or lessee to whose account such amount is debited or from whom such payment is received, a certificate to the effect that tax has been collected specifying the sum so collected, the rate at which the tax has been collected and such other particulars as may be prescribed.

(ii) Certificate of tax collected at source under section 206C(5) in Form No.27D shall be furnished by the collector within 15 days from the due date for furnishing the quarterly statement of TCS under Rule 31AA [Rule 37D].

(iii) The prescribed income-tax authority or the person authorized by such authority have now been vested with the responsibility to prepare and deliver a statement in the prescribed form specifying the amount of tax collected and such other particulars as may be prescribed, within the prescribed time after the end of each financial year beginning on or after 1.4.2008 [Proviso to sub-section (5)].

(iv) Accordingly, Rule 31AB requires the statement in Form 26AS to be delivered by the Director General of Income-tax (Systems) or the person authorised by the Director General of Income-tax (Systems) on or before 31st July following the Financial Year during which taxes were collected or paid to:

(a) every person in respect of whose income the tax has been paid or

(b) the buyer or licencee or lessee from whom the amount has been collected.

(13) Consequences of failure to collect tax at source

(i) ***Personal liability to pay tax collectible at source [Section 206C(6)]*** - A person who is responsible for collecting the tax in accordance with the provisions of this section shall be liable to pay the tax to the credit of the Central Government, even if he has failed to collect the tax

(ii) ***Deemed assessee-in-default for failure to collect tax [Section 206C(6A)]*** - Any person responsible for collecting tax shall be deemed to be an assessee in default in respect of the tax if such person -

(1) does not collect the whole or any part of the tax or

(2) fails to pay such tax after having collected the tax

(iii) ***Deeming provision not applicable if tax is paid by buyer/licensee/lessee [First Proviso to section 206C(6A)]*** - Any person responsible for collecting tax at source would not be deemed to be an assessee-in-default for failure to collect tax on the amount received from a buyer or licensee or lessee or on the amount debited to the account of the buyer or licensee or lessee, if such buyer or licensee or lessee has furnished his return of income under section 139, taking into account such amount for computing income and paid the tax due on the income declared by him in such return of income. Further, the person should also furnish a certificate to this effect from an accountant in the prescribed form.

(iv) ***Levy of penalty for failure to collect and pay tax [Second proviso to section 206C(6A)]*** - No penalty shall be charged under section 221 from such person unless the Assessing Officer is satisfied that the person has without good and sufficient reasons failed to collect and pay the tax.

(v) ***Interest payable for failure to collect and pay tax within the prescribed time [Sub-section (7)]*** - If the person responsible for collecting tax does not collect the tax or after collecting the tax fails to pay it as required under this section, he shall be liable to pay simple interest at the rate of 1% p.m. or part thereof on the amount of such tax from the date on which such tax was collectible to the date on which the tax was actually paid and such interest shall be paid before furnishing the quarterly statement for each quarter in accordance with the provisions of sub-section (3).

In such cases where a person is not deemed to be an assessee-in-default on account of the tax being paid by the buyer/licensee/lessee, interest shall be payable by the collector from the date on which tax was collectible to the date of furnishing return of income by such buyer or licensee or lessee.

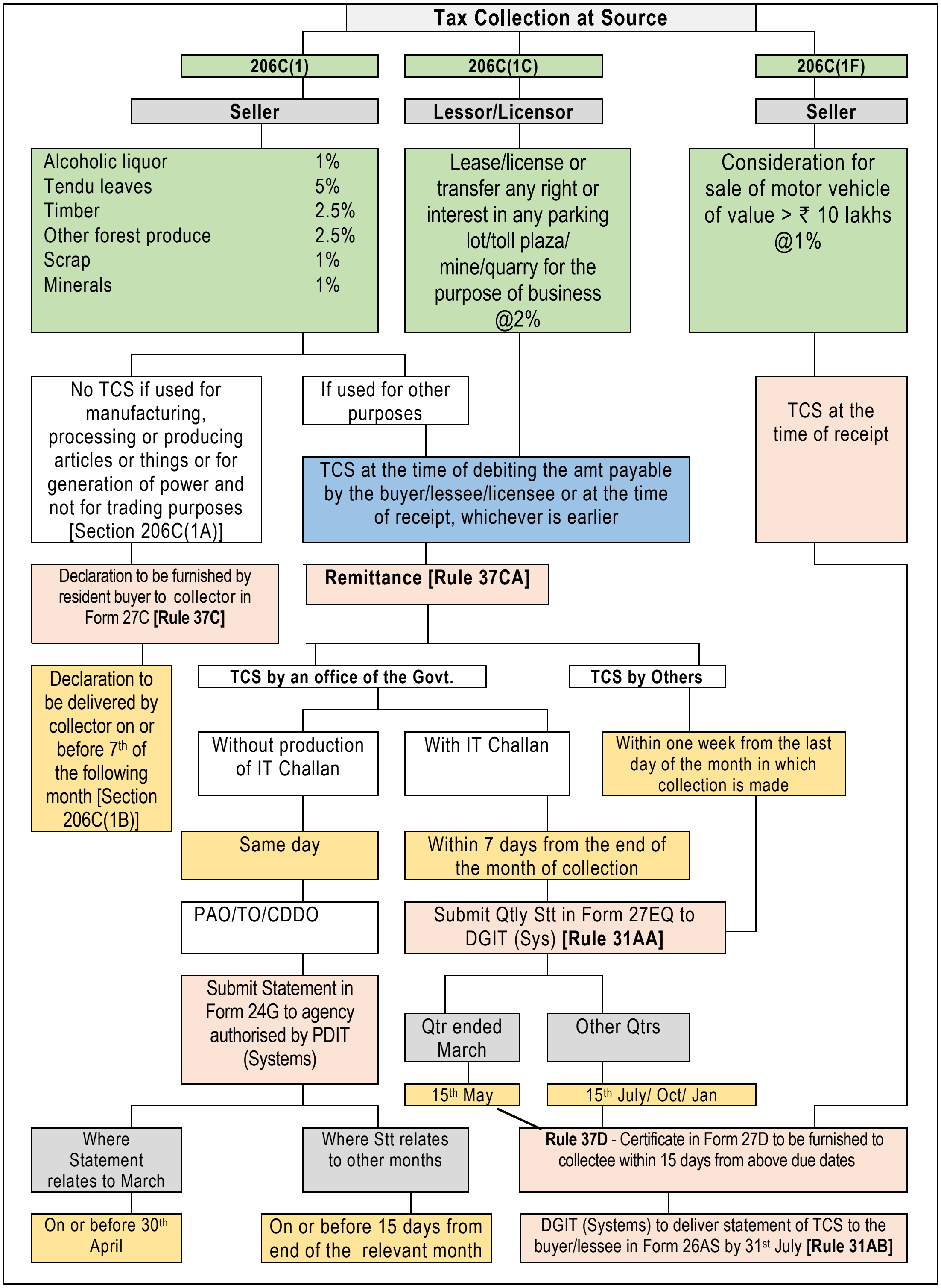
(vi) ***Tax not collected to be a charge upon all assets of the collector [Section 206C (8)]*** - Where the tax has not been paid as aforesaid, after it is collected, the amount of tax together with the amount of simple interest thereon referred to in sub-section (7) shall be a charge upon all the assets of the person responsible for collecting tax

(14) Other Provisions [Section 206C(9)/(10)/(11)]

(i) ***Certificate for collection of tax at lower rate [Section 206C(9)]*** - The Assessing Officer can issue certificate for collection of tax at a lower rate than those specified in sub-section (1)/(1C). Such certificate shall be issued on an application made by the buyer or licensee or lessee in this behalf.

(ii) ***Tax to be collected at the rate specified in the Certificate [Section 206C(10)]*** - The person responsible for collecting tax shall collect the same at the rate specified in such certificate until such certificate in cancelled by the Assessing Officer.

(iii) ***CBDT empowered to make rules relating to grant of Certificates [Section 206C(11)]*** – The CBDT is empowered to make rules specifying the cases in which and the circumstances under which an application maybe made for the grant of such certificate and the conditions subject to which certificate may be granted.



Tax Collection at Source

206C(1)

Seller

Alcoholic liquor	1%
Tendu leaves	5%
Timber	2.5%
Other forest produce	2.5%
Scrap	1%
Minerals	1%

No TCS if used for manufacturing, processing or producing articles or things or for generation of power and not for trading purposes [Section 206C(1A)]

Declaration to be furnished by resident buyer to collector in Form 27C **[Rule 37C]**

Declaration to be delivered by collector on or before 7th of the following month [Section 206C(1B)]

If used for other purposes

206C(1C)

Lessor/Licensor

Lease/license or transfer any right or interest in any parking lot/toll plaza/ mine/quarry for the purpose of business @2%

TCS at the time of debiting the amt payable by the buyer/lessee/licensee or at the time of receipt, whichever is earlier

206C(1F)

Seller

Consideration for sale of motor vehicle of value > ₹ 10 lakhs @1%

TCS at the time of receipt

Remittance [Rule 37CA]

TCS by an office of the Govt.

Without production of IT Challan

Same day

PAO/TO/CDDO

Submit Statement in Form 24G to agency authorised by PDIT (Systems)

Where Statement relates to March

On or before 30th April

Where Stt relates to other months

On or before 15 days from end of the relevant month

With IT Challan

Within 7 days from the end of the month of collection

TCS by Others

Within one week from the last day of the month in which collection is made

Submit Qtly Stt in Form 27EQ to DGIT (Sys) **[Rule 31AA]**

Qtr ended March

15th May

Other Qtrs

15th July/ Oct/ Jan

Rule 37D - Certificate in Form 27D to be furnished to collectee within 15 days from above due dates

DGIT (Systems) to deliver statement of TCS to the buyer/lessee in Form 26AS by 31st July **[Rule 31AB]**

15.8 PROCESSING OF TCS STATEMENTS [SECTION 206CB]

(1) Section 206CB facilitates processing of statements of tax collected at source in the like manner as processing of TDS statements under section 200A.

(2) The manner of processing a statement of tax collection at source or a correction statement made by a person collecting any sum under section 206C, as provided in section 206CB(1), is as follows -

(a) **Permissible adjustments** - the sums collectible under Chapter XVII-BB shall be computed after making the following adjustments, namely:—

(i) any arithmetical error in the statement;

(ii) an incorrect claim, apparent from any information in the statement (i.e., a claim, on the basis of an entry, in the statement—

(1) of an item, which is inconsistent with another entry of the same or some other item in such statement;

(2) in respect of rate of collection of tax at source, where such rate is not in accordance with the provisions of the Income-tax Act, 1961).

(b) **Interest** - The interest, if any, shall be computed on the basis of the sums collectible as computed in the statement;

(c) **Fee** - The fee, if any, shall be computed in accordance with the provisions of section 234E;

(d) **Determination of sum payable by, or the amount of refund due to, the collector** – Such sum shall be determined after adjustment of such interest and fee against any amount paid under section 206C or section 234E and any amount paid otherwise by way of tax or interest or fee;

(e) **Intimation** - An intimation shall be prepared or generated and sent to the collector specifying the sum determined to be payable by, or the amount of refund due to, him; and

(f) **Grant of refund** - The amount of refund due to the collector in pursuance of such determination shall be granted to the collector:

However, no intimation under section 206CB(1) shall be sent after the expiry of the period of **one year** from the end of the financial year in which the statement is filed.

(3) The CBDT is empowered to make a scheme for centralised processing of statements of tax collected at source to expeditiously determine the tax payable by, or the refund due to, the collector, as required under section 206CB(1).

15.9 PAN QUOTING MECHANISM IN THE TCS REGIME [SECTION 206CC]

In order to strengthen the PAN mechanism, section 206CC provides the following:

(1) **Tax collectible at higher rate if PAN not furnished [Section 206CC(1)]** - Any person paying any sum or amount, on which tax is collectible at source (collectee) shall furnish his PAN to the person responsible for collecting such tax (collector), failing which tax shall be collected at the higher of the following rates -

(i) at the twice the rate mentioned in the relevant section under Chapter XVII-BB; or

(ii) at the rate of five per cent.

(2) **Declaration invalid if PAN not furnished** - The declaration filed under section 206C(1A) shall not be valid unless the person filing the declaration furnishes his PAN in such declaration.

In case any declaration becomes invalid under sub-section (2), the collector shall collect the tax at source in accordance with the provisions of sub-section (1).

Where the PAN provided by the collectee is invalid or it does not belong to the collectee, then it shall be deemed that PAN has not been furnished to the collector.

(3) **Granting of Certificate subject to furnishing of PAN** - No certificate under section 206C(9) shall be granted unless it contains the PAN of the applicant.

(4) **Documents to contain PAN of the collectee** -The collectee shall furnish his PAN to the collector and both shall indicate the same in all their correspondence, bills, vouchers and other documents which are sent to each other.

(5) The requirement to furnish PAN to the collector does not apply to a non-resident who does not have permanent establishment in India from the provisions of this proposed section 206CC of the Act.

15.10 ADVANCE PAYMENT OF TAX [SECTION 207 TO 219]

15.10.1 Liability for payment of advance tax

(1) Tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219, in respect of an assessee's current income i.e. the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year [Section 207].

(2) Under section 208, obligation to pay advance tax arises in every case where the advance tax payable is ₹ 10,000 or more.

***Note -** An assessee who is liable to pay advance tax of less than ₹ 10,000 will not be saddled with interest under sections 234B and 234C for defaults in payment of advance tax. However, the consequences under section 234A regarding interest for belated filing of return would be attracted.*

(3) In case of senior citizens who have passive source of income like interest, rent, etc., the requirement of payment of advance tax causes genuine compliance hardship. Therefore, in order to reduce the compliance burden on such senior citizens, exemption from payment of advance tax has now been provided to a resident individual-

(i) not having any income chargeable under the head "Profits and gains of business or profession"; and

(ii) of the age of 60 years or more.

Such senior citizens need not pay advance tax and are allowed to discharge their tax liability (other than TDS) by payment of self-assessment tax.

15.10.2 Computation of advance tax

(1) An assessee has to estimate his current income and pay advance tax thereon. He need not submit any estimate or statement of income to the Assessing Officer, except where he has been served with notice by the Assessing Officer.

(2) Where an obligation to pay advance tax has arisen, the assessee shall himself compute the advance tax payable on his current income at the rates in force in the financial year and deposit the same, whether or not he has been earlier assessed to tax.

(3) In the case of a person who has been already assessed by way of a regular assessment in respect of the total income of any previous year, the Assessing Officer, if he is of the opinion that such person is liable to pay advance tax, can serve an order under section 210(3) requiring the assessee to pay advance tax.

(4) For this purpose, the total income of the latest previous year in respect of which the assessee has been assessed by way of regular assessment or the total income returned by the assessee in any return of income for any subsequent previous year, whichever is higher, shall be taken as the basis for computation of advance tax payable.

(5) The above order can be served by the Assessing Officer at any time during the financial year but not later than the last date of February.

(6) If, after sending the above notice, but before 1st March of the financial year, the assessee furnishes a return relating to any later previous year or an assessment is completed in respect of a later return of income, the Assessing Officer may amend the order for payment of advance tax on the basis of the computation of the income so returned or assessed.

(7) If the assessee feels that his own estimate of advance tax payable would be less than the one sent by the Assessing Officer, he can file estimate of his current income and advance tax payable thereon.

(8) Where the advance tax payable on assessee's estimation is higher than the tax computed by the Assessing Officer, then, the advance tax shall be paid based upon such higher amount.

(9) In all cases, the tax calculated shall be reduced by the amount of tax deductible at source.

No reduction of 'tax deductible but not deducted' while computing advance tax liability

(i) As per the provisions of section 209, the amount of advance tax payable by a person is computed by reducing the amount of income-tax which would be deductible at source during the financial year from any income which has been taken into account in computing the total income.

(ii) Some courts have opined that in case where the payer pays any amount (on which tax is deductible at source) without deduction of tax at source, the payee shall not be liable to pay advance tax to the extent tax is deductible from such amount.

(iii) With a view to make such a person (payee) liable to pay advance tax, the proviso to section 209(1)(d) provides that the amount of tax deductible at source but not so deducted by the payer shall not be reduced from the income tax liability of the payee for determining his liability to pay advance tax.

(iv) In effect, only if tax has actually been deducted at source, the same can be reduced for computing advance tax liability of the payee. Tax deductible but not so deducted cannot be reduced for computing advance tax liability of the payee.

(v) Similarly, only if tax has actually been collected at source, the same can be reduced for computing advance tax liability of the buyer or licensee or lessee. Tax collectible but not so collected cannot be reduced for computing advance tax liability of the buyer or licensee or lessee.

(10) The amount of advance tax payable by an assessee in the financial year calculated by -

(i) the assessee himself based on his estimation of current income; or

(ii) the Assessing Officer as a result of an order under section 210(3) or amended order under section 210(4)

is subject to the provisions of section 209(2), as per which the net agricultural income has to be considered for the purpose of computing advance tax.

15.10.3 Installments of advance tax and due dates

(1) **Common advance tax payment schedule for both corporates and non-corporates [other than an assessee who declares profits and gains in accordance with section 44AD(1) or section 44ADA(1)]:**

Due date of installment	Amount payable
On or before 15th June	Not less than 15% of advance tax liability
On or before 15th September	Not less than 45% of advance tax liability, as reduced by the amount, if any, paid in the earlier installment.
On or before 15th December	Not less than 75% of advance tax liability, as reduced by the amount or amounts, if any, paid in the earlier installment or installments.
On or before 15th March	The whole amount of advance tax liability as reduced by the amount or amounts, if any, paid in the earlier installment or installments.

Note - Any amount paid by way of advance tax on or before 31st March shall also be treated as advance tax paid during each financial year on or before 15th March.

(2) **Eligible assessee computing profits on presumptive basis under section 44AD(1) or section 44ADA(1) to pay advance tax by 15th March**

An eligible assessee, opting for computation of profits or gains of business on presumptive basis in respect of eligible business referred to in section 44AD(1) or for computation of profits or gains of profession on presumptive basis in respect of eligible profession referred to in section 44ADA(1), shall be required to pay advance tax of the whole amount in one instalment on or before the 15th March of the financial year.

However, any amount paid by way of advance tax on or before 31st March shall also be treated as advance tax paid during each financial year on or before 15th March.

(3) If the last day for payment of any installment of advance tax is a day on which the receiving bank is closed, the assessee can make the payment on the next immediately following working day, and in such cases, the mandatory interest leviable under sections 234B and 234C would not be charged.

(4) Where advance tax is payable by virtue of the notice of demand issued under section 156 by the Assessing Officer, the whole or the appropriate part of the advance tax specified in such notice shall be payable on or before each of such due dates as fall after the date of service of notice of demand.

(5) Where the assessee does not pay any installment by the due date, he shall be deemed to be an assessee in default in respect of such installment.

15.11 INTEREST CHARGEABLE IN CERTAIN CASES

15.11.1 Interest for defaults in furnishing return of income [Section 234A]

(1) **Rate and Period for calculation of interest** - Where the return of income for any assessment year under section 139(1) or section 139(4) or in response to a notice under section 142(1), is furnished after the due date or is not furnished, the assessee shall be liable to pay simple interest at the rate of 1% for every month or part of a month comprised in the period commencing on the day immediately following the due date and,

(a) where the return is furnished after the due date, ending on that date of furnishing the return; and

(b) where no return has been furnished, ending on the date of completion of assessment under section 144.

The interest payable under this section shall be reduced by the interest paid under section 140A.

Note *- 'Due date' means the date specified in section 139(1) as applicable in the case of the assessee.*

(2) **Amount on which interest is payable -** The amount on which interest will be payable will be the amount of the tax on the total income as determined under section 143(1) or on regular assessment, as reduced by the amount of -

(i) advance tax, if any, paid ;

(ii) any tax deducted or collected at source;

(iii) any relief of tax allowed under section 89;

(iv) any relief of tax allowed under section 90 or 90A;

(v) any deduction of tax allowed under section 91;

(vi) any tax credit allowed to be set-off in accordance with the provisions of section 115JAA or section 115JD.

Notes

(i) The tax on total income as determined under section 143(1) shall not include additional income-tax payable under section 143.

(ii) Where in relation to an assessment year an assessment is made for the first time under section 147 or section 153A, the assessment so made shall be regarded as regular assessment for the purposes of this section.

(3) **Computation of interest where return is furnished after the time period specified in notice under section 148 or 153A -** Where the return of income for any assessment year, required by a notice under section 148 issued after the determination of income under

section 143(1) or after completion of assessment under section 143(3) or section 144 or section 147, is furnished after the expiry of the time allowed under such notice, or is not furnished, the assessee shall be liable to pay simple interest at the rate of 1% for every month or part of a month comprised in the period commencing on the date immediately following the expiry of the time allowed as aforesaid and ending on the following dates specified in column (3) below:

	Case	Ending date
(i)	where the return is furnished after the expiry of the time aforesaid	on the date of furnishing the return
(ii)	where no return has been furnished	on the date of completion of the reassessment or re-computation under section 147 or reassessment under section 153A

(4) **Amount on which interest is payable** - The amount on which the above interest is payable is the amount by which the tax on the total income determined on the basis of such reassessment or re-computation exceeds the tax on the total income determined under section 143(1) or on the basis of the earlier assessment aforesaid.

(5) **Consequence where interest is increased or reduced subsequently as a result of rectification, appeal, revision etc.** - Where as a result of an order of rectification or appellate order or an order of revision or an order of the Settlement Commission, the interest payable is reduced or increased, the Assessing Officer shall proceed as follows:

	Case	Ending date
(i)	Where the interest is increased	The Assessing Officer shall serve on the assessee a notice of demand in the prescribed form specifying the sum payable and such demand notice shall be a notice under section 156.
(ii)	Where interest is reduced	The excess paid shall be refunded

(6) Interest under section 234A not chargeable on self assessment tax paid before the due date of filing of return of income [*Circular No. 2/2015, dated 10-2-2015*]

The Hon'ble Supreme Court has, in the case of *CIT vs Prannoy Roy (2009) 309 ITR 231,* held that interest under section 234A on default of furnishing return of income shall be payable only on the amount of tax that has not been deposited before the due date of filing of the Income-tax return for the relevant assessment year.

Accordingly, the CBDT has clarified that no interest under section 234A shall be charged on self assessment tax paid by the assessee on or before the due date of filing of return.

15.11.2 Interest for defaults in payment of advance tax [Section 234B]

(1) **Rate and period of interest** : Interest under section 234B would be attracted where an assessee, who is liable to pay advance tax, fails to pay such tax or the advance tax paid is less than 90% of assessed tax. Accordingly, interest would be leviable at the rate of 1% for every month or for part of month for the following period, if the advance tax paid falls short of 90% of the 'assessed tax'.

Period commencing from:		**Period ending on:**		
the 1st April of the following F.Y.	**and**	(i)	Where regular assessment is not made	The date of determination of total income u/s 143(1)
		(ii)	Where regular assessment is made	The date of regular assessment

Amount on which interest is payable:		
(i)	Where no advance tax is paid	Assessed tax
(ii)	Where advance tax paid falls short of 90% of assessed tax	Assessed tax **minus** Advance tax paid

(2) **Meaning of the term 'assessed tax':** The tax on the total income determined under section 143(1) or on regular assessment as reduced by the amount of -

(i) any tax deducted or collected at source on any income which is taken into account for calculating the total income;

(ii) any relief of tax allowed under section 89;

(iii) any relief of tax allowed under section 90 or 90A;

(iv) any deduction of tax allowed under section 91;

(v) any tax credit allowed to be set-off in accordance with the provisions of section 115JAA or section 115JD.

***Notes**:*

(i) An assessment made for the first time under section 147 or section 153A shall be deemed to be regular assessment.

(ii) Tax on the total income determined under section 143(1) shall not include the additional income-tax, if any, payable.

(3) **Interest paid on Self-assessment**: Where before the date of determination of total income under section 143(1) or completion of regular assessment, tax is paid by the assessee under section 140A, interest shall be calculated up to the date on which the tax is so paid and reduced by the interest paid under section 140A towards interest under section 234B.

Thereafter, interest shall be calculated on the amount by which the tax paid under section 140A together with the advance tax paid falls short of the assessed tax.

(4) **Where an application under section 245C(1) for any assessment year has been made**: In such a case, the assessee shall be liable to pay simple interest at the rate of 1% for every month or part of a month comprised in the following period:

Period commencing from:		Period ending on:
the 1st April of such assessment year	and	the date of making such application
Amount on which interest is payable:		
the additional amount of income-tax referred to in section 245C(1)		

Further, where as a result of an order of the Settlement Commission under section 245D(4) for any assessment year, the amount of total income disclosed in the application under section 245C(1) is increased, the assessee shall be liable to pay simple interest at the rate of 1% for every month or part of a month comprised in the following period –

Period commencing from:		Period ending on:
the 1st April of such assessment year	and	the date of order under section 245D(4)
Amount on which interest is payable:		
Tax on total income determined on the basis of order under section 245D(4) **minus** Tax on total income disclosed in the application filed under section 245C(1).		

If, as a consequence of an order passed by the Settlement Commission under section 245D(6B) to rectify a mistake apparent from the record, the amount on which interest is payable is increased or decreased, the interest shall be increased or decreased accordingly.

(5) **Where total income is increased on reassessment under section 147 or section 153A:** As per section 234B(3), where the total income is increased on reassessment under section 147 or section 153A, the assessee shall be liable for interest@1% for every month or part of a month on the amount of the increase in tax on total income as a consequence of reassessment or recomputation [Tax on total income determined on the basis of reassessment or recomputation – Tax on total income determined under section 143(1) or on the basis of regular assessment].

Period for which interest is payable

Period commencing from:		Period ending on:
the 1st April next following the financial year	**and**	the date of reassessment or recomputation under section 147 or section 153A.

(6) **Consequence where interest payable is increased or reduced subsequently as a result of rectification, appeal, revision etc. -** Where as a result of an appellate order or an order of revision, the interest payable is reduced or increased, the Assessing Officer shall proceed as follows:

	Case	Ending date
(i)	Where the interest is increased	The Assessing Officer shall serve on the assessee a notice of demand in the prescribed form specifying the sum payable and such demand notice shall be a notice under section 156.
(ii)	Where interest is reduced	The excess paid shall be refunded

15.11.3 Interest for deferment of advance tax [Section 234C]

(1) Manner of computation of interest under section 234C for deferment of advance tax by corporate and non-corporate assessees:

In case an assessee, other than **an assessee who declares profits and gains in accordance with the provisions of section 44AD(1) or section 44ADA(1)**, who is liable to pay advance tax under section 208 has failed to pay such tax or the advance tax paid by such assessee on its current income on or before the dates specified in column (1) is less than the specified percentage [given in column (2)] of tax due on returned income, then simple interest@1% per month for the period specified in column (4) on the amount of shortfall, as per column (3) is leviable under section 234C.

Specified date	Specified%	Shortfall in advance tax	Period
(1)	(2)	(3)	(4)
15th June	15%	15% of tax due on returned income (-) advance tax paid up to 15th June	3 months
15th September	45%	45% of tax due on returned income (-) advance tax paid up to 15th September	3 months
15th December	75%	75% of tax due on returned income (-) advance tax paid up to 15th December	3 months

15th March	100%	100% of tax due on returned income (-) advance tax paid up to 15th March	1 month

***Note** – However, if the advance tax paid by the assessee on the current income, on or before 15th June or 15th September, is not less than 12% or, as the case may be, 36% of the tax due on the returned income, then, the assessee shall not be liable to pay any interest on the amount of the shortfall on those dates.*

(2) Computation of interest under section 234C in case of an assessee who declares profits and gains in accordance with the provisions of section 44AD(1) or section 44ADA(1):

In case an assessee who declares profits and gains in accordance with the section 44AD(1) or section 44ADA(1), as the case may be, who is liable to pay advance tax under section 208 has failed to pay such tax or the advance tax paid by the assessee on its current income on or before 15th March is less than the tax due on the returned income, then, the assessee shall be liable to pay simple interest at the rate of 1% on the amount of the shortfall from the tax due on the returned income.

(3) Non-applicability of interest under section 234C in certain cases:

Interest under section 234C shall not be leviable in respect of any shortfall in payment of tax due on returned income, where such shortfall is on account of under-estimate or failure to estimate –

(i) the amount of capital gains;

(ii) income of nature referred to in section 2(24)(ix) i.e., winnings from lotteries, crossword puzzles etc.;

(iii) income under the head "Profits and gains of business or profession" in cases where the income accrues or arises under the said head for the first time;

(iv) income of the nature referred to in section 115BBDA i.e., dividend in aggregate exceeding of ₹ 10 lakhs received during the previous year.

However, the assessee should have paid the whole of the amount of tax payable in respect of such income referred to in (i), (ii), (iii) or (iv), as the case may be, had such income been a part of the total income, as part of the remaining instalments of advance tax which are due or where no such instalments are due, by 31st March of the financial year.

(4) Tax due on the returned income: means the tax chargeable on the total income declared in the return of income furnished by the assessee for the assessment year immediately following the financial year in which the advance tax is paid or payable, as reduced by the amount of –

(i) any tax deductible or collectible at source on any income which is taken into account for calculating the total income;

(ii) any relief of tax allowed under section 89;

(iii) any relief of tax allowed under section 90 or 90A;

(iv) any deduction of tax allowed under section 91;

(v) any tax credit allowed to be set-off in accordance with the provisions of section 115JAA or section 115JD.

15.11.4 Interest on excess refund granted at the time of summary assessment [Section 234D]

(1) **Applicability**: Under section 143(4), where a regular assessment under section 143(3) or section 144 is made, any tax or interest paid under section 143(1) shall be deemed to have been paid towards such regular assessment and if no refund is due on regular assessment or the amount refunded under section 143(1) exceeds the amount refundable on regular assessment, the whole or the excess amount so refunded is deemed to be tax payable by the assessee. In order to charge interest for the period during which the refund amount has been utilised by the assessee, section 234D levies interest on excess refund granted at the time of summary assessment.

(2) **Rate and period of interest**: Where any refund is granted to the assessee under section 143(1) and no refund is due on regular assessment or the amount refunded under section 143(1) exceeds the amount refundable on regular assessment, then, the assessee shall be liable to pay simple interest at the rate of ½% on the whole or the excess amount so refunded for every month or part of the month from the date of grant of the refund to the date of such regular assessment.

Note *- An assessment made for the first time under section 147 or section 153A shall be regarded as regular assessment for the purpose of this section.*

(3) **Reduction of interest**: The interest chargeable under sub-section (1) shall be reduced, where, as a consequence to the order passed due to rectification, appeal, revisions etc. under sections 154/155/250/254/260/262/263/264 or an order of the Settlement Commission under section 245D(4), the amount of refund granted under section 143(1) is held to be correctly allowed.

15.11.5 Fee for default in furnishing TDS/TCS Statements [Section 234E]

(1) **Quantum of fee**: A fee of ₹ 200 for every day would be levied under section 234E for late furnishing of TDS/TCS statement from the due date of furnishing of TDS/TCS statement to the date of furnishing of TDS/TCS statement. However, the total amount of fee shall not exceed the total amount of tax deductible/collectible and such fee has to be paid before delivering the TDS/TCS statement.

(2) **Penalty**: In addition to said fee, a penalty ranging from a minimum of ₹ 10,000 to a maximum of ₹ 1,00,000 shall also be levied under section 271H for not furnishing TDS/TCS

statement within the prescribed time or furnishing incorrect information in the said statements in respect of tax deducted or collected at source on or after 01.07.2012. Consequently, with effect from 1.7.2012, penalty shall not be leviable under section 272A in respect of such failure.

(3) **Fee and penalty where TDS/TCS statement is furnished after one year** : Since late furnishing of TDS/TCS statements would attract levy of fees under section 234E, no penalty under section 271H shall be levied for delay in furnishing of TDS/TCS statement, if the TDS/TCS statement is furnished within one year of the prescribed due date after payment of tax deducted or collected along with applicable interest and fee. However, if the delay is beyond the period of one year, both fee under section 234E and penalty under section 271H would be leviable.

15.11.6 Fee for default in furnishing return of income [Section 234F]

Where a person, who is required to furnish a return of income under section 139, fails to do so within the prescribed time limit under section 139(1), he shall pay, by way of fee, a sum of –

Fee	Circumstances
₹ 5,000	if the return is furnished on or before the 31st December of the assessment year;
₹ 10,000	in any other case
However, if the total income of the person does not exceed ₹ 5 lakhs, the fees payable shall not exceed ₹ 1,000	

15.12 COLLECTION AND RECOVERY OF TAX - OTHER METHODS

15.12.1 Payment of tax and defaults by the assessee [Section 220]

(1) Under section 220(1), any amount specified as payable in a notice of demand under section 156 shall be paid within thirty days of the service of notice at the place and to the person mentioned in the notice.

(2) If the amount specified in the notice is not paid within the period, the assessee shall be liable to pay simple interest at 1% for every month or part of a month comprised in the period commencing from the day immediately following the end of the period mentioned in section 220(1) and ending with the day on which the amount is paid. This is provided for in section 220(2).

(3) The first proviso to section 220(2) states that where as a result of an order under sections 154/155/250/254/260/262/264/245D(4), the amount on which interest payable under this section had been reduced, the interest shall be reduced accordingly and the excess interest paid, if any, shall be refunded.

(4) The liability of the assessee to pay interest is based on the theory of continuity of the proceedings and the doctrine of relation back.

(5) Accordingly, section 220(1A) provides that where any notice of demand has been served upon an assessee and any appeal or other proceeding, as the case may be, is filed or initiated in respect of the amount specified in the said notice of demand, then such demand shall be deemed to be valid till the disposal of appeal by the last appellate authority or disposal of proceedings, as the case may be, and any such notice of demand shall have effect as provided in section 3 of the Taxation Laws (Continuation and Validation of Recovery Proceedings) Act, 1964 [See Note below]

(6) Further, the second proviso to section 220(2) provides that if as a result of order under the sections specified in the first proviso to section 220(2), the amount of interest payable was reduced, and thereafter, as a result of another order under any of the sections given in the first proviso or section 263, the interest payable was increased, the assessee would be liable to pay interest under section 220(2) from the day immediately following the end of the period mentioned in the first notice of demand referred to in section 220(1) till the date on which the amount is paid.

Note - Section 3 of the Taxation Laws (Continuation and Validation of Recovery Proceedings) Act, 1964

Continuation and validation of certain proceedings

(1) Where any notice of demand in respect of any Government dues is served upon an assessee by a Taxing Authority under any scheduled Act, and any appeal or other proceeding is filed or taken in respect of such Government dues, then,-

(a) where such Government dues are enhanced in such appeal or proceeding, the Taxing Authority shall serve upon the assessee another notice of demand only in respect of the amount by which such Government dues are enhanced and any proceeding in relation to such Government dues as are covered by the notice or notices of demand served upon him before the disposal of such appeal or proceeding may, without the service of any fresh notice of demand, be continued from the stage at which such proceedings stood immediately before such disposal;

(b) where such Government dues are reduced in such appeal or proceeding,-

(i) it shall not be necessary for the Taxing Authority to serve upon the assessee a fresh notice of demand;

(ii) the Taxing Authority shall give intimation of the fact of such reduction to the assessee. Further, where a certificate has been issued to the Tax Recovery Officer for the recovery of such amount, intimation of the fact of reduction shall also be given to him;

(iii) any proceedings initiated on the basis of the notice or notices of demand served upon the assessee before the disposal of such appeal or proceeding may be continued in relation to the amount so reduced from the stage at which such proceedings stood immediately before such disposal;

(c) no proceedings in relation to such Government dues (including the imposition of penalty or charging of interest) shall be invalid by reason only that no fresh notice of demand was served upon the assessee after the disposal of such appeal or proceeding or that such Government dues have been enhanced or reduced in such appeal or proceeding:

(2) No fresh notice of demand shall be necessary in any case where the amount of Government dues is not varied as a result of any order passed in any appeal or other proceeding under any scheduled Act.

(3) The provisions of this section shall have effect notwithstanding any judgment, decree or order of any court, tribunal or other authority.

ILLUSTRATION 21

The Assessing Officer issued a notice of demand under section 156 to Mr. X on 1.10.2019 for payment of ₹ 15 lakhs towards his income-tax liability for the A.Y.2018-19, requiring him to pay the said amount within 30 days.

(a) Is he required to issue fresh notice of demand and if so, for what amount, in the following two cases (each case has to be considered independently) –

(i) If the tax demand is reduced to ₹ 12 lakhs by the Commissioner (Appeals) by issue of order under section 250;

(ii) If the tax demand is increased to ₹ 20 lakhs by the Appellate Tribunal, by issue of an order under section 254.

(b) How would the interest liability under section 220(2) be calculated if the tax demand is reduced to ₹ 12 lakhs by the Commissioner (Appeals) by issue of order under section 250 and subsequently increased to ₹ 15 lakhs by the Appellate Tribunal by way of issue of order under section 254?

SOLUTION

(a) (i) No fresh notice of demand is required to be served on Mr. X. The Assessing Officer is only required to give an intimation of the fact of reduction of demand to ₹ 12 lakhs to Mr. X. The proceedings initiated on the basis of the original notice of demand may be continued in relation to the reduced amount of ₹ 12 lakhs from the stage at which such proceedings stood immediately before disposal of appeal.

(ii) A fresh notice of demand has to be given only in respect of ₹ 5 lakhs, being the amount of enhancement. Any proceedings in relation to ₹ 15 lakhs covered by the original notice of demand served upon Mr. X may be continued from the stage at which such proceedings stood immediately before disposal of appeal.

(b) The interest under section 220(2) has to be paid on ₹ 15 lakhs @1% per month or part of the month comprised in the period commencing from 1.11.2019 and ending with the date on which the amount is paid, assuming that Mr. X has not paid any interest so far.

(7) **Reduction or waiver of interest payable under section 220(2)** - Section 220(2A) empowers the Principal Chief Commissioner or Chief Commissioner of Principal Commissioner or Commissioner to reduce or waive any interest payable under section 220(2) if he is satisfied that:

(i) payment of such amount has caused or would cause genuine hardship to the assessee;

(ii) default in the payment of the amount on which interest was made payable under the said sub-section was due to circumstances beyond the control of the assessee; and

(iii) the assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

(8) **Interest under section 220(2) not leviable where interest is charged u/s 201(1A) or section 206C(7)** -

Since the intimation generated after processing the TDS statement under section 200A(1) would be deemed as a notice of demand under section 156, consequently, interest under section 220 would be attracted for failure to pay the tax specified in the intimation. However, interest under section 201(1A) is leviable for non-payment of tax specified in the intimation. Therefore, it has been provided that in cases where interest is charged for any period under section 201(1A) on the tax specified in the intimation under section 200A, then, interest under section 220(2) would not be levied on the same amount for the same period.

Likewise, since the intimation generated after processing of TCS statement shall be deemed as a notice of demand under section 156, failure to pay the tax specified in the intimation shall attract levy of interest as per the provisions of section 220(2). Section 206C(7) also provides for levy of interest for non-payment of tax specified in the intimation to be issued. In order to remove the possibility of charging interest on the same amount for the same period of default both under section 206C(7) and section 220(2), sub-section (2C) of section 220 specifically provides that **where interest is charged for any period under section 206C(7) on the amount of tax specified in the intimation issued under**

206CB(1), no interest shall be charged under section 220(2) on the same amount for the same period.

15.12.2 Penalty payable [Section 221]

(1) **Penalty for default in payment of tax -** Where an assessee is in default in payment of tax including advance tax and interest payable thereon, the Assessing Officer shall impose a penalty which in cases of continuing default, may be increased from time to time. However, the total penalty should not exceed the tax in arrears. The Assessing Officer should give the assessee a reasonable opportunity of being heard before levying such a penalty.

No penalty shall be levied on the assessee for default in payment of tax in cases where he proves to the satisfaction of the Assessing Officer that default was for good and sufficient reasons.

(2) **Payment of tax before levy of penalty not to absolve the assessee from penalty** - The *Explanation* to section 221(1) provides that an assessee would not cease to be liable to pay any penalty for his default or delay in payment of the tax merely by reason of the fact that before the date of levy of such penalty the tax which was in arrears had actually been paid by him.

Thus wherever there is delay on the part of the assessee, he would be liable to penalty even though by the time the Assessing Officer initiates action for the levy of penalty the amount of tax in arrears is actually paid.

An order imposing penalty is appealable and the assessee's right of appeal is subject to the condition that he must first pay the tax or penalty; the assessee should first pay the tax before filing the appeal.

(3) **Circumstance when penalty levied will be cancelled** – If, as a consequence of any final order, the amount of tax, with respect to the default in the payment of which the penalty was levied, has been wholly reduced, the penalty levied shall be cancelled and the amount of penalty paid shall be refunded.

15.12.3 Certificate to Tax Recovery Officer (TRO) [Section 222]

(1) **TRO to draw up statement specifying amount of arrears due from an assessee-in-default [Section 222(1)]** - When an assessee is in default or is deemed to be in default in making a payment of tax the TRO may draw up under his signature a statement in the prescribed form and specifying the amount of arrears due from the assessee and shall proceed to recover from such assessee the amount specified in the certificate by one of more of the modes mentioned below in accordance with the Second Schedule.

(a) Attachment and sale of the assessee's movable property.

(b) Attachment and sale of assessee's immovable properties.

(c) Arrest of the assessee and his detention in prison.

(d) Appointing a receiver for the management of assessee's movable and immovable properties.

(2) **Property to include property transferred to spouse/minor child/son's wife/son's minor child for inadequate consideration [Proviso to section 222(1)]** - For the purpose of this section, the assessee's movable or immovable property shall include any property which has been transferred directly or indirectly by the assessee to his spouse or minor child or son's wife or son's minor child otherwise than for adequate consideration and which is held by any of the persons aforesaid. So far as the movable or immovable property so transferred to his minor child or his son's minor child is concerned, they shall even after the date of attainment of majority by such minor child or son's minor child continue to be included in the assessee's movable or immovable property for recovering any arrears.

(3) The TRO may take action under sub-section (1) notwithstanding that proceedings or recovery of the arrears by any special mode have been taken.

15.12.4 Tax Recovery Officer (TRO) by whom recovery is to be effected [Section 223]

(1) **TRO competent to take action under section 222**: The TRO competent to take action under section 222 shall be the TRO within whose jurisdiction:

(i) the assessee carries on business or profession.

(ii) the principal place of his business or profession is situated.

(iii) the assessee resides or any movable or immovable property of the assessee is situated.

(2) **Assignment of jurisdiction**: The jurisdiction is assigned either by the CBDT or the Chief Commissioner or Commissioner who is authorised in this behalf by the CBDT under section 120.

(3) **Procedure where an assessee has property within the jurisdiction of more than one TRO**: In such a case, if the TRO by whom the certificate is drawn up is not able to recover the entire amount by sale of the property within his jurisdiction, he may send the certificate to a TRO within whose jurisdiction the assessee has property. Thereupon, that TRO shall proceed to recover the amount as if the certificate was drawn up by him.

15.12.5 Validity of certificate and cancellation and amendment thereof [Section 224]

(1) The assessee cannot dispute the correctness of any certificate drawn up by the TRO on any ground whatsoever.

(2) However, the TRO is empowered to cancel the certificate if, for any reason, he thinks it necessary so to do, or to correct any clerical or arithmetical mistake therein.

15.12.6 Stay of proceedings in pursuance of certificate and amendment or cancellation thereof [Section 225]

(1) **TRO empowered to grant time for payment of tax:** It shall be lawful for the TRO to grant time for the payment of any tax and when he does so he shall stay proceedings for the

recovery of such tax until the expiry of the time so granted.

(2) **TRO empowered to stay proceedings where demand is reduced in appeal but subject matter of further proceedings:** Where as a result of appeal, the demand is reduced but the order is the subject matter of further proceedings, the TRO shall stay the recovery of such part of the amount specified in the certificate as pertains to such deduction for the period in which an appeal or other proceedings remains pending.

(3) **TRO empowered to modify or cancel certificate where demand is reduced on appeal**: Where a certificate has been drawn up and subsequently, as a result of appellate order the amount is reduced, the TRO shall modify the certificate or cancel it if it is necessary, when the order which was the subject matter of appeal or other proceeding becomes final and conclusive.

15.12.7 Other modes of recovery [Section 226 & 227]

(1) **Recovery of tax where certificate has/has not been drawn up under section 222:**

	Whether Certificate has been drawn up under section 222?	**Income-tax authority empowered to recover taxes by one or more of the modes specified in section 226**
(i)	No	Assessing Officer
(ii)	Yes	TRO, without prejudice to the modes of recovery specified in section 222

Note *- This section enumerates the various modes of recovery by the Assessing Officer and Tax TRO. Students may refer to the section in the Bare Act for details.*

(2) **Non-validity of claim in regard to any property where notice is issued**: Any claim in regard to any property in relation to which a notice under this section is issued, shall be void as against any demand contained therein.

(3) **Consequences where the person on whom notice is served objects on oath**: Where a person, on whom a notice (garnishee order) under this section has been served, objects on oath that the amount demanded from him is not due to the assessee or that he does not hold any money for or on account of the assessee, he cannot be compelled by the Assessing Officer to make the payment. However, if it is later on found that such a statement made by him was false, he would personally become liable to pay the amount to the Assessing Officer or TRO to the extent of his own liability to the assessee or to the extent of the assessee's liability, whichever is less.

Such personal liability would arise even in cases where the person in receipt of a notice from the Assessing Officer or TRO, makes a payment in disregard of the notice served on him.

(4) **Recovery of tax dues from money in custody of a Court or Receiver and distraint and sale of movable property**: Moneys belonging to the assessee-in-default which are in the custody of a Court or Receiver are also liable for attachment. Further, on being authorised by the Principal Chief Commissioner/Chief Commissioner/Principal Commissioner/ Commissioner, the Assessing Officer or the TRO is also empowered, by general or special order to recover any arrears of tax due by distraint and sale of movable property as laid down in the Third Schedule. For details, students may refer to the Third Schedule in the Act.

(5) **Recovery through State Government**: In addition, tax may be recovered through the State Government if the recovery of tax in any area has been entrusted to it under the Constitution. In such a case, the State Government may direct that the tax shall be recovered in respect of any particular area together with the municipal taxes or local rates by the municipality or local authority [Section 227].

15.12.8 Recovery of tax in pursuance of agreements with foreign countries [Section 228A]

(1) Section 228A provides for the procedure of recovery of tax in pursuance of an agreement entered into by the Central Government with the Government of any country outside India or any authority under that Government.

(2) Where the Government of the foreign country or any authority under that Government sends a certificate to the CBDT for the recovery of any tax due under that law from ***a resident, or*** a person having any property in India, the CBDT may forward such certificate to any TRO ***having jurisdiction over the resident***, or within whose jurisdiction such property is situated.

(3) The TRO shall proceed to recover the amount specified in the certificate in the manner in which he would proceed to recover the amount specified in a certificate drawn up by him under section 222.

(4) Thereafter, the TRO has to remit any sum so recovered to the CBDT after deducting the expenses in connection with the recovery proceedings.

(5) Where an assessee is in default or is deemed to be in default in making a payment of tax, the TRO may, ***if the assessee is a resident of a country (being a country with which the Central Government has entered into an agreement for the recovery of income-tax under the Income-tax Act, 1961 and the corresponding law in force in that country) or has any property in that country***, forward to the CBDT a certificate drawn up by him under section 222 and the CBDT may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

15.12.9 Tax Clearance Certificate [Section 230]

(1) Undertaking to be furnished by a person not domiciled in India visiting India in connection with business, profession or employment [Section 230(1)]

(i) No person, who is not domiciled in India and who has come to India in connection with business, profession or employment; and who has income derived from any source in India, shall leave the territory of India by land, sea or air unless he furnishes to the prescribed authority an undertaking in the prescribed form.

(ii) The said undertaking should be furnished from the employer of the said person or through whom such person is in receipt of the income.

(iii) The undertaking should be to the effect that tax payable by such person who is not domiciled in India shall be paid by the employer or the person through whom any income is receivable by the first-mentioned person.

(iv) The prescribed authority shall, on receipt of the undertaking, immediately give to such person a no-objection certificate, for leaving India.

(v) However, the provisions contained in sub-section (1) shall not apply to a person who is not domiciled in India but visits India as a foreign tourist or for any other purpose not connected with business, profession or employment.

(2) Furnishing of PAN by person domiciled in India at the time of departure [Section 230(1A)]

(i) Every person, who is domiciled in India at the time of his departure, shall furnish, to the income-tax authority or such other authority as may be prescribed his permanent account number allotted to him under section 139A, the purpose of his visit and the estimated period of his stay outside India.

(ii) In case no such permanent account number has been allotted to him, or his total income is not chargeable to income-tax or he is not required to obtain a permanent account number under the Income-tax Act, 1961 a certificate in the prescribed form shall be furnished to the income-tax authority or such other authority, as may be prescribed.

(iii) However, where an income-tax authority opines that there exist circumstances which render an Indian domiciled to obtain a certificate under this section, such person shall not leave the territory of India by land, sea or air unless -

(a) he obtains a certificate from the income-tax authority stating that he has no liabilities under the Income-tax Act 1961 and the Wealth-tax Act, 1957 or

(b) that satisfactory arrangements have been made for the payment of all or any of such taxes which are or may become payable by that person [First proviso to sub-section (1A)]

(iv) No income-tax authority shall make it necessary for any person who is domiciled in India to obtain a certificate under this section unless he records the reasons therefor and obtains the prior approval of the Principal Chief Commissioner or Chief Commissioner of Income-tax.

(3) Personal liability of owner or charterer of ship or aircraft carrying such persons [Section 230(2) & (3)]

If the owner or charterer of any ship or aircraft carrying persons from any place in India to any place outside India allows any of the above mentioned persons to travel by such ship or aircraft without first satisfying that such person is in possession of a certificate as required, he shall be personally liable to pay the whole or any part of the tax payable by such person. In such a case, the owner or charterer shall be deemed to be an assessee in default for such sum and recovery shall be as if it were an arrear of tax.

***Note** - The expressions "owner" and "charterer" include any representative, agent or employee empowered by the owner or charterer to allow persons to travel by the ship or aircraft.*

(4) Power to make Rules [Section 230(4)]

The CBDT is empowered to make Rules for carrying out the provisions of this section.

15.12.10 Recovery by suit or under other law [Section 232]

Section 232 provides that the Assessing Officer or the Government can have recourse to the other modes of recovery under any other law for the time being in force, over the above various modes specified above to recover the tax dues under the Act, in the same way as other debts due to the Government. It shall also be lawful for the Assessing Officer or the Government to take recourse to any other law or file a suit in any manner for the recovery of the arrears due from the assessee.

15.13 REFUNDS

(1) Eligibility [Sections 237 and 242]

(i) An assessee is entitled to claim a refund of tax if the tax actually paid (and not merely payable) by him or on his behalf or treated as paid by him or on his behalf for any assessment year exceeds the amount of tax with which he is properly chargeable under the Act for that year.

(ii) This may arise usually as a result of excess deduction of tax at source from salaries, dividends, interest, to or as a result of excess payment of advance tax or when the tax originally paid on assessment is reduced on appeal, revision, rectification or reference.

(iii) Where such a claim or refund is made, the assessee cannot question the correctness or validity of the assessment or any other matter related thereto which has become final and conclusive. He is also debarred from asking for a review or revision of the assessment.

(2) Persons entitled to claim refund in certain cases [Section 238]

(i) Generally, a claim for refund can be made only by the person on whose account the tax was already paid.

(ii) However, in cases where the income of one person is included in the total income of another person under sections 60 to 65, the latter person alone is entitled to claim the refund.

(iii) If any person is not able to claim or receive the refund due to him on account of his death, mental incapacity, insolvency, dissolution, liquidation, etc., his legal representative or trustee, guardian liquidator or receiver, the case may be, is entitled to claim or receive the refund on behalf of such person.

(3) Claim for refund [Section 239]

In order to simplify the procedure for claim of refund, it has been provided that every claim for refund should be made by furnishing return in accordance with the provisions of section 139.

(4) Refund on appeal etc. [Section 240]

(i) Where refund becomes due to the assessee as a result of an order passed in appeal or any other proceeding under the Income-tax Act, 1961, he need not make an application to claim the same.

(ii) In such a case, the Assessing Officer is bound to pass an order of refund without waiting for the application from the assessee.

(iii) Where, by the order aforesaid, an assessment is set aside or cancelled and an order of fresh assessment is directed to be made, the refund shall become due only on the making of such fresh assessment.

(iv) Where the assessment is annulled the refund shall become due only of the amount of tax paid in excess of the tax chargeable on the total income returned by the assessee.

(5) Withholding of refund in certain cases [Section 241A]

(i) In a case where refund of any amount becomes due to the assessee under section 143(1) and the Assessing Officer is of the opinion, having regard to the fact that notice has been issued under section 143(2) in respect of such return, that the grant of the refund is likely to adversely affect the revenue, he may, withhold refund upto the date on which the assessment is made.

(ii) However, for withholding the refund, he has to satisfy the following two conditions:

(a) The prior approval of the Principal Commissioner or Commissioner has to be obtained; and

(b) The reasons have to be recorded in writing.

(iii) The above provisions would apply for A.Y.2017-18 and subsequent years.

(6) Correctness of assessment not to be questioned [Section 242]

(i) While making a claim for refund, an assessee cannot question the correctness of any assessment or other matter decided which has become final and conclusive or ask for a review of the same.

(ii) The assessee shall not be entitled to any relief on such claim except refund of tax wrongly paid or paid in excess.

(7) Interest on Refunds [Section 244A]

(i) **Applicability and Rate**: interest at ½% for every month or part of a month shall be payable on tax or penalty becoming refundable on account of excess payment of advance tax, advance tax on fringe benefits, tax deducted at source or collected at source and other tax or penalty becoming refundable.

(ii) **Period of interest**: Interest @0.5% for every month or part of a month for the period specified in the following table for each of the cases mentioned in column (2) hereunder –

	Case	Period for grant of interest on refund	
		Beginning from	Ending with
(1)	(2)	(3)	(4)
(a)	Where the refund is out of TCS u/s 206C or paid by way of advance tax or treated as paid u/s 199, during the financial year immediately preceding the A.Y.		
	(1) Where the return is filed on or before the due date u/s 139(1)	1st April of the assessment year	Date of grant of refund
	(2) Where the return is filed after the due date	the date of filing of return	
(b)	Where the refund is out of self-assessment tax paid u/s 140A	Date of furnishing return of income or payment of tax, whichever is later	Date of grant of refund

c)	In any other case	Date of payment of tax or penalty	Date of grant of refund
Note *– The assessee can claim interest on refund due also in pursuance of determination of total income under section 143(1) or on regular assessment. However, no interest shall be payable if the amount of refund due is less than 10% of the tax determined under section 143(1) or on regular assessment, in case of (a) and (b) above.*			

(iii) **Additional interest payable on refund arising out of fresh assessment order giving effect to appellate or revisionary order** : Where a refund arises as a result of giving effect to an order under section 250/254/260/262/264, wholly or partly, otherwise than by making a fresh assessment or reassessment, the assessee shall be entitled to receive, in addition to the interest payable under section 244A(1), an additional interest on such refund amount calculated at the rate of 3% p.a., for the period beginning from the date following the date of expiry of the time allowed under section 153(5) to the date on which the refund is granted. Further, in cases where extension is granted by the Principal Commissioner or Commissioner by invoking proviso to section 153(5), the period of additional interest, if any, shall begin from the expiry of such extended period.

Circumstance	Period[5]
Where a refund arises as a result of giving effect to an order under section 250/254/260/262/264, wholly or partly, otherwise than by making a fresh assessment or reassessment	From the expiry of 3 months from the end of the month in which the order u/s 250/254/260/262 is received, or order u/s 263 or 264 is passed, by the PCC/CC/PC/CIT.
Where extension is granted by the Principal Commissioner or Commissioner by invoking proviso to section 153(5)	From the expiry of 9 months from the end of the month in which the order u/s 250/254/260/262 is received, or order u/s 263 or 264 is passed, by the PCC/CC/PC/CIT.
Where the order of rectification, appeal or revision requires verification of any issue by way of submission of any document by the assessee or any other person or where an opportunity of being heard is to be provided to the assessee	From the expiry of 9 months from the end of the F.Y. in which order u/s 254 is received by the PCC/CC/PC/CIT or order u/s 263 or 264 is passed by the PC/CIT.

[5] Period for which assessee would be entitled to receive additional interest on refund

(iv) **Interest on refund payable to deductor [Section 244A(1B**] : Interest @0.5% for every month or part of a month for the period specified in the following table for each of the cases mentioned in column (1) hereunder –

Case	Period for grant of interest on refund	
	Beginning from	Ending with
(1)	(2)	(3)
Where the refund of any amount becomes due to the deductor in respect of any amount paid to the credit of the Central Government under Chapter XVII-B		
(1) Where refund arises on account of giving effect to an order u/s 250/254/260/262	Date on which tax is paid	Date of grant of refund
(2) In any other case	Date on which claim for refund is made in prescribed form	

(v) **Consequence where delay in granting refund is attributable to the assessee or the deductor [Section 244A(2)]** : Where there is a delay in granting refund and the reasons for such delay are attributable to the assessee or the deductor, as the case may be, either wholly or in part, the period of the delay so attributable to the assessee shall be excluded from the period for which interest is payable. In case any question arises as to the period of delay attributable to the assessee, it shall be decided by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

(vi) **Increase or reduction of interest of refund as a result of assessment/ rectification/appellate/revisionary order [Section 244A(3)]**

(a) Where as a result of an order under sections 143(3)/144/147/154/155/ 250/254/260/262/264/245D(4), the amount on which interest payable under this section has been increased or reduced, the interest shall be increased or reduced.

(b) If the interest is reduced, the Assessing Officer has to serve a notice of demand on the assessee in the prescribed form specifying the amount of excess interest paid and require him to pay such amount.

(c) Such notice of demand shall be deemed to be notice under section 156 and the provisions of the Act shall accordingly apply.

(vii) **Interest under section 244A is income of the P.Y. in which it is allowed**

Interest allowed under section 244A is the income of the previous year in which it is allowed, and should be declared in the return of income furnished in the assessment year relevant to the previous year.

(viii) **Payment of interest on refund under section 244A of excess TDS deposited under section 195 [Circular No.11/2016 dated 26.4.2016]**

The procedure for refund of tax deducted at source under section 195 to the person deducting the tax is set out in CBDT *Circular No.7/2007 dated 23.10.2007*. *Circular No.7/2007* states that no interest under section 244A is admissible on refunds to be granted in accordance with the circular or on the refunds already granted in accordance with *Circular No.769* or *Circular No.790 dated 20.4.2000*.

The issue of eligibility for interest on refund of excess TDS to a tax deductor has been a subject matter of controversy and litigation. The Supreme Court of India, in *Tata Chemical Limited 1, Civil Appeal No. 6301 of 2011 vide order dated 26.02.2014,* held that refund due and payable to the assessee is debt-owed and payable by the Revenue. The State having received the money without right, and having retained and used it, is bound to make the party good, just as an individual would be under like circumstances. The obligation to refund money received and retained without right implies and carries with it the right to interest."

In view of the above judgment of the Apex Court, it is settled that if a resident deductor is entitled for the refund of tax deposited under section 195, then, it has to be refunded with interest under section 244A from the date of payment of such tax.

(8) Set off of refunds against tax remaining payable [Section 245]

(i) **Set-off of refunds against tax or interest payable**: Where a refund is found due to any person, the Assessing Officer, Commissioner (Appeals) or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may, in lieu of payment of the refund, set off the amount to be refunded or any part of that amount, against any tax or interest remaining payable by the said person under the Act.

(ii) **Intimation to be given before setting off**: The set off can, however, be done only after giving intimation in writing to such person of the action proposed to be taken under this section.

EXERCISE

Question 1

Mr. Madhusudan is regular in deducting tax at source and depositing the same. In respect of the quarter ended 31st December, 2019 a sum of ₹ 80,000 was deducted at source from the contractors. The statement of tax deducted at source under section 200 was filed on 23rd March, 2020 for the quarter ended 31.12.2019.

(i) Is there any delay on the part of Mr. Madhusudan in filing the statement of TDS?

(ii) If the answer to (i) above is in the affirmative, how much amount can be levied on Mr. Madhusudan for such default under section 234E?

(iii) Is there any remedy available to him for reduction/waiver of the levy?

Answer

(i) Yes, there has been a delay on the part of Mr. Madhusudan in filing the statement of TDS.

As per section 200(3) read with Rule 31A, the statement of tax deducted at source for the quarter ended 31st December, 2019 has to be filed on or before 31st January, 2020. However, the same has been filed only on 23rd March, 2020. Hence, there has been a 52 day delay on the part of Mr. Madhusudan in filing the statement of TDS.

(ii) As per section 234E of the Income-tax Act, 1961, where a person fails to file deliver or cause to be delivered the statement of tax deducted at source within the prescribed time, then, he shall be liable to pay, by way of fee, a sum of ₹ 200 for every day during which the failure continues.

The amount of fee shall not, however, exceed the amount of tax deductible.

In this case, since Mr. Madhusudhan has delayed filing the statement of TDS by 52 days, he would be liable to pay a fee of ₹ 10,400 (₹ 200 x 52 days) under section 234E. The said fee does not exceed the tax deductible (₹ 80,000, in this case).

(iii) The CBDT is empowered to issue general or special orders, whether by way of relaxation of any of the provisions of sections 139, 143, 144, 147 etc. or otherwise, in respect of any class of incomes or class of cases. The CBDT may issue such order(s) from time to time if it considers expedient so to do, for the purpose of proper and efficient management of the work of assessment and collection of revenue. Section 234E is included in the list of sections in respect of which the CBDT is empowered to issue order for relaxation of the provisions of the Act.

Hence, the remedy available to Mr. Madhusudhan is that he can file an application to the CBDT under section 119 and seek waiver/reduction of the penalty levied/leviable under section 234E.

Question 2

Smt. Vijaya, proprietor of Lakshmi Enterprises, made turnover of ₹ 210 lakhs during the previous year 2018-19. Her turnover for the year ended 31-3-2020 was ₹ 90 lakhs.

Decide whether provisions relating to deduction of tax at source are attracted for the following payments made during the financial year 2019-20:

(i) *Purchase commission paid to one agent ₹ 25,000 on 13.6.2019 towards purchases made during the year.*

(ii) *Payments to Civil engineer of ₹ 5,00,000 for construction of residential house for self use.*

Answer

Since Smt. Vijaya's turnover was ₹ 210 lakhs in the immediately preceding financial year (i.e., F.Y.2018-19), she is liable to deduct tax at source in the P.Y.2019-20, irrespective of her turnover being only ₹ 90 lakhs in the F.Y.2019-20.

(i) Tax@5% has to be deducted under section 194H in respect of purchase commission of ₹ 25,000 to an agent for purchases made during the year, since the same exceeds the threshold limit of ₹ 15,000 for non-deduction of tax at source thereunder.

(ii) Tax has to be deducted under section 194C in case of payment to resident contractors. The rate of tax is 1% if the payee is an individual or HUF and 2% in case of payees, other than individuals and HUFs.

However, as per section 194C(4), no individual or Hindu undivided family shall be liable to deduct income tax on the sum credited or paid to the account of the contractor where such sum is credited or paid exclusively for personal purposes of such individual or any member of the Hindu undivided family.

In this case, since Smt. Vijaya, an individual, makes payment of ₹ 5 lakh to a civil engineer for construction of residential house for self use, she is not liable to deduct tax at source under section 194C from such sum.

Question 3

What is the rate at which the tax is either to be deducted or collected under the provisions of the Act in the following cases?

(i) *A partnership firm making sales of timber which was procured and obtained under a forest lease.*

(ii) *Payment of income of Rs.25 lakh on investments in the securities to the Foreign Institutional Investor.*

(iii) *A nationalized bank receiving professional services from a registered society made provision on 31-03-2020 of an amount of ₹ 25 lakh against the service charges bills to be received.*

(iv) *Payment of ₹ 5 lakh made to Mr. Phelps who is an athlete by a manufacturer of a swim wear for brand ambassador.*

Answer

Applicable Rate of TDS/TCS

Situation	TCS/TDS	Rate	Note
(i) Partnership firm selling timber obtained under forest lease	TCS	2.5%	1
(ii) Payment of income on investments in the securities to the Foreign Institutional Investors	TDS	20.8%	2
In case the securities are Government securities		5.20%	
(iii) Professional services rendered by a registered society to a nationalised bank	TDS	10%	3
(iv) Payment by a manufacturer of swim wear to its brand ambassador Mr. Phelps, an athlete	TDS		4
If Mr. Phelps is a resident		10%	
If Mr. Phelps is a non-resident		20.8%	

Notes:

(1) As per section 206C(1), tax has to be collected at source@2½% by the partnership firm, being a seller, at the time of debiting of the amount payable by the buyer to the account of the buyer or at the time of receipt of such amount, whichever is earlier.

(2) As per section 196D, tax has to be deducted at source @ 20.8% (20% plus cess@4%) by any person who is responsible for paying to a Foreign Institutional Investor, any income by way of interest on securities at the time of credit of such income to the account of the payee or at the time of payment of such income, whichever is earlier.

Alternatively, if the said securities are assumed to be government securities, tax is deductible@5.20% (i.e., 5% *plus* cess@4%) under section 194LD.

(3) Tax has to be deducted at source@10% under section 194J, by the nationalized bank at the time of credit of fees for professional services to the account of the registered society (i.e., on 31.3.2020), even though payment is to be made after that date.

(4) Tax has to be deducted at source@10% under section 194J[6] in respect of income of ₹ 5 lakh paid to Mr. Phelps, athlete, for advertisement, on the inherent presumption that Mr. Phelps is a resident.

[6] CBDT Circular No.715 dated 8.8.1995

Alternatively, if Mr. Phelps is assumed to be a non-resident, who is not a citizen of India, tax has to be deducted at source@20.8% (20% *plus* cess 4%) under section 194E in respect of income of ₹ 5 lakh paid to Mr. Phelps, an athlete, for advertisement referred under section 115BBA.

Question 4

Examine the liability for tax deduction at source in the following cases for the assessment year 2020-21:

(i) *Wings Ltd. has paid amount of ₹ 15 lacs during the year ended 31-3-2020 to Airports Authority of India towards landing and parking charges.*

(ii) *Omega Ltd., an event management company, organized a concert of international artists in India. In this connection, it engaged the services of an overseas agent Mr. John from UK to bring artists to India. He contacted the artists and negotiated with them for performance in India in terms of the authority given by the company. He did not take part in event organized in India. The company made the payment of commission equivalent to ₹ 1 lac to the overseas agent.*

(iii) *Ramesh gave a building on sub-lease to Mac Ltd. with effect from 1-7-2019 on a rent of ₹ 20,000 per month. The company also took on hire machinery from Ramesh with effect from 1-11-2019 on hire charges of ₹ 15,000 per month. The rent of building and hire charges of machinery for the year 2019-20 were credited by the company to the account of Ramesh in its books of account on 31-3-2020.*

(iv) *₹ 2,45,000 paid to Mr. X on 01-02-2020 by Karnataka State Government on compulsory acquisition of his urban land. What would be your answer if the land is agricultural land?*

Answer

(i) **TDS on landing and parking charges:** The landing and parking charges which are fixed by the Airports Authority of India are not merely for the "use of the land". These charges are also for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport *[Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372 (SC)]*. Thus, tax is not deductible under section 194I which provides deduction of tax for payment in the nature of rent.

Hence, tax is deductible @2% under section 194C by the airline company, Wings Ltd., on payment of ₹ 15 lacs made towards landing and parking charges to the Airports Authority of India for the previous year 2019-20.

(ii) **TDS on services of overseas agent outside India:** An overseas agent of an Indian company operates in his own country and no part of his income accrues or arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. The commission paid to the non-resident agent for services rendered outside India is, thus, not chargeable to tax in India.

Since commission income for contacting and negotiating with artists by Mr. John, a non-resident, who remains outside India is not subject to tax in India, consequently, there is no liability for deduction of tax at source. It is assumed that the commission equivalent to ₹ 1 lakh was remitted to Mr. John outside India.

(iii) **TDS on rent for building and machinery:** Tax is deductible on rent under section 194-I, if the aggregate amount of rental income paid or credited to a person exceeds ₹ 2,40,000. Rent includes payment for use of, *inter alia*, building and machinery.

The aggregate payment made by Mac Ltd. to Ramesh towards rent in P.Y.2019-20 is ₹ 2,55,000 (i.e., ₹ 1,80,000 for building and ₹ 75,000 for machinery). Hence, Mac Ltd. has to deduct tax@10% on rent paid for building and tax@2% on rent paid for machinery.

(iv) **TDS on compensation for compulsory acquisition:** Tax is deductible at source @10% under section 194LA, where payment is made to a resident as compensation or enhanced compensation on compulsory acquisition of any immovable property (other than agricultural land).

However, no tax deduction is required if the aggregate payments in a year does not exceed ₹ 2,50,000.

Therefore, no tax is required to be deducted at source on payment of ₹ 2,45,000 to Mr. X, since the aggregate payment does not exceed ₹ 2,50,000.

Since the definition of immovable property specifically excludes agricultural land, no tax is deductible at source on compensation paid for compulsory acquisition of agricultural land.

Question 5

Examine whether tax has to be deducted at source under the provisions of the Income-tax Act, 1961 in the following situations, which have taken place during the year ended 31-3-2020:

(i) *M/s. Jiva & Co., a partnership firm, pays a sum of ₹ 43,000 as interest on loan borrowed from an Indian branch of a foreign bank.*

(ii) *Above firm has paid ₹ 42,000 as interest on capital to partner Mr. A, a resident in India, and ₹ 44,000 as interest on capital to partner Mr. B, a non-resident.*

(iii) *The above firm paid ₹ 50,000 being share of profit of partner Mr. B, a non-resident*

Answer

(i) Section 194A requires deduction of tax on any income by way of interest, other than interest on securities, credited or paid to a resident, at the rates in force.

However, it specifically excludes from its scope, income credited or paid to any banking company to which the Banking Regulation Act, 1949 applies.

An Indian branch of a foreign bank, transacting the business of banking in India, is a banking company to which the Banking Regulation Act, 1949 applies. Therefore, interest payment to such bank will not attract tax deduction under section 194A.

Consequently, no tax is required to be deducted at source under section 194A on interest of ₹ 43,000 paid by M/s. Jiva & Co., a partnership firm, on loan borrowed from an Indian branch of a foreign bank.

(ii) Section 194A requiring deduction of tax at source on any income by way of interest, other than interest on securities, credited or paid to a resident, excludes from its scope, income credited or paid by a firm to its partner. Therefore, no tax is required to be deducted at source under section 194A on interest on capital of ₹ 42,000 paid by the firm to Mr. A, a resident partner.

Section 195, which requires tax deduction at source on payments to non-residents, does not provide for any exclusion in respect of payment of interest by a firm to its non-resident partner. Therefore, tax has to be deducted under section 195 at the rates in force in respect of interest on capital of ₹ 44,000 paid to partner Mr. B, a non-resident.

(iii) As per section 10(2A), share of profit received by a partner from the total income of the firm is exempt from tax. Therefore, the share of profit paid to non-resident partner is not liable for tax deduction at source.

However, section 195(6) provides that the person responsible for paying any sum, whether or not chargeable to tax, to a non-corporate non-resident or to a foreign company, shall be required to furnish the information relating to payment of such sum in the prescribed form and manner.

Question 6

"Come Air Ltd." has paid a sum of ₹ 12 lakhs during the year ended 31-3-2020 to Airports Authority of India towards landing and parking charges. The company has deducted tax at source@2% under section 194C on the said payment and remitted the tax deducted within the prescribed time. The Assessing Officer contended that landing and parking charges were levied for use of the land of the airport and hence, the payment was in the nature of rent attracting TDS@10% under section 194-I. Discuss the correctness or otherwise of the contention of the Assessing Officer.

Answer

The issue as to whether the charges fixed by the Airport Authority of India (AAI) for landing and take-off facilities and parking facility for the aircraft are for the “use of the land” by the airline company came up before the Supreme Court in *Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372.*

The Supreme Court observed that the charges which are fixed by the AAI for landing and take-off services as well as for parking of aircrafts are not for the "use of the land". These charges are for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport.

There are various international protocols which mandate all authorities manning and managing these airports to construct the airport of desired standards which are stipulated in the protocols. The services which are required to be provided by these authorities, like AAI, are aimed at passengers' safety as well as for safe landing and parking of the aircrafts. Therefore, the services are not restricted to merely permitting "use of the land" of airport. On the contrary, it encompasses all the facilities that are to be compulsorily offered by the AAI in tune with the requirements of the protocol.

The Supreme Court observed that the charges levied on air-traffic includes landing charges, lighting charges, approach and aerodrome control charges, aircraft parking charges, aerobridge charges, hangar charges, passenger service charges, cargo charges, etc. Thus, when the airlines pay for these charges, treating such charges as charges for "use of the land" would tantamount to adopting a totally simplistic approach which is far away from reality.

The Supreme Court opined that the substance behind such charges has to be considered and when the issue is viewed from this angle, keeping the larger picture in mind, it becomes very clear that the charges are not for use of the land *per se* and, therefore, it cannot be treated as "rent" within the meaning of section 194-I. The Supreme Court, thus, concurred with the view taken by the Madras High Court in *Singapore Airlines* case and overruled the view taken by the Delhi High Court in *United Airlines/Japan Airlines* case.

Applying the rationale of the Supreme Court ruling to the facts of this case, the contention of the Assessing Officer that landing and parking charges are levied for use of the land of airport and hence, the charges are in the nature of rent to attract the provisions of tax deduction at source under section 194-I is ***not*** correct.

Question 7

Mr. Harish, Vice President of ABC Bank, sold his house property in Chennai as well as his rural agricultural land for a consideration of ₹ 60 lakh and ₹ 15 lakh, respectively, to Mr. Suresh, a retail trader of garments, on 10.10.2019. Mr. Harish had purchased the house property and rural agricultural land in December 2017 for ₹ 40 lakh and ₹ 10 lakh, respectively. The stamp duty value on the date of transfer, i.e., 10.10.2019, is ₹ 85 lakh and ₹ 20 lakh for the house property and rural agricultural land, respectively.

(a) Determine the tax implications in the hands of Mr. Harish and Mr. Suresh, if the date of agreement for sale of house property and rural agricultural land is 1.7.2019 and the stamp duty value on the said date was ₹ 75 lakh and ₹ 15 lakh, respectively. On the said date, Mr. Suresh made payment of ₹ 5 lakh by way of account payee cheque to Mr. Harish for purchase of house property. Also, discuss the TDS implications, if any, in the hands of Mr.

Suresh, assuming that both Mr. Harish and Mr. Suresh are resident Indians.

(b) *Would your answer be different if Mr. Harish is a property dealer and sold the house property in the course of his business?*

Answer

(a) Tax implications on sale of rural agricultural land and house property representing a capital asset in the hands of Mr. Harish, a salaried employee

(i)	**Tax implications in the hands of Mr.Harish, a salaried employee**
	Since rural agricultural land is not a capital asset, the gains arising on sale of such land is not taxable in the hands of Mr. Harish. However, capital gains would arise on sale of house property, being a capital asset. As per section 50C(1), the stamp duty value of house property on the date of agreement (i.e., ₹ 75 lakh) would be deemed to be the full value of consideration arising on transfer of property. Therefore, ₹ 35 lakh (i.e., ₹ 75 lakh – ₹ 40 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y.2020-21. It may be noted that the stamp duty value on the date of agreement can be adopted since the advance was received on the date of agreement through account payee cheque and such stamp duty value exceeds 105% of the consideration. As the date of agreement is different from the date of registration and part of the consideration was received on or before the date of agreement by way of account payee cheque, the stamp duty value on the date of agreement is to be adopted as the deemed sale consideration.
(ii)	**Tax implications in the hands of the buyer – Mr.Suresh, a retail trader**
	The house property purchased would be a capital asset in the hands of Mr. Suresh, who is a retail trader of garments. The provisions of section 56(2)(x) is attracted in the hands of Mr. Suresh who has acquired the immovable property, being a capital asset, for inadequate consideration. For the purpose of section 56(2)(x), Mr. Suresh can take the stamp duty value on the date of agreement instead of the date of registration since he has paid a part of the consideration by account payee cheque on the date of agreement. Therefore, ₹ **15 lakh,** being the difference between the stamp duty value of the property **on the date of agreement** (i.e., ₹ 75 lakh) and the actual consideration (i.e., ₹ 60 lakh) would be taxable as per section 56(2)(x) under the head "**Income from other sources**" in the hands of Mr. Suresh, since such difference exceeds the higher of ₹ 50,000 or 5% of consideration. As rural agricultural land is not a capital asset, the provisions of section 56(2)(x) are not attracted in respect of acquisition of agricultural land for inadequate

	consideration, since the definition of "property" under section 56(2)(x) includes only **capital assets** specified thereunder.
(iii)	**TDS implications in the hands of the buyer, Mr.Suresh**
	Since the sale consideration of house property exceeded ₹ 50 lakh, Mr. Suresh is required to deduct tax at source under section 194-IA. The tax deduction under section 194-IA would be ₹ 60,000, being 1% of ₹ 60 lakh. TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

Tax implications on sale of house property representing stock-in-trade in the hands of Mr. Harish, a property dealer:

(i)	**Tax implications in the hands of Mr. Harish for A.Y.2020-21**
	If Mr. Harish is a property dealer who has sold the house property in the course of his business, the provisions of section 43CA would be attracted, since the house property represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value. For the purpose of section 43CA, Mr. Harish can take the stamp duty value on the date of agreement instead of the date of registration, since he has received part of the sale consideration by an account payee cheque on the date of agreement and it exceeds 105% of consideration. Therefore, **₹ 35 lakh**, being the difference between the stamp duty value on the date of agreement (i.e., ₹ 75 lakh) and the purchase price (i.e., ₹ 40 lakh), would be chargeable as **business income** in the hands of Mr. Harish.
(ii)	**TDS implications and taxability in the hands of Mr. Suresh for A.Y.2020-21**
	There would be no difference in the TDS implications or taxability in the hands of Mr. Suresh, whether Mr. Harish is a property dealer or a salaried employee. Therefore, the provisions of section 56(2)(x) would be attracted in the hands of Mr. Suresh who has received house property, being a capital asset, for inadequate consideration. The TDS provisions under section 194-IA would also be attracted since the actual consideration for house property exceeds ₹ 50 lakh.

Question 8

Siddharth Hospitals Pvt. Ltd., has recently been accorded recognition by several insurance companies to admit and treat patients on cashless hospitalization basis. Payment to the assessee hospital will be made by Third Party Administrators (TPA) who will process the claims of the patients admitted and make payments to the various hospitals including the assessee. All TPAs are corporate entities. The assessee wants to know whether the TPAs are bound to deduct tax at source under section 194J or under section 194C?

Answer

This issue has been clarified by the CBDT *Circular No.8/2009 dated 24.11.2009*. As per provisions of section 194J(1), any person, who is responsible for paying to a resident any sum by way of fees for professional services, shall, at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to 10% of such sum as TDS.

Further, as per clause (a) of *Explanation* to section 194J "professional services" includes services rendered by a person in the course of carrying on medical profession.

The services rendered by hospitals to various patients are primarily medical services and, therefore, **the provisions of section 194J are applicable on payments made by TPAs to hospitals** etc. Further, for invoking provisions of section 194J, there is no stipulation that the professional services have to be necessarily rendered to the person who makes payment to hospital. Therefore, TPAs who are making payment on behalf of insurance companies to hospitals for settlement of medical/ insurance claims etc. under various schemes including Cashless Schemes are liable to deduct tax at source under section 194J on all such payments to hospitals etc.

In view of the above, all such transactions between TPAs and hospitals would fall within the ambit of provisions of section 194J.

Question 9

Examine in the context of provisions contained in Chapter XVII of the Act and also work out the amount of tax to be deducted by the payer of income in the following cases:

(i) *Payment of ₹ 5 lakh made by JCP & Co. to Pingu Events Co. Ltd. for organizing a debate competition on the subject "Preservation of Rural Heritage of Rajasthan".*

(ii) *"Profit Commission" of ₹ 1 lakh paid on 10.6.2019 by a re-insurance company to the insurer company after the expiry of the term of insurance and where there was no claim during the treaty.*

(iii) *KD, a part time director of DAF Pvt. Ltd. was paid an amount of ₹ 2,25,000 as fees which was actually in the nature of commission on sales for the period 1.4.2019 to 30.6.2019.*

Answer

(i) The services of Event Managers in relation to sports activities alone have been notified by the CBDT as "professional services" for the purpose of section 194J. In this case, payment of ₹ 5 lakh was made to an event management company for organization of a debate competition. Hence, the provisions of section 194J are not attracted.

However, TDS provisions under section 194C relating to contract payments would be attracted and consequently, tax has to be deducted @ 2% under section 194C. The tax deductible under section 194C would be ₹ 10,000, being 2% of ₹ 5 lakh.

(ii) Section 194D requires deduction of tax at source@5% from insurance commission, where the commission exceeds ₹ 15,000.

Reinsurance is different from insurance since there is no direct contractual relationship between the person insured and the re-insurer.

In order to attract section 194D, the commission or any other payment covered under the section should be a remuneration or reward for soliciting or procuring the insurance business. The insurance companies do not procure business for the reinsurance company nor does the reinsurer pay commission or other payment for soliciting the business from the insurance companies. Therefore, section 194D has no application.

Hence, when profit commission is paid by a reinsurance company to an insurance company, after the expiry of the term of insurance, in respect of cases where there is no claim during the operation of the reinsurance treaty, tax deduction under section 194D is not attracted.

(iii) Section 194J provides for deduction of tax at source @10% on any remuneration or fees or commission, by whatever name called, paid to a director, which is not in the nature of salary in respect of which tax is deductible at source under section 192.

Hence, tax is to be deducted at source under section 194J @10% by DAF Pvt. Ltd. on the commission of ₹ 2,25,000 paid to KD, a part-time director. The tax deductible under section 194J would be ₹ 22,500, being 10% of ₹ 2,25,000.

Question 10

Examine the applicability of the provisions relating to deduction of tax at source in the following transactions:

(i) *Max Limited pays ₹ 1,02,000 to Mini Limited, a resident contractor who, under the contract dated 15th October, 2019, manufactures a product according to specification of Max Limited by using materials purchased from Max Limited.*

(ii) *A company operating a television channel makes payment of ₹ 5 lakh to a former cricketer for making running commentary of a one-day cricket match.*

(iii) *EL Ltd., a foreign company, pays outside India, salary to its employee, Mr. Raghavan, a foreign national and a non-resident, for services rendered in India.*

Answer

(i) The definition of "work" under section 194C includes manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. In the instant case, Mini Limited manufactures the product as per the specification given by Max Limited **by using the raw materials purchased from Max Limited**. **Therefore, it falls within the definition of "work"** under section 194C. Consequently, tax is to be deducted on the invoice value excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. If the material component is not mentioned separately in the invoice, tax is to be deducted on the whole of the invoice value.

(ii) Provisions for deduction of tax at source under section 194J are attracted in respect of payment of fees for professional services, if the amount of such fees exceeds ₹ 30,000 in the relevant financial year. The service rendered by a commentator in relation to sports activities has been notified by the CBDT as a professional service for the purposes of section 194J vide its *Notification No. 88 dated 21st August, 2008.* Therefore, tax is required to be deducted@10% from the fee of ₹ 5 lacs payable to the former cricketer.

(iii) Section 195 requires deduction of tax at source by any person responsible for making payment to a non-resident, any interest or any other sum chargeable under the provisions of the Income-tax Act, 1961 (other than income chargeable under the head "Salaries").

Section 192(1) requires "any person" responsible for paying income under the head "Salaries" to deduct tax at source. Therefore, even if the payer is a foreign company, section 192 would be applicable.

TDS provisions under section 192 are attracted, if the salary payable to a non-resident is chargeable to tax in India. Under section 9(1)(ii), income which falls under the head "Salaries" shall be deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India shall be regarded as income earned in India. Therefore, salary paid to Mr. Raghavan, a non-resident, attracts tax liability in India, as he has rendered services in India and the salary is attributable to such services.

Therefore, the foreign company, EL Limited, is liable to deduct tax at source under section 192 from the salary of Mr. Raghavan.

Question 11

Examine in the following cases the obligation of the person paying the income in respect of tax deduction at source and indicate the due date for payment of such tax, wherever applicable:

(i) *MNO Ltd., the employer, credited salary due for the financial year 2019-20 amounting to ₹ 3,40,000 to the account of Q, an employee, in its books of account on 31.3.2020. Q has not furnished any information about his income/loss from any other head or proof of investments/ payments qualifying for deduction under section 80C.*

(ii) *T, an individual whose total sales in business during the year ended 31.3.2019 was ₹ 2.20 crores, paid ₹ 9 lacs by cheque on 1.1.2020 to a contractor (an individual), for construction of his factory building. No amount was credited earlier to the account of the contractor in the books of T.*

(iii) *BCD Ltd. credited ₹ 28,000 towards fees for professional services and ₹ 27,000 towards fees for technical services to the account of HG in its books of account on 6.10.2019. The total sum of ₹ 55,000 was paid by cheque to HG on 18.12.2019.*

Answer

(i) Section 192 requires deduction of tax from salary at the time of payment. Thus, the employer is not required to deduct tax at source when salary has not been paid but is merely credited to the account of the employee in its books of account. MNO Ltd. therefore, is not required to deduct tax at source in respect of the salary merely credited to the account of employee Q which is not paid.

If salary has been paid during the year to Q, then, MNO Ltd has to obtain from Q, the evidence/proof/particulars of prescribed claims (including claim for set-off of loss) under the provisions of the Act in such form and manner as may be prescribed.

If Q has not furnished any information about his income/loss under any other head or proof of investments/expenditure qualifying for deduction under section 80C, then, the employer has to deduct tax without considering any claim for any expenditure or set-off of losses or deduction under section 80C.

(ii) An individual who is liable for tax audit under section 44AB in the immediately preceding financial year 2018-19 is liable to deduct tax at source under section 194C for the financial year 2019-20 in respect of the payment made to contractor exceeding ₹ 30,000 in a single contract and ₹ 1,00,000 in aggregate of contracts during the financial year. Turnover of the individual T is ₹ 2.20 crores in the financial year 2018-19. Therefore, T is liable to get his accounts for that year audited under section 44AB. As the payment during financial year 2019-20 to the contractor has exceeded the limits prescribed in section 194C, tax has to be deducted under section 194C.

The rate of tax deduction is 1% as the contractor is an individual.

(iii) The limit of ₹ 30,000 for non-deduction of tax under section 194J would apply separately for fees for professional services and fees for technical services. This means that if a person has rendered services falling under both the categories, tax need not be deducted if the fee for each category does not exceed ₹ 30,000 even though the aggregate of the amounts credited to the account of such person or paid to him for both the categories of services exceed ₹ 30,000. Therefore, BCD Ltd. is not required to deduct tax at source in respect of the fees either at the time of credit or at the time of payment.

Question 12

Examine the liability for tax deduction at source in the following cases for the assessment year 2020-21:

(i) *Mr. Anand has been running a sole proprietary business whose accounts are audited under section 44AB with turnover of ₹ 202 lakhs for the A.Y. 2019-20. He pays a monthly rent of ₹ 15,000 for the office premises to Mr. R, the owner of building and an individual. Besides, he also pays service charges of ₹ 6,000 per month to Mr. R towards the use of furniture, fixtures and vacant land appurtenant thereto.*

(ii) *By virtue of an agreement with a nationalised bank, a catering organisation receives a sum of ₹ 50,000 per month towards supply of food, water, snacks etc. during office hours to the employees of the bank.*

(iii) *An Indian company pays gross salary including allowances and monetary perquisites amounting to ₹ 7,30,000 to its General Manager. Besides, the company provides non-monetary perquisites to him whose value is estimated at ₹ 1,20,000.*

(iv) *A notified infrastructure debt fund eligible for exemption under section 10(47) of the Income-tax Act, 1961 pays interest of ₹ 5 lakhs to a company incorporated in USA. The US Company incurred expenditure of ₹ 12,000 for earning such interest. The fund also pays interest of ₹ 3 lakhs to Mr. X, who is a resident of a notified jurisdictional area.*

Answer

(i) Where the payer is an individual or HUF whose turnover exceeds the monetary limits specified in clause (a) of section 44AB, he has to deduct tax at source. Since the turnover of Mr. Anand was ₹ 202 lakhs for the A.Y.2019-20, he is liable to deduct tax at source under section 194-I in respect of rental payments during the financial year 2019-20.

Accordingly, Mr. Anand is liable to deduct tax at source under section 194-I on the rental payments made. Section 194-I provides that rent includes any payment, by whatever name called, for the use of land or building together with furniture, fittings etc. Therefore, in the given case, apart from monthly rent of ₹ 15,000 p.m., service charge of ₹ 6,000 p.m. for use of furniture and fixtures would also attract TDS under section 194-I. Since the aggregate rental payments of ₹ 2,52,000 to Mr. R during the financial year 2019-20 exceeds ₹ 2,40,000, Mr. Anand is liable to deduct tax at source @10% under section 194-I from rent paid to Mr. R.

(ii) The definition of "work" under *Explanation* to section 194-C includes catering services and therefore, TDS provisions under section 194C are attracted in respect of payments to a caterer. As the payment exceeds ₹ 30,000, the nationalised bank is required to deduct tax at source at 2% on the payments made to catering organisation under 194-C. If the catering organization is an individual or HUF, then the tax deduction shall be @1%.

(iii)

	₹
Gross salary, allowances and monetary perquisites	7,30,000
Non-Monetary perquisites	1,20,000
	8,50,000
Less: Standard deduction under section 16(ia)	50,000
	8,00,000
Tax Liability	75,400

Average rate of tax (₹ 75,400 / ₹ 8,00,000 × 100)	9.425%

The company can deduct ₹ 75,400 at source from the salary of the General Manager. Alternatively, the company can pay tax on non-monetary perquisites as under –

Tax on non-monetary perquisites = 9.425% of ₹ 1,20,000 = ₹ 11,310

Balance to be deducted from salary = ₹ 64,090

If the company pays tax of ₹ 11,310 on non-monetary perquisites, the same is not a deductible expenditure as per section 40(a). The amount of tax paid towards non-monetary perquisite by the employer, however, is not chargeable to tax in the hands of the employee as per section 10(10CC).

(iv) As per section 194LB, tax would be deductible @ 5% on gross interest paid/credited by a notified infrastructure debt fund, eligible for exemption under section 10(47), to a foreign company.

In the first case, since the payment is to a foreign company, health and education cess @4% has to be added to the applicable rate of TDS. Therefore, the tax deductible under section 194LB would be ₹ 26,000 (i.e., 5.20% of ₹ 5 lakhs).

However, in case the notified infrastructure debt fund pays interest to a person who is a resident of a notified jurisdictional area, section 94A will apply. Accordingly, tax would be deductible @30% (*plus* health and education cess@4%) under section 94A, even though section 194LB provides for deduction of tax at a concessional rate of 5%. Therefore, the tax deductible in respect of payment of ₹ 3 lakh to Mr. X, who is a resident of a notified jurisdictional area, would be ₹ 93,600, being 31.2% of ₹ 3,00,000.

Question 13

The following issues arise in connection with the deduction of tax at source under Chapter XVII-B. Examine the liability for tax deduction in these cases:

(a) An employee of the Central Government receives arrears of salary for the earlier 3 years. He enquires whether he is liable for deduction of tax on the entire amount during the current year.

(b) A T.V. channel pays ₹ 10 lakh on 1.9.2019 as prize money to the winner of a quiz programme, "Who will be a Millionaire"?

(c) State Bank of India pays ₹ 50,000 per month as rent to the Central Government for a building in which one of its branches is situated.

(d) A television company pays ₹ 80,000 to a cameraman for shooting of a documentary film.

(e) A State Government pays ₹ 22,000 on 2.7.2019 as commission to one of its agents on sale of lottery tickets.

(f) A Turf Club awards a jack-pot of ₹ 5 lakh to the winner of one of its races on 1.2.2020.

Answer

(a) As per section 192, tax is deductible at source by any person who is responsible for paying any income chargeable under the head 'Salaries'. However, as per sub-section (2A) of that section, the employee will be entitled to relief u/s 89 and consequently he will be required to furnish to the person responsible for making the payment, such particulars in the prescribed form (i.e., Form No.10E). The person responsible for making the payment shall compute the relief and take into account the same while deducting tax at source from salary.

(b) Under section 194B, the person responsible for paying by way of winnings from any card game and other game in an amount exceeding ₹ 10,000 shall at the time of payment deduct income-tax at 30%. Therefore, tax of Rs.3 lakh has to be deducted at source from the prize money of ₹ 10 lakh payable to the winner.

(c) Section 194-I, which governs the deduction of tax at source on payment of rent, exceeding ₹ 2,40,000 p.a., is applicable to all taxable entities except individuals and HUFs, whose turnover/gross receipts do not exceed the monetary limits specified under clause (a) of section 44AB. Section 196, however, provides exemption in respect of payments made to Government from application of the provisions of tax deduction at source.

Therefore, no tax is required to be deducted at source by State Bank of India from rental payments to the Government.

(d) If the cameraman is an employee of the T.V. Company, the provisions of section 192 will apply. However, if he is a professional, TDS provisions under section 194-J will apply. Tax at 10% will have to be deducted at the time of credit of ₹ 80,000 or on its payment, whichever is earlier.

(e) Under section 194G, the person responsible for paying to any person stocking, distributing, purchasing or selling lottery tickets shall at the time of credit of the commission or payment thereof, whichever is earlier, amounting to more than ₹ 15,000, deduct income-tax at source @5%.

Accordingly, tax@5% under section 194G amounting to ₹ 1,100 has to be deducted from commission payment of ₹ 22,000 to the agent of the State Government.

(f) The payment by way of winnings from horse race is governed by section 194BB. Under this section, the person responsible for payment shall, at the time of payment, deduct tax at source @ 30%, if the payment exceeds ₹ 10,000.

Accordingly, tax@30% amounting to ₹ 1,50,000 has to be deducted from the winnings of ₹ 5 lakh payable to the winner of the race.

Question 14

Examine and compute the liability for deduction of tax at source, if any, in the cases stated hereunder, for the financial year ended 31st March, 2020

(i) *Mr. X, a resident, acquired a house property at Mumbai from Mr. Y for a consideration of ₹ 90 lakhs, on 20.6.2019. On the same day, Mr. X made two separate transactions, thereby acquiring an urban plot in Kolkata from Mr. C for a sum of ₹ 49,50,000 and rural*

agricultural land from Mr. D for a consideration of ₹ 60 lakhs.

(ii) *On 17.6.2019, a commission of ₹ 50,000 was retained by the consignee 'ABC Packaging Ltd.' and not remitted to the consignor 'XYZ Developers', while remitting the sale consideration. Examine the obligation of the consignor to deduct tax at source.*

(iii) *Raj is working with AB Ltd. He is entitled to a salary of ₹ 55,000 per month w.e.f. 1.4.2019. He has a house property which is self-occupied. He paid an interest of ₹ 80,000 on loan, during the previous year 2019-20. The loan was taken for construction of house. He has notified his employer AB Ltd. that there will be a loss of ₹ 80,000 in respect of this house property for financial year ended 31.3.2020.*

Answer

		Amount of TDS (₹)
(i)	Since the consideration for transfer of house property at Mumbai exceeds ₹ 50 lakhs, Mr. X, being the transferee, is required to deduct tax @1% under section 194-IA on ₹ 90 lakhs, being the amount of consideration for transfer of property.	90,000
	Mr. X is not required to deduct tax as source under section 194-IA from the consideration of ₹ 49,50,000 paid to Mr. C for transfer of urban plot, since the consideration is less than ₹ 50 lakhs.	Nil
	Mr. X is also not required to deduct tax at source under section 194-IA from the consideration of ₹ 60 lakhs paid to Mr. D for transfer of rural agricultural land, since the same is specifically excluded from the scope of immovable property for the purpose of tax deduction under section 194-IA.	Nil
	***Note** - Section 194-IA requires every transferee responsible for paying any sum as consideration for transfer of immovable property (land, other than agricultural land, or building or part of building) to deduct tax, at the rate of 1% of such sum, at the time of credit of such sum to the account of the resident transferor or at the time of payment of such sum to the resident transferor, whichever is earlier. However, no tax is required to be deducted where the consideration for transfer of an immovable property is less than ₹ 50 lakhs.*	
(ii)	Section 194H requires deduction of tax at source@5% from commission and brokerage payments to a resident. However, no tax is to be deducted at source where the amount of such payment does not exceed ₹ 15,000. In the given case, 'ABC Packaging Ltd.', the consignee, has not remitted the commission of ₹ 50,000 to the consignor 'XYZ Developers' while remitting the sales consideration.	

	Since the retention of commission by the consignee/agent amounts to constructive payment of the same to him by the consignor/principal, deduction of tax at source is required to be made from the amount of commission *[CBDT Circular No.619 dated 4/12/1991].*		
	Therefore, XYZ Developers has to deduct tax at source on ₹ 50,000 at the rate of 5%.		2,500
(iii)	Section 192 provides that tax is required to be deducted on the payment made as salaries. Tax is to be deducted on the estimated income at the average of income tax computed on the basis of the rates in force for the financial year in which payment is made.		
	The employee may declare details of his other incomes (including loss under the head "Income from house property" but not any other loss) to his employer. In this case, since Mr. Raj has notified his employer AB Ltd. of loss from self-occupied house property, the employer has to take the same into consideration for deduction of tax at source.		
	Therefore, AB Ltd. is required to deduct tax at source on the salary of ₹ 55,000 per month paid to Mr. Raj, in the following manner:		
	Income under the head salaries (₹ 55,000 x 12)	6,60,000	
	Less: Standard deduction under section 16(ia)	50,000	
		6,10,000	
	Income under the head "house property"	(80,000)	
	Gross total income	5,30,000	
	Less: Deduction under Chapter VI-A	Nil	
	Total Income	5,30,000	
	Tax on ₹ 5,30,000	18,500	
	Add: Health and Education cess@4%	740	
	Tax to be deducted at source	19,240	19,240

Question 15

A foreign company seconded some employees to the assessee, an Indian collaborator. These employees worked with the Indian collaborator throughout the P.Y.2019-20. The employees were in receipt of salary from the Indian collaborator. They were also in receipt of special allowance directly from the foreign company in foreign currency outside India. The Indian collaborator deducted tax under section 192, on the component of salary paid by it, without taking into account the special allowance paid abroad by the foreign company in foreign currency to these employees. For this reason, the Revenue authorities treated the Indian collaborator as an 'assessee-in-default' under section 201 for non-deduction of tax at source on the "special allowance" component of salary paid by the foreign company.

Is such treatment by the Revenue Authorities and the consequent levy of interest and penalty justified?

Answer

Section 9(1)(ii) provides that any income which falls under the head "salaries" is deemed to accrue or arise in India, if it is earned in India. The *Explanation* thereto further clarifies that income payable for services rendered in India shall be regarded as income earned in India.

Section 192(1) requires the person responsible for paying any income chargeable under the head "Salaries" to deduct income-tax, at the time of payment, at the average rate of income-tax computed on the basis of the rates in force for the financial year on the amount payable.

Since the TDS provisions relating to payment of income chargeable under the head "Salaries" form an integrated code along with the charging and computation provisions under the Act, section 192(1) has to be read with section 9(1)(ii) and the *Explanation* thereto. Therefore, if any payment under the head "Salaries" falls within section 9(1)(ii), then TDS provisions under section 192 gets attracted. Consequently, the Indian tax deductor assessee is duty bound to deduct, from the portion of salary paid by it, tax at source under section 192(1) on the entire salary paid to the employee, including special allowance paid abroad to the employee by the foreign company.

It was so held by the Apex Court in *CIT, New Delhi v. Eli Lilly & Co. (India) P. Ltd. (2009) 312 ITR 225.*

In this case, all the employees are resident in India, since they have worked with the Indian collaborator throughout the previous year 2019-20. If the tax due on special allowance received from the foreign company is paid by the recipient-employees, then, the Indian collaborator would not be treated as an assessee-in-default under section 201(1), if these resident-employees have furnished a return of income under section 139 on or before the due date of filing return of income, disclosing such income, and have also furnished a certificate to this effect from an accountant in the prescribed form. However, interest under section 201(1A)@1% per month or part of month shall be payable by the Indian collaborator from the date on which such tax was deductible to the date of furnishing of return by such resident employee.

In cases where the tax has not been paid by the recipient employee, the Assessing Officer can proceed under section 201(1) to recover the shortfall in payment of tax and interest thereon under section 201(1A).

However, no penalty under section 271C would be attracted, if the Indian collaborator was under the genuine and *bona fide* belief that it was not under any obligation to deduct tax at source from the special allowance paid by the foreign company. This is provided for under section 273B.

SIGNIFICANT SELECT CASES

1. **Whether "tips" received by the hotel-company from its customers (who made payment through credit card) and distributed to the employees would fall within the meaning of "Salaries" to attract tax deduction at source under section 192?**

ITC Ltd v. CIT (2016) 384 ITR 14 (SC)

Facts of the case: The assessee company, engaged in the business of owning, operating and managing hotels, allowed its employees to receive tips from customers. In case of credit card payments by the customers, the employer company collected the tips which were later on disbursed to its employees. The Assessing Officer treated the receipt of tips as income under the head "Salaries" in the hands of the employees and contended that the assessee was liable to deduct tax at source from such payments under section 192. As the assessee company had not deducted tax at source on the tips disbursed to the employees, the Assessing Officer treated the assessee as assessee in default under section 201(1).

However, the Commissioner (Appeals) held that the assessee could not be treated as assessee in default under section 201(1) for non-deduction of tax on tips collected by them and disbursed to their employees. Thereafter, the Tribunal also dismissed the appeal of the revenue.

High Court's Decision: The High Court held that the tips would amount to "profit in addition to salary or wages" and hence would fall under section 15 read with section 17(1) and section 17(3). It also held that the while the tips received by the employees directly from customers would be outside the purview of section 192 but the moment a tip is paid by the customer by way of credit card along with the bill amount to the employer, it would assume the character of salary since it goes into the account of the employer after which it is distributed to the employees.

Supreme Court's Observations: The Apex Court analysed the provisions of section 192 and noted that "any person responsible" for paying any income chargeable under the head "salaries" is alone brought into the dragnet of deduction of tax at source. The person responsible for paying an employee an amount which is to be regarded as the employee's income is only the employer. However, in the present case, the person who is responsible for paying the employee is not the employer at all, but a third party, namely, the customer. Thus, income from tips would be chargeable in the hands of employees as "Income from Other Sources". Since such tips are being received from customers and not from the employer, section 192 would not get attracted.

The Supreme Court observed that section 15 applies when an employee has a vested right to claim any salary from an employer or former employer. However, in the case on hand, there is no vested right on the part of the employee to claim any amount of tips from the employer, since tips are purely voluntary amounts that may or may not be paid by customers for services rendered.

The Supreme Court observed that the amount of tips paid by the employer to the employees had no reference to the contract of employment at all. Tips were received by the employer in a fiduciary capacity as trustee for payments that were received from customers which they disbursed to their employees for service rendered to the customer. There was, therefore, no reference to the contract of employment when these amounts were paid by the employer to the employee.

Therefore, the tips received by the employees could not be regarded as "profits in lieu of salary" in terms of section 17(3). The payment by the employer of tips collected from the customers to the employees would not be a payment made "by or on behalf of" an employer. Such payments would be outside the purview of section 15(b) of the Act.

The Apex Court observed that the person who paid the tip was the customer and not the employer. Even though the amounts were with the employer he had no title to the money and it was held in a fiduciary capacity as trustee for and on behalf of the employees.

Supreme Court's Decision: The Supreme Court observed that contract of employment is not the proximate cause for the receipt of tips by the employee from a customer hence, it would be outside the dragnet of sections 15 and 17 of the Act. Therefore, it held that, in such a case, no liability to deduct tax at source under section 192 arises, and hence, the assessee company cannot be treated as an assessee in default for non-deduction of tax at source from the amount of tips collected and distributed to its employees.

2. **Is section 194A applicable in respect of interest on fixed deposits in the name of Registrar General of High Court?**

UCO Bank v. Dy. CIT (2014) 369 ITR 335 (Del)

Facts of the case: The assessee-bank accepted ₹ 707.46 lakhs as fixed deposit in the name of Registrar General of the High Court and issued a fixed deposit receipt in compliance with a direction passed by the court in relation to certain proceedings. Subsequently, the Assistant Commissioner of Income-tax issued a show cause notice to the bank for not deducting tax at source on the interest accrued and to show cause as to why it should not be treated as an assessee-in-default under section 201(1)/201(1A). The bank replied that the FDRs in the name of Registrar General of the Court was as a custodian because the actual beneficiary was unknown as the matter was sub judice and tax at source would be deducted when the payment is made to beneficiary as and when it is decided by the court. The Assistant Commissioner, however, passed an order treating the bank as assessee-in-default and raised a demand of ₹ 40.33 lakhs and ₹ 14.20 lakhs under sections 201(1) and 201(1A), respectively. Further, he initiated penalty proceedings under section 271C. The assessee preferred a writ challenging the order passed imposing penal interest and initiation of penalty proceedings.

High Court's Opinion and Decision: The High Court opined that in the normal course, the bank is obliged to deduct tax at source in respect of any credit or payment of interest on deposits made with it. However, in this case, the actual payee is not ascertainable and the person in whose name the interest is credited is not a person liable to pay tax under the Act. The deposits kept with the bank under the orders of the court were, essentially, funds which were in *custodia legis*, that is, funds in the custody of the court. The interest on that account – although credited in the name of the Registrar General – was also part of funds under the custody of the Court. The Registrar General is not the recipient of the income represented by interest that accrues on the deposits made in his name. The credit of interest is not a credit to the account of a person who is liable to be assessed to tax.

The High Court observed that in the absence of a payee, the machinery provisions for deduction of tax to his credit are ineffective. The expression "payee" under section 194A would mean the recipient of income whose account is maintained by the person paying interest. The Registrar General is neither recipient of the amount credited to his account nor to interest accruing thereon. Therefore, he cannot be considered as a 'payee' for the purposes of section 194A. The credit by the bank in the name of the Registrar General would, thus, not attract the provisions of section 194A.

The High Court was of the view that *Circular No.8/2011 dated 14.10.2011* makes an assumption that the litigant depositing the money is the account holder with the bank or is the recipient of the income represented by the interest accruing thereon. This assumption is basically erroneous as the litigant who is asked to deposit the money in Court ceases to have any control or proprietary right over these funds. The person to whom the funds would be paid ultimately is determined by the court order and at that stage, tax would be required to be deducted at source to the credit of the recipient. However, the litigant who deposits the funds cannot be stated to be the recipient of income.

The High Court allowed the writ and set aside the orders passed by the tax authorities.

***Note** - The CBDT has accepted the aforesaid judgment and accordingly, vide Circular No.23/2015 dated 28.12.2015, clarified that interest on FDRs made in the name of Registrar General of the Court or the depositor of the fund on the directions of the Court, will not be subject to TDS till the matter is decided by the Court. However, once the Court decides the ownership of the money lying in the fixed deposit, the provisions of section 194A will apply to the recipient of the income.*

3. Can payment of interest by Canara Bank to NOIDA be exempted from the requirement of tax deduction at source under section 194A on the ground that the same is a corporation established by or under the Uttar Pradesh Industrial Area Development Act, 1976?

CIT (TDS) and Anr v. Canara Bank [2018] 406 ITR 161 (SC)

Facts of the case: The assessee, New Okhla Industrial Development Authority (NOIDA), was constituted by a notification dated April 17, 1976 issued under section 3 of the Uttar Pradesh Industrial Development Act, 1976. Canara Bank, the respondent, made a payment of Rs. 20.10 crores as interest on deposits to the assessee (NOIDA) for the relevant financial year. The Commissioner of Income-tax (TDS) issued notices to the respondent, Canara Bank, asking for information pertaining to interest paid and for showing cause for not deducting tax at source under section 194A.

Section 194A imposes an obligation on persons such as the respondent to deduct tax at source while making interest payments. However, under section 194A(3)(iii)(f), the Central Government is empowered to notify payments made to a specified class institution(s) for exemption from this requirement. A notification dated October 20, 1970 under section 194A(3)(iii)(f) was issued by the Central Government exempting payments made to "*any corporation established by a Central, State or Provincial Act*" from the requirement of tax deduction at source.

Issue: The issue under consideration is whether NOIDA is a Corporation established by or under the Uttar Pradesh Industrial Area Development Act, 1976, consequent to which it is eligible for exemption from requirement of tax deduction at source in respect of payment of interest made to it by Canara Bank.

Appellate authorities' view: The Tribunal was of the view that the payment of interest by the bank to NOIDA did not require deduction at source. The further appeal of the revenue authorities to the High Court was dismissed. The High Court held that the assessee is a corporation established by the Uttar Pradesh Industrial Area Development Act, 1976 and is, thus, covered under the exemption provided under section 194A(3)(iii)(f).

Supreme Court's Observations: The Supreme Court explained a 'corporation' as an artificial being created by law having a legal entity entirely separate and distinct from the individuals who compose it with the capacity of continuous existence and succession, notwithstanding changes in its membership. There was no dispute about NOIDA being a corporation and a statutory corporation. The only question was whether it was established by a State legislation and thus covered under the notification dated October 20, 1970.

The revenue authorities argued that NOIDA would not be covered by the notification as it was established ***under*** the 1976 Act. The respondents argued that NOIDA was established ***by*** the 1976 Act and thus, covered under the notification. Relying on the ratio of *Dalco Engineering Pvt. Ltd. v. Shree Satish Prabhakar Padhye [2011] 164 Comp Cas 275 (SC)*, the Court held that that the phrase "established by or under" is used to denote a statutory corporation established or brought into existence by or under a statute. The establishment of Corporation is by a notification issued by State Government. In the present case, notification has been issued by the State Government in exercise of power of section 3 and the Authority has been constituted.

Supreme Court's Decision: The Supreme Court observed that the Preamble to the 1976 Act itself provides for constitution of an authority. NOIDA has, thus, been established by the 1976 Act and is clearly covered under the Notification dated October 22, 1970. Hence, it is eligible for exemption from tax deduction at source provided under section 194A(3)(iii)(f).

4. **Where the assessee fails to deduct tax at source under section 194B in respect of the winnings, which are wholly in kind, can he be deemed as an assessee-in-default under section 201?**

CIT v. Hindustan Lever Ltd. (2014) 361 ITR 0001 (Kar.)

Facts of the case: In the present case, the assessee is a company engaged in the business of manufacture and sale of various consumer goods/products. During the previous years relevant to A.Y.2001-02 and A.Y.2002-03, it had conducted certain sales promotion schemes. The assessee advertised the schemes wherein coupons were inserted in packs/containers of their products. Some of those coupons indicated that on purchase of the packs/ containers, they would get prizes, as indicated in coupons. The prizes that were offered were Santro car, Maruti car, gold chains, gold coins, gold tablas, silver coins, emblems, etc. The total amount of prizes distributed valued ₹ 6,51,238 for the A.Y.2001-02 and ₹ 54,73,643 for the A.Y.2002-03.

The Assessing Officer, having received the information about the schemes, sought clarification and also conducted survey of the assessee's business premises under section 133A. The Assessing Officer, thereafter, passed an order dated 3.1.2002, under sections 201(1) and 201(1A) for the A.Y.2001-02 and treated the assessee as an assessee-in-default of its obligation in terms of section 194B. Similar order was passed for the A.Y.2002-03. According to the Assessing Officer, the assessee was obliged to ensure that the tax in respect of the winnings, wholly in kind, was remitted before the winnings were released. Having failed to do so, the proceedings under section 201(1) were initiated. The Assessing Officer held that although the customers did not pay anything extra to receive the prize, nevertheless, they had participated in the scheme by purchasing the products advertised to take a chance at winning the prize. It was further held that what has been paid as prize-in-kind in various schemes conducted by the assessee is a lottery on which the tax was deductible under section 194B. As the assessee neither deducted the tax nor ensured payment thereof before the winnings were released, he treated the assessee as an assessee-in-default. He passed similar order dated 28.3.2002 for the A.Y.2002-03.

Appellate Tribunal's view: The Tribunal held that the schemes conducted by the assessee were not a lottery, as the said expression was understood up to the A.Y.2001-02. The Tribunal observed that the customers did not pay any excess amount for getting coupons indicating winnings in the packs/containers of products they purchased, and, therefore, nothing was paid by them for participating in the scheme. Accordingly, the Tribunal concluded that although there was an element of chance but as no consideration or payment was made by the customers for the purpose of participation in the lottery with the object of winning the prizes, the schemes conducted by the assessee would not fall within the ambit of section 194B.

The Tribunal further held that having regard to the insertion of *Explanation* below section 2(24)(ix), the scheme conducted by the assessee would be a lottery for the A.Y.2002-03 but nevertheless they accepted the alternate contention that having regard to *Circular No. 390, dated August 8, 1984 [See (1984) 149 ITR (St.) 5]*, there was no obligation on the respondent to deduct tax at source in respect of prizes paid in kind and in the absence of any such obligation, no proceedings under section 201 could be taken against the respondent.

High Court's view: From a bare perusal of section 194B, it is clear that the person responsible for paying to any person any income by way of winnings from any lottery in an amount exceeding ten thousand rupees shall, at the time of payment thereof, deduct income-tax thereon at the rates in force. A combined reading of sections 194B and 201 shows that if any such person fails to "deduct" the whole or any part of the tax or after deducting, fails to pay the tax as required by or under the Act, then such person shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default in respect of such tax. **The provisions contained in these sections do not cast any duty to deduct tax at source where the winnings are wholly in kind. If the winnings are wholly in kind, as a matter of fact, there cannot be any deduction of tax at source. The word "deduction" employed in this provision postulates a reduction or subtraction of an amount from a gross sum to be paid and payment of the net amount thereafter.** Where the winnings are wholly in kind the question of deduction of any sum therefrom does not arise and in that eventuality, the only responsibility, as cast under section 194B, is to ensure that tax is paid by the winner of the prize before the prize or winnings is or are released in his favour.

High Court's Decision: The High Court observed that if the assessee fails to ensure that tax is paid before the winnings are released in favour of the winner, then, section 271C empowers the Joint Commissioner to levy penalty equivalent to the amount of tax not paid, and under section 276B, such non-payment of tax is an offence attracting rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine. However, the High Court held that proceedings under section 201 cannot be initiated against the assessee.

5. **Can the transmission, wheeling and SLDC charges paid by a company engaged in distribution and supply of electricity, under a service contract, to the transmission company be treated as fees for technical services so as to attract TDS provisions under section 194J or in the alternative, under 194C?**

Ajmer Vidyut Vitran Nigam Ltd., In re (2013) 353 ITR 640 (AAR)

Facts of the case: In the present case, the applicant is a government company engaged in the business of distribution and supply of electricity to customers in various districts of Rajasthan. The activity of distribution is preceded by the production of electricity and its transmission from the point of production to the point of distribution. The production is by the generating company, which is another entity and transmission to the applicant is through the transmission system network of the transmission company. The transmission company carries the electrical energy to the applicant at the distribution system network of the applicant. The applicant then distributes the energy to the end customers.

The transmission of electricity from the point of generation to the point of distribution of the applicant is termed as "wheeling". The applicant pays transmission and wheeling charges for this wheeling, which it contends are statutory charges. The transmission company also functions as a State Load Dispatch Centre (SLDC), which is responsible for the general co-ordination of production and transmission of electricity to ensure uniform distribution in the State. The applicant pays to the transmission company, SLDC charges, which it claims as statutory in nature, since the levy is in terms of the Electricity Act, 2003.

Applicant's contention: The applicant contended that the above charges were not in the nature of fees for technical services to attract TDS provisions under section 194J, on the following grounds –

(i) The transmission does not involve rendering of any technical services nor were technically qualified staff of the transmission company involved in the transmission of electrical energy;

(ii) The SLDC charges were also mere statutory charges and does not involve rendering of technical services;

(iii) The payment of transmission, wheeling and SLDC charges were in the nature of reimbursement of actual cost and hence, do not generate any income in the hands of the transmission company.

Revenue's contention: The Revenue, on the other hand, was of the view that the transmission of electrical energy from the point of generation to the point of distribution of the applicant involves rendering of technical services and consequently, the applicant was bound to withhold tax. The Revenue supported its view on the basis of the following contentions –

(i) Transmission of electrical energy is a technical service and requires constant involvement of a technical system consisting of sophisticated instruments, constant monitoring and supervision by persons with a technical ability and knowledge to operate and manage the system so as to ensure regular and consistent supply of electricity at the grid voltage at the distribution point of the applicant.

(ii) As regards SLDC charges, the services rendered require the technical support and services of technically qualified staff and therefore they were technical services within the meaning of section 194J.

(iii) The fact that the contract between both the parties is backed by a statutory obligation cannot alter the nature of services rendered.

AAR's Observations: The AAR did not agree with the applicant's contention regarding transmission and wheeling charges not constituting fees for technical services on the ground that no rendering of technical services was involved for maintaining proper and regular transmission of electrical energy. It was also not in agreement with the applicant's argument that the services of technical personnel were not needed for ensuring due and proper transmission of electrical energy from the generation point to the distribution point. The AAR concurred with the Revenue's view that the personnel of the transmission company had to ensure regular and consistent transmission of electrical energy at the grid voltage at the distribution point of the applicant.

AAR's Decision: The AAR, considering the definition of fees for technical services under section 9(1)(vii) and the process involved in proper transmission of electrical energy, held that transmission and wheeling charges paid by the applicant to the transmission company are in the nature of fees for technical services, in respect of which the applicant has to withhold tax thereon under section 194J.

As regards SLDC charges, the AAR opined that the main duty of the SLDC is to ensure integrated operation of the power system in the State for optimum scheduling and dispatch of electricity within the State. The SLDC charges paid appeared to be more of a supervisory charge with a duty to ensure just and proper generation and distribution in the State as a whole. Therefore, such services were not in the nature of technical service to the applicant; Resultantly, it does not attract TDS provisions under section 194J or under section 194C.

6. Can discount given to stamp vendors on purchase of stamp papers be treated as 'commission or brokerage' to attract the provisions for tax deduction under section 194H?

CIT v. Ahmedabad Stamp Vendors Association (2012) 348 ITR 378 (SC)

Issue: The principal issue in this case is whether stamp vendors are agents of the State Government who are being paid commission or brokerage or whether the sale of stamp papers by the Government to the licensed vendors is on "principal-to-principal" basis involving a "contract of sale".

High Court's Observations: On this issue, the Gujarat High Court had in, *Ahmedabad Stamp Vendors Association v. Union of India (2012) 348 ITR 378*, observed that the crucial question is whether the ownership in the stamp papers passes to the stamp vendor when the treasury officer delivers stamp papers on payment of price less discount. The Gujarat Stamp Supply and Sales Rules, 1987 contemplates that the licensed vendor, while taking delivery of the stamp papers from the Government offices, is purchasing the stamp papers. The Rules also indicate that the discount which the licensed vendor has obtained from the Government is on purchase of the stamp papers.

If the licensed stamp vendors were mere agents of the State Government, no sales tax would have been leviable when the stamp vendors sell the stamp papers to the customers, because it would have been sale by the Government "**through**" stamp vendors. However, entry 84 in Schedule I to the Gujarat Sales Tax Act, 1969 specifically exempts sale of stamp papers by the licensed vendors from sales-tax. The very basis of the State Legislature enacting such exemption provision in respect of sale of stamp papers by the licensed vendors makes it clear that the sale of stamp papers by the licensed vendors to the customers would have, but for such exemption, been subject to sales tax levy. The question of levy of sales tax arises only because the licensed vendors themselves sell the stamp papers on their own and not as agents of the State Government. Had they been treated as agents of the State Government, there would be no question of levy of sales tax on sale of stamp papers by them, and consequently, there would have been no necessity for any exemption provision in this regard.

Therefore, although the Government has imposed a number of restrictions on the licensed stamp vendors regarding the manner of carrying on the business, the stamp vendors are required to purchase the stamp papers on payment of price less discount on "principal to principal" basis and there is no "contract of agency" at any point of time. The definition of "commission or brokerage" under clause (i) of the *Explanation* to section 194H indicates that the payment should be received, directly or indirectly, by a person acting on behalf of another person*, inter alia,* for services in the course of buying or selling goods. Therefore, the element of agency is required in case of all services and transactions contemplated by the definition of "commission or brokerage" under *Explanation (i)* to section 194H. When the licensed stamp vendors take delivery of stamp papers on payment of full price less discount and they sell such stamp papers to the retail customers, neither of the two activities (namely, buying from the Government and selling to the customers) can be termed as service in the course of buying and selling of goods. The High Court, therefore, held that discount on purchase of stamp papers does not fall within the expression "commission or brokerage" to attract the provisions of tax deduction at source under section 194H.

Supreme Court's Decision: The Supreme Court affirmed the above decision of the High Court holding that the given transaction is a sale and the discount given to stamp vendors for purchasing stamps in bulk quantity is in the nature of cash discount and consequently, section 194H has no application in this case.

7. **Can incentives given to stockists and distributors by a manufacturing company be treated as "commission" to attract –**

   (i) **the provisions for tax deduction at source under section 194H; and**

   (ii) **consequent disallowance under section 40(a)(ia) for failure to deduct tax at source?**

CIT v. Intervet India P Ltd (2014) 364 ITR 238 (Bom)

Facts of the case: The assessee-company engaged in manufacture of biological vaccines and animal health care pharmaceutical products, sold the same either through consignment or commission agents or directly through distributors or stockists. During the relevant financial year, it introduced a sales promotion scheme to boost sales by way of product discounts and product campaign. It passed on the incentives to distributors through consignment agents by way of sales credit notes. The Assessing Officer held that as the assessee was paying the stockists/distributors for the services rendered by them for buying and selling goods, on the basis of quantum of sales effected, such payment has to be considered as commission, on which tax was deductible at source under section 194H. Consequently, disallowance under section 40(a)(ia) was attracted for failure to deduct tax at source.

High Court's Observations: The High Court observed that the assessee had undertaken sales promotion by way of product discount scheme under which it offered incentive to the stockists / distributors and dealers. **The relationship between the assessee and the distributors / stockists was that of principal to principal.** The products were firstly sold to distributors / stockists who in turn resold the goods in the market. No service was offered by the assessee to them except a discount under the product discount scheme/product campaign scheme to buy the assessee's product.

High Court's Decision: The High Court, accordingly, held that the stockists and distributors were not acting on behalf of the assessee and most of the credit was by way of goods on meeting the sales target which could not be said to be a commission within the meaning of the *Explanation (i)* to section 194H. Accordingly, the High Court affirmed the order of the Tribunal which held that such payment does not attract deduction of tax at source. Consequently, disallowance under section 40(a)(ia) would not be attracted.

8. **Can discount given on supply of SIM cards and pre-paid cards by a telecom company to its franchisee be treated as commission to attract the TDS provisions under section 194H?**

Bharti Cellular Ltd. v. ACIT (2013) 354 ITR 507 (Cal.)

High Court's Observations: On this issue, the Calcutta High Court observed the Supreme Court ruling in *Bhopal Sugar Mills' case (1977) 40 STC 42*, wherein it was held that the true relationship between the parties has to be gathered from the nature of the contract, its terms and conditions. The terminology used by the parties is not decisive of the said relationship.

The High Court, on perusal of the agreement between the assessee-telecom company and the franchisees, observed that –

(1) the property in the start-up pack and pre-paid coupons, even after transfer and delivery to the franchisee, remained with the assessee-telecom company;

(2) the franchisee really acted as a facilitator and/or instrument of providing services by the assessee-telecom company to the ultimate subscriber;

(3) the franchisee had no free choice to sell the pre-paid coupons and sim cards and everything including the selling price was regulated by the assessee-telecom company;

(4) the rate at which the franchisee sells to the retailers is also regulated and fixed by the assessee-telecom company.

In the real sense, the franchisee acted on behalf of the assessee-telecom company for selling start-up pack, prepaid recharge coupons to the customer. Therefore, the relationship between the assessee and the franchisee is essentially that of principal and agent, though the nomenclature used is "franchisee". The franchisees were, thus, agents of the assessee, getting a fixed percentage of commission, in the form of discount.

High Court's Decision: Considering the above, the High Court held that there is an indirect payment of commission, in the form of discount, by the assessee-telecom company to the franchisee. Therefore, the assessee is liable to deduct tax at source on such commission as per the provisions of section 194H.

***Note -** Similar ruling was pronounced by the Kerala High Court in Vodafone Essar Cellular Ltd. v. ACIT (TDS) (2011) 332 ITR 255, wherein it was held that there was no sale of goods involved as claimed by the assessee-telecom company and the entire charges collected by the assessee from the distributors at the time of delivery of SIM cards or recharge coupons were only for rendering services to ultimate subscribers. The assessee was accountable to the subscribers for failure to render prompt services pursuant to connections given by the distributor. Therefore, the distributor only acted as a middleman on behalf of the assessee for procuring and retaining customers and consequently, the discount given to him was within the meaning of commission on which tax was deductible under section 194H.*

9. Can the difference between the published price and the minimum fixed commercial price be treated as additional special commission in the hands of the agents of an airline company to attract TDS provisions under section 194H, where the airline

company has no information about the exact rate at which tickets are ultimately sold by the agents?

CIT v. Qatar Airways (2011) 332 ITR 253 (Bom.)

Facts of the case: In this case, the airline company sold tickets to the agents at a minimum fixed commercial price. The agents were permitted to sell the tickets at a higher price, however, up to the maximum of published price. Commission at the rate of 9% of published price was payable to the agents of the airline company, on which tax was deducted under section 194H. The issue under consideration is whether the difference between the published price and the minimum fixed commercial price amounts to additional special commission in the hands of the agents to attract the provisions of section 194H.

High Court's Observations: On this issue, the Bombay High Court observed that the difference between the published price and minimum fixed commercial price cannot be taken as additional special commission in the hands of the agents, since the published price was the maximum price and airline company had granted permission to the agents to sell the tickets at a price lower than the published price. In order to deduct tax at source, the exact income in the hands of the agents must necessarily be ascertainable by the airline company. However, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents, since the agents had been given discretion to sell the tickets at any rate between the minimum fixed commercial price and the published price. It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of each ticket sold.

High Court's Decision: Thus, tax at source was not deductible on the difference between the actual sale price and the minimum fixed commercial price, even though the amount earned by the agent over and above minimum fixed commercial price would be taxable as income in his hands.

Note - *It may be noted that in the case of CIT v. Singapore Airlines Ltd. (2009) 319 ITR 29, the billing analysis statement clearly indicated the extra commission in the form of special or supplementary commission that was paid to the travel agent with reference to the deal code. Therefore, in that case, the Delhi High Court, held that the supplementary commission in the hands of the agent was ascertainable by the airline company and hence the airline company was liable to deduct tax at source on the same under section 194H.*

10. Are the provisions of tax deduction at source under section 194H attracted in respect of amount retained by accredited advertising agencies out of remittance of sale proceeds of "airtime" purchased from Doordarshan and sold to customers?

Director, Prasar Bharati v. CIT [2018] 403 ITR 161 (SC)

Facts of the Case: The assessee, Prasar Bharati Doordarshan Kendra, functions under the

Ministry of Information and Broadcasting, Government of India and runs the television channel called Doordarshan. For the purpose of telecasting advertisements of consumer companies on its channel, the assessee entered into agreements with advertising agencies, on the basis of the application made by such agencies to the assessee for gaining "accredited status". The agencies were to give minimum annual business of Rs.6 lakhs to the assessee in a financial year and furnish bank guarantee for a sum of Rs.3 lakhs. The agreement provided that the accredited agencies would retain 15% by way of commission out of the amount collected from customers and paid to the assessee. The agencies were to retain the commission earned and not to part with the same either directly or indirectly to any other person.

In the relevant assessment years, the agencies retained Rs.4.87 crores towards commission as per the terms of the agreement. The Assessing Officer was of the view that such retention by the agencies were in the nature of "commission" under section 194H, and the assessee was in default under section 201(1) as it had failed to deduct tax at source on such commission retained.

The assessee, however, contended that its relationship with accredited agencies were on "principal-to-principal" basis since the accredited agencies purchased airtime from the assessee and then sold it in the market for advertisement to their customer after retaining 15% of the said sum. Therefore, the assessee contended the sum retained is not 'commission' to attract the provisions of section 194H.

Issue: The issue under consideration is whether the amount retained by the accredited agencies is in the nature of commission to attract the provisions of section 194H.

High Court's Observations: The Kerala High Court took the view that such retentions were in the nature of commission under section 194H. The assessee was, thus, under a statutory obligation to deduct the tax at source.

Supreme Court's Observations: The Supreme Court observed that the definition of "commission or brokerage" under section 194H is inclusive and covers any payment received or receivable directly or indirectly by a person acting on behalf of another person for the services rendered. The agreement itself uses the expression "commission" in all relevant clauses. The payment clause is free of ambiguity and the terms of the agreement indicate that both parties intended that the amount to be paid/retained is in the nature of commission. It is for this reason that the parties used the expression "commission" in the agreement. The relationship in question was a pure agency arrangement because the agency acted on behalf of the assessee and the actions of the agency were binding on the assessee. Moreover, the agreement itself contained a clause for deduction of tax at source on trade discount.

Supreme Court's Decision: The Supreme Court, thus, held that the amount retained by the accredited advertising agencies is commission and consequently, the provisions of tax deduction at source under Section 194H are attracted. Consequently, for failure to deduct tax at source under section 194H, the assessee would be treated as an assessee-in-default.

Note *- It may be noted that the CBDT has, vide Circular No.5/2016 dated 29.2.2016, clarified that TDS under section 194H is not attracted on retentions by an advertising agency (for booking or procuring of or canvassing for advertisements) from payments remitted to television channels/newspaper companies. The CBDT has issued this clarification on the basis of the Allahabad High Court ruling in Jagran Prakashan Ltd.'s case and Delhi High Court ruling in Living Media Ltd.'s case that the relationship between the media company and advertising agency is that of a "principal to principal". However, the Supreme Court, in this case, has distinguished from the Allahabad High Court ruling, on the basis of the fact that an agreement has been entered into by Doordarshan with the accredited agencies specifically appointing them as agents; and the agreement also contains a specific clause for deduction of tax at source on trade discount, which is in the nature of commission. Accordingly, the Supreme Court held that the relationship between Doordarshan and its accredited agencies is that of a principal and agent, consequent to which TDS provisions under section 194H would get attracted in respect of retentions by accredited advertising agencies from payments remitted to Doordarshan. Therefore, the applicability or otherwise of the CBDT Circular will depend on the facts of the specific case.*

11. Are landing and parking charges paid by an airline company to Airports Authority of India in the nature of rent to attract tax deduction at source under section 194-I?

Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372 (SC)

Facts of the case: The assessees in both the cases are foreign airlines. Being international airlines, they fly their aircrafts to several destinations across the world, including New Delhi. For landing the aircrafts and parking thereof at the Indira Gandhi International Airport (IGIA), New Delhi, the Airports Authority of India (AAI) levies charges on these airlines. The airlines are deducting tax @2% under section 194C for payment of landing and parking charges in respect of its aircrafts to AAI and remitting the same. However, the income-tax authorities are of the view that tax is to be deducted at the higher rate applicable under section 194-I *(currently, 10%)*.

Issue under consideration: The issue under consideration is whether landing and parking charges paid by the airline companies to AAI is in the nature of rent to attract tax deduction at source under section 194-I.

Delhi High Court's view *vis-a-vis* Madras High Court's view: On this issue, contrary views were expressed by the Delhi High Court in *Japan Airlines Co. Ltd.*'s case and the Madras High Court in *Singapore Airlines Ltd.'s* case.

The Delhi High Court observed that “rent” as defined in section 194-I has a wider meaning than rent in common parlance and includes any agreement or arrangement for use of land. The Delhi High Court further observed that when the wheels of the aircraft coming into an airport touch the surface of the airfield, use of the land of the airport immediately begins. Similarly, for parking the aircraft in that airport, again, there is use of the land. Therefore, the Delhi High Court, following its own judgment in the case of *United Airlines v. CIT (2006) 287 ITR 281* held that landing and parking fee were “rent” within the meaning of the provisions of section 194-I, as they were payments for the use of the land of the airport.

The Madras High Court, however, expressed a contrary view on the above issue in *CIT v. Singapore Airlines Ltd. (2012) 209 Taxman 581 (Mad.).* The Court has observed that only if the agreement or arrangement has the characteristics of lease or sub-lease or tenancy for systematic use of the land, the charges levied would fall for consideration under the definition of 'rent' for the purpose of section 194-I.

The Madras High Court further observed that the principles guiding the levy of charges on landing and take-off show that the charges are with reference to the number of facilities provided by the Airport Authority of India in compliance with the international protocols and the charges are not made for any specified land usage or area allotted. The charges are for various facilities offered to meet the requirement of passenger safety and for safe landing and parking of the aircraft. Thus, the charges levied are, at the best, in the nature of fee for the services offered rather than in the nature of rent for the use of the land.

Therefore, the levy of charges, which is not only for the use of land, but for maintenance of various services, including technical services involving navigation, would not automatically bring the transaction and the charges within the meaning of either lease or sub-lease or tenancy or any other agreement or arrangement in the nature of lease or tenancy so that the charges would fall within the meaning of ‘rent’ as appearing in *Explanation* to section 194-I.

Thus, the Madras High Court held that going by the nature of services offered by the AAI in respect of landing and parking charges, collected from the assessee, there is no ground to accept that the payment would fit in with the definition of “rent” as given under section 194-I.

Supreme Court’s Observations: The Apex Court considered the moot question as to whether landing and take-off facilities on the one hand and parking facility on the other hand would tantamount to use of land. After due consideration of the views of the Delhi High Court and the Madras High Court on this issue, the Supreme Court concluded that the Madras High Court’s view is justified on the basis of sound rationale and reasoning.

The Supreme Court observed that the charges which are fixed by the AAI for landing and take-off services as well as for parking of aircrafts are not for the "use of the land". These charges are for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport.

There are various international protocols which mandate all authorities manning and managing these airports to construct the airport of desired standards which are stipulated in the protocols. The services which are required to be provided by these authorities, like AAI, are aimed at passengers' safety as well as for safe landing and parking of the aircrafts. Therefore, it is not mere "use of the land". On the contrary, it encompasses all the facilities that are to be compulsorily offered by the AAI in tune with the requirements of the protocol.

For example, runways are not constructed like any ordinary roads. Special technology is required for the construction of these runways for smooth landing and take-off of the aircrafts. Specialised kind of orientation and dimensions are needed for these runways which are prescribed with precision and those standards are to be adhered to. Further, there has to be proper runway lighting, runway safety area, runway markings, etc. Technical specifications for such lighting, safety area and markings are stipulated which have to be provided. The technical specifications keep in mind the basic fact, namely, on landing, the aircraft is light on fuel and usually less than 5% of the weight of the aircraft touches the runway in one go. On take-off, the aircraft is heavy but as the aircraft accelerates, the weight gradually moves from the wheels to the wings. The technological aspects of these runways have been emphasized in some detail to highlight the precision in designing and engineering which goes into making these runways fool proof for safety purposes. The purpose is to show that the AAI is providing all these facilities for landing and take-off of an aircraft and in this whole process, "use of the land" pales into insignificance.

The Supreme Court observed that the charges levied on air-traffic includes landing charges, lighting charges, approach and aerodrome control charges, aircraft parking charges, aerobridge charges, hangar charges, passenger service charges, cargo charges, etc. Thus, when the airlines pay for these charges, treating such charges as charges for "use of the land" would tantamount to adopting a totally simplistic approach which is far away from the reality.

Supreme Court's Decision: The Supreme Court opined that the substance behind such charges has to be considered and when the issue is viewed from this angle, keeping the full and larger picture in mind, it becomes very clear that the charges are not for use of the land *per se* and, therefore, it cannot be treated as "rent" within the meaning of section 194-I. The Supreme Court, thus, concurred with the view taken by the Madras High Court in *Singapore Airlines* case and overruled the view taken by the Delhi High Court in *United Airlines/Japan Airlines* case.

The Supreme Court was, however, not in agreement with the Madras High Court's view that the words "any other agreement or arrangement for the use of any land or any building" have to be read *ejusdem generis* and it should take its colour from the earlier portion of the definition, namely, "lease, sub-lease and tenancy", thereby, limiting the ambit of the words "any other agreement or arrangement". The Supreme Court observed that this reasoning was not correct. A bare reading of the definition of "rent" contained in *Explanation* to section 194-I would make it clear that in the first place, the payment, by whatever name called, under any lease, sub-lease, tenancy is to be treated as "rent". This is rent as understood in the traditional sense. However, the second part is independent of the first part which gives a much wider scope to the term "rent". Accordingly, whenever payment is made for use of any land or any building by any other agreement or arrangement, that is also to be treated as "rent". Once such a payment is made for use of land or building under any other agreement or arrangement, such agreement or arrangement gives the definition of “rent” a very wide connotation. The Supreme Court observed that the interpretation of the Delhi High Court appears to be correct to that extent i.e., to the extent that the scope of the definition of rent under section 194-I is very wide and not limited to what is understood as rent in common parlance; though the Delhi High Court did not apply this definition correctly to the present case as it failed to notice that in substance the charges paid by these airlines are not for "use of land" but for other facilities and services wherein the use of the land was only a minor and insignificant aspect. Thus, the Supreme Court was of the considered view that the Delhi High Court did not correctly appreciate the nature of charges that are paid by the airlines as landing and parking charges, in the sense, it did not appreciate that such charges were not, in substance, for use of land but for various other facilities extended by the Airports Authority of India to the airlines.

12. Is payment made for use of passive infrastructure facility such as mobile towers subject to tax deduction under section 194C or section 194-I?

Indus Towers Ltd v. CIT (2014) 364 ITR 114 (Del)

Facts of the case: The assessee owned a network of telecom towers and infrastructure services which were let out to major telecom operators in the country. Under section 197, the assessee sought for lower tax deduction under section 194C for the financial year 2013-14 at 0.5% and whereas the Assessing Officer issued a certificate under section 197 for lower tax deduction at 2.5% under section 194-I. The assessee filed a writ before the Delhi High Court. The Court directed the assessee to prefer a revision petition before the Commissioner of Income-tax.

The Commissioner of Income-tax rejected the contention of the assessee for applying section 194C and upheld the order of the Assessing Officer applying section 194-I, on the ground that the mobile operators had the right to install the equipment on the tower owned by the assessee, which tantamounts to use of the land or telecommunication site and the tower owned by the assessee. The assessee once again preferred a writ before the High Court.

Assessee’s Contentions: The assessee explained that its responsibility is to provide the entire passive infrastructure service with the aid of equipment belonging to it which is fully operated, controlled and managed by it. The customers do not have access, control or possession over the towers, sites or designated areas which are limited to rectification or maintenance of any defects in the equipments installed by them. The assessee, further, contended that its customers do not pay for any leasing rights but only for the services. Therefore, the provisions of section 194-I would not be attracted in this case.

High Court's Observations: The High Court observed that it was the intention of the parties to use the technical and specialized equipment maintained by the assessee. The infrastructure was given for the use of mobile operators. The towers were the neutral platform without which the mobile operators could not operate. Each mobile operator has to carry out this activity, by necessarily renting premises and installing the same equipment. The dominant intention was the use of equipment or plant or machinery and the use of premises was only incidental.

High Court's Decision: The High Court held that the submission of the assessee that the transaction is not "renting" is incorrect. Also, the Revenue's contention that the transaction is primarily "renting of land" is also incorrect. The underlying object of the arrangement was the use of machinery, plant or equipment i.e., the passive infrastructure and it is incidental that it was necessary to house the equipment in some premises. It directed that tax deduction be made at 2% as per section 194-I(a), the rate applicable for payment made for use of plant and machinery.

13. **Is the assessee-company engaged in refining, distribution and sale of petroleum products, liable to deduct tax under section 194C or under section 194-I, in respect of payment made to the carrier engaged for road transport of bulk petroleum products?**

CIT v. Indian Oil Corporation [2019] 410 ITR 106 (Uttarakhand)

Facts of the Case: The assessee-company was engaged in refining crude oil and storing, distributing and selling the petroleum products. The assessee-company required tank trucks for road transportation of bulk petroleum products from its various storage points to customers or other storage points. It entered into an agreement with another company for the said purpose.

Upon scrutinizing the contract, the Assessing Officer came to the conclusion that the assessee was liable to deduct tax under section 194-I as the carrier is being hired and being paid for full time unlike in the case of a works contract. However, the Commissioner (Appeals) and the Appellate Tribunal held that tax was deductible under section 194C not under section 194-I.

Relevant provision of the Income-tax Act, 1961: Section 194-I provides for deduction of tax at source on payment of rent. As per clause (i) of the *Explanation* to section 194-I, "rent" means payment, by whatever name called, for, *inter alia*, use of any plant. Section 194C deals with deduction of tax at source in respect of payment made to a contractor for carrying out any work. Clause (iv) of *Explanation* to section 194C defines "work" to include carriage of goods or passengers by any mode of transport other than by railways.

Issue: The issue under consideration is whether the assessee-company is liable to deduct tax under section 194C or under section 194-I on payment made to the carrier engaged for road transport of bulk petroleum products.

High Court's Observations: Upon perusing the terms of the contract, the High Court observed that the parties understood the agreement as one where the carrier would be paid transport charges, and that too, for the shortest route travelled by it in the course of transporting the goods of the assessee. The contract did not require payment of idle charges and it was clear that there was no entitlement to any payment other than the actual transportation of the goods. Hence, the carrier was not being hired for full time.

The carrier under the contract was undoubtedly obliged to maintain the requisite number of trucks of a particular type subject to various restrictions and conditions. However, the carrier was under the obligation to operate the trucks for the specific purpose of transporting the goods belonging to the assessee.

High Court's Decision: The High Court held that, even after amendment to the *Explanation* under section 194-I to include within its scope, payment for use of plant, the case could not fall within its ambit. The contract is one for transpotation of goods and, therefore, is a contract of work within the meaning of section 194C and not section 194-I.

14. In respect of a co-owned property, would the threshold limit mentioned in section 194-I for non-deduction of tax at source apply for each co-owner separately or is it to be considered for the complete amount of rent paid to attract liability to deduct tax at source?

CIT v. Senior Manager, SBI (2012) 206 Taxman 607 (All.)

Facts of the case: In the present case, the assessee was paying rent for the leased premises occupied. The said premise was co-owned and the share of each co-owner was definite and ascertainable. Also, the assessee made payment to each co-owner separately by way of cheque. The assessee did not deduct tax at source under section 194-I stipulating that the payment made to each co-owner was less than the minimum threshold mentioned in the said section (now, ₹ 1,80,000) and therefore, no liability to deduct tax at source on the rent so paid is attracted, though the whole rent taken together exceeds the said threshold limit.

Revenue's contentions: The Revenue contended that since the premises let out to the assessee had not been divided/partitioned by metes and bounds, it cannot be said that any specified portion let out to the assessee was owned by a particular person. Therefore, the assessee had to deduct tax at source on the rent so paid assessing the co-owners as association of persons and the threshold limit mentioned in section 194-I was to be seen in respect of the entire rent amount. Hence, the Revenue was of the view that assessee was liable to deduct tax on the payment of rent and interest would be leviable on failure to deduct such tax under section 201.

High Court's Decision: Considering the above mentioned facts, the Allahabad High Court held that, since the share of each co-owner is definite and ascertainable, they cannot be assessed as an association of persons as per section 26. The income from such property is to be assessed in the individual hands of the co-owners. Therefore, it is not necessary that there should be a physical division of the property by metes and bounds to attract the provisions of section 26.

Therefore, in the present case, since the payment of rent is made to each co-owner by way of separate cheque and their share is definite, the threshold limit mentioned in section 194-I has to be seen separately for each co-owner. Hence, the assessee would not be liable to deduct tax on the same and no interest under section 201 is leviable.

15. Can the payment made by an assessee engaged in transportation of building material and transportation of goods to contractors for hiring dumpers, be treated as rent for machinery or equipment to attract provisions of tax deduction at source under section 194-I?

CIT (TDS) v. Shree Mahalaxmi Transport Co. (2011) 339 ITR 484 (Guj.)

Facts of the case: In this case, the assessee was engaged in the business of transportation of building material, salt, black trap, iron, etc. During the relevant previous year, the assessee made payment for hiring of dumpers and deducted tax at source at the rate under section 194C applicable for sub-contracts which, according to the Assessing Officer, was not correct as the assessee had taken dumpers on hire and such payments were governed under section 194-I. The Assessing Officer, accordingly, held that the assessee had short deducted tax at source and passed an order under section 201(1) holding the assessee to be an assessee-in-default.

High Court's Observations: The High Court observed that the assessee had given contracts to the parties for the transportation of goods and had not taken machinery and equipment on rent. The Court observed that the transactions being in the nature of contracts for shifting of goods from one place to another would be covered as works contracts, thereby attracting the provisions of section 194C.

High Court's Decision: Since the assessee had given sub-contracts for transportation of goods and not for the renting out of machinery or equipment, such payments could not be termed as rent paid for the use of machinery and the provisions of section 194-I would, therefore, not be applicable.

Note - *Similar ruling was pronounced by the Gujarat High Court on an identical issue in CIT (TDS) v. Swayam Shipping Services (P) Ltd. (2011) 339 ITR 647.*

16. Would transaction charges paid by the members of the stock exchange for availing fully automated online trading facility, being a facility provided by the stock exchange to all its members, constitute fees for technical services to attract the provisions of tax deduction at source under section 194J?

CIT v. Kotak Securities Ltd (2016) 383 ITR 1 (SC)

Facts of the case: The assessee company was engaged in the business of share broking, depositories, mobilisation of deposits and marketing public issues. Being a member of the Bombay Stock Exchange (BSE), it made payment to the Stock Exchange by way of transaction charges in respect of fully automated online trading facility and other facilities. These services are available to all the members of the stock exchange in respect of every transaction that is entered into. Revenue contended that tax is deductible at source under section 194J considering such transaction charges as "fees for technical services".

High Court's Decision: The Bombay High Court held that the transaction charges paid by a member of the BSE to the stock exchange to transact business of sale and purchase of shares amounts to payment of a "fee for technical services" and hence, tax is deductible at source under section 194J.

Supreme Court's Observations: The Apex Court made the following observations:

- The services provided by the stock exchange are available to all members in respect of every transaction that is entered into. There is nothing special, exclusive or customized in the service that is rendered by the stock exchange.
- A member who wants to conduct his daily business in the stock exchange has no option but to avail such services. Each and every transaction by a member involves the use of such services provided by the stock exchange for which the member is required to pay transaction charge based on the transaction value besides charges for the membership of the stock exchange.
- Technical services like managerial and consultancy service are in the nature of specialised services made available by the service provider to cater to the special needs of the customer-user as may be felt necessary. ***It is the above feature that would distinguish or identify a service provider from a facility offered.***
- However, there is no exclusivity in the services rendered by the stock exchange and each and every member has to avail such service in the normal course of trading in securities in the stock exchange.

Supreme Court's Decision: The Apex Court, accordingly, held that the service provided by the BSE for which transaction charges are paid failed to satisfy the test of specialized, exclusive and individual requirement of the user or the consumer who may approach the service provider for such assistance or service.

Therefore, the transaction charges paid to BSE by its members are not for technical services but are in the nature of payments made for facilities provided by the stock exchange. Such payments would, therefore, not attract the provisions of tax deduction at source under section 194J.

17. Is tax is required to be deducted under section 195 on the demurrage charges paid to a foreign shipping company which is governed by section 172 for the purpose of levy and recovery of tax?

CIT v. V.S. Dempo & Co P Ltd (2016) 381 ITR 303 (Bom) (FB)

Facts of the case: In the present case, the assessee, being a company engaged in the business of mining and export of processed iron ore as also in construction business, claimed demurrage charges paid to a foreign shipping company on which no tax was deducted at source under section 195 as deductible expenditure. Since tax was not deducted at source under section 195, the Assessing Officer, in view of provisions of section 40(a)(i), disallowed the claim of expenditure in respect of such demurrage charges paid.

High Court's Observations: The High Court took note of the Tribunal's observation that section 40(a)(i) would apply only when there is an obligation to deduct tax at source. The Tribunal placed reliance upon the CBDT Circular No. 723 dated September 19, 1995 to support its conclusion that there was no obligation to deduct tax at source in respect of payment made towards demurrage charges to non-resident shipping company falling within the scope of section 172. The Revenue did not dispute that section 172 applied in the present case. Section 172 is a charging as well as machinery provision in respect of non-resident shipping companies. It provides for determination and collection of tax. Thus, no obligation to deduct at source under section 195 would arise in respect of payment of demurrage charges to such companies.

The High Court also noted that section 172 is a complete code that applies to non-resident Indians and section 195 is part of recovery provision under the Income-tax Act, 1961.

The provisions of section 172 would apply notwithstanding anything contained in the other provision of this Act, for the purpose of the levy and recovery of tax in the case of any ship, belonging to or chartered by a non-resident which carries passengers, etc. shipped at a port in India. Since section 172(1) begins with a non-obstante clause, it would prevail over other provisions of the Act including section 195. Thus, the provisions contained thereunder would take care of the manner of determination of income from shipping business of non-residents as well as the levy and recovery of tax thereon.

High Court's Decision: The High Court, accordingly, held that since section 172 dealing with shipping business of non-residents contains a non-obstante clause and applies both for the purpose of the levy and recovery of tax in the case of any ship carrying passengers etc., belonging to or chartered by a non-resident and shipping at a port in India, there would be no obligation on the payer-assessee to deduct the tax at source under section 195 on payment of demurrage charges to the non-resident shipping company.

18. Is payment made to an overseas agent, who did not perform any service in India, liable for tax deduction at source?

DIT (International Taxation) v. Wizcraft International Entertainment (P) Ltd (2014) 364 ITR 227 (Bom)

Facts of the case: The assessee, an event management company, engaged the services of an agent to bring artistes to India. The assessee-company (i) paid commission to overseas agent; (ii) reimbursed the expenses in connection with the visit of the artistes in India; and (iii) paid fees to the artistes in India. The assessee-company deducted tax at source on the fees paid to the international artistes in India but did not deduct tax at source on the commission paid to the agent and on the reimbursement of expenses incurred in India by the artistes.

Assessing Officer's view *vis-à-vis* Commissioner (Appeals) view: The Assessing Officer contended that the payments made by the assessee including the payment made by way of commission to the agent and payment for reimbursement of expenses in connection with the visit of the artistes to India are liable for tax deduction at source. The Commissioner (Appeals) was of the view that expenses incurred and reimbursed do not constitute income derived by the artistes from their personal activities, so as to be taxable under Article 18 of the Double Taxation Avoidance Agreement between India and UK; and hence, the same is not liable for deduction of tax at source.

Issue: The issue under consideration before the High Court was with regard to deduction of tax on commission paid to overseas agent who never took part in the events organized in India and amount paid as reimbursement of expenses incurred on travelling of artistes.

High Court's Observations: The High Court observed that the assessee has deducted tax on the payments made to artistes for the services rendered in India. In so far as reimbursement of expenses is concerned, it has been verified with supporting documents that it was towards their air travel on which no tax was required to be deducted. With regard to the payment of commission, the agent did not act as a performing artist or entertainer. He was concerned only with the services rendered outside India. Thus, the Tribunal had recorded the finding of fact that the income of the agent did not arise from the personal activities in the contracting status of an entertainer or artist. He only contacted the artistes and negotiated with them for performance in India in terms of the authority given by the assessee. Hence, the commission paid to the overseas agent was not liable to tax in India. Consequently, there was no obligation for deducting tax at source at the time of making payment to the overseas agent.

High Court's Decision: The High Court, therefore, affirmed the decision of the Tribunal and Commissioner (Appeals) holding that the service rendered by the agent was outside India and hence, was not chargeable to tax in India. Thus, the requirement for deducting tax at source under section 195 on such payment does not arise.

19. Is interest under section 201(1A) attracted even in a case where non-deduction of tax at source was under a *bona fide* belief that tax was not deductible and the default was not willful?

Sun Outsourcing Solutions Private Limited v. CIT (Appeals) [2018] 407 ITR 480 (T&AP)

Facts of the Case: The assessee is a private limited company engaged in the business of software development with its office in Hyderabad and branch office in London. In the course of executing software projects in the U.K., the assessee had deputed some employees from Hyderabad to London and it had also employed local personnel (NRIs) in the U. K. The assessee did not deduct tax at source on the allowances paid to the staff deputed to the U. K. and the salary payments made to the local personnel engaged in the U. K.

The Assessing Officer charged interest on payments made to staff deputed to the U. K. and on salaries paid to the personnel engaged in the U.K. under section 201(1A). The first appellate authority set aside the demand raised under section 201(1A) with respect to non-deduction of tax at source from payments made to the non-resident consultants working abroad. However, it upheld the order of the Assessing Officer with respect to non-deduction of tax at source on allowances paid to Indian residents deputed to work in the U. K.

The assessee contended that since it was under a *bona fide* impression that the amounts paid to its employees were not taxable, it did not deduct tax on such payment. There was no malice or *mens rea* on its part, and hence, the assessee was of the view that interest under section 201(1A) should not be attracted.

Relevant provision of the Income-tax Act, 1961: Under section 201(1), if any person, including an employer, who is required to deduct tax, does not deduct or does not pay or after so deducting fails to pay, the whole or any part of the tax, as required by or under the Act, such person shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default in respect of such tax. Under section 201(1A), such person is liable to pay simple interest at the rate specified therein for failure to deduct tax or remit tax within the prescribed time after deduction.

Under section 221(1), penalty is attracted where an assessee is in default or is deemed to be in default for making payment of tax. However, the second proviso to section 221(1) provides that where the assessee proves to the satisfaction of the Assessing Officer that the default was for good and sufficient reasons, no penalty would be leviable.

Issue: The issue under consideration is whether interest under section 201(1A) is attracted even in a case where non-deduction of tax at source was under a *bona fide* belief that tax was not deductible and the default was not willful

High Court's Observations: The High Court observed that section 201(1A) was automatically attracted for failure to deduct tax at source on the payments made. Only in case of penalty under section 221, there is a provision for non-levy where the assessee proves that the default was for good and sufficient reasons. Unlike section 221, section 201(1A) does not require proof of willful default. Even if the assessee was *bona fide* in not making such deduction, interest was nevertheless payable. Therefore, for levying interest under section 201(1A), *mens rea* or willful conduct is wholly irrelevant.

High Court's Decision: The High Court, accordingly, held that since the company had failed to deduct tax on the payments made to its employees, being Indian residents deputed to work in the U.K., section 201(1A) is automatically attracted; even if such non-deduction was due to the *bona fide* belief that tax is not deductible in such case, the company is, nevertheless, liable to pay interest under section 201(1A).

20. Can items of finished products from ship breaking activity which are usable as such be treated as "Scrap" to attract provisions for tax collection at source under section 206C?

CIT v. Priya Blue Industries (P) Ltd (2016) 381 ITR 210 (Guj)

Facts of the case: The assessee-company, engaged in ship breaking activity, sold old and used plates, wood etc. It did not produce any document or papers to show collection of tax at source on sale of such items and payment thereof to the credit of the Central Government nor was certificate in Form No.27C produced. The Assessing Officer observed that such items were in the nature of scrap and therefore, the assessee was under an obligation to collect tax at source from the buyers of scrap. Accordingly, he raised a demand under section 201(1) and interest under section 201(1A). The assessee claimed that such items are usable as such, and are hence not 'scrap' to attract the provisions for collection of tax at source.

Appellate Authorities' views: The Commissioner (Appeals) observed that the assessee was engaged in ship breaking activity and the products obtained from the activity were finished products which constituted sizable chunk of production done by the ship breakers. The Commissioner (Appeals) agreed with the assessee that such products though commercially known as 'scrap' were definitely not "waste and scrap". He further agreed with the contention of the assessee that the items in question were usable as such and, therefore, do not fall within the definition of "scrap" as given in clause (b) of *Explanation* to section 206C(1).

The Tribunal firstly recorded a list of items sold by the assessee from the ship breaking activity. It found that the assessee collected and paid tax, for seven items, but did not collect tax at source on certain items viz. old and used plates; non-excisable (exempted) goods like wood etc. It observed that the 'waste and scrap' must be from manufacture or mechanical working of material which is *definitely not usable as such because of breakage, cutting up, wear and other reasons.* Since the assessee is engaged in ship breaking activity, these items/products are finished products obtained from such activity which are usable as such and hence, are not 'waste and scrap' though commercially known as scrap. Accordingly, the Tribunal also decided the issue in favour of the assessee.

High Court's Decision: The High Court concurred with the views of the Tribunal and held that any material which is usable as such would not fall within the ambit of the expression 'scrap' as defined in clause (b) of the *Explanation* to section 206C.

21. **Is levy of interest under section 234B attracted in a case where the assessment order does not contain any specific direction for payment of interest, but is accompanied by form ITNS 150 containing a calculation of interest payable on tax assessed?**

CIT v. Bhagat Construction Co (P) Ltd (2016) 383 ITR 9 (SC)

Facts of the case: The assessment order passed did not contain any direction for the payment of interest under section 234B. The appellate order also simply stated that interest is payable under section 234B, without any further substantiation. The amount of interest payable under section 234B was contained in the Income-tax Computation Form or 'Form for Assessment of Tax/Refund (I.T.N.S 150)'.

Apex Court's Observations: The Apex Court observed that the facts of the present case are squarely covered by the three judges' bench decision of this court in the case of *Kalyankumar Ray v. CIT (1991) 191 ITR 634,* wherein it was held that the Form I.T.N.S 150 is also a form for determination of tax payable and when it is signed or initialled by the Assessing Officer, it is certainly an order in writing by the Assessing Officer determining the tax payable within the meaning of section 143(3). The said form also contains the calculation of interest payable on the tax assessed. This form must, therefore, be treated as part of the assessment order.

The Supreme Court further observed that the provisions of section 234B are attracted the moment an assessee liable to pay advance tax has failed to pay such tax or the advance tax paid by him is less than 90% of the assessed tax. The assessee, thus, becomes liable to pay simple interest at 1% for every month or part of the month.

Supreme Court's Decision: The Apex Court, accordingly, held that the levy of interest under section 234B is automatic when the conditions specified therein are satisfied and the assessment order is accompanied by the prescribed form containing the calculation of interest payable.

CHAPTER 16

INCOME TAX AUTHORITIES

LEARNING OUTCOMES

After studying this chapter, you would be able to:

❑ **identify** the various income-tax authorities and comprehend the provisions of law relating to their appointment, control and jurisdiction;

❑ **appreciate** the powers of income-tax authorities under the Income-tax Act, 1961;

❑ **examine** the provisions relating to survey, search and seizure and the related powers of various income-tax authorities; **analyse and apply** such provisions to address related issues.

16.1 APPOINTMENT AND CONTROL [SECTIONS 116 TO 119]

(1) **Classes of Income-tax authorities**: The following are the classes of income-tax authorities

(i) The Central Board of Direct Taxes.

(ii) Principal Directors-General of Income-tax or Principal Chief Commissioners of Income-tax.

(iii) Directors-General of Income-tax or Chief Commissioners of Income-tax.

(iv) Principal Directors of Income-tax or Principal Commissioners of Income-tax.

(v) Directors of Income-tax or Commissioners of Income-tax or Commissioners of Income-tax (Appeals).

(vi) Additional Directors of Income-tax or Additional Commissioners of Income-tax or Additional Commissioners of Income-tax (Appeals).

(vii) Joint Directors or Joint Commissioners of Income-tax.

(viii) Deputy Directors of Income-tax or Deputy Commissioners of Income-tax.

(ix) Assistant Directors of Income-tax or Assistant Commissioners of Income-tax.

(x) Income-tax Officers.

(xi) Tax Recovery Officers.

(xii) Inspectors of Income-tax.

(2) **Meaning of "Assessing Officer":** In this connection, it may be noted that under section 2(7A), the term 'Assessing Officer' means –

(i) the Assistant Commissioner or Deputy Commissioner or Assistant Director or Deputy Director; or

(ii) the Income-tax Officer who is vested with the relevant jurisdiction by virtue of directions or orders issued under section 120(1) or (2) or any other provision of the Act; and

(iii) the Additional Commissioner or Additional Director or Joint Commissioner or Joint Director who is directed under section 120(4)(b) to exercise or perform all or any of the powers and functions conferred on, or assigned to, an Assessing Officer.

(3) **Central Board of Direct Taxes (CBDT):** The Central Board of Direct Taxes (CBDT) is a statutory body constituted under the Central Board of Revenue Act, 1963. It consists of a number of members appointed by the Central Government for the performance of such duties, as may be entrusted to the Board from time to time. It is functioning under the jurisdiction of the Ministry of Finance. The CBDT, besides being the highest executive authority, exercises control and supervision over all officers of the Income-tax Department and is authorised to exercise certain powers conferred upon it by the Income-tax Act, 1961. In particular, it has the powers, subject to the control and approval of the Central Government to make any rules, from time to time for the proper administration of the provisions of the Income-tax Act, 1961.

All the rules under the Act are framed by the CBDT under section 295 and placed before the Parliament. In addition to the general power of making rules and of superintendence, the Board has been given specific powers on several matters.

(4) Appointment and Control of Income-tax Authorities [Sections 117 & 118]

(i) Section 117 empowers the Central Government to appoint such persons as it thinks fit to be income-tax authorities.

(ii) It may also authorise the Board or a Principal Director General or Director General, a Principal Chief Commissioner or Chief Commissioner or a Principal Director or Director or a Principal Commissioner or Commissioner to appoint income-tax authorities below the rank of an Assistant Commissioner or Deputy Commissioner.

(iii) An income-tax authority authorised by the CBDT may appoint such executive or ministerial staff as may be necessary to assist it in the execution of its functions.

(iv) Section 118 authorises the CBDT to also direct, by way of notification, that any Income-tax authority or authorities shall be subordinate to such other income-tax authority or authorities, as may be specified.

(5) Instruction to Subordinate Authorities [Section 119]

(i) The CBDT has been empowered under section 119 to issue instructions and circulars to its subordinates for the proper administration of the Act.

(ii) It is obligatory for the various authorities and all other persons employed in the execution of the Act to observe and follow such orders, instructions and directions of the CBDT.

(iii) The CBDT, however, is not empowered to issue orders, instructions or directions in such a way as to –

(1) require any income-tax authority to make the assessment of a particular case in a particular manner; or

(2) interfere with the discretion of the Commissioner (Appeals) in the exercise of his appellate functions.

(iv) The CBDT may, if it considers necessary or expedient to do so, for the purpose of proper and effective management of the work of assessment and collection of revenue, issue general or special orders from time to time in respect of any class of incomes or class of cases setting forth directions and instructions not being prejudicial to the assessee.

(v) In appropriate cases, the CBDT may relax the provisions of sections 115P,115S, 139,143,144, 147, 148, 154, 155, 234A, 234B, 234E, 270A, 271C, 271CA and 273. The CBDT can exercise its powers to remove difficulties in the matter of sections 201(1A), 210, 211 and 234C.

The following table gives a brief glimpse of what these sections relate to –

Section	Particulars of section
115P	Interest payable for non-payment of tax by domestic companies
115S	Interest payable for non-payment of tax on distributed income to unit-holders
139	Return of income
143	Assessment of income
144	Best Judgment Assessment of income
147	Income escaping assessment
148	Issue of notice where income has escaped assessment
154	Rectification of mistake apparent on record
155	Other amendments relating to assessment of income
201(1A)	Interest for non-deduction of tax or non-payment of tax after deduction by such person/principal officer/company, as the case may be.
210	Payment of advance tax by the assessee of his own accord or in pursuance of order of Assessing Officer.
211	Installments of advance tax and due dates
234A	Interest for default in furnishing return of income
234B	Interest for default in payment of advance tax
234C	Interest for deferment of advance tax
234E	Fee for failure to deliver the statement of deduction of tax at source under section 200(3) and for failure to deliver the statement of collection of tax at source under section 206C(3) within the prescribed time.
270A	Penalty for underreporting of income
271C	Penalty for failure to deduct tax at source
271CA	Penalty for failure to collect tax at source
273	Penalty for false estimate of, or failure to pay, advance tax

(vi) The CBDT is empowered to authorise any income-tax authority [not being a Commissioner(Appeals)] by general or special order to admit an application or claim for any exemption, deduction, refund or any other relief under the Act after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of late filing of a return is relatable to a claim arising under the category of "any other relief available under the Act".

16.2 JURISDICTION

(1) Jurisdiction of income-tax authorities [Section 120]

(i) **Income-tax authorities to exercise powers in accordance with CBDT directions [Section 120(1)]:** The income-tax authorities shall exercise all or any of the powers and perform all or any of the functions conferred on, or assigned to, such authorities in accordance with the directions issued by the CBDT for the exercise of such powers and performance of the functions by all or any of those authorities.

(ii) **Deemed directions under section 120(1) by CBDT [Section 120(2)]:** Any income-tax authority, being an authority higher in rank, may exercise the powers and perform the functions of the income-tax authority lower in rank, if so directed by the CBDT. Such direction issued by the CBDT shall be deemed to be a direction issued under the said section 120(1).

(iii) **Criteria for issue of directions [Section 120(3)]:** In issuing such directions, the Board may have regard to the following criteria:

(a) Territorial area.

(b) Persons or classes of persons.

(c) Incomes or classes of incomes.

(d) Cases or classes of cases.

(iv) **CBDT authorisation assigning functions [Section 120(4)]:** The CBDT may authorise any Principal Director General or Director General or Principal Director or Director of Income-tax to perform such functions of any other income-tax authority as may be assigned to him. Such authorisation may be through a general or special order.

The CBDT can empower the Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner to issue orders in writing to the effect that the powers and functions conferred on or assigned to the Assessing Officer under this Act in respect of any specified area or person or class of person or persons or incomes or classes of income or cases or classes of cases shall be exercised or performed by an Additional Commissioner or Additional Director or a Joint Commissioner or Joint Director.

The CBDT or any other authority authorised in this behalf can confer jurisdiction with more than one income-tax authority in relation to any case.

(2) Jurisdiction of Assessing Officers [Section 124]

(i) **Persons in respect of whom Assessing Officer has jurisdiction:** Where the Assessing Officer has been vested with jurisdiction over any area within the limits of such area, he shall have jurisdiction:

(a) in respect of any person carrying on business or profession within that area or in respect of a person whose business or profession is carried on in more than one place, if his principal place of business is in that area and

(b) in respect of any other person residing within the area.

(ii) **Income-tax Authorities higher in rank to determine question of Assessing Officer's jurisdiction:** Where a question arises under this section as to whether an Assessing Officer has jurisdiction to assess any person the question shall be determined by the Principal Director General or Director General or the Principal Chief Commissioner or Chief Commissioners or Principal Commissioner or Commissioner.

In case the question relates to an area within the jurisdiction of different Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioners or Principal Commissioner or Commissioner then the question shall be determined by the Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner concerned or if they are not in agreement, then the same shall be determined by the Board or by such Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner as the Board may specify by way of notification in the Official Gazette.

(iii) **Time limit for calling in question jurisdiction of the Assessing Officer:**

S. No.	Case	Time Limit
(a)	Where a return of Income has been filed under section 139(1)	One month from the date of service of notice under section 142(1) or 143(2) or completion of assessment, whichever is earlier.
(b)	Where no return of income has been filed	Time allowed by notice under section 142(1) or 148 for filing return of income or by notice under section 144 to show cause why the best judgement assessment should not be made, whichever is earlier.
(c)	Where search is initiated under section 132 or books of accounts or other documents or any assets are requisitioned under section 132A	One month from the date on which notice was served under section 153A(1) or 153(2) or completion of assessment, whichever is earlier.

(iv) **Assessing Officer may refer matter for determination:** Where the assessee questions the jurisdiction of an Assessing Officer, then, the Assessing Officer shall, if not satisfied with the correctness of the claim refer the matter for determination under (ii) above before the assessment is made.

(v) **Jurisdictional Powers of Assessing Officer:** Every Assessing Officer shall have all the powers conferred by or under this Act on an Assessing Officer in respect of the income accruing or arising or received within the area, if any, over which he has been vested with jurisdiction by virtue of the direction or order issued under section 120(1) and 120(2).

(3) Power to transfer cases [Section 127]

(i) **Authorities empowered to transfer cases from one Assessing Officer to another:** The power to transfer a case from one Assessing Officer to another subordinate Assessing Officer or Officers is vested with the Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Commissioner or Principal Commissioner of Income-tax. However, this power can be exercised only after giving the assessee a reasonable opportunity of being heard and after recording reasons for doing so, wherever possible.

(ii) **Mutual agreement between higher authorities to transfer cases:** There may be situations where the Assessing Officer from whom the case is transferred and the Assessing Officer to whom the case is transferred do not fall under the control of the same Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Commissioner or Principal Commissioner of Income-tax. In such cases, the Principal Director General or Director General of Principal Chief Commissioner or Chief Commissioner or Commissioner or Principal Commissioner of Income-tax from whose jurisdiction the case is transferred shall pass an order, if such concerned higher authorities mutually agree for such transfer.

If the higher authorities are not in agreement about the transfer, then, the CBDT or any such authority authorized by the Board may pass the order.

(iii) **No requirement of giving opportunity to be heard in certain cases:** If the case is transferred between Assessing Officers within the same city or locality or place, then, it is not necessary to give the assessee an opportunity of being heard.

(iv) **Re-issue of notice not required:** The transfer of a case may be made at any stage of the proceedings and it is not necessary to re-issue any notice already issued.

(v) **Meaning of 'Case':** For the purpose of section 120 and section 127, "case" in relation to any person whose name is specified in any order or direction issued thereunder, means all proceedings under this act in respect of any year which may be pending on the date of such order or direction or which may have been completed on or before such date, and includes also all proceedings under this act which may be commenced after the date of such order or direction in respect of any year.

(4) **Change of Income-tax Authority [Section 129]**

(i) **Stage from which the succeeding Income-tax authority would continue:** In cases where an income-tax authority succeeds another income-tax authority, who ceases to exercise jurisdiction, then, the succeeding income-tax authority may continue the proceedings from the stage at which the proceedings was left by his predecessor.

(ii) **Opportunity to be reheard:** The assessee concerned may demand that before continuance of proceedings as in (i) above, the previous proceedings or any part thereof be reopened or be reheard before passing of any assessment order against him.

16.3 POWERS OF INCOME TAX AUTHORITIES [SECTIONS 131 TO 136]

(1) **Discovery, production of evidence etc. [Section 131]**

(i) **Income-tax Authorities to have powers vested in a Civil Court in certain matters [Section 131(1)]:** The Assessing Officer, Deputy Commissioner (Appeals), Joint Commissioner, Commissioner (Appeals), the Principal Chief Commissioner or Chief Commissioner and the Dispute Resolution Panel referred to in section 144C have the powers vested in a Civil Court under the Code of Civil Procedure, 1908 while dealing with the following matters:

(a) discovery and inspection;

(b) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;

(c) compelling the production of books of account and documents; and

(d) issuing commissions

The powers aforementioned are normally those exercisable by a Court when it is trying a suit. While exercising these powers, the authorities act in a quasi-judicial capacity and ought to conform to the principles of judicial procedure.

(ii) **Powers under section 131(1) to be exercised in certain cases, even if no proceeding is pending [Section 131(1A)/(2)]:**

(a) If the Principal Director General or Director General or Principal Director or Director or Joint Director or Assistant Director or Deputy Director or the authorized officer referred to in section 132(1), before he takes action under the said sub-section, has reason to suspect that any income has been concealed, or is likely to be concealed, by any person or class of persons, within his jurisdiction, then for the purposes of making an enquiry or investigation relating thereto, it shall be competent for him to exercise the powers conferred in section 131(1) on the income-tax authorities referred to therein, even if no proceedings with respect to such person or class of persons are pending before him or any other income-tax authority.

(b) For facilitating quick collection of information on request from tax authorities outside India, notified income-tax authorities (not below the rank of Assistant Commissioner of Income-tax), as may be notified by the Board, to have powers under section 131(1) for making an inquiry or investigation in respect of any person or class of persons relating to an agreement for exchange of information under section 90 or 90A, even if no proceeding is pending before it or any other income-tax authority with respect to the concerned person or class of persons.

(iii) Power to impound or retain books of accounts [Section 131(3)]: The income-tax authority is vested with the power to impound or retain in its custody for such period as it may think fit, any books of account or other documents produced before it in any proceeding under this Act.

The powers are unrestricted in the case of all the authorities except the Assessing Officer or an Assistant Director or Deputy Director whose powers are subjected to two restrictions;

(a) he must record his reasons for impounding books of account or other documents; and

(b) if he desires to retain in his custody any such books or documents for a period exceeding 15 days (excluding holidays), he must obtain the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Commissioner or Principal Commissioner or Principal Director or Director, as the case may be, for the purpose.

(2) Search and Seizure [Section 132]: Under this section, wide powers of search and seizure are conferred on the income-tax authorities.

The provisions of the Criminal Procedure Code relating to searches and seizure would, as far as possible, apply to the searches and seizures under this Act. Contravention of the orders issued under this section would be punishable with imprisonment and fine under section 275A.

(i) Authorities empowered to issue authorisation [Section 132(1)]: Search and seizure can be authorised by Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Commissioner or Principal Commissioner or Additional Director or Additional Commissioner or any such Joint Director or Joint Commissioner as may be empowered by the Board.

A Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may authorise any Joint Director, Joint Commissioner, Additional

Director or Additional Commissioner, Assistant Director, or Deputy Director, Assistant Commissioner or Deputy Commissioner or Income-tax Officer.

An Additional Director or Additional Commissioner, Joint Director or Joint Commissioner can authorise Assistant Director or Deputy Director or Assistant Commissioner or Deputy Commissioner or Income-tax Officer.

Thus, under section 132(1), the income-tax authorities listed above are empowered to authorise other income-tax authorities to conduct search and seizure operations.

The authorities empowered to issue authorization are:

(1) Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner;

(2) Principal Director or Director or Principal Commissioner or Commissioner; and

(3) Such Additional Director or Additional Commissioner, Joint Director or Joint Commissioner as are empowered by the CBDT to do so.

(ii) 'Reasons to believe' pre-requisite for authorisation [Section 132(1)]: Such authorisation could take place if the authority believes, on the basis of information in his possession:

(a) that the person to whom a summons under section 131(1) or notice under section 142(1) was issued to produce or cause to produce books of account or other documents has omitted or failed to do so; or

(b) that a person to whom a summons or a notice has been or might be issued, does not or would not produce any books of account or other documents called for or which will be useful or relevant to any proceeding under the Income-tax Act, 1961; or

(c) that a person who is in possession of any valuable articles or things, including money, bullion or jewellery etc. (which has not been disclosed or would not be disclosed by the person concerned for income-tax purposes).

However, the reason to believe, as recorded by the income-tax authority, shall not be disclosed to any person or any authority or the Appellate Tribunal.

(iii) Powers of Authorised Officer [Section 132(1)]

(a) Power to seize money, books of accounts etc.: Such an authorisation can empower the authorised officer to enter any building or place or vehicle, vessel or aircraft where he has reasons to suspect that such books of account, documents, articles including money, jewellery, valuables etc. are kept and in case they are found, he may seize them, place marks of identification on them or make a note or inventory thereof for the purpose.

However, any bullion, jewellery or other valuable article or thing, which is in the nature of stock-in-trade of the business, found as a result of search shall not be seized but the authorised officer shall make a note or inventory of such stock-in-trade of the business.

The person who is in possession or control of books of account or other documents maintained in the form of electronic records, shall be required to afford the necessary facility to authorised officer to inspect all such books of account or other documents.

Electronic record as defined in section 2(1)(t) of the Information Technology Act, 2000 means data, record or data generated, image or sound stored, received or sent in an electronic form or microfilm or computer generated microfile.

In the discharge of such a duty, he is authorised to break open the locks in case keys are not readily available. However, the books of account and other documents seized should be returned within a period of 30 days from the date of the order of assessment under section 153A, unless the reasons for retaining the same are recorded and approved by the Principal Chief Commissioner or Chief Commissioner or Commissioner or Principal Commissioner or Principal Director General or Director General or Principal Director or Director. The books or other records cannot be retained for a period exceeding 30 days after the assessment proceedings for the relevant year are over. The persons from whose custody any books of account or other documents have been seized may make copies thereof or take extracts therefrom [Section 132(8)].

(b) **Powers exercisable if there is 'reason to suspect' concealment:** The examination of any person may be not merely in respect of any books of account, other documents or assets found as a result of the search but also in respect of all matters relevant for the purposes of any investigation under the Act.

The Authorised Officer is empowered to search any person in or about the building or place in respect of which a search has been authorised, if he has reason to suspect that any article for which the search is being made is concealed about his person. This Authorised Officer is also entitled to search any person who has got out of or is able to get into or is in the building, place, vessel, vehicle or aircraft in respect of which a search has been authorised, if he has reason to suspect that such person has secreted about his person any books of account or other documents, money, bullion, jewellery or other valuable articles for which the search is being made.

However, the reason to suspect, as recorded by the income-tax authority, shall not be disclosed to any person or any authority or the Appellate Tribunal.

(c) **Power exercisable outside jurisdiction, if delay would be prejudicial to the interests of the revenue:** The Commissioner or Principal Commissioner of Income-tax has the power to authorise the search of any building, place, vessel, vehicle, aircraft etc., within his territorial jurisdiction and also in cases where he has no jurisdiction over the persons concerned, if he has reason to believe that any delay in obtaining authorisation from the Commissioner or Principal Commissioner having jurisdiction over the person would be prejudicial to the interests of revenue.

(d) **Authorisation for search in other place not specified in the warrant:** Where a search for any books of account or other documents or assets has been authorised by any authority who is competent to do so, and the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner has reason to suspect that such books of account or the documents of the assessee are kept in any building, place, vessel, vehicle or aircraft not specified in the search warrant, he may authorise the authorised officer to search such other building, place, vessel, vehicle or aircraft. Accordingly, if a search warrant is issued by the Principal Commissioner or Commissioner of Income-tax, authorising the search of a premises in a particular place specified in the search warrant and the Authorised Officer finds that the books of account or other documents and/or assets have been secreted in a building or place not specified in the search warrant, he could request the local Commissioner to authorise him to search that building or place.

(iv) **Rebuttable presumption [Section 132(4A)]:** Now there is a rebuttable presumption to the effect that the books of account or other documents and assets found in the possession of any person in the course of a search belong to such person and also that the contents of such books of account and other documents are true and that the signature and every other part of such books of account and other documents are in hand-writing of the persons who can reasonably be assumed to have signed or written the books of account or other documents.

(v) **Deemed Seizure:** Where it is not possible or practicable to take physical possession of any valuable article or thing and remove it to a safe place due to its volume, weight or other physical characteristics or due to its being of a dangerous nature, the Authorised Officer may serve an order on the owner or the person who is in immediate possession thereof that he shall not remove, part with or otherwise deal with it except with the previous permission of such authorised officer and such action of the Authorised Officer shall be deemed to be seizure of such valuable article or thing. This is called a restraint order. However, such a deeming seizure would not apply to stock-in-trade of the business.

(vi) **Order not to remove books of account etc. without prior permission of Authorised Officer [Section 132(8A)]:** The authorised officer may, where it is not practicable to seize any such books of account, other documents, money, bullion, jewellery or other valuable article or thing (for reasons other than those mentioned in (viii) above] serve an order on the owner or the person who is in immediate possession or control thereof that he shall not remove, part with or otherwise deal with it except with the previous permission of such officer and such officer may take such steps as may be necessary for ensuring compliance with this sub-section. However, serving of such an order shall not be deemed to be seizure of such valuable article or thing. Such order shall not be in force for a period exceeding 60 days from the date of the order.

(vii) **Making copies and taking extracts of books of account permitted [Section 132(9)]:**The person from whose custody any books of account or other documents are seized under sub-section (1) or sub-section (1A) may make copies thereof, or take extracts therefrom, in the presence of the authorized officer or any other person empowered by him in this behalf, at such place and time as the authorized officer may appoint in this behalf.

(viii) **Time limit for handing over books of account etc. to jurisdictional Authorised Officer [Section 132(9A)]:** Where the authorized officer has no jurisdiction over the person referred to in clause (a) or clause (b) or clause (c) of point (ii) above, the books of account or other documents, or any money, bullion, jewellery or other valuable article or thing seized under that sub-section shall be handed over by the Authorised Officer to the Authorised Officer having jurisdiction over such person within a period of 60 days from the date of which the last of the authorizations for search was executed and thereupon the powers exercisable by the authorized officer under sub-section (8) or sub-section (9) shall be exercisable by such Assessing Officer.

(ix) **Provisional attachment of property [Section 132(9B)]:** For the purpose of protecting the interest of the revenue and safeguarding recovery in search cases, the authorized officer during the course of search or seizure or within a period of **sixty days** from the date on which the last of the authorisations for search was executed is satisfied for reasons to be recorded in writing, it is necessary so to do, he may with the prior approval of the Principal Director General or Director General or the Principal Director or Director, by order in writing, attach provisionally any property belonging to the assessee

(x) **Period of provisional attachment [Section 132(9C)]:** Every provisional attachment made under sub-section (9B) shall cease to have effect **after the expiry of a period of six months** from the date of the order referred to in sub-section (9B).

(xi) **Reference to Valuation Officer [Section 132(9D)]:** The authorised officer may, during the course of the search or seizure or within a period of 60 days from the date on which the last of the authorisations for search was executed, make a reference to a Valuation Officer referred to in section 142A, who shall estimate the fair market value of the property in the manner provided under that section and submit a report of the estimate to the said officer within a period of 60 days from the date of receipt of such reference.

For the purpose of subsection (9A)/(9B)/(9D) of section 132 authorisation is deemed to have been executed on the conclusion of search as recorded in the last panchnama drawn in relation to any person in whose case the warrant of authorisation has been issued. [Section 153B(2)]

(xii) Request by person for return of books of account [Section 132(10)]: If a person, legally entitled to the books of account or other documents seized, objects for any reason to the approval given by the Principal Chief Commissioner or Chief Commissioner, Commissioner or Principal Commissioner, Principal Director General or Director General or Principal Director or Director to extend the period of retention of the same by the Assessing Officer beyond 30days, he may make an application to the Board stating therein the reasons for such objection and requesting for the return of the books of account or other documents and the Board may, after giving the applicant an opportunity of being heard, pass such orders as it thinks fit.

(xiii) Rules providing for procedure to be followed by Authorised Officer [Section 132(14)]: The Board may make rules in relation to any search or seizure under this section; in particular, and without prejudice to the generality of the foregoing power, such rules may provide for the procedure to be followed by the Authorised Officer—

(a) for obtaining ingress into any building, place, vessel, vehicle or aircraft to be searched where free ingress thereto is not available;

(b) for ensuring safe custody of any books of account or other documents or assets seized.

(xiv) Meaning of 'Proceeding' [*Explanation 2* below Section 132]: For the purpose of this section, the word "proceeding" means any proceeding in respect of any year under this Act, which may be pending on the date on which a search is authorised under this section or which may have been completed on or before such date and includes also all proceedings under this Act which may be commenced after such date in respect of any year.

(3) Power to requisition books of account etc. [Section 132A]

(i) Requirement of "reasons to believe" for requisition of books of account [Section 132A(1)]: Where the Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner on the basis of information in his possession, has reason to believe that-

(a) any person to whom a summons under section 131(1) or a notice under section 142(1) was issued to produce, or cause to be produced, any books of account or other documents has omitted or failed to produce, or cause to be produced, such books of account or other documents, as required by such summons or notice and the said books of account or other documents have been taken into custody by any officer or authority under any other law for the time being in force, such as, by the Collector of Customs, the Sales-tax Commissioner etc. or

(b) any books of account or other documents will be useful for, or relevant to, any proceeding under this Act and any person to whom a summons or notice as aforesaid has been or might be issued will not, or would not, produce or cause to be produced, such books of account or other documents on the return of such books of account or other documents by any officer or authority by whom or which such books of account or other documents have been taken into custody under any other law for the time being in force, such as, by the Collector of Customs, the Sales-tax Commissioner etc. or

(c) any assets represent either wholly or partly income or property which has not been, or would not have been, disclosed for the purposes of this Act by any person from whose possession or control such assets have been taken into custody by any officer or authority under any other law for the time being in force, such as, by the Collector of Customs, the Sales-tax Commissioner etc.

then, the Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Commissioner or Principal Commissioner may authorise any Additional Director, Additional Commissioner, Joint Director Joint Commissioner, Assistant Director or Deputy Director, Assistant Commissioner, Deputy Commissioner or Income-tax Officer (referred to as the requisitioning officer) to require the officer or authority under any other law referred above, as the case may be, to deliver such books of account, other documents or assets to the requisitioning officer.

However, the reason to believe, as recorded by the income-tax authority, shall not be disclosed to any person or any authority or the Appellate Tribunal.

Clarificatory provision for non-disclosure of reason to believe or reason to suspect recorded by the Income-tax Authorities

✓ The need for this clarification arose because the Commissioner of Income-tax & Benches of the Income-tax Appellate Tribunal, in the context of appeals before them, started demanding copies of reasons to believe in search, seizure and requisition cases, which the Income Tax Department has not been giving to them on ground of secrecy.

✓ Though there are some decisions wherein it has already been held that search cannot be held invalid on the ground that reasons to believe not disclosed to assessee, the said amendment provides statutory recognition to such decisions so as to avoid any further litigation on the issue. These decisions are:

(i) In *M.S. Associates v. Union of India (2005) 275 ITR 502 (Gau),* it was observed that revenue authorities are not required to disclose to the person

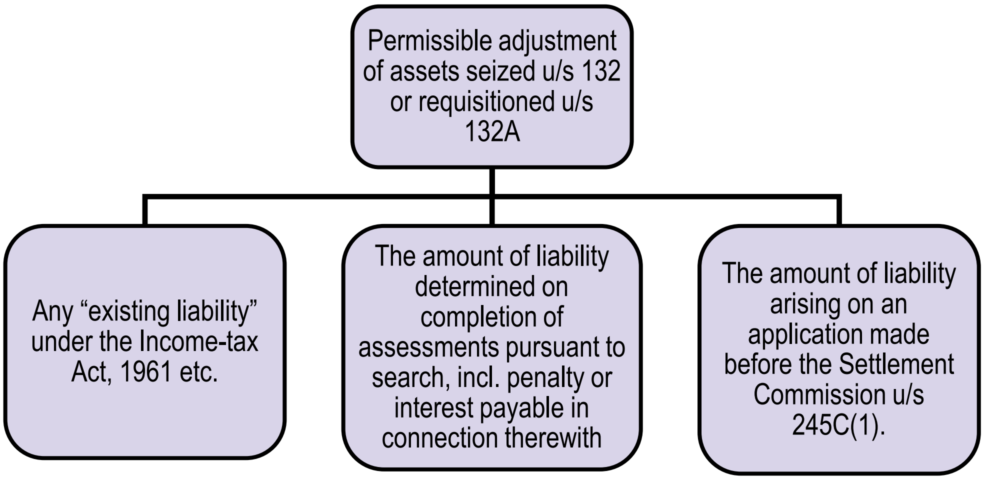
> challenging the warrant of authorisation as to what materials were available against him, which had led to the issuance of the warrant. It is required to be disclosed only when the authorities concerned resolve to impose tax or penalties.
>
> (ii) In *Genom Biotech (P) Ltd. & Ors. v. Director of IT (Investigation) & Ors. (2009) 180 Taxman 395 (Bom),* it was observed that it is not the mandate of section 132 or any other provision in the Act that the reasonable belief recorded by the designated authority before issuing the warrant of authorisation must be disclosed to the assessee.

(ii) **Delivery of books of accounts to the Requisition Officer [Section 132A(2)]:** On a requisition being made under (i), the officer or authority under any other law referred above, as the case may be, shall deliver the books of account, other documents or assets to the requisitioning officer either forthwith or when such officer or authority is of the opinion that it is no longer necessary to retain the same in his or its custody.

(iii) **Certain search provisions to apply in case of requisition also [Section 132A(3)]:** Where any books of account, other documents or assets have been delivered to the requisitioning officer, the provisions of sections 132(4A) to 132(14) and section 132B shall, so far as may be, apply as if such books of account, other documents or assets had been seized under section 132(1) by the requisitioning officer from the custody of the concerned person and for the words "the Authorised Officer" occurring in any of the above mentioned sections, the words "the requisitioning officer" were substituted.]

(4) Application of retained assets [Section 132B]

(i) **Permissible adjustment of assets seized or requisitioned [Section 132B(1)(i)]:** The permissible adjustment of assets seized under section 132 or requisitioned under section 132A are shown below:


Permissible adjustment of assets seized u/s 132 or requisitioned u/s 132A
Any “existing liability” under the Income-tax Act, 1961 etc.
The amount of liability determined on completion of assessments pursuant to search, incl. penalty or interest payable in connection therewith
The amount of liability arising on an application made before the Settlement Commission u/s 245C(1).

Note - "**Existing liability**" does **not** include **advance tax payable** in accordance with the provisions of Part C of Chapter XVII of the Income-tax Act, 1961.

(ii) **Manner of application of assets seized [Section 132B(1)(ii)/(iii)]:** If the assets consist solely of money or partly of money and partly of other assets, the Assessing Officer may apply the money in discharge of the liabilities mentioned above. The assessee shall be discharged to the extent of the money so applied.

The assets other than money may also be applied for the discharge of such liabilities which still remains undischarged. For this purpose, such assets shall be deemed to be under distraint, as if such distraint was effected by the Assessing Officer or, as the case may be, the Tax Recovery Officer under authorization from the Principal Chief Commissioner or Chief Commissioner or Commissioner or Principal Commissioner under section 226(5). The Assessing Officer or the Tax Recovery Officer, as the case may be, may recover the amount of such liabilities by the sale of such assets in the manner laid down in the Third Schedule.

(iii) **Release of seized asset [Section 132B(4)]:** Where the person concerned makes an application to the Assessing Officer within 30 days from the end of the month in which the asset was seized, for release of the asset and explains the nature and source of acquisition of seized assets is explained satisfactorily, then, such assets are required to be released within a period of 120 days from the date on which last of the authorisations for search under section 132 is executed after meeting any existing liabilities. The assessee shall be entitled to simple interest at ½ % per month or part of a month, if the amount of assets seized exceeds the liabilities eventually, for the period immediately following the expiry of 120 days from the date on which the last of the authorisations for search under section 132 or requisition under section 132A was executed to the date of completion of the assessment under section 153A or under Chapter XIV-B.

(5) Power to call for information [Sections 133]

(i) **Details of information to be furnished by different persons:** The Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals)] may call for following information from the following persons for the purposes of this Act-

S. No.	Person	Information to be furnished
(a)	Firm	The names and addresses of the partners of the firm and their respective shares.
(b)	Hindu undivided family	The names and addresses of the manager and the members of the family.
(c)	A trustee,	The names of the persons for or of whom he is trustee,

	guardian or agent	guardian or agent, and of their addresses.
(d)	Any assessee	A statement of the names and addresses of all persons to whom he has paid in any previous year rent, interest, commission, royalty or brokerage, or any annuity, not being any annuity taxable under the head "Salaries" amounting to more than one thousand rupees, or such higher amount as may be prescribed], together with particulars of all such payments made.
(e)	Any dealer, broker or agent or any person concerned in the management of a stock or commodity exchange	A statement of the names and addresses of all persons to whom he or the exchange has paid any sum in connection with the transfer, whether by way of sale, exchange or otherwise, of assets, or on whose behalf or from whom he or the exchange has received any such sum, together with particulars of all such payments and receipts.
(f)	Any person, including a banking company or any officer thereof	Information in relation to such points or matters, or statements of accounts and affairs verified in the manner specified by the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), giving information in relation to such points or matters as, in the opinion of the Assessing Officer, the Deputy Commissioner (Appeals)], the Joint Commissioner or the Commissioner (Appeals)], will be useful for, or relevant to, any enquiry or proceeding under this Act.

(ii) **Exercise of power by the Income-tax authorities:** Under the existing provisions of section 133(6), the prescribed authorities have the power to call for any information from any person which will be useful for or relevant to any proceedings under the Act. Such powers may also be exercised by the Director-General, the Principal Chief Commissioner or Chief Commissioner, the Principal Director or Director or the Principal Commissioner or Commissioner or the Joint Director or Deputy Director or Assistant Director. Further, the power in respect of an inquiry, in a case where no proceeding is pending, shall not be exercised by any income-tax authority below the rank of Principal Director or Director or Commissioner or Principal Commissioner other than the Joint Director or Deputy Director or Assistant Director without the prior approval of the Principal Director or Director or as the case may be, the Commissioner or Principal Commissioner.

For facilitating quick collection of information on request from tax authorities outside India, notified income-tax authorities (not below the rank of Assistant Commissioner of Income-tax) to have powers under section 131(1) for making an inquiry or investigation in respect of any person or class of persons relating to an agreement for exchange of information under section 90 or 90A, even if no proceeding is pending before it or any other income-tax authority with respect to the concerned person or class of persons. Such notified authorities are also empowered, for the purposes of an agreement referred to in section 90 or section 90A, to exercise the powers conferred under section 133 to call for information, irrespective of whether any proceedings are pending before it or any other income-tax authority.

(6) Power of Survey [Section 133A]

(i) **Power to enter a place within jurisdiction to inspect books of account, to verify cash, stock etc. [Section 133A(1)]:** An income-tax authority may enter any place:

(a) within the limits of the area assigned to him, or

(b) any place occupied by any person in respect of whom he exercises jurisdiction, or

(c) any place in respect of which he is authorised for the purposes of this section by such income-tax authority, who is assigned the area within which such place is situated or who exercises jurisdiction in respect of any person occupying such place

at which a business or profession or an activity for charitable purpose is carried on, whether such place be the principal place or not of such business or profession or of such activity for charitable purpose, and require any proprietor, trustee, employee or any other person who may at that time and place be attending in any manner to, or helping in, the carrying on of such business or profession or such activity for charitable purpose. This power may be exercised:

(a) to afford him the necessary facility to inspect such books of account or other documents as he may require and which may be available at such place;

(b) to afford him the necessary facility to check or verify the cash, stock or other valuable articles or things which may be found therein; and

(c) to furnish such information as he may require as to any matter which may be useful for or relevant to any proceeding under the Income-tax Act, 1961.

This power may be exercised in respect of any place with which the assessee is connected, whether or not such place is the principal place of business or profession or activity for charitable purpose. It will also include any other place, whether any business or profession or activity for charitable purpose is carried on therein or not, in which the person carrying on the business or profession or activity for charitable purpose states that any of his books of account or other valuable article or thing relating to his business or profession or activity for charitable purpose are kept.

(ii) **Permitted time for conduct of survey [Section 133A(2)]:** The income-tax authority may enter any place of business or profession mentioned above only during the hours at which such place is open for the conduct of business or profession and in the case of any other place, only after sunrise and before sunset**.**

(iii) **Powers of an income-tax authority while conducting survey [Section 133A(3)]: The income-tax authority exercising this power of survey may:**

(a) place marks of identification, if he finds it necessary, on the books of account or other documents inspected by him and make or cause to be made extracts or copies therefrom;

(b) impound and retain in his custody for such period as he thinks fit any book of account or other documents inspected by him after recording reasons for doing so.

However, the income tax authority cannot retain in his custody such books of account etc. for a period exceeding 15 days (excluding holidays) without obtaining the approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or the Principal Commissioner or Commissioner or Principal Director or Director, as the case may be.

(c) make an inventory of any cash, stock or valuable article or thing checked or verified by him; and

(d) record the statements of any person which may be useful for or relevant to any proceedings under the Income-tax Act, 1961.

However, the income-tax authority cannot remove or cause to be removed from the place where he has entered, any cash, stock or other valuable article or thing **[Section 133A(4)]**.

(iv) **Exercise of power of survey for verification of TDS/TCS [Section 133A(2A)]:** An income-tax authority may, for the purpose of verifying that tax has been deducted or collected at source in accordance with the provisions of Chapter XVII-B or Chapter XVII-BB, as the case may be, enter-

(a) any office, or a place where business or profession is carried on, within the limits of the area assigned to him, or

(b) any such place in respect of which he is authorised for the purposes of this section by such income-tax authority who is assigned the area within which such place is situated, where books of account or documents are kept.

The income-tax authority may for this purpose enter an office, or a place where business or profession is carried on after sunrise and before sunset. Further, such income-tax authority may require the deductor or the collector or any other person who may at the time and place of survey be attending to such work,—

(a) to afford him the necessary facility to inspect such books of account or other documents as he may require and which may be available at such place, and

(b) to furnish such information as he may require in relation to such matter.

(v) **Permissible and impermissible acts while conducting survey [Section 133A(3)]: An income-tax authority may -**

(a) place marks of identification on the books of account or other documents inspected by him and take extracts and copies thereof;

(b) record the statement of any person which may be useful for, or relevant to, any proceeding under the Act.

However, while acting under sub-section (2A), the income-tax authority shall not impound and retain in his custody, any books of account or documents inspected by him or make an inventory of any cash, stock or other valuable articles or thing checked or verified by him.

(vi) **Power to collect information and record statements [Section 133A(5)]:** The income-tax authorities would also have the power to collect information and record the statements of any of the persons concerned at any time after any function, ceremony or event even before the stage of commencement of assessment proceedings for the following year for which the information may be relevant, if they are of the opinion that having due regard to the nature, scale and extent of the expenditure incurred, it is necessary to do so. This provision is intended to help in collecting evidence about ostentatious expenditure immediately after the event to be used at the time of the assessment.

(vii) **Power to enforce compliance [Section 133A(6)]:** If any person who is required to provide facility to the income-tax authority to inspect the books of account or the other documents or to check or verify any cash, stock or other valuable articles or to furnish any information or to have his statement recorded, either refuses or evades do so, the income-tax authority would be entitled to use all the powers vested in it under section 131(1) for enforcing proper compliance with the requirements. However, no action under sub-section (1) shall be taken by the Assistant Director or a Deputy Director or an Assessing Officer or a Tax Recovery Officer or an Inspector of Income-tax except with the prior approval of the Joint Director or the Joint Commissioner, as the case may be.

(viii) **Meaning of 'proceeding':** For the purpose of this section, “proceeding" means any proceeding under this Act in respect of any year which may be pending on the date on which the powers under this section are exercised or which may have been completed on or before such date and includes also all proceedings under this Act which may be commenced after such date in respect of any year.

(7) Power to collect certain information [Section 133B]

(i) Under this section, an income-tax authority may enter any building or place (at which a business or profession is carried on) within its jurisdiction or any building or place (at which a business or profession is carried on) which is occupied by any person in respect of whom the said authority exercises jurisdiction for the purpose of collecting any information which may be useful for or relevant for the purposes of the Act. It is not necessary that such a place should be the principal place of the business or profession.

(ii) The authority may require any proprietor, employee or any other person who may at the time and place be attending in any manner to or helping in carrying on such business or profession to furnish such information as may be prescribed.

(iii) An income-tax authority may enter any place of business or profession referred to above only during the hours at which such place is open for business.

(iv) Such authority shall on no account remove or cause to be removed from the building or place wherein he has entered any books of account or other valuable articles or things.

(v) In this section, income-tax authority means a Joint Commissioner, an Assistant Director or Deputy Director or an Assessing Officer, and includes an Inspector of Income-tax who has been authorised by the Assessing Officer to exercise the power conferred under this section in relation to the area in respect of which the Assessing Officer exercises jurisdiction or any part thereof.

(8) Prescribed income-tax authorities empowered to call for information [Section 133C]

(i) Section 133C enables the prescribed income-tax authority to verify the information in its possession relating to any person.

(ii) Under this section, for the purposes of verification of information in its possession relating to any person, prescribed income-tax authority, may, issue a notice to such person requiring him,

- on or before a date to be therein specified,
- to furnish information or documents,
- verified in the manner specified therein
- which may be useful for, or relevant to, any inquiry or proceeding under the Act.

(iii) The prescribed income-tax authority may process such information or documents received from the assessee and make available the outcome of such processing to the Assessing Officer.

(iv) The CBDT may make a scheme for centralised issuance of notice and for processing of information or documents and making available the outcome of the processing to the Assessing Officer.

(v) The term “proceeding” means any proceeding under the Act in respect of any year which may be pending on the date on which the powers under this section are exercised or which may have been completed on or before such date. The term “proceeding” also includes all proceedings under the Income-tax Act, 1961 which may be commenced after such date in respect of any year.

(9) **Power to inspect registers of companies [Section 134]:** The Assessing Officer, the Joint Commissioner or the Commissioner (Appeals), or any person subordinate to him authorised in writing in this behalf by the Assessing Officer, the Joint Commissioner or the Commissioner (Appeals), as the case may be, may inspect and if necessary, take copies, or cause copies to be taken, of any register of the members, debenture holders or mortgagees of any company or of any entry in such register.

(10) **Other powers [Sections 135 and 136]:** The Principal Director General or Director General or Principal Director or Director, the Principal Chief Commissioner or Chief Commissioner or Commissioner or Principal Commissioner and the Joint Commissioner are competent to make any enquiry under this act and for all purposes they shall have the powers vested in an Assessing Officer in relation to the making of enquiries.

If the Investigating officer is denied entry into the premises, the Assessing Officer shall have all the powers vested in him under sections 131(1) and (2). All the proceedings before Income-tax authorities are judicial proceedings for purposes of section 196 of the Indian Penal Code, 1860, and fall within the meaning of sections 193 and 228 of the Code.

An income-tax authority shall be deemed to be a Civil Court for the purposes of section 195 of the Criminal Procedure Code, 1973.

(11) **Disclosure of information respecting assessees [Section 138]**

(i) Under section 138(1)(a), the CBDT, or any other income-tax authority specified by it by a general or special order, may furnish or cause to be furnished, any information received or obtained by any income-tax authority, in the performance of his functions under the Act which may be necessary for the purpose of enabling any officer, or authority or body performing any function:

(a) under any law relating to the imposition of any tax, duty or cess or to dealings in foreign exchange

(b) under any other law as the Central Government may notify in the Official Gazette in the public interest.

As per section 138(1)(b), if a person makes an application in accordance with Rule 113 of the Income-tax Rules, 1962 to the Principal Chief Commissioner or Chief Commissioner or the Commissioner or Principal Commissioner of Income-tax in the prescribed form for obtaining any information relating to any assessee received or obtained by any income-tax authority in the performance of his functions under the Income-tax Act, 1961, the Principal Chief Commissioner or Chief Commissioner or

Commissioner or Principal Commissioner, may, if he is satisfied that it is in the public interest, furnish or cause to be furnished the information asked for. His decision in this regard cannot be called in question in any court of law. Nevertheless, section 138(2) empowers the Central Government to direct, having regard to practice and usage customary or otherwise, and any other relevant factors, that no information or documents shall be furnished or produced by a public servant in respect of such matters relating to a particular class of assessees or except to certain authorities which may be specified.

(ii) For instance, in exercise of the powers conferred by section 138(2), the Central Government having regard to all the relevant factors, has directed, vide *Notification No.56/2016 dated 6.7.2016,* that no public servant shall produce before any person or authority any such document or record or any information or computerised data or part thereof as comes into his possession during the discharge of official duties in respect of a valid declaration made under 'the Income Declaration Scheme, 2016', contained in Chapter IX of the Finance Act, 2016.

(iii) It may be observed that, under section 138, the Principal Commissioner or Commissioner can make a disclosure on the basis of an application made to him; he cannot volunteer to give the information.

EXERCISE

Question 1

Rajesh regularly files his return of income electronically. While he was trying to upload his return of income for assessment year 2019-20 on 31st August, 2019 (extended due date), last date for filing the same, he found it extremely difficult to do the same due to network problems and ultimately he became successful in making e-filing of his return only at 1 a.m. on 1st September, 2019. The return contained a claim for carry forward of business loss of ₹ 51 lakh. This circumstance was recorded in a letter delivered to the office of the Deputy Commissioner of Income Tax on 1st September, 2019 during normal office hours. Rajesh made a request to the CBDT for condonation of delay in filing the return of income.

Discuss whether the CBDT has the power to condone the delay in filing the return of income and permit carry forward of loss in the given circumstance.

Would your answer change, if the return contained a claim for carry forward of business loss of ₹ 48 lakh.

Answer

Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or **any other relief under the Act** after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of late filing of a return is relatable to a claim arising under the category of "any other relief available under the Act". Therefore, the CBDT has the power to condone delay in filing of such loss return due to genuine reasons.

The facts of the case are similar to the case of *Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 0441*, where the Delhi High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown justifiable reason for the delay of one day in filing the return of income. If the delay is not condoned, it would cause genuine hardship to the assessee. Therefore, the Court held that the delay of one day in filing of the return had to be condoned.

Further, the CBDT Circular No. 9/2015 dated 09.06.2015 has expressly clarified that CBDT can consider application for such claim where the amount exceeds ₹ 50 lakhs.

Applying the rationale of the above court ruling and the clarification given in CBDT Circular to the case on hand, the CBDT has the power to condone the delay in filing the return of income of Mr. Rajesh and permit carry forward of business loss of ₹ 51 lakhs, since the delay of one hour was due to a genuine and justifiable reason i.e., network problem while e-filing the return.

However, if the claim for carry forward of business loss is 48 lakhs, then, the Principal Chief Commissioner of Income-tax/Chief Commissioner of Income-tax has the power to condone the delay (since the amount is between 10 lakhs to 50 lakhs). It may be noted that if the claim is less than ₹10 lakhs, the Principal Commissioner of Income-tax/Commissioner of Income-tax is empowered to condone the delay. This clarification is given in CBDT Circular No. 9/2015 dated 09.06.2015.

Question 2

Examine the correctness of the statement "the jurisdiction of an Assessing Officer cannot be objected by the assessee".

Answer

According to section 124(3), the assessee can raise a question as to the jurisdiction of an Assessing Officer within the prescribed time limit as under:

(i) **where a return has been filed** under section 139(1) then, within one month from the date of service of notice under section 142(1) or section 143(2) or before the completion of assessment, whichever is earlier.

(ii) **where no return has been filed,** then, within the expiry of time allowed by the notice under section 142(1) or section 148 for filing the return or within the time allowed in show cause notice issued seeking as to why a best judgment assessment under section 144 should not be made, whichever is earlier.

(iii) where search is initiated under section 132 or books of accounts, other documents or any assets are requisitioned under section 132A, within one month from the date on which he was served with a notice under section 153A(1) or 153C(2) or before the completion of assessment, whichever is earlier.

Where the assessee calls in question the jurisdiction of an Assessing Officer and the Assessing Officer is not satisfied with such claim, he shall refer the matter for determination by the Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner before the assessment is made.

Therefore, in view of the above provisions, the statement that "the jurisdiction of an Assessing Officer cannot be objected by the assessee" is not correct.

Question 3

The Director General of Income Tax after getting the information that Mr. Mogambo is in possession of unaccounted cash of ₹ 50 lacs, issued orders by invoking powers vested in him as per section 131(1A), for its seizure. Is the order for seizure of cash issued by the Director General of Income Tax correct? If not, does the Director General of Income Tax have any other power to seize such cash?

Answer

The powers under section 131(1A) deal with power of discovery and production of evidence. They do not confer the power of seizure of cash or any asset. The Director General, for the purposes of making an enquiry or investigation relating to any income concealed or likely to be concealed by any person or class of persons within his jurisdiction, shall be competent to exercise powers conferred under section 131(1), which confine to discovery and inspection, enforcing attendance, compelling the production of books of account and other documents and issuing commissions. Thus, the power of seizure of unaccounted cash is not one of the powers conferred on the Director General under section 131(1A).

However, under section 132(1), the Director General has the power to authorize any Additional Director or Additional Commissioner or Joint Director or Joint Commissioner etc. to seize money found as a result of search [Clause (iii) of section 132(1)], if he has reason to believe that any person is in possession of any money which represents wholly or partly income which has not been disclosed [Clause (c) of section 132(1)]. Therefore, the proper course open to the Director General is to exercise his power under section 132(1) and authorize the Officers concerned to enter the premises where the cash is kept by Mr. Mogambo and seize such unaccounted cash.

Question 4

The premises of Ganesh were subjected to a search under section 132 of the Act. The search was authorized and the warrant was signed by the Joint Commissioner of Income-tax having jurisdiction over the assessee, consequent to information in his possession. The assessee challenged the validity of search on the ground that section 132(1) does not empower Joint Commissioner to authorise a search under the Act. Decide the correctness of the contention raised by the assessee.

Answer

Under section 132(1), the income-tax authorities listed therein are empowered to authorise other income-tax authorities to conduct search and seizure operations. The authorities empowered to issue authorization include such Additional Director, Additional Commissioner, Joint Director and Joint Commissioner as are empowered by the CBDT to do so.

However, a Joint Commissioner can issue warrant of authorization only if he has been specifically empowered to do so by the CBDT. Therefore, only if the Joint Commissioner has not been specifically empowered by the CBDT to do so, the contention of the assessee would hold good.

Question 5

Examine whether the information regarding possession of unexplained assets and income received from the Central Bureau of Investigation, a Government agency, can constitute "information" for action under section 132. Discuss.

Answer

As per section 132(1)(c), authorization for search and seizure can take place if the authority, in consequence of information in his possession, has reason to believe that any person is in possession of money, bullion, jewellery or other valuable article or thing and these assets represent, either wholly or partly, income or property which has not been, or would not be disclosed by such person for the purposes of this Act. In the absence of such information, a search cannot be validly authorized.

The Apex Court in *UOI v Ajit Jain [2003] 260 ITR 80* has held that mere intimation by the CBI that money was found in the possession of the assessee, which according to the CBI was undisclosed, without something more, does not constitute "information" within the meaning of section 132, on the basis of which a search warrant could be issued. Consequently, the Supreme Court held that the search conducted on this basis and the assessment made pursuant to such search was not valid.

Question 6

In the course of search operations under section 132 in the month of July, 2019, a tax payer makes a declaration under section 132(4) on the earning of income not disclosed in respect of P.Y.2018-19. Can that statement save the tax payer from a levy of penalty, if he is yet to file his return of income for A.Y.2019-20?

Answer

Since the search is conducted on or after 15.12.2016, and return is yet to be filed for the P.Y. 2018-19, the penalty would be as follows

(1) penalty@30%, if undisclosed income is admitted during the course of search in the statement furnished under section 132(4), and the assessee explains the manner in which such income was derived, pays the tax, together with interest if any, in respect of the undisclosed income, and furnishes the return of income for the specified previous year declaring such undisclosed income on or before the specified date (i.e., the due date of filing return of income or the date on which the period specified in the notice issued under section 153A expires, as the case may be).

(2) penalty@60% in any other case.

Therefore, even if the tax payer furnishes the statement under section 132(4), penalty@30% of undisclosed income of the specified previous year would be attracted under section 271AAB.

Question 7

Cash of ₹ 25 lacs was seized on 12.9.2019 in a search conducted as per section 132 of the Act. The assessee moved an application on 27.10.2019 to release such cash after explaining the sources thereof, which was turned down by the department. The assessee seeks your opinion on, the following issues:

(i) Can the department withhold the explained money?

(ii) If yes, then to what extent and upto what period?

Answer

The proviso to section 132B(1)(i) provides that where the person concerned makes an application to the Assessing Officer, within 30 days from the end of the month in which the asset was seized, for release of the asset and the nature and source of acquisition of the asset is explained to the satisfaction of the Assessing Officer, then, the Assessing Officer may, with the prior approval of the

Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, release the asset after recovering the existing liability under the Income-tax Act, 1961, etc. out of such asset. 'Existing liability', however, does not include advance tax payable. Such asset or portion thereof has to be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

In this case, since the application was made to the Assessing Officer within the 30 day period the amount of existing liability may be recovered out of the asset and the balance may be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

Note: *It may be noted that one of the conditions mentioned above for release of an asset is that the nature and source of acquisition of the asset should be explained to the satisfaction of the Assessing Officer. However, in this case, it has been given that the assessee's application for release of the asset, explaining the sources thereof, was turned down by the Department. If the application was turned down by the Department due to the reason that it was not satisfied with the explanation given by the assessee as to the nature and source of acquisition of the asset, then, the asset (in this case, cash) cannot be released, since the condition mentioned above is not satisfied.*

Question 8

The business premises of Ram Bharose Ltd. and the residence of two of its directors at Delhi were searched under section 132 by the DDI, Delhi. The search was concluded on 9.8.2019 and following were also seized besides other papers and records:

(i) Papers found in the drawer of an accountant relating to Shri Krishna Ltd., Mumbai indicating details of various business transactions. However, Ram Bharose Ltd. is not having any direct or indirect connection of any nature with these transactions and Shri Krishna Ltd., Mumbai and its directors.

(ii) Jewellery worth ₹ 5 lacs from the bed room of one of the director, which was claimed by him to be of his married daughter.

(iii) Papers recording certain transactions of income and expenses having direct nexus with the business of the company for the period from 16.4.2015 to date of search. It was admitted by the director that the transactions recorded in such papers have not been incorporated in the books.

You are required to answer on the basis of aforesaid and the provisions of Act, following questions:

(a) What action the DDI shall be taking in respect of the seized papers relating to Shri Krishna Ltd., Mumbai?

(b) Whether the contention raised by the director as to jewellery found from his bed-room will be acceptable?

(c) What presumption shall be drawn in respect of the papers which indicate transactions not

recorded in the books?

(d) *Can the company move an application for settlement of case as per Chapter XIX-A of the Act?*

Answer

(a) The authorised officer being DDI, Delhi is not having any jurisdiction over Shri Krishna Ltd., Mumbai, and therefore as per section 132(9A), the papers seized relating to this company shall be handed over by him to the Assessing Officer having jurisdiction over Shri Krishna Ltd., Mumbai within a period of 60 days from the date on which the last of the authorisations for search was executed for taking further necessary action thereon.

(b) The contention raised by the Director will not be acceptable because as per the provisions of sub-section (4A)(i) of section 132, where any books of account, other documents, money, bullion, jewellery or other valuables are found in the possession or control of any person in the course of search, then, in respect thereof, it may be presumed that the same belongs to that person.

(c) As per section 132(4A), the presumptions in respect of the papers, indicating transactions not recorded in the books but having direct nexus with the business of the company, are that the same belong to the company, contents of such papers are true and the handwriting in which the same are written is/are of the persons(s) whose premises have been searched.

(d) As per clause (iiia) in the *Explanation* to section 245A, the assessee can approach the Settlement Commission at any time after the date of issue of notice under section 153A or section 153C initiating the assessment proceedings. Therefore, an application can be made to the Settlement Commission where search has been initiated under section 132 followed by assessment under section 153A or section 153C.

The proviso to section 245C(1) specifies the monetary limit for making application for settlement of cases, in respect of search cases. Accordingly, the additional amount of income-tax payable on the income disclosed in the application must exceed ₹ 50 lacs so that application for settlement of the case is eligible for admission.

Question 9

In the course of search on 25.03.2020, assets were seized. Examine the procedure laid down to deal with such seized assets under the Act.

Answer

Section 132B of the Income-tax Act, 1961 deals with the application of assets seized under section 132. Such assets will be first applied towards the existing liability under the Income-tax Act, 1961, etc. ‘Existing liability’, however, does not include advance tax payable. Further, the amount of liability determined on completion of search assessment (including any penalty levied or interest payable in connection with such assessment) and in respect of which the assessee is in default or deemed to be in default, may be recovered out of such assets.

Where the nature and source of acquisition of such seized assets is explained to the satisfaction of the Assessing Officer, the amount of any existing liability mentioned in para 1 above may be recovered out of such asset and the remaining portion, if any, of the asset may be released, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, as the case may be. The release must be made within 120 days from the date on which the last of the authorisations for search under section 132 or for requisition under section 132A was executed. The assets would be released to the person from whose custody they were seized.

When the assets consist of solely of money, or partly of money and partly of other assets, the Assessing Officer may apply such money in the discharge of the liabilities referred to in para 1 above and the assessee shall be discharged of such liability to the extent of the money so applied. However, the assets other than money may also be applied for the discharge of such liabilities if the complete recovery could not be made from the money seized or the money seized was not sufficient.

SIGNIFICANT SELECT CASES

1. **Does the Central Board of Direct Taxes (CBDT) have the power to amend legislative provisions through a Circular?**

Commissioner of Income-tax and Anr v. SV Gopala and Others [2017] 396 ITR 694 (SC)

Facts of the Case: The CBDT had issued a Circular invoking the powers under Section 119 of the Income-tax Act, 1961. The Circular amended the provisions contained in Rule 68B of the Second Schedule to the Income-tax Act, 1961 relating to time limit for sale of attached immovable property.

The issue under consideration is whether the CBDT has the power to amend legislative provisions through a Circular.

Supreme Court's Decision: The Supreme Court observed that the CBDT does not have the power to amend legislative provisions in exercise of its powers under section 119 of the Income-tax Act, 1961 by issuing a Circular. The High Court had held so on similar grounds. The Supreme Court, accordingly, upheld the decision of the High Court quashing the circular for being ultra vires.

2. **Can the assessee's application, for adjustment of tax liability on income surrendered during search by sale of seized gold bars, be entertained where assessment has not been completed?**

Hemant Kumar Sindhi & Another v. CIT (2014) 364 ITR 555 (All)

Facts of the case: Consequent to a search in the premises of the assessee, some gold bars were seized from the locker. The assessee voluntarily disclosed some income during the course of search. The assessee filed an application for sale of the gold bars and adjustment of tax liability on undisclosed income out of the sale proceeds. This would obviate his liability to pay interest under sections 234B and 234C. The Assessing Officer dismissed the application on the reasoning that only when the assessment is completed and tax demand is crystallized, can recovery be initiated by the sale of gold bars. The assessee filed a writ contesting the dismissal of application by the Assessing Officer.

High Court's Observations: The High Court observed that section 132B(1)(i) uses the expression "the amount of any existing liability" and "the amount of the liability determined". The words "existing liability" postulates a liability that is crystallized by adjudication; Likewise, "a liability is determined" only on completion of the assessment. **Until the assessment is complete, it cannot be postulated that a liability has been crystallized.**

As per the first proviso to section 132B(1)(i), the assessee may make an application to the Assessing Officer for release of the assets seized. However, he has to explain the nature and source of acquisition of the asset to the satisfaction of the Assessing Officer. It is not the *ipse dixit* of the assessee but the satisfaction of the Assessing Officer on the basis of the explanation tendered by the assessee which is material.

High Court's Decision: The High Court, accordingly, held that the Assessing Officer was justified in his conclusion that it is only when the liability is determined on the completion of assessment that it would stand crystallized and in pursuance of which a demand can be raised and recovery can be initiated. Therefore, in the present case, the first proviso to section 132B(1)(i) would not be attracted. The High Court, thus, dismissed the writ petition.

3. Is the cancellation of registration of a trust under section 12AA, on the basis of search conducted in the premises of its Secretary General and the statement recorded by him under section 132(4), valid?

U.P. Distillers Association (UPDA) v. CIT [2017] 399 ITR 143 (Del)

Facts of the case: A search and seizure operation took place in the premises of the Secretary General of the assessee, that is, Uttar Pradesh Distillers Association, in February 2006. During the search, the Secretary General's statement was recorded under section 132(4) of the Act. The statement was retracted after two years. In the meanwhile, the Commissioner of Income-tax (CIT) cancelled the assessee's registration under section 12AA(3) on the basis of the search operation and the statement made. The order was upheld by the Appellate Tribunal. The assessee contended that Secretary General's statement was made in the course of search in respect of his premises and not those of the assessee. Hence, the Secretary General's statement was not attributable to the assessee nor could the materials indicated by him be the basis for cancellation of registration of the trust under section 12AA

Issue: The issue under consideration is whether the cancellation of registration under section 12AA as a charitable trust on the basis of search conducted in the premises of the Secretary General of the assessee-trust and the statement recorded by him under section 132(4) is valid.

High Court's Observations: The Court dismissed the appeal to hold that although the premises, in which the search under section 132 took place, belonged to the Secretary General, he virtually ran the assessee-trust's activities from the same premises. The information which he provided in the course of the search pointed out to the activities of the assessee-trust and not to his own activities. Further, the Tribunal had expressly recorded that the search proceedings took place in the context of section 153A, in the very premises of the Secretary General, with respect to the assessee-trust.

High Court's Decision: The Delhi High Court, accordingly, held that cancellation of the trust's registration under section 12AA on the basis of search conducted in the premises of the Secretary General and the statement recorded under section 132(4) from him, is valid.

Note – *The appeal filed by the assessee against the judgement of the Delhi High Court was dismissed.*

4. Where no proceeding is pending against a person, can the Assessing Officer call for information under section 133(6), which is useful or relevant to any enquiry, with the permission of Director or Commissioner?

Kathiroor Service Co-operative Bank Ltd. v. CIT (CIB) (2014) 360 ITR 0243 (SC)

Facts of the case: The Assessing Officer, with the prior approval of the Commissioner, issued notice under section 133(6) to the assessee, a co-operative society engaged in banking business, calling for general information regarding details of all persons (whether resident or non-resident) who had made (a) cash transactions of ₹ 1 lakh and above in any account, and/or (b) time deposits of ₹ 1 lakh or above, for the period of three years between April 1, 2005, and March 31, 2008, expressly stating therein that failure to furnish the information would attract penal consequences.

The assessee objected to the said notice, *inter alia*, on the ground that such notice seeking for information which is unrelated to any existing or pending proceeding against the assessee could not be issued under the provisions of the Act.

Supreme Court's Observations: The Supreme Court observed that the Assessing Officer has been empowered to requisition information which will be useful for or relevant to **any enquiry** or proceeding under the Income-tax Act, 1961 in the case of any person. However, an income-tax authority below the rank of the Director or Commissioner can exercise this power in respect of an **enquiry** in a case where no proceeding is pending, only with the prior approval of the Director or the Commissioner.

Supreme Court's Decision: The Supreme Court held that information of general nature could be called for from banks. In this case, since notices have been issued after obtaining approval of the Commissioner, the assessing authority had not erred in issuing the notices to assessees requiring them to furnish information regarding account holders with cash transactions or deposits of more than ₹ 1 lakh. The Supreme Court, therefore, held that for such enquiry under section 133(6), the notices could be validly issued by the assessing authority.

***Note** – The Finance Act, 2017 has amended the second proviso to section 133 to provide that the power in respect of an inquiry, in a case where no proceeding is pending, can be exercised by the Joint Director, Deputy Director and Assistant Director, without the prior approval of the Principal Director/Director/Principal Commissioner/Commissioner.*

5. Is the requirement to grant a reasonable opportunity of being heard, stipulated under section 127(1), mandatory in nature?

Sahara Hospitality Ltd. v. CIT (2013) 352 ITR 38 (Bom.)

High Court's Observations: On this issue, the Bombay High Court observed that the provisions of section 127(1) stipulate, *inter alia,* that the income tax authority mentioned therein **may** give an opportunity of being heard to the assessee, wherever it is possible to do so, and after recording his reasons for doing so, transfer any case from one or more Assessing Officers subordinate to him to any other Assessing Officer or officers subordinate to him.

High Court's Decision: The Bombay High Court held that the word "may" used in this section should be read as "shall" and such income-tax authority has to mandatorily give a reasonable opportunity of being heard to the assessee, wherever possible to do so, and thereafter, record the reasons for taking any action under the said section. "Reasonable opportunity" can only be dispensed with in a case where it is not possible to provide such opportunity. In such a case also, the authority should record its reasons for making the transfer, even though no opportunity was given to the assessee. The discretion of the authority is only to consider as to what is a reasonable opportunity in a given case and whether it is possible to give such an opportunity to the assessee or not. The authority cannot deny a reasonable opportunity of being heard to the assessee, wherever it is possible to do so.

6. Does the Central Board of Direct Taxes (CBDT) have the power under section 119(2)(b) to condone the delay in filing return of income?

Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 441 (Del.)

Facts of the case: The assessee filed his return of income, which contains a claim for carry forward of losses, a day after the due date. The delay of one day in filing the return of income was due to the fact that the assessee had not reached the Central Revenue Building on time because he was sent from one room to the other and by the time he reached the room where his return was to be accepted, it was already 6.00 p.m. and he was told that the return would not be accepted because the counter had been closed. These circumstances were recorded in the letter along with the return of income delivered to the office of the Deputy Commissioner of Income-tax on the very next day. Later on, the CBDT, by a non-speaking order, rejected the request of the assessee for condonation of delay in filing the return of income under section 119.

Issue: The issue under consideration is whether the CBDT has the power under section 119(2)(b) to condone the delay in filing return of income.

High Court's Decision: The High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown sufficient reason for the delay of one day in filing the return of income. If the delay is not condoned, it would cause genuine hardship to the petitioner. Therefore, the Court held that the delay of one day in filing of the return has to be condoned.

***Note** – Section 119(2)(b) empowers the CBDT to authorize any income tax authority to admit an application or claim for any exemption, deduction, refund or **any other relief under the Act** after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of a loss return is relatable to a claim arising under the category of any other relief available under the Act. Therefore, the CBDT has the power to condone delay in filing of such loss return due to genuine reasons.*

Accordingly, the CBDT has vide Circular No. 9/2015 dated 09.06.2015, clarified that the Principal Commissioner of Income-tax/Commissioner of Income-tax is vested with the power to consider cases for condonation of delay in filing return of income where refund claim or claim of carry forward of losses does not exceed ₹ 10 lakhs for any one assessment year. If the amount of such claim exceeds ₹ 10 lakhs but does not exceed ₹ 50 lakhs, the Principal Chief Commissioner of Income-tax/Chief Commissioner of Income-tax is empowered to condone such delay and where the amount of such claims exceed ₹ 50 lakhs, the Board may consider for condonation of delay in filing return of income.

7. Can the CBDT refuse to condone delay in filing the tax return, where such delay was caused by circumstances beyond the control of the assessee?

Regen Powertech Private Limited v. CBDT and Another [2019] 410 ITR 483 (Mad)

Facts of the Case: The assessee company was engaged in the manufacture of wind energy generators. For the A.Y.2014-15, the assessee filed its return of income on January 7, 2015 with a delay of 37 days. The assessee contended that the delay was on account of obtaining the audit report required under section 44AB. The appointed firm of chartered accountants (SRB) had some reservations regarding the valuation of the assessee company's business transfer which was communicated to the assessee only on the last day of filing the audit report. In such circumstances, the assessee had to look for an alternative auditor which could also be done subject to a "No Objection Certificate" from SRB. The "No Objection Certificate" was only issued on December 15, 2014, after which the return of income along with audit report was filed on January 7, 2015.

The assessee contends that the delay in filing the return was beyond its control. The assessee wished to modify the return of income but under section 139(5), revision of return of income was possible only when the original return was made within the due date[1]. The assessee's application for condonation of 37 days delay before the CBDT under section 119(2)(b) had been pending for a long time, and hence, the assessee approached the High Court under a writ petition.

Issue: The issue under consideration is whether the CBDT can refuse to condone delay in filing the return of income, where such delay was caused by circumstances beyond the

[1] As per the current provisions of law, even a belated return under section 139(4) can be revised u/s 139(5).

control of the assessee**.**

High Court's Observations: The High Court opined that the assessee could not be blamed for the delay in carrying out its audit, as it was beyond its control. Since there was some misunderstanding between the erstwhile auditor and the assessee, the return of income could not be presented before the due date. The assessee had also not been able to obtain the "No Objection Certificate" from the erstwhile auditor immediately.

The High Court observed the view of the Bombay High Court in *Bombay Mercantile Co-op. Bank Ltd. v. CBDT [2010] 195 Taxman 106* that in condonation matters "a highly pedantic approach should be eschewed and a justice oriented approach should be adopted".

High Court's Decision: The High Court held that application for condonation of delay could not have been rejected by the CBDT as the circumstances causing delay were beyond the control of the assessee. The High Court opined that the CBDT should have exercised its discretion in a proper manner and condoned the delay.

Note - *Even though as per the current provisions of income-tax law, a belated return filed u/s 139(4) can also be revised u/s 139(5), this case law is still relevant since filing of return on or before the due date is required for carry forward of certain losses and claim of profit-linked deductions under Chapter VI-A. If delay in filing of return is condoned, such carry forward of losses and claim of profit-linked deductions would be permissible under law.*

CHAPTER 17

ASSESSMENT PROCEDURE

LEARNING OUTCOMES

After studying this chapter, you would be able to

- **appreciate** when return filing becomes mandatory for different persons;
- **identify and recall** the due dates for filing of return in case of such persons;
- **comprehend and apply** the provisions relating to belated return, revised return and defective return;
- **appreciate** the statutory provisions relating to special audit directed by the Assessing Officer;
- **appreciate** the procedure for assessment – self-assessment, summary assessment, scrutiny assessment and best judgement assessment;
- **appreciate** the circumstances when the Assessing Officer can issue notice for reassessment of income and the time limit for issuance of such notice;
- **know and recall** the time limits for completion of assessments, including search assessments;
- **appreciate** the provisions for rectification of mistake apparent from the record.

17.1 RETURN OF INCOME

The Income-tax Act, 1961 contains provisions for filing of return of income. Return of income is the format in which the assessee furnishes information as to his total income and tax payable. The format for filing of returns by different assessees is notified by the CBDT. The particulars of income earned under different heads, gross total income, deductions from gross total income, total income and tax payable by the assessee are generally required to be furnished in a return of income. In short, a return of income is the declaration of income by the assessee in the prescribed format.

17.2 COMPULSORY FILING OF RETURN OF INCOME [SECTION 139(1)]

(1) As per section 139(1), it is compulsory for companies and firms to file a return of income or loss for every previous year on or before the due date in the prescribed form.

(2) In case of a person other than a company or a firm, filing of return of income on or before the due date is mandatory, if his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeds the basic exemption limit.

(3) A return of income or loss for the previous year in the prescribed form and verified in the prescribed manner on or before the due date, has to be filed by every person, being a resident other than not ordinarily resident in India within the meaning of section 6(6), who is not required to furnish a return under section 139(1) if such person, at any time during the previous year –

(a) holds, as a beneficial owner or otherwise, any asset (including any financial interest in any entity) located outside India or has a signing authority in any account located outside India; or

(b) is a beneficiary of any asset (including any financial interest in any entity) located outside India.

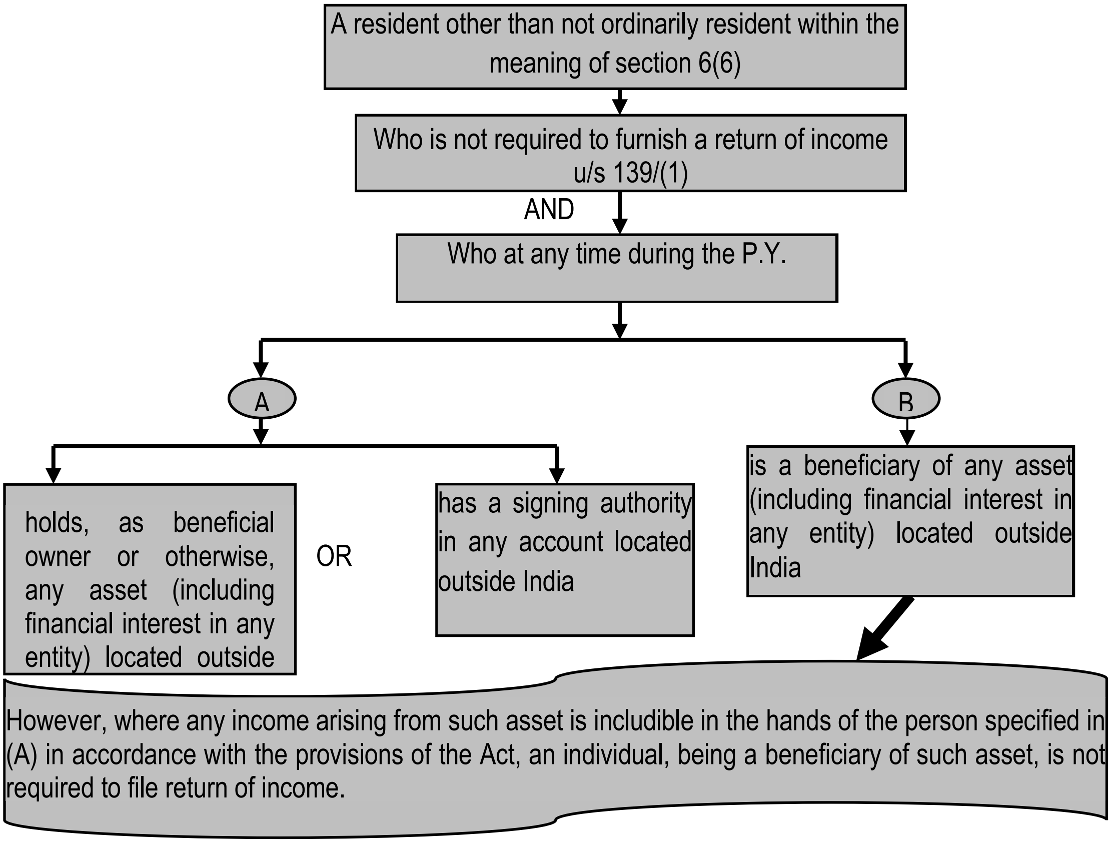
However, an individual being a beneficiary of any asset (including any financial interest in any entity) located outside India would not be required to file return of income, where, income, if any, arising from such asset is includible in the income of the person referred to in (a) above in accordance with the provisions of the Income-tax Act, 1961.

Meaning of "beneficial owner" and "beneficiary" in respect of an asset for the purpose of section 139:

Beneficial Owner → An individual who has provided, directly or indirectly, consideration for the asset for the immediate or future benefit, direct or indirect, of himself or any other person.

Beneficiary → An individual who derives benefit from the asset during the previous year and the consideration for such asset has been provided by any person, other than such beneficiary.

Requirement of filing of return of income as per the fourth and fifth proviso to section 139(1)



A resident other than not ordinarily resident within the meaning of section 6(6)

Who is not required to furnish a return of income u/s 139/(1)

AND

Who at any time during the P.Y.

A

holds, as beneficial owner or otherwise, any asset (including financial interest in any entity) located outside

OR

has a signing authority in any account located outside India

B

is a beneficiary of any asset (including financial interest in any entity) located outside India

However, where any income arising from such asset is includible in the hands of the person specified in (A) in accordance with the provisions of the Act, an individual, being a beneficiary of such asset, is not required to file return of income.

(4) All such persons mentioned in (1), (2) & (3) above should, on or before the due date, furnish a return of his income or the income of such other person during the previous year in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed.

(5) Further, every person, being an individual or a HUF or an AOP or BOI or an artificial juridical person -

- whose total income or the total income of any other person in respect of which he is assessable under this Act during the previous year
- without giving effect to the ***exemption provisions contained in sections 54/54B/54D/54EC/54F/54G/54GA/54GB in respect of capital gains*** or deductions under Chapter VI-A
- exceeds the basic exemption limit

is required to file a return of his income or income of such other person on or before the due date in the prescribed form and manner and setting forth the prescribed particulars.

For the A.Y.2020-21, the basic exemption limit is ₹ 2,50,000 for individuals/HUFs/AOPs/BOIs and artificial juridical persons, ₹ 3,00,000 for resident individuals of the age of 60 years or more but less than 80 years and ₹ 5,00,000 for resident individuals of the age of 80 years or more at any time during the previous year. These amounts denote the level of total income, which is arrived at after claiming ***exemption under sections 54/54B/54D/54EC/54F/54G/54GA/54GB in respect of capital gains*** and the admissible deductions under Chapter VI-A. However, the level of total income to be considered for the purpose of filing return of income is the income before claiming ***exemption under sections 54/54B/54D/54EC/54F/54G/54GA/54GB in respect of capital gains*** and the admissible deductions under Chapter VI-A.

(6) Any person other than a company or a firm, who is not required to furnish a return under section 139(1), would have to file income-tax return in the prescribed form and manner on or before the due date if, during the previous year, such person –

(a) has deposited an amount or aggregate of the amounts exceeding ₹ 1 crore in one or more current accounts maintained with a banking company or a co-operative bank; or

(b) has incurred expenditure of an amount or aggregate of the amounts exceeding ₹ 2 lakh for himself or any other person for travel to a foreign country; or

(c) has incurred expenditure of an amount or aggregate of the amounts exceeding ₹ 1 lakh towards consumption of electricity; or

(d) fulfils such other prescribed conditions

(7) **Meaning of due date** : ‘Due date’ means -

	Assessee	Due Date
(i)	Where the assessee, other than an assessee referred to in clause (ii), is - (a) a company, (b) a person (other than a company) whose accounts are required to be audited under the Income-tax Act, 1961 or any other law in force; or (c) a working partner of a firm whose accounts are required to be audited under the Income-tax Act, 1961 or any other law for the time being in force.	30th September of the assessment year
(ii)	in the case of an assessee who is required to furnish a report referred to in section 92E.	30th November of the assessment year
(iii)	in the case of any other assessee.	31st July of the assessment year

17.3 INTEREST FOR DEFAULT IN FURNISHING RETURN OF INCOME [SECTION 234A]

(1) Interest under section 234A is attracted for failure to file a return of income on or before the due date mentioned above i.e. interest is payable where an assessee furnishes the return of income after the due date or does not furnish the return of income.

(2) Simple interest @ 1% per month or part of the month is payable for the period commencing from the date immediately following the due date and ending on the following dates -

Circumstances	Ending on the following dates
Where the return is furnished after due date	the date of furnishing of the return
Where no return is furnished	the date of completion of assessment

(3) The interest has to be calculated on the amount of tax on total income as determined under section 143(1) or on regular assessment as reduced by the advance tax paid and any tax deducted or collected at source, relief of tax allowed under section 89/90/90A/91, and tax credit allowed to be set-off in accordance with section 115JAA or 115JD.

17.4 OPTION TO FURNISH RETURN OF INCOME TO EMPLOYER [SECTION 139(1A)]

(1) This section gives an option to a person, being an individual who is in receipt of income chargeable under the head "Salaries", to furnish a return of his income for any previous year to his employer, in accordance with such scheme as may be notified by the CBDT and subject to such conditions as may be specified therein.

(2) Such employer shall furnish all returns of income received by him on or before the due date, in such form (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media) and manner as may be specified in that scheme.

(3) In such a case, any employee who has filed a return of his income to his employer shall be deemed to have furnished a return of income under sub-section (1).

17.5 SPECIFIED CLASS OR CLASSES OF PERSONS TO BE EXEMPTED FROM FILING RETURN OF INCOME [SECTION 139(1C)]

(1) Under section 139(1), every person has to furnish a return of his income on or before the due date, if his total income exceeds the basic exemption limit.

(2) For reducing the compliance burden of small taxpayers, the Central Government has been empowered to notify the class or classes of persons who will be exempted from the requirement of filing of return of income, subject to satisfying the prescribed conditions.

Accordingly, the Central Government has, vide Notification No. S.O.2672(E) dated 26.7.2019, exempted non-corporate non-residents and foreign companies, having any income chargeable under the Income-tax Act, 1961 during a previous year from any investment fund set up in an International Financial Services Centre (IFSC) located in India, from the requirement of furnishing a return of income under section 139(1) from A.Y.2019-20 onwards.

The exemption from filing return of income would be available to such class of persons only if any income-tax due on income of the said class of persons has been deducted at source and remitted to the Central Government by the investment fund at the tax-rate in force as per provisions of section 194LBB; and there is no other income during the previous year for which the said class of persons, is otherwise liable to file the tax-return.

Also, the exemption from the requirement of furnishing a return of income shall not be available to the said class of persons where a notice under section 142(1) or section 148 or section 153A or section 153C has been issued for filing a return of income for the assessment year specified therein.

For this purpose, "investment fund" means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or Category II Alternative Investment Fund (AIF) and is regulated under the SEBI (AIF) Regulations, 2012 made under the SEBI Act, 1992.

(3) Every notification issued under section 139(1C) shall, as soon as may be after its issue, be laid before each House of Parliament while it is in session, for a total period of thirty days. If both Houses agree in making any modification in the notification, the notification will thereafter have effect only in such modified form. If both Houses agree that the notification should not be issued, the notification shall thereafter have no effect.

17.6 RETURN OF LOSS [SECTION 139(3)]

(1) This section requires the assessee to file a return of loss in the same manner as in the case of return of income within the time allowed under section 139(1).

(2) Section 80 requires mandatory filing of return of loss under section 139(3) on or before the due date specified under section 139(1) for carry forward of the following losses

(a) Business loss under section 72(1)

(b) Speculation business loss under section 73(2)

(c) Loss from specified business under section 73A(2)

(d) Loss under the head "Capital Gains" under section 74(1)

(e) Loss from the activity of owning and maintaining race horses under section 74A(3)

(3) Consequently, section 139(3) requires filing of return of loss mandatorily within the time allowed under section 139(1) for claiming carry forward of the losses mentioned in (2) above.

(4) However, loss under the head "Income from house property" under section 71B and unabsorbed depreciation under section 32 can be carried forward for set-off even though return of loss has not been filed before the due date.

(5) A return of loss has to be filed by the assessee in his own interest and the non-receipt of a notice from the Assessing Officer requiring him to file the return cannot be a valid excuse under any circumstances for the non-filing of such return.

17.7 BELATED RETURN [SECTION 139(4)]

(1) Any person who has not furnished a return within the time allowed to him under section 139(1) may furnish the return for any previous year at any time -

(i) before the end of the relevant assessment year; or

(ii) before the completion of the assessment,

whichever is earlier.

(2) Thus, belated return can be filed only in case a person has not furnished his return within the time allowed under section 139(1). Also, the belated return cannot be furnished after the end of the relevant assessment year.

17.8 RETURN OF INCOME OF CHARITABLE TRUSTS AND INSTITUTIONS [SECTION 139(4A)]

(1) Every person in receipt of income -

(i) derived from property held under a trust or any other legal obligation wholly or partly for charitable or religious purpose; or

(ii) by way of voluntary contributions on behalf of such trust or institution

must furnish a return of income if the total income in respect of which he is assessable as a representative assessee (computed before allowing any exemption under sections 11 and 12) exceeds the basic exemption limit.

(2) Such persons should furnish the return in the prescribed form and verified in the prescribed manner containing all the particulars prescribed for this purpose.

(3) This return must be filed by the representative-assessee voluntarily within the time limit. Any failure on the part of the assessee would attract liability to pay interest and penalty.

17.9 RETURN OF INCOME OF POLITICAL PARTIES [SECTION 139(4B)]

(1) Under this section, a political party is required to file a return of income if, before claiming exemption under section 13A, the party has taxable income.

(2) The grant of exemption from income-tax to any political party under section 13A is subject to the condition that the political party submits a return of its total income within the time limit prescribed under section 139(1).

(3) The Chief Executive Officer of the political party is statutorily required to furnish a return of income of the party for the relevant assessment year, if the amount of total income of the previous year exceeds the basic exemption limit before claiming exemption under section 13A.

(4) The return must be filed in the prescribed form and verified in the prescribed manner setting forth such other particulars as may be prescribed by the CBDT.

(5) The provisions of the Act would apply as if it were a return required to be furnished under section 139(1).

17.10 MANDATORY FILING OF RETURNS BY SCIENTIFIC RESEARCH ASSOCIATIONS, NEWS AGENCY, TRADE UNIONS, ETC. [SECTION 139(4C)]

(1) It will be mandatory for the following institutions/associations/***persons*** etc. to file the return of income if their total income without giving effect to exemption under section 10, exceeds the basic exemption limit –

	Institution/Association etc.	Applicable section
(a)	Research association	10(21)
(b)	News agency	10(22B)
(c)	Association or institution	10(23A)
(d)	Fund for the welfare of employees or their dependents	10(23AAA)
(e)	Institution	10(23B)
(f)	Fund or institution	10(23C)(iv)
(g)	Trust or institution	10(23C)(v)
(h)	University or other educational institution	10(23C)(vi)/(iiiad)
(i)	Hospital or other medical institution	10(23C)(via)/(iiiae)
(j)	Mutual Fund	10(23D)
(k)	Securitisation Trust	10(23DA)
(l)	Investor Protection Fund	10(23EC)/(ED)
(m)	Core Settlement Guarantee Fund	10(23EE)
(n)	Venture Capital Company/Venture Capital Fund	10(23FB)
(o)	Trade Union	10(24)(b)
(p)	Board or Authority as referred	10(29A)
(q)	Body or Authority or Board or Trust	10(46)
(r)	Infrastructure Debt Fund	10(47)

(2) Such return of income should be in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed.

(3) Then, the provisions of the Act would apply as if it were a return required to be furnished under section 139(1).

17.11 MANDATORY FILING OF RETURNS BY UNIVERSITIES, COLLEGES ETC. [SECTION 139(4D)]

(1) It will be mandatory for every university, college or other institution referred to in clause (ii) and clause (iii) of section 35(1), which is not required to furnish its return of income or loss under any other provision of section 139, to furnish its return in respect of its income or loss in every previous year.

(2) All the provisions of the Income-tax Act, 1961 shall apply to such return as if it were a return under section 139(1).

17.12 FILING OF RETURN OF INCOME BY A BUSINESS TRUST [SECTION 139(4E)]

(1) Every business trust, which is not required to furnish return of income or loss under any other provision of this section, has to furnish the return of its income in respect of its income or loss in every previous year.

(2) All the provisions of the Income-tax Act, 1961 shall apply as if it were a return required to be filed under section 139(1).

17.13 FILING OF RETURN OF INCOME BY INVESTMENT FUND [SECTION 139(4F)]

(1) Every investment fund referred to in section 115UB, which is not required to furnish return of income or loss under any other provision of this section, shall furnish the return of income in respect of income or loss in every previous year.

(2) All the provisions of the Income-tax Act, 1961 shall apply as if it were a return required to be filed under section 139(1).

17.14 REVISED RETURN [SECTION 139(5)]

(1) If any person having furnished a return under section 139(1) or section 139(4), discovers any omission or any wrong statement therein, he may furnish a revised return **at any time before the end of the relevant assessment year** or before completion of assessment, whichever is earlier.

(2) The return can be revised for any number of times within the given time limit. In this case the latest revised return filed replaces all other returns filed earlier.

17.15 PARTICULARS TO BE FURNISHED WITH THE RETURN [SECTION 139(6)]

The prescribed form of the return shall, in certain specified cases, require the assessee to furnish the particulars of -

(1) income exempt from tax

(2) assets of the prescribed nature and value, held by him as a beneficial owner or otherwise or in which he is a beneficiary.

(3) his bank account and credit card held by him

(4) expenditure exceeding the prescribed limits incurred by him under prescribed heads

(5) such other outgoings as may be prescribed.

17.16 PARTICULARS TO BE FURNISHED WITH RETURN OF INCOME IN THE CASE OF AN ASSESSEE ENGAGED IN BUSINESS OR PROFESSION [SECTION 139(6A)]

The prescribed form of the return shall, in the case of an assessee engaged in any business or profession also require him to furnish -

(1) the report of any audit referred to in section 44AB.

(2) the particulars of the location and style of the principal place where he carries on the business or profession and all the branches thereof.

(3) the names and addresses of his partners, if any, in such business or profession.

(4) if he is a member of an association or body of individuals,

  (a) the names of the other members of the association or the body of individuals; and

  (b) the extent of the share of the assessee and the shares of all such partners or members, as the case may be, in the profits of the business or profession.

17.17 DEFECTIVE RETURN [SECTION 139(9)]

(1) Under this sub-section, the Assessing Officer has the power to call upon the assessee to rectify a defective return.

(2) Where the Assessing Officer considers that the return of income furnished by the assessee is defective, he may intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation. The Assessing Officer has the discretion to extend the time period beyond 15 days, on an application made by the assessee.

(3) If the defect is not rectified within the period of 15 days or such further extended period, then the return would be treated as an invalid return. The consequential effect would be the same as if the assessee had failed to furnish the return.

(4) Where, however, the assessee rectifies the defect after the expiry of the period of 15 days or the further extended period, but before assessment is made, the Assessing Officer can condone the delay and treat the return as a valid return.

(5) A return of income shall be regarded as defective unless all the following conditions are fulfilled, namely:

(i) The annexures, statements and columns in the return of income relating to computation of income chargeable under each head of income, computations of gross total income and total income have been duly filled in.

(ii) The return of income is accompanied by the following, namely:

(a) a statement showing the computation of the tax payable on the basis of the return.

(b) the report of the audit obtained under section 44AB (If such report has been furnished prior to furnishing the return of income, a copy of such report and the proof of furnishing the report should be attached).

(c) the proof regarding the tax, if any, claimed to have been deducted or collected at source and the advance tax and tax on self-assessment, if any, claimed to have been paid. (However, the return will not be regarded as defective if (a) a certificate for tax deducted or collected was not furnished under section 203 or section 206C to the person furnishing his return of income, (b) such certificate is produced within a period of 2 years).

(d) the proof of the amount of compulsory deposit, if any, claimed to have been paid under the Compulsory Deposit Scheme (Income-tax Payers) Act, 1974;

(iii) Where regular books of account are maintained by an assessee, the return of income is accompanied by the following -

(a) copies of manufacturing account, trading account, profit and loss account or income and expenditure account, or any other similar account and balance sheet;

(b) the personal accounts as detailed below -

(1)	Proprietary business or profession	The personal account of the proprietor
(2)	Firm, association of persons or body of individuals	personal accounts of partners or members

(3)	Partner or member of a firm, association of persons or body of individuals	partner's personal account in firm, member's personal account in the association of persons or body of individuals

(iv) Where the accounts of the assessee have been audited, the return should be accompanied by copies of the audited profit and loss account and balance sheet and the auditor's report.

(v) Where the cost accounts of an assessee have been audited under section 233B[1] of Companies Act, 1956, the return should be accompanied by such report.

(vi) Where regular books of account are not maintained by the assessee, the return should be accompanied by -

(a) a statement indicating the amount of turnover or gross receipts, gross profit, expenses and net profit of the business or profession;

(b) the basis on which such amounts mentioned in (1) above have been computed,

(c) the amounts of total sundry debtors, sundry creditors, stock-in-trade and cash balance as at the end of the previous year.

It may be noted that a return which is otherwise valid would not be treated as defective merely because self-assessment tax and interest payable in accordance with the provisions of section 140A has not been paid on or before the date of furnishing the return.

Notes:

(i) Many of these particulars are now required to be incorporated as part of the relevant return form, for example, details of tax deducted at source, advance tax paid, self-assessment tax paid, amount of turnover/gross receipts etc.

(ii) Section 292B provides that no return of income, order of assessment, notice, summons or other proceedings furnished or made or taken or purported to have been furnished or made in pursuance of any of the provisions of the Income-tax Act, 1961 shall be invalid or shall be deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment, notice, summons or other proceeding, if they are in substance and effect in conformity with or according to the intent and purposes of the Income-tax Act, 1961. The provision, thus, enables tax authorities to accept returns and other documents and tax payers to accept orders, notice, etc., received from tax authorities even in cases where there are a few typographical, arithmetical or other mistakes which do not materially affect the objects with which the document was submitted by the assessee or order was issued by the department.

[1] Section 148 of the Companies Act, 2013

17.18 PERMANENT ACCOUNT NUMBER (PAN) [SECTION 139A]

(1) Section 139A(1) requires the following persons mentioned in column (2), who have not been allotted a permanent account number (PAN), to apply to the Assessing Officer within the time specified in column (3) for the allotment of a PAN –

(1)	(2)	(3)
	Persons required to apply for PAN	**Time limit for making such application**
(i)	Every person, if his total income or the total income of any other person in respect of which he is assessable under the Act during any previous year exceeds the maximum amount which is not chargeable to income-tax	On or before 31st May of the assessment year for which such income is assessable
(ii)	Every person carrying on any business or profession whose total sales, turnover or gross receipts are or is likely to exceed ₹ 5 lakhs in any previous year	Before the end of that financial year (previous year).
(iii)	Every person who is required to furnish a return of income under section 139(4A)	Before the end of the financial year
(iv)	Every person being a resident, other than an individual, which enters into a financial transaction of an amount aggregating to ₹ 2,50,000 or more in a financial year	On or before 31st May of the immediately following financial year
(v)	Every person who is a managing director, director, partner, trustee, author, founder, karta, chief executive officer, principal officer or office bearer of any person referred in (iv) above or any person competent to act on behalf of such person referred in (iv) above	On or before 31st May of the immediately following financial year in which the person referred in (iv) enters into financial transaction specified therein.

Further, for widening the tax base, every person who has not been allotted a PAN and intends to enter into such transaction as prescribed by the CBDT is also required to apply to the Assessing Officer for allotment of PAN (inserted w.e.f. 1.9.2019)

(2) The Central Government is empowered to specify, by notification in the Official Gazette, any class or classes of persons by whom tax is payable under the Act or any tax or duty is payable under any other law for the time being is force. Such persons are required to apply within such time as may be mentioned in that notification to the Assessing Officer for the allotment of a PAN [Sub-section (1A)].

(3) For the purpose of collecting any information which may be useful for or relevant to the purposes of the Act, the Central Government may notify any class or classes of persons, and such persons shall within the prescribed time, apply to the Assessing Officer for allotment of a PAN [Sub-section (1B)].

(4) The Assessing Officer, having regard to the nature of transactions as may be prescribed, may also allot a PAN to any other person (whether any tax is payable by him or not) in the manner and in accordance with the procedure as may be prescribed [Sub-section (2)].

(5) Any person, other than the persons mentioned in (1) to (4) above, may apply to the Assessing Officer for the allotment of a PAN and the Assessing Officer shall allot a PAN to such person immediately.

(6) Such PAN comprises of 10 alphanumeric characters.

(7) Quoting of PAN is mandatory in all documents pertaining to the following prescribed transactions:

(a) in all returns to, or correspondence with, any income-tax authority;

(b) in all challans for the payment of any sum due under the Act;

(c) in all documents pertaining to such transactions entered into by him, as may be prescribed by the CBDT in the interests of revenue. In this connection, CBDT has notified the following transactions, namely:

S. No.	Nature of transaction	Value of transaction
1.	Sale or purchase of a motor vehicle or vehicle, as defined in the Motor Vehicles Act, 1988 which requires registration by a registering authority under that Act, other than two wheeled vehicles.	All such transactions
2.	Opening an account [other than a time-deposit referred to at Sl. No.12 and a Basic Savings Bank Deposit Account] with a banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act).	All such transactions
3.	Making an application to any banking company or a co-operative bank to which the Banking Regulation Act, 1949, applies (including any bank or banking institution referred to in section 51 of that Act) or to any other company or institution, for issue of a credit or debit card.	All such transactions
4.	Opening of a demat account with a depository, participant, custodian of securities or any other person registered under section 12(1A) of the SEBI Act, 1992.	All such transactions

5.	Payment to a hotel or restaurant against a bill or bills at any one time.	Payment in cash of an amount exceeding ₹ 50,000.
6.	Payment in connection with travel to any foreign country or payment for purchase of any foreign currency at any one time.	Payment in cash of an amount exceeding ₹ 50,000.
7.	Payment to a Mutual Fund for purchase of its units	Amount exceeding ₹ 50,000.
8.	Payment to a company or an institution for acquiring debentures or bonds issued by it.	Amount exceeding ₹ 50,000.
9.	Payment to the Reserve Bank of India for acquiring bonds issued by it.	Amount exceeding ₹ 50,000.
10.	Deposit with - a banking company or a co-operative bank to which the Banking Regulation Act, 1949, applies (including any bank or banking institution referred to in section 51 of that Act); or - post office	Cash deposits exceeding ₹ 50,000 during any one day.
11.	Purchase of bank drafts or pay orders or banker's cheques from a banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act).	Payment in cash of an amount exceeding ₹ 50,000 during any one day.
12.	A time deposit with, - (i) a banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act); (ii) a Post Office; (iii) a Nidhi referred to in section 406 of the Companies Act, 2013; or (iv) a non-banking financial company which holds a certificate of registration under section 45-IA of the Reserve Bank of India Act, 1934, to hold or accept deposit from public.	Amount exceeding ₹ 50,000 or aggregating to more than ₹ 5 lakh during a financial year.
13.	Payment for one or more pre-paid payment instruments, as defined in the policy guidelines for issuance and operation of pre-paid payment instruments issued by Reserve Bank of India under the Payment and Settlement Systems Act, 2007, to a banking company or a co-operative bank to which the Banking Regulation Act, 1949,	Payment in cash or by way of a bank draft or pay order or banker's cheque of an amount aggregating to more than ₹ 50,000 in a financial year.

	applies (including any bank or banking institution referred to in section 51 of that Act) or to any other company or institution.	
14.	Payment as life insurance premium to an insurer as defined in the Insurance Act, 1938.	Amount aggregating to more than ₹ 50,000 in a financial year.
15.	A contract for sale or purchase of securities (other than shares) as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956.	Amount exceeding ₹ 1 lakh per transaction
16.	Sale or purchase, by any person, of shares of a company not listed in a recognised stock exchange.	Amount exceeding ₹ 1 lakh per transaction.
17.	Sale or purchase of any immovable property.	Amount exceeding ₹ 10 lakh or valued by stamp valuation authority referred to in section 50C at an amount exceeding ₹ 10 lakh
18.	Sale or purchase, by any person, of goods or services of any nature other than those specified at Sl. No. 1 to 17 of this Table, if any.	Amount exceeding ₹ 2 lakh per transaction:

Minor to quote PAN of parent or guardian

Where a person, entering into any transaction referred to in this rule, is a minor and who does not have any income chargeable to income-tax, he shall quote the PAN of his father or mother or guardian, as the case may be, in the document pertaining to the said transaction.

Declaration by a person not having PAN

Further, any person who does not have a PAN and who enters into any transaction specified in this rule, shall make a declaration in Form No.60 giving therein the particulars of such transaction either in paper form or electronically under the electronic verification code in accordance with the procedures, data structures, and standards specified by the Principal Director General of Income-tax (Systems) or Director General of Income-tax (Systems).

Non-applicability of Rule 114B

Also, the provisions of this rule shall not apply to the following class or classes of persons, namely:-

(i) the Central Government, the State Governments and the Consular Offices;

(ii) the non-residents referred to in section 2(30) in respect of the transactions other than a transaction referred to at Sl. No. 1 or 2 or 4 or 7 or 8 or 10 or 12 or 14 or 15 or 16 or 17 of the Table.

Meaning of certain phrases:

	Phrase	Inclusion
(i)	Payment in connection with travel	Payment towards fare, or to a travel agent or a tour operator, or to an authorized person as defined in section 2(c) of the Foreign Exchange Management Act, 1999
(ii)	Travel agent or tour operator	A person who makes arrangements for air, surface or maritime travel or provides services relating to accommodation, tours, entertainment, passport, visa, foreign exchange, travel related insurance or other travel related services either severally or in package
(iii)	Time deposit	Any deposit which is repayable on the expiry of a fixed period.

(8) Every person who receives any document relating to any transaction cited above shall ensure that the PAN is duly quoted in the document.

(9) If there is a change in the address or in the name and nature of the business of a person, on the basis of which PAN was allotted to him, he should intimate such change to the Assessing Officer.

(10) **Intimation of PAN to person deducting tax at source**

Every person who receives any amount from which tax has been deducted at source shall intimate his PAN to the person responsible for deducting such tax [Sub-section (5A)]. Such person has to be make an application of PAN before the end of such financial year.

(11) **Quoting of PAN in certain documents**

Where any amount has been paid after deducting tax at source, the person deducting tax shall quote the PAN of the person to whom the amount was paid in the following documents:

(i) in the statement furnished under section 192(2C) giving particulars of perquisites or profits in lieu of salary provided to any employee;

(ii) in all certificates for tax deducted issued to the person to whom payment is made;

(iii) in all returns made to the prescribed income-tax authority under section 206;

(iv) in all statements prepared and delivered or caused to be delivered in accordance with the provisions of section 200(3)[Sub-section (5B)].

(12) **Requirement to intimate PAN and quote PAN not to apply to certain persons**

The above sub-sections (5A) and (5B) shall not apply to a person who –

(i) does not have taxable income or

(ii) who is not required to obtain PAN

if such person furnishes a declaration under section 197A in the prescribed form and manner that the tax on his estimated total income for that previous year will be nil.

(13) **Intimation of PAN to person collecting tax at source**

Likewise, every buyer or licensee or lessee referred to in section 206C shall intimate his PAN to the person responsible for collecting tax.

(14) **Quoting of PAN in certain documents**

Every person collecting tax in accordance with section 206C shall quote PAN of every buyer or licensee or lessee referred to therein –

(i) in all certificates furnished in accordance with the provisions of section 206C(5);

(ii) in all returns prepared and delivered or caused to be delivered in accordance with the provisions of section 206C(5A) or section 206C(5B) to an income-tax authority;

(iii) in all statements prepared and delivered or caused to be delivered in accordance with the provisions of section 206C(3).

(15) ***Inter-changeability of PAN with the Aadhaar number***

Every person who is required to furnish or intimate or quote his PAN may furnish or intimate or quote his Aadhaar Number in lieu of the PAN w.e.f. 1.9.2019 if he

- *has not been allotted a PAN but possesses the Aadhaar number*
- *has been allotted a PAN and has intimated his Aadhaar number to prescribed authority in accordance with the requirement contained in section 139AA(2) [Sub-section (5E)]*

PAN would be allotted in prescribed manner to a person who has not been allotted a PAN but possesses Aadhaar number.

Note – *Rule 114(4) requires submission of application for allotment of PAN by the applicant in the prescribed form accompanied by the prescribed documents as proof of identity, address and date of birth of such applicant. Sub-rule (1A) has been inserted in Rule 114 w.e.f. 1.9.2019 to provide that any person, who has not been allotted a PAN but possesses the Aadhaar number and has furnished or intimated or quoted his Aadhaar number in lieu of the PAN in accordance with section 139A(5E), shall be deemed to have applied for allotment of PAN and he shall not be required to apply or submit any documents under Rule 114.*

Further, sub-rule (1B) has been inserted in Rule 114 w.e.f. 1.9.2019 to provide that any person, who has not been allotted a PAN but possesses the Aadhaar number may apply for allotment of the PAN under section 139A(1)/(1A)/(3) by intimating his Aadhaar number and he shall not be required to apply or submit any documents under Rule 114.

(16) ***Quoting and authentication of PAN or Aadhaar number***

(a) Every person entering into such prescribed transactions is required to quote his PAN

or Aadhaar number, as the case may be, in the documents pertaining to such transactions. Such persons are also required to authenticate such PAN or Aadhaar number in the prescribed manner [Sub-section (6A), inserted w.e.f. 1.9.2019].

(b) Every person receiving such document relating to transactions referred to in (a) has to ensure that PAN or Aadhaar number has been duly quoted in such document. They also have to ensure that such PAN or Aadhaar number is so authenticated [Sub-section (6B), inserted w.e.f. 1.9.2019].

(17) ***Meaning of certain terms for the purpose of section 139A***

	Term	***Definition***
(i)	*Aadhaar Number*	*An identification number issued to an individual under section 3(3) of Aadhar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 by the Unique Identification Authority of India, after verification of the demographic information and biometric information submitted by the individual.*
(ii)	*Assessing Officer*	*Includes an income-tax authority who is assigned the duty of allotting PANs.*
(iii)	*Authentication*	*The process by which –* *(i) the PAN or Aadhaar number along with demographic information or biometric information of an individual is submitted to the income-tax authority or such other prescribed authority or agency for its verification; and* *(ii) Such authority or agency verifies the correctness or the lack thereof, on the basis of the information available with it.*
(iv)	Permanent Account Number (PAN)	A number which the Assessing Officer may allot to any person for the purpose of identification and includes a PAN allotted under the new series i.e., PAN having 10 alphanumeric characters.

(18) **Penalty for failure to comply with the provisions of section 139A [Section 272B]**

Section	**Default**	**Penalty**
272B(1)	Failure to comply with the provisions of section 139A	₹ 10,000
272B(2)	Failure to quote PAN/***Aadhaar number*** in any document referred to in section 139A(5)(c)	₹ 10,000 ***for each such default***
	Failure to intimate PAN/***Aadhaar number*** as required by section 139A(5A)/(5C)	
	Knowingly quoting or intimating a number which is false	
272B(2A) inserted w.e.f. 1.9.2019	***Failure to quote PAN/Aadhaar Number in documents referred to in section 139A(6A) or authenticate such number in accordance with the provisions contained therein***	***₹ 10,000 for each such default***

272B(2B) inserted w.e.f. 1.9.2019	***(i) Failure to ensure that PAN/Aadhaar Number is duly quoted in the documents relating to transactions referred to in section 139A(5)(c) or section 139A(6A)***	***₹ 10,000 for each such default***
	(ii) Failure to ensure that PAN/Aadhaar Number has been duly authenticated in respect of transactions referred to under section 139A(6A)	
Note – *It is necessary to give an opportunity to be heard to the person on whom the penalty under section 272B is proposed to be imposed.*		

17.19 QUOTING OF AADHAAR NUMBER [SECTION 139AA]

(1) **Mandatory quoting of Aadhar Number**

Every person who is eligible to obtain Aadhar Number is required to mandatorily quote Aadhaar Number, on or after 1st July, 2017:

(a) in the application form for allotment of Permanent Account Number (PAN)

(b) in the return of income

(2) **Mandatory quoting of Enrolment Id, where person does not have Aadhaar Number**

If a person does not have Aadhar Number, he is required to quote Enrolment ID of Aadhaar application form issued to him at the time of enrolment in the application form for allotment of Permanent Account Number (PAN) or in the return of income furnished by him.

Enrolment ID means a 28 digit Enrolment Identification Number issued to a resident at the time of enrolment

(3) **Intimation of Aadhaar Number to prescribed Authority**

Every person who has been allotted Permanent Account Number (PAN) as on 1st July, 2017, and who is eligible to obtain Aadhar Number, shall intimate his Aadhar Number to the Principal Director General of Income-tax (Systems) or Principal Director of Income-tax (Systems) ***on or before 31st December, 2019.***

Notwithstanding the last date of intimating/linking of Aadhaar Number with PAN being 31.12.2019, it is clarified that w.e.f. 01.04.2019, it is mandatory to quote and link Aadhaar number while filing the return of income, either manually or electronically, unless specifically exempted in cases referred to in para (5) below.

(4) **Consequences of failure to intimate Aadhar Number**

If a person fails to intimate the Aadhar Number, the Permanent Account Number (PAN) allotted to such person shall be ***made inoperative after the date so notified in the prescribed manner.***

> ***Note -*** *To give effect to the Supreme Court ruling on Aadhar Card linkage, the CBDT vide Press Release dated 10th June 2017, clarified that in consequence of failure to intimate Aadhar Number, the permanent account number (PAN) of those who do not have Aadhaar and who do not wish to obtain Aadhaar for the time being, will not be cancelled so that other consequences under the Income-tax Act for failing to quote PAN may not arise. This clarification was consequent to the position of law prior to 1.9.2019 deeming the PAN to be invalid if a person failed to intimate the Aadhaar Number and providing that other provisions of the Income-tax Act, 1961 would apply as if the person had not applied for PAN.*

(5) **Provision not to apply to certain person or class of persons**

The provisions of section 139AA relating to quoting of Aadhar Number would, however, not apply to such person or class or classes of persons or any State or part of any State as may be notified by the Central Government.

Accordingly, the Central Government has, vide Notification No. 37/2017 dated 11.05.2017 effective from 01.07.2017, notified that the provisions of section 139AA relating to quoting of Aadhar Number would not apply to an individual who does not possess the Aadhar number or Enrolment ID and is:

(i) residing in the States of Assam, Jammu & Kashmir and Meghalaya;

(ii) a non-resident as per Income-tax Act, 1961;

(iii) of the age of 80 years or more at any time during the previous year;

(iv) not a citizen of India

17.20 SCHEME FOR SUBMISSION OF RETURNS THROUGH TAX RETURN PREPARERS [SECTION 139B]

(1) This section provides that, for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income, the CBDT may notify a Scheme to provide that such persons may furnish their returns of income through a Tax Return Preparer authorised to act as such under the Scheme.

(2) The Tax Return Preparer shall assist the persons furnishing the return in a manner that will be specified in the Scheme, and shall also affix his signature on such return.

(3) A **Tax Return Preparer** can be an individual, other than

(i) any officer of a scheduled bank with which the assessee maintains a current account or has other regular dealings.

(ii) any legal practitioner who is entitled to practice in any civil court in India.

(iii) a chartered accountant.

(iv) an employee of the 'specified class or classes of persons'.

(4) The **"specified class or classes of persons"** for this purpose means any person other than a company or a person whose accounts are required to be audited under section 44AB (tax audit) or under any other existing law, who is required to furnish a return of income under the Income-tax Act, 1961.

(5) The Scheme notified under the said section may provide for the following -

(i) the manner in which and the period for which the Tax Return Preparers shall be authorised,

(ii) the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax Return Preparer,

(iii) the code of conduct for the Tax Return Preparers,

(iv) the duties and obligations of the Tax Return Preparers,

(v) the circumstances under which the authorisation given to a Tax Return Preparer may be withdrawn, and

(vi) any other relevant matter as may be specified by the Scheme.

(6) Accordingly, the CBDT has, in exercise of the powers conferred by this section, framed the Tax Return Preparer Scheme, 2006, which came into force from 1.12.2006.

Particulars	Contents
Applicability of the scheme	The scheme is applicable to all eligible persons.
Eligible person	Any person being an individual or a Hindu undivided family.
Tax Return Preparer	Any individual who has been issued a "Tax Return Preparer Certificate" and a "unique identification number" under this Scheme by the Partner Organisation to carry on the profession of preparing the returns of income in accordance with the Scheme. However, the following person are not entitled to act as Tax Return Preparer: (i) any officer of a scheduled bank with which the assessee maintains a current account or has other regular dealings. (ii) any legal practitioner who is entitled to practice in any civil court in India. (iii) an accountant.
Educational qualification for Tax	An individual, who holds a bachelor degree from a recognised Indian University or institution, or has passed the intermediate

Return Preparers	level examination conducted by the Institute of Chartered Accountants of India or the Institute of Company Secretaries of India or the Institute of Cost Accountants of India, shall be eligible to act as Tax Return Preparer.
Preparation of and furnishing the Return of Income by the Tax Return Preparer	An eligible person may, at his option, furnish his return of income under section 139 for any assessment year after getting it prepared through a Tax Return Preparer: However, the following eligible person (an individual or a HUF) cannot furnish a return of income for an assessment year through a Tax Return Preparer: (i) who is carrying out business or profession during the previous year and accounts of the business or profession for that previous year are required to be audited under section 44AB or under any other law for the time being in force; or (ii) who is not a resident in India during the previous year. An eligible person cannot furnish a revised return of income for any assessment year through a Tax Return Preparer unless he has furnished the original return of income for that assessment year through such or any other Tax Return Preparer.

Note - It may be noted that as per section 139B(3), an employee of the "specified class or classes of persons" is not authorized to act as a Tax Return Preparer. Therefore, it follows that employees of companies and persons whose accounts are required to be audited under section 44AB or any other law for the time being in force (since they are not falling in the category of specified class or classes of persons), are eligible to act as Tax Return Preparers.

17.21 POWER OF CBDT TO DISPENSE WITH FURNISHING DOCUMENTS ETC. WITH THE RETURN AND FILING OF RETURN IN ELECTRONIC FORM [SECTIONS 139C &139D]

(1) Section 139C provides that the CBDT may make rules providing for a class or classes of persons who may not be required to furnish documents, statements, receipts, certificate, reports of audit or any other documents, which are otherwise required to be furnished along with the return under any other provisions of this Act.

(2) However, on demand, the said documents, statements, receipts, certificate, reports of audit or any other documents have to be produced before the Assessing Officer.

(3) Section 139D empowers the CBDT to make rules providing for –

(a) the class or classes of persons who shall be required to furnish the return of income in electronic form;

(b) the form and the manner in which the return of income in electronic form may be furnished;

(c) the documents, statements, receipts, certificates or audited reports which may not be furnished along with the return of income in electronic form but have to be produced before the Assessing Officer on demand;

(d) the computer resource or the electronic record to which the return of income in electronic form may be transmitted.

17.22 PERSONS AUTHORISED TO VERIFY RETURN OF INCOME [SECTION 140]

This section specifies the persons who are authorized to verify the return of income under section 139 of the Act.

	Assessee	Circumstance	Authorised Persons
1.	Individual	(i) In circumstances not covered under (ii), (iii) & (iv) below	- the individual himself
		(ii) where he is absent from India	- the individual himself; or - any person duly authorised by him in this behalf holding a valid power of attorney from the individual (Such power of attorney should be attached to the return of income)
		(iii) Where he is mentally incapacitated from attending to his affairs	- his guardian; or - any other person competent to act on his behalf
		(iv) where, for any other reason, it is not possible for the individual to verify the return	- any person duly authorised by him in this behalf holding a valid power of attorney from the individual (Such power of attorney should be attached to the return of income)
2.	Hindu Undivided Family	(i) in circumstances not covered under (ii) and (iii) below	- the karta
		(ii) where the karta is absent from India	- any other adult member of the HUF
		(iii) where the karta is mentally incapacitated from attending to his affairs	- any other adult member of the HUF

3.	Company	(i)		in circumstances not covered under (ii) to (vi) below	-	the managing director of the company
		(ii)	(a)	where for any unavoidable reason such managing director is not able to verify the return; or	-	any director of the company
			(b)	where there is no managing director	-	any director of the company
		(iii)		Where the company is not resident in India	-	a person who holds a valid power of attorney from such company to do so (such power of attorney should be attached to the return).
		(iv)	(a)	Where the company is being wound up (whether under the orders of a court or otherwise); or	-	Liquidator
			(b)	where any person has been appointed as the receiver of any assets of the company	-	Liquidator
		(v)		Where the management of the company has been taken over by the Central Government or any State Government under any law	-	the principal officer of the company
		(vi)		Where an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under the Insolvency and Bankruptcy Code, 2016.	-	insolvency professional appointed by such Adjudicating Authority
4.	Firm	(i)		in circumstances not covered under (ii) below	-	the managing partner of the firm
		(ii)	(a)	where for any unavoidable reason such managing partner is not able to verify the return; or	-	any partner of the firm, not being a minor
			(b)	where there is no managing partner.	-	any partner of the firm, not being a minor
5.	LLP	(i)		in circumstances not covered under (ii) below	-	Designated partner
		(ii)	(a)	where for any unavoidable	-	any partner of the LLP

		reason such designated partner is not able to verify the return; or	
		(b) where there is no designated partner.	- any partner of the LLP
6.	Local authority	-	- the principal officer
7.	Political party [referred to in section 139(4B)]	-	- the chief executive officer of such party (whether he is known as secretary or by any other designation)
8.	Any other association	-	- any member of the association or the principal officer of such association
9.	Any other person	-	- that person or some other person competent to act on his behalf.

17.23 SELF ASSESSMENT [SECTION 140A]

(1) **Payment of tax, interest and fee before furnishing return of income**

Where any tax is payable on the basis of any return required to be furnished under, *inter alia*, section 139, after taking into account -

(i) the amount of tax, already paid, under any provision of the Income-tax Act, 1961

(ii) any tax deducted or collected at source;

(iii) any relief of tax claimed under section 89;

(iv) relief of tax claimed under section 90 or 90A;

(v) deduction of tax claimed under section 91;

(vi) any tax credit claimed to be set-off in accordance with the provisions of section 115JAA or section 115JD.

the assessee shall be liable to pay such tax together with interest and fee payable under any provision of this Act for any delay in furnishing the return or any default or delay in payment of advance tax before furnishing the return. The return shall be accompanied by the proof of payment of such tax, interest and fee.

(2) **Order of adjustment of amount paid by the assessee**

Where the amount paid by the assessee under section 140A(1) falls short of the aggregate of the tax, interest and fee as aforesaid, the amount so paid shall first be adjusted towards the fee payable and thereafter towards interest and the balance, if any, shall be adjusted towards the tax payable.

(3) **Interest under section 234A**

For the above purpose, interest payable under section 234A shall be computed on the amount of tax on the total income as declared in the return, as reduced by the amount of-

(i) advance tax paid, if any;

(ii) any tax deducted or collected at source;

(iii) any relief of tax claimed under section 89;

(iv) relief of tax claimed under section 90 or 90A;

(v) deduction of tax claimed under section 91;

(vi) any tax credit claimed to be set-off in accordance with the provisions of section 115JAA or section 115JD.

(4) **Interest under section 234B**

Interest payable under section 234B shall be computed on the assessed tax or on the amount by which the advance tax paid falls short of the assessed tax.

For this purpose, "assessed tax" means the tax on total income declared in the return as reduced by –

(i) the amount of tax deducted or collected at source;

(ii) any relief of tax claimed under section 89;

(iii) relief of tax claimed under section 90 or 90A

(iv) deduction of tax claimed under section 91

(v) any tax credit claimed to be set-off in accordance with the provisions of section 115JAA or section 115JD [Sub-section (1B)].

(5) **Self-assessment tax deemed to have been paid towards regular assessment or assessment under section 153A**

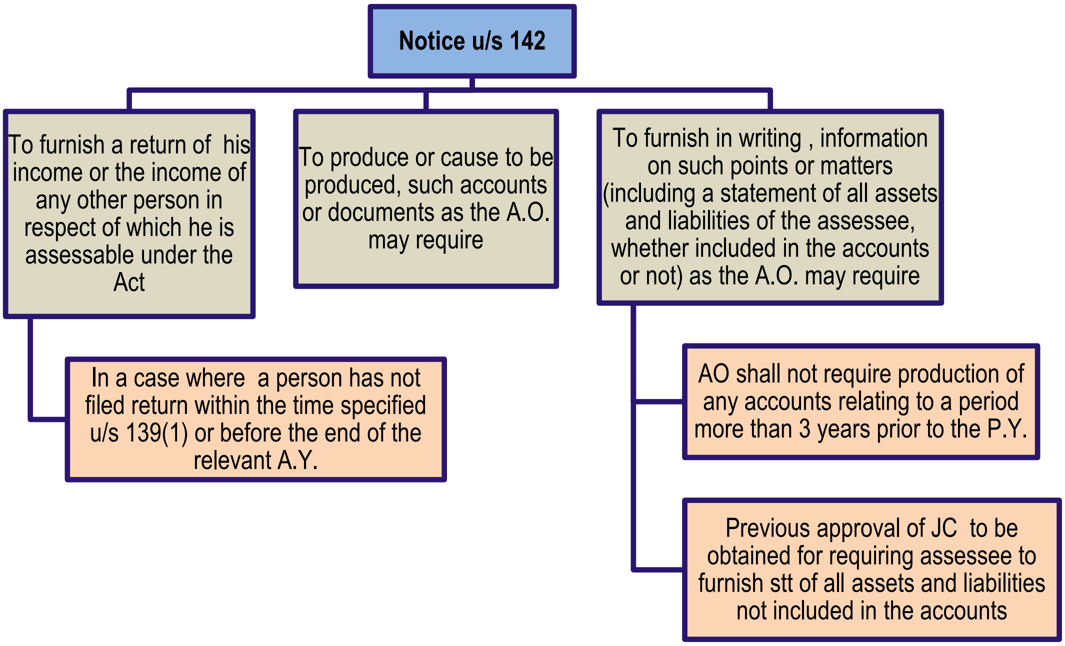
After regular assessment under section 143 or section 144 or an assessment under section 153A has been made, any amount paid under section 140A shall be deemed to have been paid towards such regular assessment or assessment.

(6) **Consequence of failure to pay tax, interest or fee**

If any assessee fails to pay the whole or any part of such of tax or interest or fees, he shall be deemed to be an assessee in default in respect of such tax or interest or fees remaining unpaid and all the provisions of this Act shall apply accordingly.

17.24 INQUIRY BEFORE ASSESSMENT [SECTION 142]

For the purpose of making an assessment, the Assessing Officer may serve on any person who has made a return under section 139 or in whose case the time allowed under section 139(1) for furnishing the return has expired, a notice ùnder section 142. The purposes for which such notice can be served are depicted in the diagram in the next page:



Notice u/s 142

To furnish a return of his income or the income of any other person in respect of which he is assessable under the Act

In a case where a person has not filed return within the time specified u/s 139(1) or before the end of the relevant A.Y.

To produce or cause to be produced, such accounts or documents as the A.O. may require

To furnish in writing , information on such points or matters (including a statement of all assets and liabilities of the assessee, whether included in the accounts or not) as the A.O. may require

AO shall not require production of any accounts relating to a period more than 3 years prior to the P.Y.

Previous approval of JC to be obtained for requiring assessee to furnish stt of all assets and liabilities not included in the accounts

Note - *It may be noted that the time-limit for completion of assessment under section 153(1) is 21 months/18 months/12 months, as the case may be, from the end of the assessment year in which the income was first assessable. Therefore, since assessment has to be completed within the said period, it appears that notice under section 142(1) should also be issued within that period.*

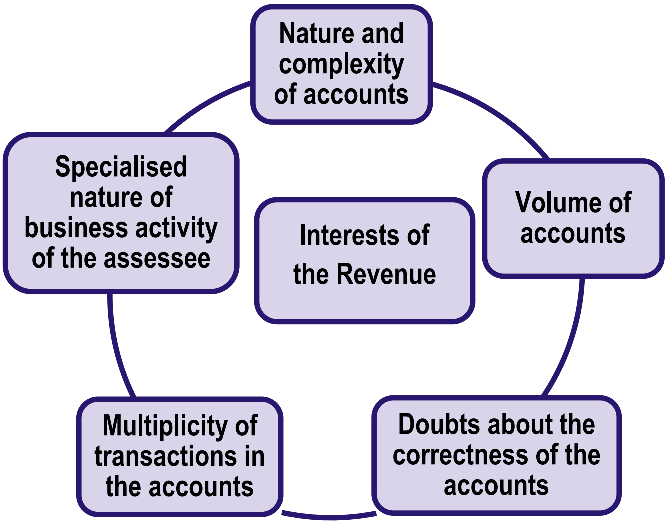
17.25 AUDIT UNDER SECTION 142

Sub-sections (2A), (2B), (2C), and (2D), of section 142 contain the statutory provisions relating to the conduct of audit. Students may note that the audit envisaged under this provision is different from the compulsory tax audit under section 44AB.

(1) **Basis for direction to get accounts audited:** If at any stage of the proceedings before him, the Assessing Officer, having regard to the nature and complexity of the accounts, volume of the accounts, doubts about the correctness of the accounts, multiplicity of transactions in the accounts or specialized nature of business activity of the assessee, and the interests of the revenue, is of the opinion that it is necessary so to do, he may, with the previous approval of the Principal Chief Commissioner or Chief Commissioner or the Principal Commissioner or

Commissioner, direct the assessee to get his accounts audited by an accountant and to furnish a report of such audit.

The expression 'accountant' for this purpose means a 'chartered accountant' within the meaning of the Chartered Accountants Act, 1949.


Nature and complexity of accounts
Specialised nature of business activity of the assessee
Interests of the Revenue
Volume of accounts
Multiplicity of transactions in the accounts
Doubts about the correctness of the accounts

(2) **Special Audit to be conducted by the accountant nominated by the Principal Chief Commissioner/Chief Commissioner/Principal Commissioner/Commissioner** - The accountant by whom the audit should be carried out would be nominated by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner of Income-tax specifically for the purpose and the auditor is required to furnish the report of his audit in the prescribed form duly signed and verified by him and setting forth such other particulars as may be prescribed and also giving details in regard to such additional particulars as the Assessing Officer may require in respect of each individual case. The report of the auditor should be furnished in Form No.6B prescribed under Rule 14A of the Income-tax Rules, 1962. The accountant appointed for carrying out the audit becomes liable to carry out the requirements of audit as directed by Assessing Officer and it is the Principal Commissioner or Commissioner and not the assessee who would be his client for this purpose.

(3) **Opportunity of being heard to be given before issuing directions for special audit** -The Supreme Court in *Rajesh Kumar & Ors. v. DCIT (2006) 287 ITR 91* observed that the order under section 142(2A) is a quasi judicial order. Therefore, the principles of natural justice have to be applied and the assessee has to be given an opportunity of being heard before directing the special audit. The principles of natural justice are based on two principles, namely, (i) nobody shall be condemned unheard; (ii) nobody shall be a judge of his own cause. Once it is held that the assessee suffers civil consequences and any order passed would be prejudicial to him, the principles of natural justice must be held to be implicit. If the principles of natural justice were to be excluded, the Parliament could have said so expressly.

Accordingly, to give effect to the observation of the Supreme Court, it has been provided that the Assessing Officer is required to give the assessee an opportunity of being heard before issuing directions for special audit under section 142(2A).

(4) **Special audit may be directed even if accounts are audited under any other law** **-** The Assessing Officer is empowered to direct the audit to be carried out in the case of any particular assessee even if the accounts of the assessee have already been audited under any other law for the time being in force or otherwise.

(5) **Time limit** **-** The report of the auditor after conducting the audit must be furnished to Assessing Officer by the assessee within the period specified by the Assessing Officer in his order. The Assessing Officer is, however, entitled, *suo motu* on receipt of an application made in this behalf by the assessee for any good any sufficient reason to extend the time-limit by such further period or periods as he deems fit. Further, the aggregate of the period originally fixed and the period or periods so extended **should not exceed 180 days** in any case. This time of 180 days must be reckoned from the date on which the Assessing Officer's direction to get the accounts audited is received by the assessee.

(6) **Expenses of special audit to be paid by the Central Government** **-** Where the direction for special audit is issued by the Assessing Officer, the expenses of, and incidental to, such special audit, including remuneration of the Accountant, shall be determined by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner in accordance with the prescribed guidelines. The expenses so determined shall be paid by the Central Government.

Rule 14B lays down the guidelines for the purposes of determining expenses for audit under section 142(2A). The said Rule is applicable when the audit under section 142(2A) is directed by an Assessing Officer on or after 1st June, 2007. The expenses of, and incidental to, audit (including the remuneration of the accountant, qualified assistants, semi-qualified and other assistants who may be engaged by such Accountant) should not be less than ₹ 3,750 and not more than ₹ 7,500 for every hour of the period as specified by the Assessing Officer under section 142(2C). Such period shall be specified in terms of the number of hours required for completing the report.

(7) **Assessee to be given an opportunity of being heard** **-** The assessee should, however, be given an opportunity of being heard in respect of any material gathered on the basis of –

(i) any inquiry under section 142(2); or

(ii) any audit under section 142(2A)

which is proposed to be utilized for the purposes of the assessment. If, however, the assessment is in nature of a best judgment assessment under section 144, it is not obligatory for the Assessing Officer to give the assessee an opportunity to be heard, before passing the assessment order on the basis of the report of the auditor.

(8) **Consequence of failure to get special audit done** - In any case, where the assessee is directed to get audit done and the assessee fails to do so, the Assessing Officer is entitled to make a best judgment assessment under section 144 in addition to imposing penalty or taking such steps as may be necessary under the law.

In a case where a Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner issued instructions under section 142(2A) nominating a Chartered Accountant for auditing the assessee's accounts and though the concerned assessee was willing to produce the records, the concerned Chartered Accountant refused to audit the accounts, a question arose as to whether there was a failure on the assessee's part to comply with the directions under section 142(2A) and consequently the best judgement assessment could be made under section 144(b).

The Supreme Court held that if for a frivolous reason the Chartered Accountant declined to undertake the audit of the assessee's accounts, the assessee could not be held responsible. In such a case, there was no default or failure to comply with the direction issued under section 142(2A) on the asssessee's part so as to attract the provisions of section 144(b). The best judgement made by the Assessing Officer was set aside with the directions to appoint another Chartered Accountant within one month to get the accounts audited *[Swadeshi Polytex Ltd. v. ITO [1983] 144 ITR 171 (SC)].*

17.26 POWER OF ASSESSING OFFICER TO MAKE A REFERENCE TO THE VALUATION OFFICER [SECTION 142A]

(1) **Position prior to 1st October, 2014** - Under the erstwhile section 142A (prior to 1st October, 2014), the Assessing Officer was empowered to make a reference to the Valuation Officer to estimate the value of any investment referred to in section 69 or section 69B, any bullion, jewellery or other valuable article referred to in section 69A or section 69B or the fair market value of any property referred to in section 56(2) for the purpose of making an assessment or reassessment. The Assessing Officer may, on receipt of the report of the Valuation Officer, take into account such report for the purposes of assessment or reassessment after giving the assessee an opportunity of being heard.

The scope of section 142A prior to 1st October, 2014, was, thus, restricted in the sense that the Assessing Officer could make a reference to the Valuation Officer to estimate the value of investment/article only under the specific sections mentioned thereunder, namely, sections 69, 69A, 69B, and 56(2). Further, section 142A did not also provide for any time limit for furnishing of the report by the Valuation Officer.

(2) **Scope of section 142A widened with effect from 1st October, 2014** - In order to expand the scope of making reference to Valuation Officer and to provide for a time limit for furnishing

of the report by the Valuation Officer, section 142A has been substituted with effect from 1st October, 2014. Section 142A also expressly clarifies that there is no pre-condition that books of account have to be rejected for the purpose of making a reference to the Valuation Officer for estimation of the value of any investment or property.

As per section 142A, the Assessing Officer may, for the purposes of assessment or reassessment, make a reference to a Valuation Officer to estimate the value, including fair market value, of any asset, property or investment and submit the report to him. Thus, the scope of section 142A has been widened by removing references to the specific sections for which reference can be made by the Assessing Officer to the Valuation Officer.

Section 142A further clarifies that the Assessing Officer may make a reference to the Valuation Officer whether or not he is satisfied about the correctness or completeness of the accounts of the assessee.

(3) **Powers of the Valuation Officer** - The Valuation Officer, shall, for the purpose of estimating the value of the asset, property or investment, have all the powers of section 38A of the Wealth-tax Act, 1957.

(4) **Estimation of value of asset, property or investment** - The Valuation Officer is required to estimate the value of the asset, property or investment after taking into account the evidence produced by the assessee and any other evidence in his possession gathered, after giving an opportunity of being heard to the assessee.

If the assessee does not co-operate or comply with the directions of the Valuation Officer he may, estimate the value of the asset, property or investment to the best of his judgment.

(5) **Time limit for submission of valuation report** - The Valuation Officer shall send a copy of his estimate to the Assessing Officer and the assessee within a period of six months from the end of the month in which the reference is made. Thus, a specific time limit has now been provided, within which the Valuation Officer has to send his report to the Assessing Officer.

(6) **Completion of assessment by taking into account valuation report** - On receipt of the report from the Valuation Officer, the Assessing Officer may, after giving the assessee an opportunity of being heard, take into account such report in making the assessment or reassessment.

17.27 ASSESSMENT [SECTION 143]

Where a return has been made under section 139 or in response to a notice under section 142(1), if any tax or interest is found due an intimation should be sent to the assessee which will deemed to be a demand notice. If any refund is due to the assessee it shall be granted.

(1) **Summary assessment [Section 143(1)/(1A)/(1B)/(1C)]**

(i) Section 143(1) provides for computation of the total income of an assessee after making the following adjustments to the returned income:-

(a) any arithmetical error in the return; or

(b) an incorrect claim, if such incorrect claim is apparent from any information in the return.

(c) Disallowance of loss claimed, if return is filed beyond due date u/s 139(1)

(d) Disallowance of expenditure indicated in the audit report but not taken into account in computing the total income in the return

(e) Disallowance of deduction u/s 10AA, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID or 80-IE, if return is filed beyond due date u/s 139(1)

However, before making any such adjustments, in the interest of natural justice, intimation has to be given to the assessee requiring him to respond to such adjustments. Such intimation may be in writing or through electronic mode. The response received, if any, has to be duly considered before effecting any adjustment. However, if no response is received within 30 days of issue of such intimation, the processing shall be carried out incorporating the adjustments.

(ii) The term "an incorrect claim apparent from any information in the return" shall mean such claim on the basis of an entry, in the return, –

(a) of an item, which is inconsistent with another entry of the same or some other item in such return;

(b) in respect of which, information required to be furnished to substantiate such entry, has not been furnished under this Act; or

(c) in respect of a deduction, where such deduction exceeds specified statutory limit which may have been expressed as monetary amount or percentage or ratio or fraction.

(iii) Tax, interest and fee should be computed on the basis of the total income computed after making the adjustments in (i) above.

(iv) The sum payable by, or the amount of refund due to, the assessee shall be determined after adjustment of such tax, interest and fee, if any, so computed by any tax deducted at source, any tax collected at source, any advance tax paid***, any relief allowable under section 89,*** any relief allowable under an agreement under section 90 or section 90A, or any relief allowable under section 91 any tax paid on self-assessment and any amount paid otherwise by way of tax, interest or fee.

(v) Based on the above adjustments, an intimation shall be prepared or generated and sent to the assessee within a period of one year from the end of the financial year in which the return was made. The intimation shall specify the sum determined to be payable by, or the amount of refund due to, the assessee.

(vi) If any amount of refund is due to the assessee, the same shall be granted to the assessee.

(vii) An intimation shall also be sent to the assessee in a case where the loss declared in the return by the assessee is adjusted but no tax, interest or fee is payable by, or no refund is due to, him.

(viii) On the other hand, where there is neither any adjustment nor any tax due from or refund payable to the assessee, the acknowledgement of the return shall be deemed to be the intimation under section 143(1).

(ix) The scheme contemplates avoiding human interface and therefore, provides for computerised processing of returns for making the above adjustments i.e., the software will be designed to detect arithmetical inaccuracies and internal inconsistencies and make appropriate adjustments in the computation of the total income/fringe benefits.

(2) **Mandatory processing of return of income before issuance of assessment order [Section 143(1D)]**

(i) Section 143(1) requires processing of return of income filed under section 139(1) or in response to a notice issued under section 142(1).

(ii) An intimation has to be prepared or generated and sent to the assessee specifying the sum payable or the refund due, to the assessee.

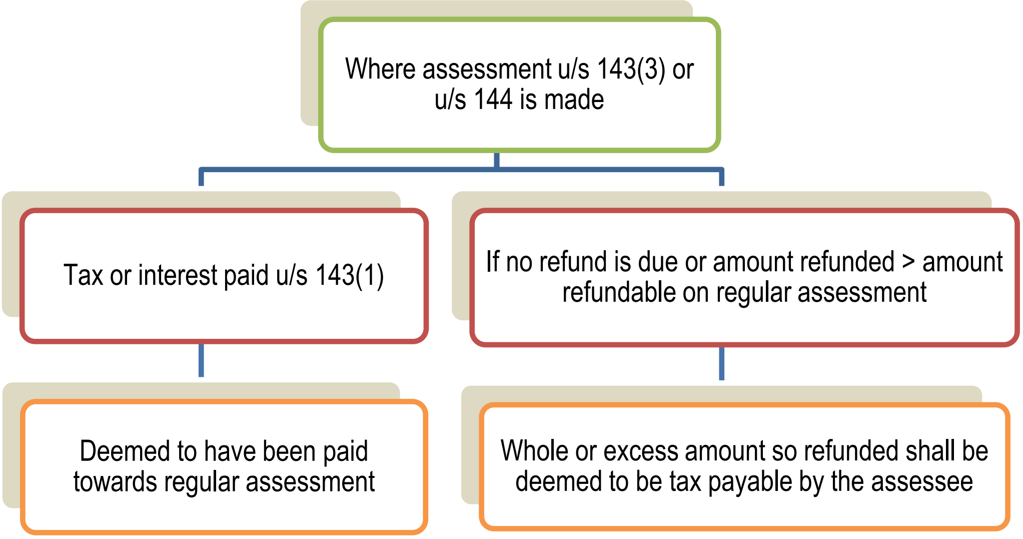
(iii) No intimation can be sent after the expiry of one year from the end of the financial year in which the return is made. This is provided in the second proviso to section 143(1).

(iv) In respect of returns furnished for A.Y.2017-18 or thereafter, processing of a return under section 143(1) is necessary even where a notice has been issued to the assessee under section 143(2).

(v) However, to address the concern of recovery of revenue in doubtful cases, section 241A provides that, for the returns furnished for A.Y.2017-18 or thereafter, where refund of any amount becomes due to the assessee under section 143(1) and the Assessing Officer is of the opinion that grant of refund may adversely affect the recovery of revenue, he may, for the reasons recorded in writing and with the previous approval of the Principal Commissioner or Commissioner, withhold the refund upto the date on which the assessment is made.

(3) **Regular assessment/Scrutiny assessment [Section 143(2)/(3)]** **-** If the Assessing Officer or the prescribed income-tax authority [i.e., an income-tax authority not below the rank of an Income-tax Officer who has been authorised by the CBDT to act as income-tax authority for the purpose of section 143(2)] considers it necessary or expedient to ensure that the assessee has not understated his income or has not computed excessive loss or has not underpaid his tax in any manner he can issue a notice for making the assessment in the normal manner as at present. This will be a scrutiny assessment. It may be noted that notice for detailed scrutiny under section 143(2) cannot be issued after the expiry of 6 months from the end of the financial year in which the return of income is furnished.

On the day specified in the notice issued under section 143(2), or as soon afterwards as may be, after hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer or the prescribed income-tax authority may require on specified points, and after taking into account all relevant material which he has gathered, the Assessing Officer shall, by an order in writing, make an assessment of total income or loss of the assessee, and determine the sum payable by him or refund of any amount due to him on the basis of such assessment.



Where assessment u/s 143(3) or u/s 144 is made

Tax or interest paid u/s 143(1)

Deemed to have been paid towards regular assessment

If no refund is due or amount refunded > amount refundable on regular assessment

Whole or excess amount so refunded shall be deemed to be tax payable by the assessee

It is also obligatory for research associations and other institutions exempt under clauses (21),(22B),(23A),(23B), sub-clauses (iv),(v),(vi) and (via) of clause (23C) of section 10 to file their returns of income. In these cases, the Assessing Officer cannot make an assessment denying exemption under section 10 without intimating the Central Government or the prescribed authority of the contravention of the provisions of the relevant sections and till the approval granted to these funds, trusts, institutions, universities, educational institutions or hospitals or medical institutions has been withdrawn or notification rescinded.

The time period for completing the assessment in such cases will exclude the period between the date on which the Assessing Officer gives the intimation of the default and date on which copy of the order withdrawing the approval is received by the Assessing Officer.

Section 2(15) provides that in case of a trust or institution, whose main object is the "advancement of object of general public utility", the purpose does not remain charitable in a previous year, if its commercial receipts exceed 20% of total receipts. However, this temporary excess in one year may not be treated as altering the very nature of the trust or institution so as to lead to cancellation of registration or withdrawal of approval or rescinding of notification issued in respect of trust or institution. Accordingly, such trust and institution does not get benefit of tax exemption under section 10(23C) or 11 or 12 in the year in which its receipts from commercial activities exceed 20% of total receipts, whether or not the registration or approval granted or notification issued is cancelled, withdrawn or rescinded in respect of such trust or institution. Consequently, in such a circumstance, no effect shall be given by the Assessing Officer to the exemption provisions under section 10(23C) while making an assessment of the total income or loss of the trust or institution for the previous year under section 143(3).

Assessing Officer empowered to send a proposal to the Central Government recommending withdrawal of approval of research association, university, college or other institution approved under section 35(1)(ii) and (iii)

(i) The guidelines, the manner and the conditions in accordance with which an application made by a research association, university, college or other institution shall be approved under section 35(1)(ii)/(iii) have been provided by the Taxation Laws (Amendment) Act, 2006. Also, the amendment provides for grant of one time approval, which means the approval is to remain in force unless it is withdrawn.

(ii) Therefore, the Assessing Officer is now required to satisfy himself as to the activities of the university, college or other institution referred to in clause (ii) or clause (iii) of section 35(1).

(iii) If the activities are not being carried out in accordance with all or any of the conditions subject to which any of the said entities had been approved, the Assessing Officer may, after giving a reasonable opportunity of showing cause to the concerned entity, send a proposal to the Central Government recommending withdrawal of approval.

(iv) The Central Government may, by order, withdraw the approval and forward a copy of the order to the concerned university, college or other institution and to the Assessing Officer.

(4) Scheme to be notified by the Central Government for greater efficiency, transparency and accountability [Section 143(3A)/(3B)/(3C)]

(i) The Central Government is empowered to notify a Scheme for assessing total income or loss of the assessee under section 143(3). ***Accordingly, the Central Government has, vide Notification No.61/2019 dated 12.9.2019, notified the E-assessment Scheme, wherein the assessment would be made in respect of such territorial area, or persons or class of persons, or incomes or class of incomes, or cases or class of cases, as may be specified by the CBDT [Refer to Annexure at the end of this Chapter wherein the E-assessment Scheme as contained in the said notification has been detailed]***

(ii) The Scheme would ensure greater efficiency, transparency & accountability by –

(a) eliminating the interface between the Assessing Officer and the assessee in the course of proceedings to the extent technologically feasible;

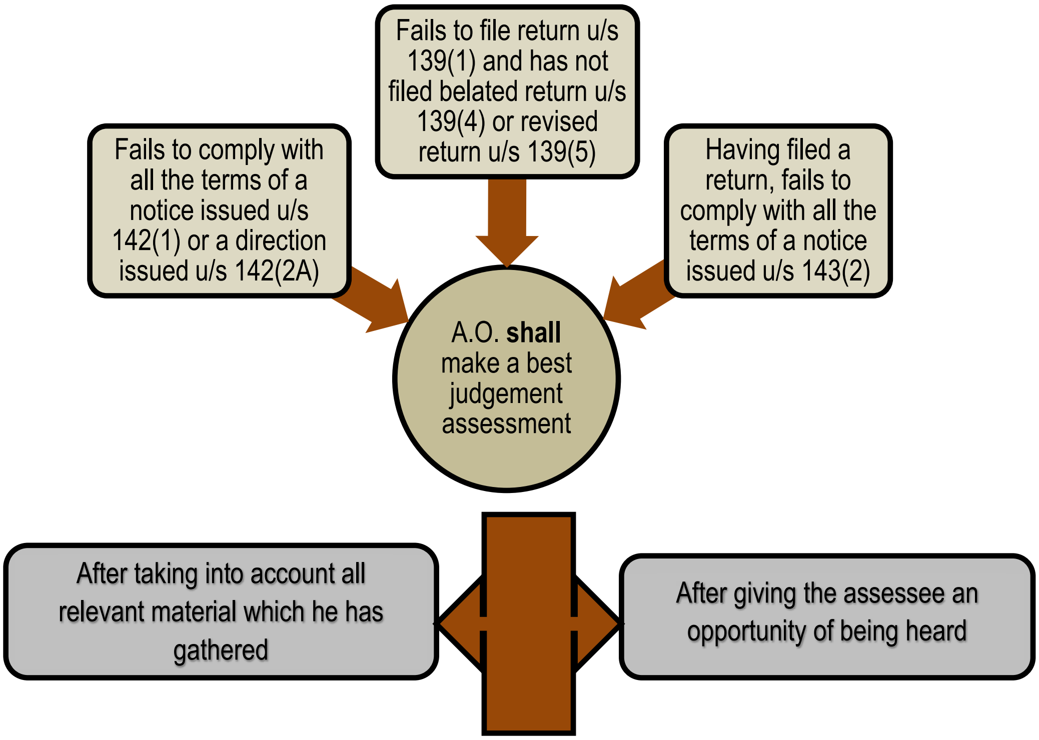
(b) optimising utilisation of the resources through economies of scale and functional specialisation;

(c) introducing a team-based assessment with dynamic jurisdiction.

The Scheme so notified has to be laid before each House of Parliament.

(iii) In order to give effect to this scheme, the Central Government, may direct on or before 31.03.2020 by way of notification, that the other provisions of this Act relating to assessment of total income or loss would not apply or would apply with certain exceptions, modifications and adaptations specified in the notification. ***Accordingly, the Central Government has, vide Notification No. 62 dated 12.9.2019, for the purposes of giving effect to the E-assessment Scheme, 2019 made under section 143(3A), directed that the provisions of section 2(7A), section 92CA, section 120, section 124, section 127, section 129, section 131, section 133, section 133A, section 133C, section 134, section 142, section 142A, section 143,section 144A, section 144BA section 144C and Chapter XXI of the Income-tax Act, 1961 would apply to the assessment made in accordance with the said Scheme subject to certain exceptions, modifications and adaptations listed in said notification given as Annexure at the end of this Chapter.***

(5) **Best judgment assessment [Section 144]**


Fails to file return u/s 139(1) and has not filed belated return u/s 139(4) or revised return u/s 139(5)
Fails to comply with all the terms of a notice issued u/s 142(1) or a direction issued u/s 142(2A)
Having filed a return, fails to comply with all the terms of a notice issued u/s 143(2)
A.O. shall make a best judgement assessment
After taking into account all relevant material which he has gathered
After giving the assessee an opportunity of being heard

(i) **Best judgement assessment mandatory in all the three cases stated above -** It is mandatory for the Assessing Officer to make a best judgment assessment and he has no discretion to make or not to make such assessment. These three cases are alternative and not cumulative for the purpose of making an *ex parte* assessment.

(ii) **Opportunity of being heard -** Before making best judgement assessment, the Assessing Officer has to take into account all relevant material which he has gathered. The assessee must be given an opportunity of being heard. Such opportunity shall be given by an Assessing Officer by serving a notice calling upon the assessee to show cause on a date and time to be specified in the notice, why the assessment should not be completed to the best of his judgment. Thereafter, the Assessing Officer shall make the assessment of total income or loss to the best of his judgment and determine the sum payable on the basis of such assessment. It may noted that no refund can be granted under section 144.

However, where a notice under section 142(1) has been issued prior to the making of an assessment under this section, it is not necessary to give such opportunity.

17.28 POWER OF JOINT COMMISSIONER TO ISSUE DIRECTIONS IN CERTAIN CASES [SECTION 144A]

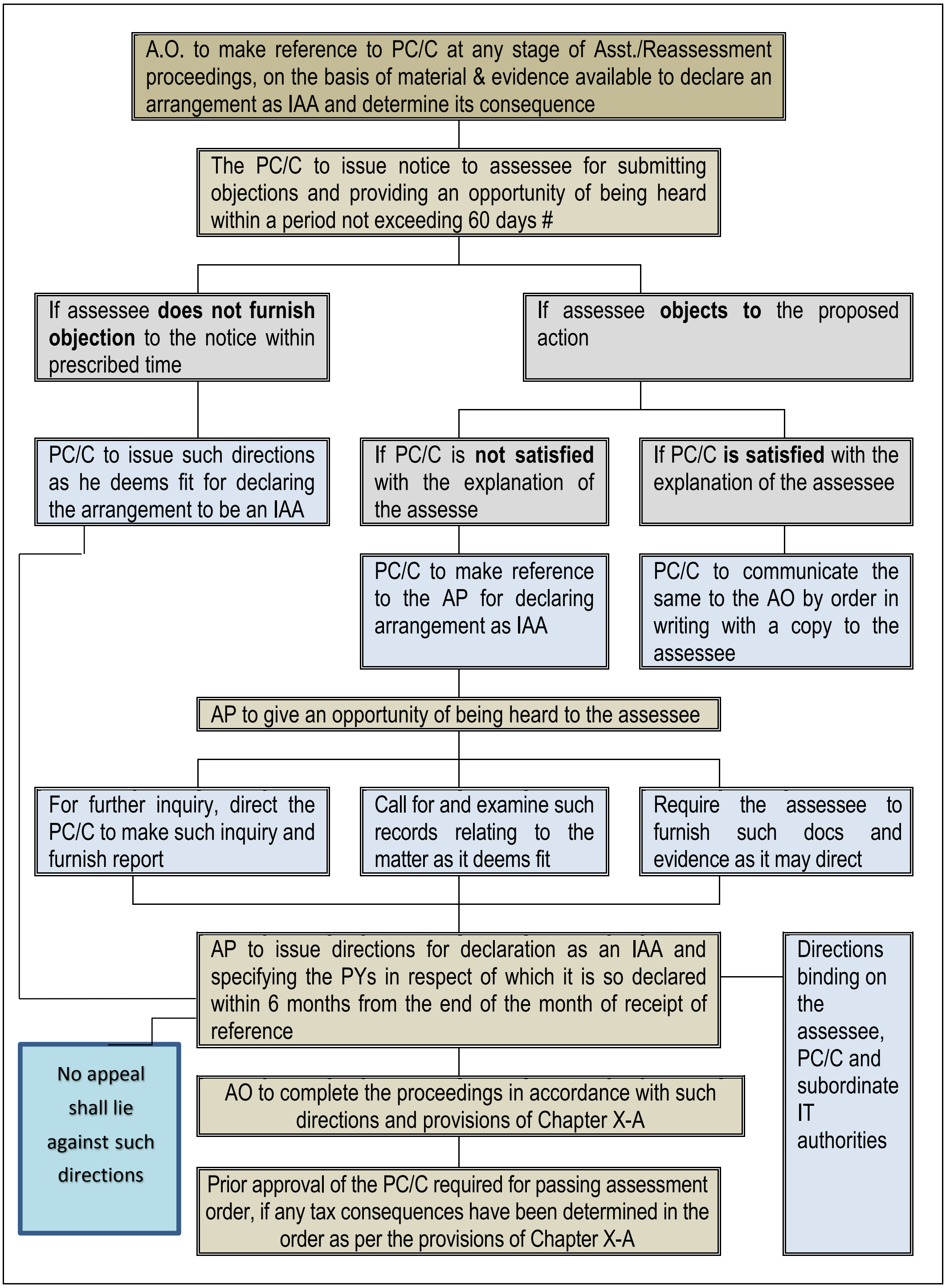
(1) A Joint Commissioner may, on his own motion or on a reference being made to him by the Assessing Officer or on the application of an assessee, call for and examine the record of any proceeding in which an assessment is pending and, if he considers that, having regard to the nature of the case or the amount involved or for any other reason it is necessary so to do, he may issue such direction as he thinks fit for the guidance of the Assessing Officer to enable him to complete the assessment. Such directions shall be binding on the Assessing Officer.

(2) No directions which are prejudicial to the assessee shall be issued before an opportunity is given to the assessee to be heard.

17.29 REFERENCE TO PRINCIPAL COMMISSIONER OR COMMISSIONER IN CERTAIN CASES [SECTION 144BA]

The diagram given in the next page would give you an understanding of the procedure for declaring any arrangement as an impermissible avoidance agreement. The short forms used in the diagram are:

PC/C	Principal Commissioner/Commissioner	AP	Approving Panel
IAA	Impermissible Avoidance Agreement	AO	Assessing Officer


A.O. to make reference to PC/C at any stage of Asst./Reassessment proceedings, on the basis of material & evidence available to declare an arrangement as IAA and determine its consequence
The PC/C to issue notice to assessee for submitting objections and providing an opportunity of being heard within a period not exceeding 60 days #
If assessee **does not furnish objection** to the notice within prescribed time
If assessee **objects to** the proposed action
PC/C to issue such directions as he deems fit for declaring the arrangement to be an IAA
If PC/C is **not satisfied** with the explanation of the assesse
If PC/C **is satisfied** with the explanation of the assessee
PC/C to make reference to the AP for declaring arrangement as IAA
PC/C to communicate the same to the AO by order in writing with a copy to the assessee
AP to give an opportunity of being heard to the assessee
For further inquiry, direct the PC/C to make such inquiry and furnish report
Call for and examine such records relating to the matter as it deems fit
Require the assessee to furnish such docs and evidence as it may direct
AP to issue directions for declaration as an IAA and specifying the PYs in respect of which it is so declared within 6 months from the end of the month of receipt of reference
Directions binding on the assessee, PC/C and subordinate IT authorities
No appeal shall lie against such directions
AO to complete the proceedings in accordance with such directions and provisions of Chapter X-A
Prior approval of the PC/C required for passing assessment order, if any tax consequences have been determined in the order as per the provisions of Chapter X-A

# The following period has to be excluded in computing the said period:	
(i)	The period commencing from the date on which the first direction is issued by the Approving Panel to the Principal Commissioner or the Commissioner for getting inquiries conducted through the authority competent under an agreement referred to in section 90 or section 90A and ending with the date on which the information so requested is last received by the Approving Panel or one year, whichever is less.
(ii)	The period during which the proceeding of the Approving Panel is stayed by an order or injunction of any court.
Note – *If, immediately after the exclusion of the aforesaid time or period, the period available to the Approving Panel for issue of directions is less than 60 days, such remaining period shall be extended to 60 days. Consequently, the aforesaid period of six months shall be deemed to have been extended accordingly.*	

Approving Panel

	Particulars	Provisions	
(1)	Constitution	The Central Government may constitute one or more Approving Panels as may be necessary	
(2)	Composition	Each Approving Panel may shall consist of three members including a Chairperson	
(3)	Qualification of members	(i)	The Chairman shall be a person who has been a judge of a High Court
		(ii)	One member shall be a member of IRS not below the rank of PCC/CCIT
		(iii)	One member shall be an academic or scholar having special knowledge of matters, such as direct taxes, business accounts and international trade practices.
(4)	Term	Ordinarily for one year; May be extended from time to time upto a period of three years.	
(5)	Frequency of Meeting	The Chairperson and members of the Approving Panel shall meet, as and when required, to consider the references made to the Panel. They shall be paid the remuneration as may be prescribed.	
(6)	Powers	(i)	The Approving Panel has to issue such directions, as it deems fit, in respect of declaration of the arrangement as an impermissible avoidance arrangement in accordance with the provisions of Chapter X-A including specifying the previous year or years to which such declaration of an arrangement as an impermissible avoidance arrangement shall apply.
		(ii)	The Approving Panel, may, before issuing any direction under section 144BA(6), if it is of the opinion that any further inquiry in the matter is necessary, direct the PC/C to make such inquiry

			or cause the inquiry to be made by any other IT authority and furnish a report containing the result of such inquiry to it.
		(iii)	Call for and examine such records relating to the matter as it deems fit.
		(iv)	Require the assessee to furnish such documents and evidence as it may direct
		(v)	All the powers which are the vested in the AAR u/s 245U
(7)	Officers	The CBDT shall provide to the Approving Panel such officials as may be necessary for the efficient exercise of powers and discharge of functions of the Approving Panel under the Income-tax Act, 1961.	
(8)	Rules	The CBDT may make rules for the purpose of the constitution and efficient functioning of the Approving Panel and expeditious disposal of the references received.	

17.30 PROVISION FOR CONSTITUTION OF ALTERNATE DISPUTE RESOLUTION MECHANISM [SECTION 144C]

An alternate dispute resolution mechanism which will aid speedy resolution of disputes on a fast track basis has now been provided for under the Income-tax Act, 1961. The significant features of the alternate dispute resolution mechanism are briefed hereunder –

(1) The Assessing Officer shall, forward a draft order of assessment to the eligible assessee if he proposes to make, on or after 1st October, 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.

“Eligible assessee” means,-

(i) any person in whose case such variation arises as a consequence of the order of the Transfer Pricing Officer passed under sub-section (3) of section 92CA; and

(ii) any foreign company.

(2) The eligible assessee shall, within thirty days of the receipt by him of the draft order,-

(a) file his acceptance of the variations to the Assessing Officer; or

(b) file his objections, if any, to such variation with,—

(i) The Dispute Resolution Panel; and

(ii) The Assessing Officer.

“Dispute Resolution Panel” means a collegium comprising of three commissioners of Income-tax constituted by the CBDT for this purpose.

(3) The Assessing Officer has to complete the assessment on the basis of the draft order, if—

(a) the assessee intimates the acceptance of the variation to the Assessing Officer; or

(b) no objections are received within the period of 30 days specified in (2) above.

(4) The Assessing Officer shall, notwithstanding anything contained in section 153 or section 153B, pass the assessment order within one month from the end of the month in which,—

(a) the acceptance is received; or

(b) the period of filing of objections expires.

(5) The Dispute Resolution Panel shall, in a case where any objections are received, issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

(6) The Dispute Resolution Panel shall issue such directions, after considering the following, namely:—

(a) Draft order;

(b) Objections filed by the assessee;

(c) Evidence furnished by the assessee;

(d) Report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority;

(e) Records relating to the draft order;

(f) Evidence collected by, or caused to be collected by, it; and

(g) Result of any enquiry made by, or caused to be made by it.

(7) The Dispute Resolution Panel may, before issuing any such directions -

(a) make such further enquiry, as it thinks fit; or

(b) cause any further enquiry to be made by any income tax authority and report the result of the same to it.

(8) The Dispute Resolution Panel may confirm, reduce or enhance the variations proposed in the draft order. However, it cannot set aside any proposed variation or issue any direction as mentioned in (5) above, for further enquiry and passing of the assessment order.

The power of the DRP to enhance the variation as mentioned in section 144C(8) shall include and shall be deemed to have always included the power to consider any matter arising out of the assessment proceedings relating to the draft order. This power to consider any issue shall be irrespective of whether the matter was raised by the eligible assessee or not.

While exercising the aforesaid power for considering any matter arising out of the assessment proceedings relating to the draft order, the DRP can only enhance the variation. The power of reducing the variation is not accorded to DRP in respect of such matters.

(9) If the members of the Dispute Resolution Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.

(10) Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer.

(11) If any direction is prejudicial to the interest of the assessee or the interest of the revenue, then, the same can be issued only after an opportunity of being heard is given to the assessee or the Assessing Officer, as the case may be.

(12) Such direction has to be issued within nine months from the end of the month in which the draft order is forwarded to the eligible assessee.

(13) Upon receipt of such direction, the Assessing Officer has to complete the assessment in accordance with the same, within one month from the end of the month in which the direction is received. This is notwithstanding anything contained in section 153 or section 153B. There is no requirement of providing any further opportunity of being heard to the assessee.

(14) The CBDT is empowered to make rules for the efficient functioning of the Dispute Resolution Panel and speedy resolution of the objections filed by the eligible assessee.

17.31 INCOME ESCAPING ASSESSMENT [SECTIONS 147 TO 149]

(1) **Applicability** - If the Assessing Officer has **reason to believe that any income chargeable to tax has escaped assessment for any assessment year**, he may, subject to the provisions of sections 148 to 153, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or re-compute the loss or the depreciation allowance or any other allowance, as the case may be, for the relevant assessment year.

The Assessing Officer may assess or reassess the income in respect of any issue (which has escaped assessment) which comes to his notice subsequently in the course of proceedings under this section, even though the reason for such issue does not form part of the reasons recorded under section 148(2).

(2) **Time limit** - Where an assessment under section 143(3) or 147 has already been made by the Assessing Officer for the relevant assessment year, then, no action shall be taken under this section after the expiry of **four years from the end of the relevant assessment year**.

The exception would be in cases where any income chargeable to tax has escaped assessment for such assessment year by reason of the failure on the part of the assessee to make a return under section 139, or in response to a notice issued under section 142(1) or section 148 or to disclose, fully and truly, all material facts necessary for his assessment for that assessment year.

It has been clarified that production before the Assessing Officer of account books or other evidence from which material evidence could with due diligence have been discovered by the Assessing Officer will not necessarily amount to disclosure.

The above time limit shall also not apply in a case where income chargeable to tax, in relation to an asset (including financial interest in an entity) located outside India, has escaped assessment for any assessment year. In effect, in such cases, the Assessing Officer can initiate assessment proceedings under section 147 even after the expiry of 4 years inspite of the assessee having –

(i) duly furnished his return of income and

(ii) fully and truly disclosing all material facts necessary for his assessment

for that assessment year.

(3) **Reason to believe** - The Assessing Officer must have 'reason to believe' that income chargeable to tax had escaped assessment. The belief which prompts an Income-tax Officer to apply section 147 to any particular case must be that of an honest and reasonable person based upon reasonable grounds, and that the Assessing Officer may act under this section on direct or circumstantial evidence but not on a mere suspicion, gossip or rumor. The powers of the Assessing Officer are wide, but not plenary in nature. Care must be taken to note that the words used in the section are "reason to believe" and not 'reason to suspect'. The expression 'reason to believe' does not, however, mean a purely subjective satisfaction on the part of the Assessing Officer. The belief must be held in good faith. It cannot be a mere pretence. It is open to the Court to examine whether the reasons for the belief have a rational connection or a relevant bearing to the formation of the belief and are not extraneous or irrelevant to the purpose of the section. There is no requirement in any of the provisions of the Act or under any section laying down as a condition for the initiation of the proceeding that the reasons which induced the Assessing Officer, to issue the notice must also be communicated to the assessee. Therefore, the Assessing Officer need not communicate to the assessee the reasons, which led him to initiate the proceedings under section 147.

(4) **Reassessment of matters other than subject matter of appeal or revision** - The Assessing Officer may assess or reassess an income which is chargeable to tax and has escaped assessment other than the income involving matters which are the subject matter of any appeal, reference or revision.

(5) **Circumstances when income is deemed to have escaped assessment** - For the purpose of this section, the following shall also be deemed to be cases where income chargeable to tax has escaped assessment:

	Case	When income is deemed to have escaped assessment
(i)	Where the assessee's total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeded the maximum amount which is not chargeable to income-tax.	No return of income has been furnished by the assessee
(ii)	Where a return of income has been furnished by the assessee but no assessment has been made	It is noticed by the Assessing Officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return.
(iii)	Where the assessee is required to furnish a report in respect of any international transaction under section 92E.	The assessee has failed to furnish such report
(iv)	Where an assessment has been made	(a) income chargeable to tax has been under-assessed (b) such income has been assessed at too low a rate (c) such income has been made the subject of excessive relief under this Act (d) excessive loss or depreciation or any other allowance under this Act has been computed.
(v)	where a return of income has **not** been furnished by the assesse	On the basis of information or document received from the prescribed income-tax authority, under section 133C(2), it is noticed by the Assessing Officer that the income of the assessee exceeds the basic exemption limit
(vi)	where a return of income has been furnished by the assessee	On the basis of information or document received from the prescribed income-tax authority, under section 133C(2), it is noticed by the Assessing Officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return

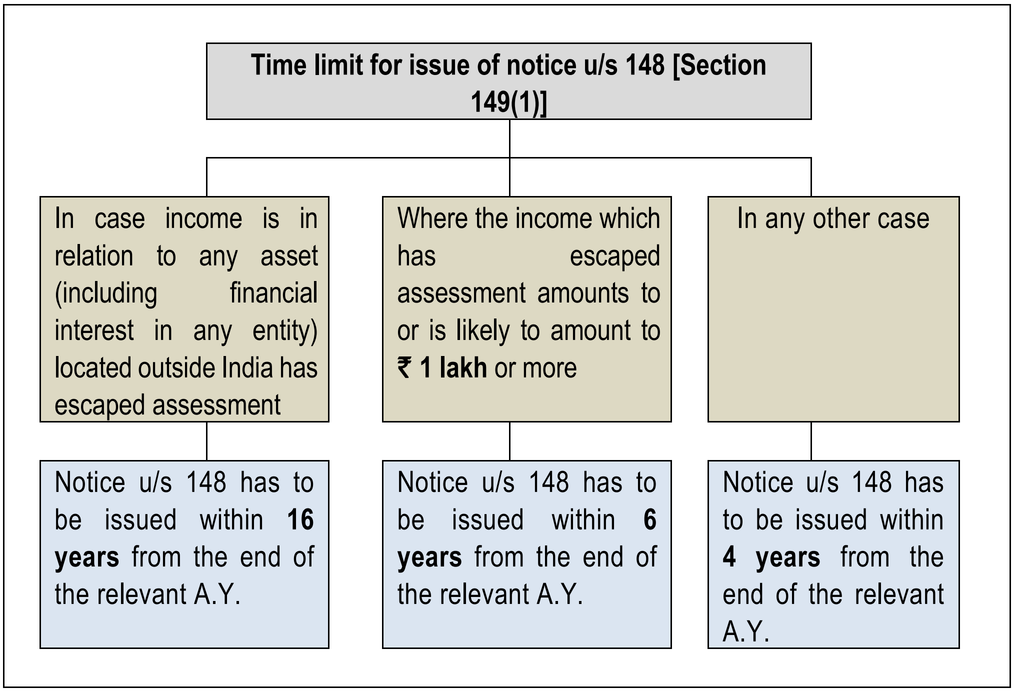
In addition, income chargeable to tax has escaped assessment, where a person is found to have any asset (including financial transaction in any entity) located outside India.

***Note -** The CBDT has, vide Circular No.40/2016 dated 9.12.2016, clarified that reopening of cases under section 147 is feasible only when the Assessing Officer "has reason to believe that any income chargeable to tax has escaped assessment for any assessment year" and not merely on the basis of any reason to suspect. Mere increase in turnover, because of use of digital means of payment or otherwise, in a particular year cannot be a sole reason to believe that income has escaped assessment in earlier years. Hence, past assessments cannot be reopened merely on the ground that the current year's turnover has increased.*

(6) **Issue of notice where income has escaped assessment [Section 148]** Before making the assessment, reassessment or recomputation under section 147, the Assessing Officer shall serve on the assessee, a notice requiring him to furnish a return within such period as may be specified in the notice, a return of his income or the income of any other person for whom he is assessable under the Act, during the previous year corresponding to the relevant assessment year in the prescribed form and verified in the prescribed manner and setting forth such other particulars may be prescribed. The provisions of this Act shall apply accordingly as if such return were a return required to be furnished under section 139.

The Assessing Officer shall, before issuing any notice under this section, record his reasons for doing so.

(7) **Time limit for notice [Section 149]**: Notice under section 148 must be issued within the following time limit:



Time limit for issue of notice u/s 148 [Section 149(1)]

In case income is in relation to any asset (including financial interest in any entity) located outside India has escaped assessment

Notice u/s 148 has to be issued within **16 years** from the end of the relevant A.Y.

Where the income which has escaped assessment amounts to or is likely to amount to **₹ 1 lakh** or more

Notice u/s 148 has to be issued within **6 years** from the end of the relevant A.Y.

In any other case

Notice u/s 148 has to be issued within **4 years** from the end of the relevant A.Y.

As per section 149(3), if the person on whom a notice under section 148 is to be served is a person treated as an agent of a non-resident under section 163 and the assessment, reassessment or re-computation in pursuance of the notice is to be made on him as the agent of such non-resident, there is a time limit of 6 years from the end of the relevant assessment year, beyond which such notice cannot be issued.

(8) **Provision for cases where assessment is in pursuance of an order on appeal, etc. [Section 150]**

(i) Section 149(1) provides the time limit for issue of notice u/s 148 for assessment, reassessment or recomputation where income has escaped assessment.

(ii) The restriction of time limit under section 149(1) is not applicable where notice u/s 148 is issued for making an assessment, reassessment or re-computation to give effect to any finding or direction contained in an order passed by any authority in any proceeding by way of appeal, reference or revision or by a Court in any proceeding under any other law. This relaxation is contained in section 150(1).

(iii) However, such relaxation will not apply where any such assessment or reassessment relates to an assessment year in respect of which an assessment or reassessment could not have been made at the time the order which was the subject matter of appeal, reference or revision, as the case may be, was made on account of the expiry of the time limit at that point of time itself. This restriction is contained in section 150(2)

(iv) Section 150(1) operates to relax the time restriction stipulated under section 149. Such relaxation can be made use of by the Assessing Officer only if the restriction placed under section 150(2) does not affect the operation of section 150(1). It may be noted that the restriction placed under section 150(2) is applicable only in respect of appeal, reference or revision referred to in section 150(1) but it does not apply with reference to an order passed by a Court in any proceeding under any law.

ILLUSTRATION

The assessment of Mr. Hari for A.Y.2012-13 was made on 28.3.2014 making an addition of ₹ 3,25,000 for a certain income received during the P.Y.2011-12. The assessee contested the addition before Commissioner (Appeals) but lost the case. The Appellate Tribunal passed an order on 26.2.2019 holding that the said income was not taxable in the P.Y.2011-12 but the same was taxable in the year of accrual, being P.Y.2006-07 relevant to A.Y.2007-08. The Assessing Officer issued notice under section 148 for A.Y.2007-08 in March 2019 bringing to tax the sum of ₹ 3,25,000. Is the notice valid?

Would your answer change if in the said case, the assessment order for A.Y.2012-13 was made on 4.4.2014 instead of 28.3.2014?

SOLUTION

Section 149 requires issue of notice under section 148 within a period of 6 years from the end of the relevant assessment year, where income escaping assessment exceeds ₹ 1 lakh. Accordingly, in respect of A.Y.2012-13, notice can be issued upto 31.3.2019. Section 150(1) enables issue of notice at any time to give effect to a finding contained in an appellate order. However, this is subject to the provisions of section 150(2), which places a restriction that, if on the date of passing of the order which was the subject-matter of appeal, no notice could have been issued, then, such notice cannot be issued by virtue of the enabling provision contained in section 150(1).

In this case, the income was taxable in the A.Y.2007-08 as per the order of the Appellate Tribunal. The six year time limit, in this case, expires on 31.3.2014. Since the original assessment in respect of such income was made on 28.3.2014, the notice issued under section 148 consequent to the Appellate Tribunal order is valid.

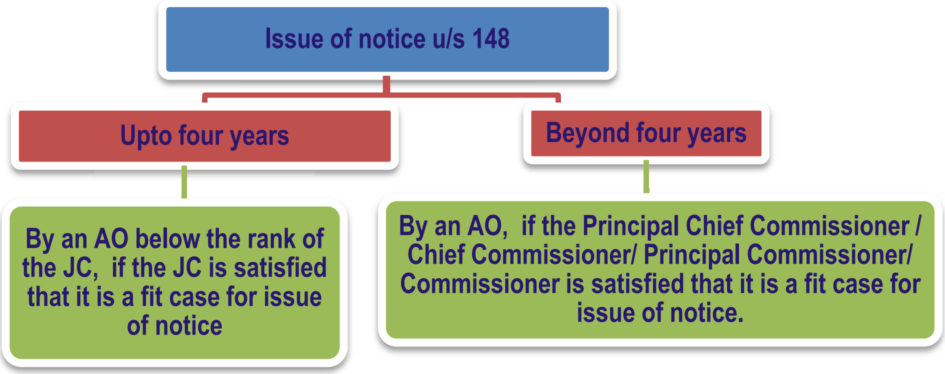
Had the assessment order for A.Y.2012-13 been made on 4.4.2014 (instead of 28.3.2014), then, the same would have been outside the six year time limit from A.Y.2007-08. Hence, since notice could not have been issued at that point of time, it cannot be now issued invoking the provisions of section 150(1).

17.32 SANCTION FOR ISSUE OF NOTICE [SECTION 151]

(i) Section 151 requires the Assessing Officer to obtain sanction from certain authorities before issue of notice for reassessment of income under section 148, under certain specified circumstances.

(ii) The simplified approval regime with effect from 1.6.2015 for issue of notice for reassessment is given hereunder -

	Time limit (from the end of the relevant A.Y.)	Issue of Notice under section 148 by	Competent authority who has to be satisfied on the reasons recorded by the A.O., that it is a fit case for the issue of such notice
(1)	Upto 4 years	Assessing Officer below the rank of Joint Commissioner	Joint Commissioner
(2)	After 4 years	Assessing Officer	Principal Chief Commissioner/ Chief Commissioner/Principal Commissioner/ Commissioner



Issue of notice u/s 148

Upto four years

Beyond four years

By an AO below the rank of the JC, if the JC is satisfied that it is a fit case for issue of notice

By an AO, if the Principal Chief Commissioner / Chief Commissioner/ Principal Commissioner/ Commissioner is satisfied that it is a fit case for issue of notice.

It is further clarified that in the above cases, the Principal Chief Commissioner or Chief Commissioner or the Principal Commissioner or Commissioner or the Joint Commissioner, as the case may be, has to be satisfied on the reasons recorded by the Assessing Officer about fitness of a case for the issue of notice under section 148. However, these authorities are not required to issue the notice themselves.

17.33 OTHER PROVISIONS [SECTION 152]

(1) **Income escaping assessment to be charged to tax at rates applicable for respective years [Section 152(1)]**

In the case of any assessment or reassessment or recomputation made under section 147, the income escaping assessment would be chargeable to tax at the rate applicable to the respective years in which such income is liable to be taxed.

(2) **Assessee entitled to claim dropping of proceedings under section 147 in certain cases [Section 152(2)]**

Where an assessment is reopened under section 147, the assessee may claim that the proceedings under section 147 shall be dropped on his showing that he had been assessed on an amount not lower than what he would be rightly liable for even if the income alleged to have escaped assessment had been taken into account. Alternatively, he can make such a claim on showing that the assessment or computation had been properly made. An assessee can avail this benefit only if he had not challenged any part of the original assessment order either by filing an appeal or filing a revision petition. The assessee, while making such claim, shall not be entitled to reopen matters concluded by an order under sections 154,155, 260, 262 or 263.

17.34 TIME LIMIT FOR COMPLETION OF ASSESSMENTS AND REASSESSMENTS [SECTION 153]

(1) **Time limits in different cases/circumstances** - The time limit for completion of assessment proceedings is 21 months from the end of the assessment year in which the income was first assessable. Further, no order of assessment, reassessment or re-computation could be made under section 147 after the expiry of 9 months from the end of the financial year in which notice under section 148 was served.

Since digitisation of processes within the Department has enhanced its efficiency in handling workload, the time limit has been accordingly reduced, so that the assessment proceedings are finalised more expeditiously.

Section	Proceeding	Case/Circumstance	Time limit for completion of assessment or reassessment
153(1)	Order of assessment u/s 143 or 144	In respect of an order relating to:	
		A.Y.2017-18 or any earlier A.Y. and made on or after 1.6.2016	21 months from the end of the assessment year in which the income was first assessable
		A.Y.2018-19	18 months from the end of the assessment year in which the income was first assessable
		A.Y.2019-20 and thereafter	12 months from the end of the assessment year in which the income was first assessable
153(2)	Order of assessment, reassessment or recomputation u/s 147	Where notice u/s 148 is served before 1.4.2019	9 months from the end of the financial year in which the notice is served
		Where notice u/s 148 is served on or after 1.4.2019	12 months from the end of the financial year in which the notice is served
153(3)	Fresh assessment u/s 143/144/ 147 where the original assessment has been set aside, cancelled and referred back to the Assessing Officer by an order u/s 254/263/264	If order u/s 254/263/ 264 is passed before 1.4.2019	9 months from the end of the financial year in which the said order u/s 254 is received by the PCC/ CC/PC/CIT[2] or the order u/s 263 or u/s 264 is passed by the PC/CIT
		If order u/s 254/263/ 264 is passed on or after 1.4.2019	12 months from the end of the financial year in which the said order u/s 254 is received by the PCC/CC/PC/CIT or the order u/s 263 or u/s 264 is passed by the PC/CIT
153(4)	Where a reference is made to the TPO u/s		An additional time period of 12 months is available for

[2] Principal Chief Commissioner (PCC) / Chief Commissioner (CC) / Principal Commissioner (PC) / Commissioner of Income-tax (CIT).

	92CA(1) during the course of proceeding for assessment or reassessment: Completion of assessment u/s 143 or u/s 144.		completion of assessment/ reassessment in such cases. Thus, the revised time limit shall be as follows:
		In relation to A.Y.2017-18 or earlier A.Y.	33 months from the end of the assessment year in which the income was first assessable.
		In relation to A.Y.2018-19	30 months from the end of the assessment year in which the income is first assessable
		In relation to A.Y.2019-20 or any subsequent A.Y.	24 months from the end of the assessment year in which the income is first assessable
	Completion of assessment/ reassessment/re-computation u/s 147	Where notice u/s 148 is served before 1.4.2019	21 months from the end of the financial year in which notice u/s 148 is served.
		Where notice u/s 148 is served on or after 1.4.2019	24 months from the end of the financial year in which the notice u/s 148 is served
	Completion of fresh assessment in pursuance of an order u/s 254 (received by the PCC or CC/PC or CIT) or an order passed by the PC or CIT u/s 263 or u/s 264.	Where order u/s 254/263/264 is passed before 01.04.2019	21 months from the end of the financial year in which such order u/s 254 is received by the PCC or CC/PC or CIT or such order u/s 263 or 264 is passed by the PC or CIT, as the case may be.
		Where order u/s 254/263/264 is passed on or after 01.04.2019	24 months from the end of the F.Y. in which the said order u/s 254 is received by the PCC/CC/PC/CIT or the order u/s 263 or u/s 264 is passed by the PC/CIT if order u/s 254/263/264 is passed on or after 01.04.2019
153(5)	Effect to be given by the Assessing Officer, to an	Where order u/s 250/ 254/260/262/263/264	The order u/s 250/254/ 260/262/263/264 shall be

	order u/s 250/254/ 260/262/263/264, wholly or partly, otherwise than by making a fresh assessment or reassessment	requires verification of issue by submission of any document by assessee or any other person or where opportunity of being heard is to be provided to the assessee.	made within time specified in section 153(3) i.e., within 9 months in respect of order passed on or before 31.03.2019 and 12 months in respect of an order passed on or after 1.4.2019.
		In any other case	3 months from the end of the month in which the order u/s 250/254/ 260/262 is received by the PCC/CC/PC/CIT or the order u/s 263/264 is passed by the PC/CIT. **Note** – Additional period of 6 months may be allowed to the A.O. to give effect to order if the PC/CIT is satisfied, on an application from the A.O., that the order could not be given effect to within 3 months due to reasons beyond the control of the A.O.
153(6)(i)	Where the assessment, reassessment or recomputation is made on the assessee or any person in consequence of or to give effect to any finding or direction contained in an order u/s 250/254/260/262/263/264 or in an order of any court in a proceeding otherwise than by way of appeal or reference.		12 months from the end of the month in which the order is received or passed by the PC or CIT.
153(6)(ii)	Where, in the case of a firm, an assessment is made on a partner of the firm in consequence of an assessment made on the firm under section 147		12 months from the end of the month in which the assessment order in the case of the firm is passed.

153(8)	The order of assessment or reassessment, relating to any assessment year, which stands revived under section 153A(2)		1 year from the end of the month of such revival or within the period specified in section 153 or section 153B(1), whichever is later. **Note** - This is notwithstanding anything contained in the foregoing provisions of section 153, section 153A(2) or section 153B(1).

(2) **Exclusion of period [*Explanation 1* to section 153]** - In computing the period of limitation for the purposes of section 153 the following time periods shall be excluded:

	Case	Exclusion of Period	
		Commencing from	Ending with
(i)	Contravention of the provisions of section 10(21)/(22B)/(23A)/(23B)/(23C)(iv)/(v)/(vi)/(via)	the date on which the A.O. intimates the Central Government or the prescribed authority, the said contravention as required under clause (i) of the proviso to section 143(3)	the date on which the copy of the order withdrawing the approval or rescinding the notification, as the case may be, is received by the A.O.
(ii)	Direction to get accounts audited under section 142(2A)	the date on which the A.O. directs the assessee to get his accounts audited under section 142(2A)	the last date on which the assessee is required to furnish a report of such audit **(or)** the date on which the order setting aside such direction is received by the PC/CIT, if such direction is challenged before a Court.
(iii)	Reference to the Valuation Officer under section 142A(1)	the date on which the Assessing Officer makes a reference to the Valuation Officer	the date on which the report of the Valuation Officer is received by the Assessing Officer.
(iv)	Where the assessee furnishes declaration claiming that any question of law arising in his	the date on which the Assessing Officer received the declaration under section 158A(1)	the date on which the order under section 158A(3) is made by him

	case for an assessment year which is pending before the A.O. or any appellate authority is identical with a question of law arising in his case for another A.Y. which is pending before the High Court or Supreme Court.		**Note** – However, such period cannot exceed 60 days.
(v)	Where an application made before the Income-tax Settlement Commission is rejected by it or is not allowed to be proceeded with by it	the date on which an application is made before the Settlement Commission under section 245C	the date on which the order u/s 245D(1) is received by the PC or CIT u/s 245D(2)
(vi)	Where an application is made before the AAR u/s 245Q(1)	the date on which an application is made before the AAR u/s 245Q(1)	the date on which the order rejecting the application is received by the PC/CIT u/s 245R(3) **(or)** the date on which the advance ruling pronounced by it is received by the PC/CIT u/s 245R(7)
(vii)	Where reference(s) for exchange of information is made by a competent authority	the date on which a reference or first of the references for exchange of information is made by an authority competent under an agreement referred to in section 90 or section 90A	the date on which the information requested is last received by the PC/CIT **(or)** a period of one year, **whichever is less**
(viii)	the time taken in reopening the whole or any part of the proceeding or in giving an opportunity to the assessee to be re-heard under the proviso to section 129; or		
(ix)	the period during which the assessment proceeding is stayed by an order or injunction of any court.		

(3) **Period of limitation in certain cases**

	Case	Period of limitation
(i)	Where immediately after the exclusion of the aforesaid period, the period of limitation referred to in section 153(1)/(2)/(3)/(8) available to the Assessing Officer for making an order of assessment, reassessment or re-computation, as the case may be, is less than 60 days	Such remaining period shall be extended to **60 days** and the aforesaid period of limitation shall be deemed to be extended accordingly
(ii)	Where the period available to the Transfer Pricing Officer is extended to 60 days in accordance with the proviso to section 92CA(3A) and the period of limitation available to the Assessing Officer for making an order of assessment, reassessment or re-computation, as the case may be, is less than 60 days	Such remaining period shall be extended to **60 days** and the aforesaid period of limitation shall be deemed to be accordingly extended.
(iii)	Where a proceeding before the Settlement Commission abates under section 245HA	The period of limitation available under this section to the Assessing Officer for making an order of assessment, reassessment or re-computation, as the case may be, after the exclusion of the period under section 245HA(4), would be not less than one year; and Where such period of limitation is less than 1 year, it shall be deemed to have been extended to 1 year. This would apply for the purposes of determining the period of limitation under sections 149, 154, 155 and158BE and for the purposes of payment of interest under section 244A.

(4) **Deeming provisions in respect of assessment of excluded income for another assessment year or on another person**

	Case	Consequence
(a)	Where, by an order referred to in section 153(6)(i), any income is	An assessment of such income for another assessment year shall, for the purposes of

	excluded from the total income of the assessee for an assessment year	sections 150 and 153, be deemed to be one made in consequence of or to give effect to any finding or direction contained in the said order
(b)	Where, by an order referred to in section 153(6)(i), any income is excluded from the total income of one person and held to be the income of another person	An assessment of such income on such other person shall, for the purposes of section 150 and section 153, be deemed to be one made in consequence of or to give effect to any finding or direction contained in the said order, provided such other person was given an opportunity of being heard before the said order was passed.

17.35 ASSESSMENT PROCEDURE IN CASE OF SEARCH OR REQUISITION [SECTION 153A/153B/153C]

The block assessment procedure introduced in 1995 and in operation since then for 8 years with various amendments from time to time has been abolished in respect of search carried out after 31st May, 2003. In the place of the block assessment, a scheme of reassessment was introduced by inserting three sections 153A, 153B and 153C with effect from 1st June, 2003 for assessment in case of search or making requisition.

(1) **Procedure for assessment where search is initiated under section 132 or books of account etc. are requisitioned under section 132A [Section 153A]**

(i) **Overriding provisions of section 153A:** The provisions of section 153A prescribing a procedure for assessment in the case of search or requisition will apply notwithstanding anything contained in sections 139/147/148/149/151 and 153.

This section provides for the procedure for completion of assessment where a search is initiated under section 132 or books of account, other documents or any assets are requisitioned under section 132A after 31st May, 2003.

(ii) **Issue of Notice:** In such cases, the Assessing Officer shall issue notice to such person. Such a person has to furnish a return of income within such period as may be specified in the notice setting forth such other particulars as may be prescribed.

(iii) **Filing of return in response to notice:** Such a return should be filed in respect of six assessment years and for the relevant assessment year or years immediately preceding the assessment year relevant to the previous year in which the search was conducted under section 132 or requisition was made under section 132A.

The expression "**relevant assessment year"** shall mean an assessment year preceding the assessment year relevant to the previous year in which search is conducted or requisition is made which falls beyond six assessment years but not later than ten assessment years from the end of the assessment year relevant to the previous year in which search is conducted or requisition is made.

(iv) **Year upto which income can be assessed:** The Assessing Officer shall assess or reassess the total income of each of these six assessment years **and for the relevant assessment year or years**.

(v) **Pending assessments to abate:** The assessment or reassessment, if any, relating to any assessment year falling within the above period of six assessment years **and for the relevant assessment year or years**, pending on the date of the initiation of the search under section 132 or requisition under section 132A, as the case may be, shall abate. In other words, they will cease to be applicable.

(vi) **Notice to be issued only for the assessment year relevant to the previous year of search in case of notified class of cases:** The Central Government is empowered to notify class or classes of cases [except the cases where any assessment or reassessment has abated] in which the Assessing Officer shall not be required to issue notice for initiation of assessment or reassessment of total income for six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted or requisition was made **and for the relevant assessment year or years**. The assessment proceedings in the class or classes of cases so notified shall be carried out only for the assessment year relevant to the previous year in which search was conducted or requisition was made, except in cases where any assessment or reassessment in respect of any of the earlier six years **and for the relevant assessment year or years** has abated.

Accordingly, in exercise of this power, the Central Government has, through Notification No.42/2012 dated 4.10.2012, inserted Rule 112F which came into force from 1st July, 2012.

The said Rule provides that the Assessing Officer is not required to issue notice for assessing or reassessing the total income for six assessment years immediately preceding the assessment year relevant to the previous year in which search is conducted or requisition is made, in the following cases:

(a) where as a result of a search under section 132(1) or a requisition made under section 132A, a person is found to be in possession of any money, bullion, jewellery or other valuable articles or things, whether or not he is the actual owner of the same, and

(b) where such search is conducted or such requisition is made in the territorial area of an assembly or parliamentary constituency in respect of which a notification has been issued under section 30 read with section 56 of the Representation of the People Act, 1951, or where the assets so seized or requisitioned are connected in any manner to the ongoing election in an assembly or parliamentary constituency.

However, this Rule is not applicable to cases where such search under section 132 or such requisition under section 132A has taken place after the hours of poll so notified.

Circular No.10/2012 dated 31.12.2012 clarifies that the aforesaid provision would reduce infructuous and unnecessary proceedings under the Income-tax Act, 1961 in cases where a search is conducted under section 132 or requisition is made under section 132A and cash or other assets are seized during the election period, generally on a single warrant, and no evidence is available, or investigation required, for any assessment year other than the assessment year relevant to the previous year in which search is conducted or requisition is made.

In such cases, the officer investigating the case, with the approval of the Director General of Income-tax, is required to certify that -

(a) the search is conducted under section 132 or the requisition is made under section 132A in the territorial area of an assembly or parliamentary constituency in respect of which a notification has been issued under section 30, read with section 56 of the Representation of the People Act, 1951; or

(b) the assets seized or requisitioned are connected in any manner to the ongoing election process in an assembly or parliamentary constituency; and

(c) no evidence is available or investigation is required for any assessment year other than the assessment year relevant to the previous year in which search is conducted or requisition is made.

The certificate of the investigating officer shall be communicated to the Commissioner of Income-tax and the Assessing Officer having jurisdiction over the case of such person.

(vii) **Conditions to be satisfied for issue of notice beyond six years prior to the year of search:** No notice for assessment or reassessment shall be issued by the Assessing Officer for the relevant assessment year or years unless:

(a) the Assessing Officer has in his possession books of account or other documents or evidence which reveal that the income, represented in the form of assets, which has escaped assessment amounts to or is likely to amount to ₹ 50 lakhs or more in the relevant assessment year or in aggregate in the relevant assessment years.

(b) the income so referred above has escaped assessment for such year or years

(c) the search under section 132 is initiated or requisition under section 132A is made on or after 1.4.2017

For this purpose, **"asset"** includes immovable property being land or building or both, shares and securities, loans and advances, deposits in bank account.

(viii) **Revival of abated proceeding:** If any proceeding initiated under section 153A or any order of assessment or reassessment made under section 153A(1) has been annulled in any appeal or other legal proceeding, the abated assessment or reassessment relating to any assessment year shall stand revived with effect from the date of receipt of the order of such annulment by the Principal Commissioner or Commissioner. If the order of annulment is set aside, such revival shall cease to have effect.

(ix) **Applicability of other provisions of the Act:** Unless section 153A, section 153B and section 153C provide otherwise, all other provisions of the Income-tax Act, 1961, shall apply to the assessment or reassessment made in respect of assessment year under this section.

(x) **Applicable rate of tax:** The tax shall be chargeable at the rate or rates as applicable to such assessment year.

(2) Time-limit for completion of search assessments [Section 153B]

(i) The time limit for assessment or reassessment under section 153B with effect from 1st June, 2016 is as follows -

Section	Proceeding under section	Case/Circumstance	Time limit for completion of assessment or reassessment
153B(1)	153A – for the assessment year relevant to the previous year in which search is conducted u/s 132 or requisition is made u/s 132A and for each of the 6 assessment years and for the relevant assessment year or years immediately preceding the assessment year relevant to the previous year in which search was conducted	Where the last of the authorisations for search u/s 132 or for requisition u/s 132A was executed prior to F.Y. 2018-19	21 months from the end of the financial year in which the last of the authorizations for search u/s 132 or for requisition u/s 132A was executed.
		Where the last of the authorisations for search u/s 132 or for requisition u/s 132A was executed during the F.Y. 2018-19.	18 months from the end of the financial year in which the last of the authorizations for search u/s 132 or for requisition u/s 132A was executed.
		Where the last of authorisations for search u/s 132 or requisition u/s 132A was executed during	12 months from the end of the financial year in which the last of the authorizations for

		the F.Y.2019-20 or thereafter	search u/s 132 or for requisition u/s 132A was executed.
		In case reference u/s 92CA(1) is made during the course of proceedings for assessment or reassessment of total income	The above time limits of 21/18/12 months shall be further extended by 12 months
153B(1) – First Proviso	In case of a person assessed under section 153C – for the assessment year relevant to the previous year in which search is conducted and for each of the 6 assessment years and for the relevant assessment year or years immediately preceding the assessment year relevant to the previous year in which search was conducted	Where the last of the authorisations for search u/s 132 or for requisition u/s 132A was executed prior to F.Y.2018-19	21 months from the end of the F.Y. in which last of the authorizations for search u/s 132 or for requisition u/s 132A was executed (or) 9 months from the end of the F.Y.in which books of account or documents or assets seized or requisitioned are handed over to the jurisdictional A.O. u/s 153C, whichever is later
		Where the last of the authorisations for search under section 132 or for requisition under section 132A was executed during the F.Y. 2018-19.	18 months from the end of the F.Y. in which last of the authorizations for search u/s 132 or for requisition u/s 132A was executed (or) 12 months from the end of the F.Y. in which books of account or documents or assets seized or

			requisitioned are handed over to the jurisdictional A.O. u/s 153C, whichever is later
		Where the last of authorisations for search u/s 132 or requisition u/s 132A was executed during the F.Y.2019-20 or thereafter	12 months from the end of the F.Y. in which last of the authorizations for search u/s 132 or for requisition u/s 132A was executed (or) 12 months from the end of the F.Y. in which books of account or documents or assets seized or requisitioned are handed over to the jurisdictional A.O. u/s 153C, whichever is later.
		In case reference under section 92CA(1) is made during the course of proceedings for the assessment or reassessment of total income in case of other person referred to in section 153C	The above time limit shall be further extended by 12 months.

(ii) **Time of deemed execution of authorization in case of search and requisition :**

	Case	Time when authorization is deemed to have been executed
(a)	Search u/s 132	On the conclusion of search as recorded in the last panchnama drawn in relation to any person in whose case the warrant of authorisation has been issued

(b)	Requisition u/s 132A	On the actual receipt of books of account or other documents or assets by the Authorised Officer.

(iii) **Exclusion of period [*Explanation* to section 153B]** - In computing the period of limitation for the purposes of section 153B, the following time periods shall be excluded:

	Case	Exclusion of Period	
		Commencing from	Ending with
(a)	Direction to get accounts audited under section 142(2A)	the date on which the A.O. directs the assessee to get his accounts audited under section 142(2A)	the last date on which the assessee is required to furnish a report of such audit (or) the date on which the order setting aside such direction is received by the PC/CIT, if such direction is challenged before a Court.
(b)	Reference to the Valuation Officer under section 142A(1)	the date on which the Assessing Officer makes a reference to the Valuation Officer	the date on which the report of the Valuation Officer is received by the Assessing Officer
(c)	Where an application made before the Income-tax Settlement Commission is rejected by it or is not allowed to be proceeded with by it	the date on which an application is made before the Settlement Commission under section 245C	the date on which the order u/s 245D(1) is received by the PC/CIT u/s 245D(2)
(d)	Where an application is made before the AAR u/s 245Q(1)	the date on which an application is made before the AAR u/s 245Q(1)	the date on which the order rejecting the application is received by the PC/CIT u/s 245R(3) (or) the date on which the advance ruling pronounced by it is received by the PC/CIT

			u/s 245R(7), as the case may be.
(e)	Where a proceeding or assessment order or reassessment order referred to in section 153A(2) is annulled	The date of annulment of the proceeding or assessment order or reassessment order	The date of receipt of order setting aside the order of such annulment, by the PC/CIT.
(f)	Where reference(s) for exchange of information is made by a competent authority	the date on which a reference or first of the references for exchange of information is made by an authority competent under an agreement referred to in section 90 or section 90A	the date on which the information requested is last received by the PC/CIT (or) a period of one year, whichever is less
(g)	the time taken in reopening the whole or any part of the proceeding or in giving an opportunity to the assessee to be re-heard under the proviso to section 129; or		
(h)	the period during which the assessment proceeding is stayed by an order or injunction of any court.		

(iv) **Period of limitation in certain cases -**

	Case	Period of limitation
(a)	Where immediately after the exclusion of the aforesaid period, the period of limitation referred to in section 153B(1)(a) and (b) available to the Assessing Officer for making an order of assessment, reassessment or re-computation, as the case may be, is less than 60 days	Such remaining period shall be extended to **60 days** and the aforesaid period of limitation shall be deemed to be extended accordingly
(b)	Where the period available to the Transfer Pricing Officer is extended to 60 days in accordance with the proviso to section 92CA(3A) and the period of limitation available to the Assessing Officer for making an order of assessment, reassessment or re-	Such remaining period shall be extended to **60 days** and the aforesaid period of limitation shall be deemed to be accordingly extended.

	computation, as the case may be, is less than 60 days	
(c)	Where a proceeding before the Settlement Commission abates under section 245HA	The period of limitation available under this section to the Assessing Officer for making an order of assessment, reassessment or re-computation, as the case may be, after the exclusion of the period under section 245HA(4), would be not less than one year; and Where such period of limitation is less than 1 year, it shall be deemed to have been extended to **1 year**. **Note** – Period u/s 245HA(4) is the period commencing from the date of application to the Settlement Commission u/s 245C and ending with the specified date for abatement.

(3) Assessment or reassessment of income of any other person [Section 153C]

(i) **Handing over of books of accounts, documents, assets seized or requisitioned to jurisdictional Assessing Officer, where they belong to another person:** Section 153C provides for assessment or reassessment of income of any other person.

Notwithstanding anything contained in section 139, section 147, section 148, section 149, section 151 and section 153, where the Assessing Officer is satisfied that -

(a) any money, bullion, jewellery or other valuable article or thing seized or requisitioned **belongs to** ; or

(b) any books of account or documents seized or requisitioned **pertain to**; or

(c) any information contained therein, **relates to**,

any person, other than the person referred to in section 153A, then, the books of account or documents or assets, seized or requisitioned shall be handed over to the Assessing Officer having jurisdiction over such other person.

(ii) **Jurisdictional Assessing Officer to proceed against other person [Section 153C(1)]:** The Assessing Officer having jurisdiction over the other person shall proceed against such other person and issue such other person notice and assess or reassess income of such other person in accordance with the provisions of section 153A only if he is satisfied that the books of account or documents or assets seized or requisitioned have a bearing on the determination of the total income of such other person for six assessment years immediately preceding the assessment year relevant to the previous year in which search is conducted or requisition is made and for the relevant assessment year or years referred to in section 153A(1).

(iii) **Pending assessments to abate:** The assessment or reassessment, if any, relating to any assessment year falling within the period of six assessment years referred to in the said section and for the relevant assessment year or years referred to in section 153A(1) pending on the date of initiation of the search under section 132 or on the date of making of requisition under section 132A, as the case may be, shall abate.

(iv) **Date of initiation of search [Section 153C(1)]:** In case of such other person, the reference to the date of initiation of the search under section 132 or making of requisition under section 132A in the second proviso to section 153A shall be construed as reference to the date of receiving the books of account or documents or assets seized or requisitioned by the Assessing Officer having the jurisdiction over such other person.

(v) **Notice for the assessment year relevant to the previous year of search in case of notified class of cases:** The Central Government is empowered to notify class or classes of cases [except the cases where any assessment or reassessment has abated] in which the Assessing Officer shall not be required to issue notice for initiation of assessment or reassessment of total income for six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted or requisition was made and for the relevant assessment year or years as referred to in sub-section (1) of section 153A.

The assessment proceedings in the class or classes of cases so notified shall be carried out only for the assessment year relevant to the previous year in which search was conducted or requisition was made, except in cases where any assessment or reassessment in respect of any of the earlier six years has abated.

Accordingly, in exercise of this power, the Central Government has, through *Notification No.42/2012 dated 4.10.2012*, inserted Rule 112F which came into force from 1st July, 2012.

The said Rule provides that the Assessing Officer is not required to issue notice for assessing or reassessing the total income for six assessment years immediately preceding the assessment year relevant to the previous year in which search is conducted or requisition is made, in the following cases:

(a) where as a result of a search under section 132(1) or a requisition made under section 132A, a person is found to be in possession of any money, bullion, jewellery or other valuable articles or things, whether or not he is the actual owner of the same, and

(b) where, such search is conducted or such requisition is made in the territorial area of an assembly or parliamentary constituency in respect of which a notification has been issued under section 30 read with section 56 of the Representation of the People Act, 1951, or where the assets so seized or requisitioned are connected in any manner to the ongoing election in an assembly or parliamentary constituency.

However, this Rule is not applicable to cases where such search under section 132 or such requisition under section 132A has taken place after the hours of poll so notified.

Circular No.10/2012 dated 31.12.2012 clarifies that the aforesaid amendment was introduced with a view to reduce infructuous and unnecessary proceedings under the Income-tax Act, 1961 in cases where a search is conducted under section 132 or requisition is made under section 132A and cash or other assets are seized during the election period, generally on a single warrant, and no evidence is available, or investigation required, for any assessment year other than the assessment year relevant to the previous year in which search is conducted or requisition is made.

In such cases, the officer investigating the case, with the approval of the Director General of Income-tax, is required to certify that -

(a) the search is conducted under section 132 or the requisition is made under section 132A in the territorial area of an assembly or parliamentary constituency in respect of which a notification has been issued under section 30, read with section 56 of the Representation of the People Act, 1951; or

(b) the assets seized or requisitioned are connected in any manner to the ongoing election process in an assembly or parliamentary constituency; and

(c) no evidence is available or investigation is required for any assessment year other than the assessment year relevant to the previous year in which search is conducted or requisition is made.

The certificate of the investigating officer shall be communicated to the Principal Commissioner or Commissioner of Income-tax and the Assessing Officer having jurisdiction over the case of such person.

(vi) **Manner of assessment where jurisdictional Assessing Officer receives books of account etc. after due date of filing of return [Section 153C(2)]:** In respect of the assessment year relevant to the previous year in which search is conducted under section 132 or requisition is made under section 132A, in case of such other person, where -

(a) no return of income has been furnished by such person and no notice under section 142(1) has been issued to him, or

(b) a return of income has been furnished by such person but no notice under sub-section (2) of section 143 has been served and limitation of serving the notice under sub-section (2) of section 143 has expired, or

(c) assessment or reassessment, if any, has been made,

before the date of receiving of books of account or documents or assets seized or requisitioned by the Assessing Officer having jurisdiction over such other person, such Assessing Officer shall issue the notice and assess or reassess total income of such other person for such assessment year in the manner provided in section 153A. [Section 153C(2)].

The provisions of sub-section (2) would apply where books of account or documents or assets seized or requisitioned referred to in sub-section (1) has been received by the Assessing Officer having jurisdiction over such other person after the due date for furnishing the return of income for the assessment year relevant to the previous year in which search is conducted under section 132 or requisition is made under section 132A.

(vii) Applicability of Supreme Court Guidelines on recording of satisfaction note under section 158BD to apply to proceedings under section 153C for the purposes of assessment of income of a person other than the person in respect of whom search is initiated under section 132 or books of account are requisitioned under section 132A *[Circular No.24/2015, dated 31-12-2015]*

The issue of recording of satisfaction for the purposes of section 158BD/153C has been subject matter of litigation.

The Hon'ble Supreme Court in the case of *M/s Calcutta Knitwears* in its detailed judgment in Civil Appeal No. 3958 of 2014 dated 12-3-2014 (available in NJRS at 2014-LL-0312-51) has laid down that for the purpose of section 158BD of the Act, recording of a satisfaction note is a pre-requisite and the satisfaction note must be prepared by the Assessing Officer before he transmits the record to the other Assessing Officer who has jurisdiction over such other person under section 158BD[3].

[3] Section 158BC lays down the procedure for block assessment dealt with in Chapter XIV-B of the Income-tax Act, 1961, which applies where search is initiated under section 132 or books of account are requisitioned under section 132A on or before 31.5.2003. Section 158BD provides that where the Assessing Officer is satisfied that any undisclosed income belongs to any person, other than the person with respect to whom search is made under section 132 or books of account are requisitioned under section 132A, then, the books of account, other documents seized or requisitioned shall be handed over to the Assessing Officer having jurisdiction over such other person

The Supreme Court held that "the satisfaction note could be prepared at any of the following stages:

(a) at the time of or along with the initiation of proceedings against the searched person under section 158BC; or

(b) in the course of the assessment proceedings under section 158BC; or

(c) immediately after the assessment proceedings are completed under section 158BC of the searched person.

Several High Courts have held that the provisions of section 153C are substantially similar/ *pari-materia* to the provisions of section 158BD and therefore, the above guidelines of the Supreme Court, apply to proceedings under section 153C, for the purposes of assessment of income of other than the searched person. This view has been accepted by CBDT.

It is further clarified that even if the Assessing Officer of the searched person and the "other person" is one and the same, then also he is required to record his satisfaction as has been held by the Courts.

(4) Prior approval of Joint Commissioner required for assessment or reassessment in respect of search cases [Section 153D]

Section 153D provides that assessment or reassessment of search cases in respect of each assessment year referred to in section 153A(1)(b) or the assessment year referred to in 153B(1)(b) shall not be made by an Assessing Officer below the rank of Joint Commissioner without the previous approval of the Joint Commissioner.

However, the prior approval of Joint Commissioner is not required where the assessment or reassessment order is required to be passed by the Assessing Officer with the prior approval of Principal Commissioner or Commissioner under section 144BA(12).

(5) Presumption as to assets, books of account, etc. [Section 292C]

This section provides that where any books of account, other documents, money, bullion, jewellery or other valuable article or thing are or is found in the possession or control of any person in the course of a search under section 132 or survey under section 133A, it may, in any proceeding under this Act, be presumed that -

(i) such books of account, other documents, money, bullion, jewellery or other valuable article or thing belong or belongs to such person;

(ii) the contents of such books of account and other documents are true; and

and that Assessing Officer shall proceed under section 158BC against such other person and the provisions of Chapter XIV-B shall apply accordingly.

(iii) the signature and every other part of such books of account and other documents which purport to be in the handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting;

(iv) In the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.

Further, this presumption has also been extended to books of account, other documents or assets which have been delivered to the requisitioning officer in accordance with the provisions of section 132A. For this purpose, sub-section (2) provides that where any books of accounts, other documents or assets have been delivered to the requisitioning officer in accordance with the provision of section 132A, then, the presumption would apply as if such books of accounts, other documents or assets which had been taken into custody from the person referred to in clause (a) or clause (b) or clause (c), as the case may be, of sub-section (1) of section 132A, had been found in the possession or control of that person in the course of a search under section 132.

(6) Assessment to be made individually in search cases even where the authorization or requisition mentions the name of more than one person [Section 292CC]

(i) Under section 132 and section 132A, an authorization can be issued or a requisition can be made, as the case may be, where the Director General or the Director, in consequence of information in his possession, has reason to believe that any person is in possession of any money, bullion, jewellery or other valuable article or thing. In such a case, he may authorize the income-tax authorities mentioned therein to enter and search any building, place, vehicle, etc. and seize any such books of accounts, other documents, undisclosed property, etc.

(ii) In a case where search is initiated under section 132 or requisition is made under section 132A, assessment is to be completed under the provisions of section 153A or section 153C or section 143(3).

(iii) Section 292CC provides that:

(a) it shall not be necessary to issue an authorization under section 132 or make a requisition under section 132A separately in the name of each person;

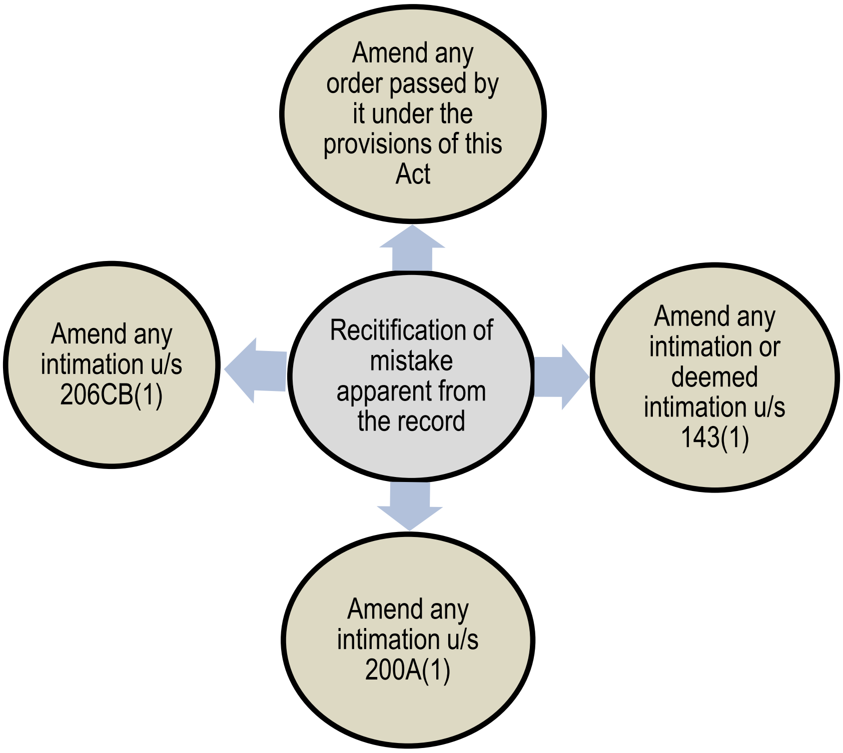
(b) where an authorization under section 132 has been issued or a requisition under section 132A has been made mentioning therein the name of more than one person, the mention of such names of more than one person on such authorization or requisition shall not be deemed to construe that it was issued in the name of an association of persons or body of individuals consisting of such persons;

These provisions would apply irrespective of anything contrary contained in any other provision of the Act.

(c) Further, even if an authorization under section 132 has been issued or requisition under section 132A has been made mentioning therein the name of more than one person, the assessment or reassessment shall be made separately in the name of each of the persons mentioned in such authorization or requisition.

17.36 RECTIFICATION OF MISTAKES [SECTION 154]

(1) **Manner of rectification of a mistake apparent from the record** - With a view to rectifying any mistake apparent from the record, an income tax authority referred to in section 116 may:


Amend any order passed by it under the provisions of this Act
Amend any intimation u/s 206CB(1)
Recitification of mistake apparent from the record
Amend any intimation or deemed intimation u/s 143(1)
Amend any intimation u/s 200A(1)

(2) **Mistake apparent from the record** - The jurisdiction of any authority under the Act to make an order under section 154 depends upon the existence of a mistake apparent on the face of the record.

(i) **Mistake apparent from the record may be a mistake of fact as well as mistake of law** - For instance, the treatment of non-agricultural income as agricultural income and granting exemption in respect of such income is an obvious mistake of law which could be rectified under section 154.

(ii) **Mere change of opinion cannot be basis for rectification** - A mere change of opinion, however, cannot be the basis on which the same or the successor Assessing Officer can treat a case as one of rectification of mistake. A mistake is one apparent from the record in case, where it is a glaring, obvious, patent or self-evident. Mistake, which has to be discovered by a long drawn process of reasoning or examination or arguments on points, where there may be two opinions, cannot be said to be mistake or error apparent from the record.

(iii) **Subsequent decision of Supreme Court** - A mistake arising as a result of subsequent interpretation of law by the Supreme Court would also constitute error apparent from the record.

(iv) **Retrospective amendment of law** - could also lead to rectification if an order is plainly and obviously inconsistent with the specific and clear provision, as amended retrospectively.

(3) **Doctrine of Partial Merger** - Where any matter has been considered and decided in any proceeding by way of appeal or revision relating to a rectifiable order, the authority passing such order may, amend the order in relation to any matter other than the matter which has been so considered and decided.

(4) **Amendment may be *suo motu* or the same may be brought to notice by the assessee or deductor** - The concerned authority may make an amendment on its own motion. However, he should mandatorily make the amendment for rectifying any such mistake which has been brought to its notice by the assessee or the deductor. Where the authority concerned is the Deputy Commissioner (Appeals) or the Commissioner (appeals), the mistake can be pointed out by the Assessing Officer also.

(5) **Opportunity of being heard to be given to the assessee or deductor before enhancing an assessment or reducing a refund** - An amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee or the deductor, shall not be made unless the authority concerned has given notice to the assessee or the deductor of its intention so to do and has allowed the assessee or the deductor a reasonable opportunity of being heard.

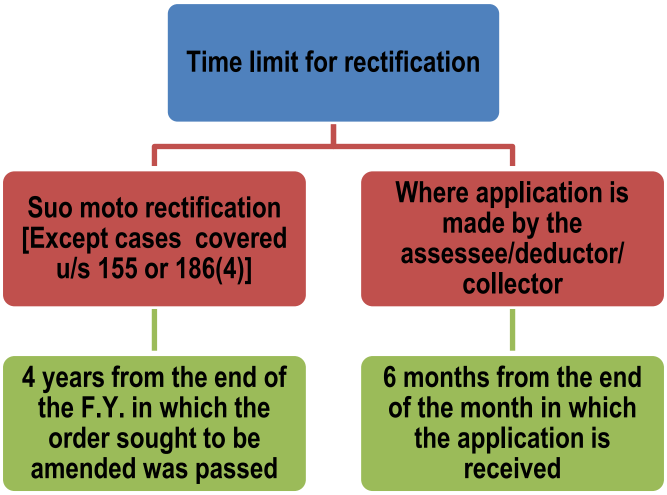
(6) **Action to be taken by the Assessing Officer depending upon the effect of the amendment made**

	Case	Action to be taken by A.O.
(i)	Where an amendment is made under this section	An order shall be passed in writing by the authority concerned
(ii)	Where any such amendment has the effect of reducing the assessment, or otherwise reducing the liability of the	The Assessing Officer shall make any refund due to such assessee or the deductor

	assessee or the deductor	
(iii)	Where any such amendment has the effect of enhancing the assessment or reducing the refund already made or otherwise increasing the liability of the assessee or the deductor	The Assessing Officer shall serve on the assessee or the deductor, as the case may be a notice of demand in the prescribed form specifying the sum payable

(7) **Time limit for rectification** - Except in cases which are specifically covered by section 155 or section 186(4) dealing with cancellation or registration, no amendment under this section shall be made after the expiry of **four years from end of the financial year in which the order sought to be amended was passed**.

Where an application for amendment is made by the assessee or by the deductor or by the collector, the income-tax authority shall pass an order within a period of **six months from the end of the month in which the application is received by it**, either making the amendment or refusing the claim.


Time limit for rectification
Suo moto rectification [Except cases covered u/s 155 or 186(4)]
Where application is made by the assessee/deductor/ collector
4 years from the end of the F.Y. in which the order sought to be amended was passed
6 months from the end of the month in which the application is received

17.37 OTHER AMENDMENTS [SECTION 155]

Where any assessment made in respect of any assessment year is required to be amended on account of any specific provisions in the Act mentioned hereunder, such an amending order can be passed at any time within 4 years from the end of the year in which such provision is attracted.

(1) **Rectification of partner's assessment consequent to disallowance of remuneration in the hands of the firm [Sub-section (1A)]** - Where a partner is assessed in respect of any remuneration from a firm under section 28(v) and later in the assessment or reassessment of the firm or reduction or enhancement made in the income of the firm under sections 154/155/250/254/263/264 or any order passed under section 245D on the application made by the firm, such remuneration is found not deductible under section 40(b), the assessment

order of the partner shall be amended to exclude such remuneration which is not deductible in the firm's case. This is in view of the proviso to section 28(v) which states that the remuneration disallowed in the firm's case cannot be charged to tax in the partner's case.

The four year period for making the amendment would be reckoned from the end of the financial year in which the final order was passed in the case of the firm.

(2) **Rectification of member's assessment consequent to enhancement or reduction of income of the AOP/BOI [Sub-section (2)]** - The amendment of the assessment of a member of an AOP/BOI consequent upon the assessment or reassessment or any enhancement or reduction in the income of the AOP/BOI as a result of an order in appeal, reference, revision or rectification or as a result of an order made by the Settlement Commission

The four year period for making the amendment would be reckoned from the end of the financial year in which the final order was passed in the case of the AOP/BOI.

(3) **Rectification of assessment consequent to disallowance of excess loss or depreciation allowed [Sub-section (4)]** – The amendment resulting from any proceedings initiated under section 147 on account of re-computation of total income, where excessive loss or depreciation allowance had been allowed or losses had been set off and carried forward under the different heads.

The four year period for making the amendment would be reckoned from the end of the financial year in which the order was passed under section 147.

(4) **Rectification necessitated on account of capital gains, which were not charged to tax by virtue of section 47(iv) or 47(v), becoming chargeable under section 47A [Sub-section (7B)]** - Under the provisions of section 47A, capital gains which were not charged to tax by virtue of section 47(iv) or (v) may be deemed to be chargeable in certain circumstances. The Assessing Officer, may, accordingly, make an order of amendment at any time before the expiry of four years from the end of the previous year in which the relevant capital asset was converted into or treated as stock-in-trade or, as the case may be, the parent company ceasing to hold the entire share capital of the subsidiary company before the expiry of 8 years from the date of transfer.

(5) **Rectification to give effect to TDS/TCS not deducted while computing tax liability [Sub-section (14)]** - Where TDS/TCS certificates are not furnished along with the return of income and such certificates are produced before the Assessing Officer within two years from the end of the assessment year in which the income covered by the TDS/TCS certificate is assessable, the Assessing Officer can amend the order of assessment or intimation or deemed intimation under section 143(1).

However, such rectification under section 155(14) is possible only if the income from which tax has been deducted or the income on which tax has been collected has been disclosed in the return of income filed by the assessee for the relevant assessment year.

(6) **Rectification to give effect to credit for income-tax paid outside India [Sub-section (14A)] -** Where in the assessment for any previous year or in any intimation or deemed intimation under section 143(1) for any previous year,

- credit for income-tax paid in any country outside India or a specified territory outside India referred to in section 90, section 90A or section 91 has not been given on the ground that the payment of such tax was under dispute, and if subsequently such dispute is settled; and
- the assessee, within six months from the end of the month in which the dispute is settled, furnishes to the Assessing Officer evidence of settlement of dispute and evidence of payment of such tax along with an undertaking that no credit in respect of such amount has directly or indirectly been claimed or shall be claimed for any other assessment year,

the Assessing Officer shall amend the order of assessment or any intimation or deemed intimation under section 143(1), as the case may be, and the provisions of section 154 shall, so far as may be, apply thereto.

However, the credit of tax which was under dispute shall be allowed for the year in which such income is offered to tax or assessed to tax in India.

(7) **Rectification consequent to revision of full value of consideration in appeal or revision [Sub-section (15)]** - Where the Assessing Officer adopts stamp duty as full value of consideration under section 50C and later, such value is revised in any appeal or revision, the Assessing Officer shall amend the assessment order to compute the capital gain by taking the full value of consideration to be the value so revised in such appeal or revision. The period of four years shall be reckoned from the end of the previous year in which the order revising the value was passed in that appeal or revision.

(8) **Recomputation of capital gains on account of reduction of any compensation in a compulsory acquisition by any Court, Tribunal or any other authority [Sub-section (16)]** - Where capital gains is recomputed on account of any reduction of any compensation in a compulsory acquisition by any Court, Tribunal, or any other authority, the Assessing Officer shall amend the assessment order so as to compute the capital gain by taking the compensation or consideration as reduced by any court, Tribunal or other authority. The four year time period shall be reckoned from the end of the previous year in which the order reducing the compensation was passed by the court, Tribunal or other authority.

(9) **Rectification consequent to revoking of patent or exclusion of name of the assessee from patents register as patentee [Sub-section (17)]** - Where deduction under section 80RRB is allowed and subsequent to the allowance of such deduction in respect of any patent, the Controller or the High Court passes an order under the Patents Act, 1970 revoking the patent or excluding the name of the assessee from the Patents Register as patentee in respect of that patent.

For the purpose of amending the order, the period of 4 years is to be reckoned from the end of the previous year in which such order of the Controller or High Court, as the case may be, is passed.

17.38 NOTICE OF DEMAND [SECTION 156]

When any tax, interest, penalty or fine or any other sum is payable consequent to any order passed under this Act, the Assessing Officer shall serve upon the assessee a notice of demand in the prescribed form, specifying the sum so payable.

The Apex Court has, in *Sri Mohan Wahi v. CIT (2001) 248 ITR 799,* held that failure to serve notice of demand renders the recovery proceedings invalid.

An intimation under section 143(1) or section 200A(1) or section 206CB(1) would be deemed to be a notice of demand for the purpose of section 156, where any sum is determined to be payable by the assessee under section 143(1) or by the deductor under section 200A(1) or by the collector under section 206CB(1).

Note - *As per section 292BB, where an assessee had appeared in any proceedings or co-operated in any enquiry relating to an assessment or reassessment, it shall be deemed that any notice required to be served upon him, has been duly served upon him in time in accordance with the provisions of the Act and such assessee shall be precluded from raising any objection in any proceeding or enquiry that the notice was (a) not served upon him or (b) not served upon him in time or (c) served upon him in an improper manner. However, the above provision shall not be applicable where the assessee has raised such objection before the completion of such assessment or reassessment.*

17.39 INTIMATION OF LOSS [SECTION 157]

When, in the course of the assessment of total income of any assessee, it is established that a loss has taken place which the assessee is entitled to have carried forward and set-off under the provisions of section 72(1)/73(2)/74(1)/74(3)/74A(3), the Assessing Officer shall notify the assessee by an order in writing the amount of the loss as computed by him for this purpose.

EXERCISE

Question 1

Teachwell Education is a trust approved under section 10(23C)(vi) which runs various educational institutions. During the course of assessment under section 143(3), the Assessing Officer finds that the trust has carried out its activities in contravention of the section under which it was approved for exemption. Hence, the Assessing Officer wants to pass an order without giving exemption under section 10, which the assessee objects. You are required to examine the following with respect to the provisions of Income-tax Act, 1961.

(a) Whether the Assessing Officer can pass an order without giving exemption under section 10?

(b) Can the Assessing Officer get any additional time limit in completing this assessment?

Answer

(a) As per the first proviso to section 143(3), in the case of an institution approved under, *inter alia*, section 10(23C)(vi), which is required to furnish the return of income under section 139(4C), the Assessing Officer shall not pass an order of assessment under section 143(3) without giving effect to the provisions of section 10, unless he is of the view that the activities of the institution are being carried on in contravention to the provisions of that section and:

(1) he has intimated the Central Government or the prescribed authority, which had earlier approved the concerned institution, about the contravention of the relevant provisions by the institution; and

(2) the approval granted to such institution has been withdrawn or notification in that respect has been rescinded.

Therefore, in the aforesaid case, the Assessing Officer can pass an assessment order without giving exemption under section 10 to Teachwell Education, which is an educational institution approved under section 10(23C)(vi), only if he has intimated the contravention made by Teachwell Education to the Central Government or the prescribed authority, as the case may be, and its approval under section 10(23C)(vi) is withdrawn.

(b) As per *Explanation 1* to section 153, in case the Assessing Officer intimates the contravention of provisions of section 10(23C)(vi) to the Central Government or the prescribed authority, the period commencing from the date of intimation of such contravention by the Assessing Officer and ending on the date on which the copy of the order of withdrawing the approval under section 10(23C)(vi) is received by the Assessing Officer, shall be excluded for computing the period of limitation for completing the assessment.

Further, in case the time limit available to the Assessing Officer for passing an assessment order, after such exclusion, is less than 60 days, such remaining period of assessment shall be deemed to have been extended to 60 days.

Therefore, the Assessing Officer will get the above mentioned additional time for completing the assessment of Teachwell Education.

Question 2

State with reasons whether return of income is to be filed in the following cases for the Assessment Year 2020-21:

(i) Mr. X, a resident individual, aged 80 years, has a total income of ₹ 2,85,000. He has claimed deduction of ₹ 1,50,000 under section 80C. Long-term capital gains of ₹ 80,000 is not taxable by virtue of the exemption available upto specified threshold under section 112A.

Would your answer change if Mr. X has incurred ₹ 1,05,000 towards payment of electricity bills for F.Y.2019-20?

(ii) ABC, a partnership firm, has a loss of ₹ 10,000 during the previous year 2019-20.

(iii) A registered association, eligible for exemption under section 10(23B), has income from house property of ₹ 2,60,000.

(iv) Mr. Y, aged 45 years, an employee of ABC (P) Ltd, draws a salary of ₹ 4,90,000 and has income from fixed deposits with bank of ₹ 10,000.

Answer

S. No.	Is filing of return required?	Reason
(i)	No	As per the provisions of section 139(1), every person, whose total income without giving effect to the provisions of Chapter VI-A exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. The gross total income of Mr. X before giving effect to deduction of ₹ 1,50,000 under section 80C is ₹ 4,35,000, which is less than the basic exemption limit of ₹ 5,00,000 applicable to an individual aged 80 years or more. Therefore, Mr. X need not furnish his return of income for the A.Y. 2020-21. ***Note** – Yes, the answer would change, since Mr. X has incurred expenditure of an amount exceeding ₹ 1 lakh towards consumption of electricity. Hence, he would have to file his return for A.Y.2020-21 on or before the due date u/s 139(1).*
(ii)	Yes	As per section 139(1), it is mandatory for a firm to furnish its return of income or loss on or before the specified due date. Therefore, M/s ABC has to furnish its return of loss for the A.Y. 2020-21 on or before the due date under section 139(1), even if it has incurred a loss.
(iii)	Yes	As per section 139(4C), every institution referred to, *inter alia*, in section 10(23B), whose total income without giving effect to the provisions of section 10 exceeds the maximum amount not chargeable to tax, is required

		to furnish the return of income for the relevant assessment year on or before the due date under section 139(2). In the above case, the registered association has income from house property of ₹ 2,60,000 before exemption under section 10, which exceeds the basic exemption limit of ₹ 2,50,000. Therefore, it is under an obligation to furnish its return of income for the A.Y. 2020-21.
(iv)	Yes	As per the provisions of section 139(1), every person, whose gross total income exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. Mr. Y's salary income is ₹ 4,40,000 (i.e., ₹ 4,90,000 *less* standard deduction of ₹ 50,000). The gross total income of Mr. Y is ₹ 4,50,000 (₹ 4,40,000 + ₹ 10,000) which exceeds the basic exemption limit of ₹ 2,50,000 applicable to an individual. Therefore, Mr. Y has to furnish his return of income for the A.Y. 2020-21.

Question 3

The Assessing Officer issued a notice under section 142(1) on the assessee on 24th December, 2019 calling upon him to file return of income for Assessment Year 2019-20. In response to the said notice, the assessee furnished a return of loss and claimed carry forward of business loss and unabsorbed depreciation. State whether the assessee would be entitled to carry forward as claimed in the return.

Answer

As per the provisions of section 139(3), any person who has sustained loss under the head 'Profit and gains of business or profession' is allowed to carry forward such a loss under section 72(1) or section 73(2), only if he has filed the return of loss within the time allowed under section 139(1). Also, the provisions of section 80 specify that a loss which has not been determined as per the return filed under section 139(3) shall not be allowed to be carried forward and set-off under, *inter alia*, section 72(1) (relating to business loss) or section 73(2) (losses in speculation business) or section 74(1) (loss under the head "Capital gains") or section 74A(3) (loss from the activity or owning and maintaining race horses) or section 73A (loss relating to a "specified business"). However, there is no such condition for carry forward of unabsorbed depreciation under section 32.

In the given case, the assessee has filed its return of loss in response to notice under section 142(1). As per the provisions stated above, the return filed by the assessee in response to notice under section 142(1) is a belated return and therefore, the benefit of carry forward of business loss under section 72(1) or section 73(2) or section 73A shall not be available. The assessee shall, however be entitled to carry forward the unabsorbed depreciation as per provisions of section 32(2).

Question 4

The regular assessment of MNO Ltd. for the Assessment Year 2018-19 was completed under section 143(3) on 13th March, 2020. There was an audit objection by the Revenue Audit team that interest *on loan should be disallowed partly as there was diversion of borrowed fund to sister concern without charge of interest.*

Based on the above facts:

(i) State, with reasons, whether the Assessing Officer can issue notice under section 148 on the basis of audit objection of the Revenue Audit team.

(ii) If the action stated in (i) above is not permitted, what is the option open to the Revenue Department to deal with the said audit objection?

Answer

(i) Section 147 states that if the Assessing Officer has **reason to believe that any income chargeable to tax has escaped assessment for any assessment year**, he may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section.

The Assessing Officer should, therefore, have reason to believe that income chargeable to tax has escaped assessment. The belief should be that of the Assessing Officer and not of the revenue audit team.

Further, the Income-tax Act, 1961 does not confer jurisdiction on the Assessing Officer to change its opinion on the interpretation of a particular provision earlier adopted by it. If the issue had already been considered earlier during the course of scrutiny assessment and the Assessing Officer had come to a conclusion that no disallowance of interest paid by the assessee is required, even though loans had been given to sister concern without any interest, the same issue cannot be the basis of reassessment, merely because the revenue audit team takes a different view.

The Supreme Court, in *ACIT v. ICICI Securities Primary Dealership Ltd. (2012) 348 ITR 299,* held that re-opening of the assessment by the Assessing Officer on the ground of change of opinion is not valid.

Therefore, the Assessing Officer cannot issue notice under section 148 solely on the basis of audit objection of the Revenue Audit team.

If the Assessing Officer has acted only under compulsion of the audit party and not independently, the action of reopening would be invalid.

(ii) The option open to the Revenue is initiation of proceedings under 263, by the jurisdictional Commissioner. He has the power to call for and examine the records, if he is of the opinion that the order passed by the Assessing Officer under section 143(3) is erroneous in so far as it is prejudicial to the interests of the Revenue.

However, where the Assessing Officer has considered the issue in the original assessment and come to a conclusion that no disallowance of interest is called for, the Commissioner cannot initiate revisionary proceedings, merely because he holds a different view. Only where the view taken by the Assessing Officer is unsustainable in law, the Commissioner will be justified in initiating the revisionary proceedings under section 263. It was so held in *CIT vs. Sohana Woollen Mills (2008) 296 ITR 238 (P & H).*

Mere audit objection and possibility of a different view are not sufficient to conclude that the order of the Assessing Officer is erroneous or prejudicial to the interest of revenue.

Question 5

State whether the following assessees have to file return of income and if so, the due date for the assessment year 2020-21:

(i) A registered trade union having income from let out property of ₹ 1,00,000.

(ii) A public trust hospital having an aggregate annual receipt of ₹ 205 lacs and availing exemption of ₹ 2,20,000 under section 10(23C)(via) with total income of ₹ 1,10,000.

Answer

(i) A registered trade union is having income from house property, which is exempt under section 10(24).

Section 139(4C) mandates filing of return only when the total income exceeds the maximum amount which is not chargeable to tax without giving effect to the provisions of section 10. In this case, even without giving effect to section 10(24), the total income of the registered trade union is below basic exemption limit and therefore, there is no mandatory requirement to file the return of income.

(ii) Since the total income without giving effect to the exemption under section 10(23C)(via) is ₹ 3,30,000, which exceeds ₹ 2,50,000, the trust has to file its return of income by 30th September, 2020.

Question 6

Dishant received a notice under section 148 from the Assessing Officer for A.Y. 2016-17 on the ground that depreciation on certain assets was allowed in excess. The Assessing Officer recorded the reason for reopening. The original assessment was completed under section 143(3). In course of reassessment proceeding, the Assessing Officer also disallowed certain sum under section 14A in respect of expenses purported to be in relation to dividend from companies and tax-free interest. However, the Assessing Officer did not record the reason for applying the provisions of section 147 in respect of the issue of disallowance under section 14A and passed the order disallowing the excess depreciation and also certain sum under section 14A. Dishant contended that the Assessing Officer can make disallowance under section 14A, since the same was not the reason for reopening the assessment. Discuss the correctness of Dishant's contention.

Answer

Explanation 3 to section 147 permits the Assessing Officer to assess or reassess the income in respect of any issue (which has escaped assessment) which comes to his notice subsequently in the course of proceedings under section 147, even though the reason for such issue does not form part of the reasons recorded under section 148(2).

Therefore, in the instant case, the Assessing Officer has the power to disallow expenses under section 14A in addition to disallowing excess depreciation for which notice under section 148 was issued even though the reason for issue relating to disallowance under section 14A was not recorded under section 148(2).

Hence, the contention of Dishant is not correct.

Question 7

In the proceedings initiated under section 153A, the assessment order passed in respect of Mr. Simbu pertaining to a particular assessment year was annulled by the Income-tax Appellate Tribunal in its order passed on 28.1.2020. The same was received on 28.2.2020 by the jurisdictional Commissioner of Income-tax. Does the Department have any power to complete the assessment subsequent to such annulment? If yes, within what time limit?

Answer

As per section 153A(2), if any proceedings initiated under section 153A or any order of assessment or reassessment made under section 153A(1) has been annulled in any appeal or other legal proceeding, the abated assessment or reassessment relating to any assessment year shall stand revived with effect from the date of receipt of the order of such annulment by the Principal Commissioner or Commissioner. If the order of annulment is set aside, such revival shall cease to have effect.

The time limit for completion of such assessment or reassessment shall be one year from the end of the month in which the abated assessment revives or within the period specified in section 153B(1) [i.e., 21 months[4] from the end of the financial year in which the last of authorisations for search or requisition was executed], whichever is later.

Question 8

What will be the consequences when Mr. Raghav made payment of ₹ 75,000 in cash to a travel agent for his travel to Saudi Arabia to be undertaken for business purposes by quoting intentionally the wrong PAN? Would your answer be different if such cash payment was made for his travel to Nepal, instead of Saudi Arabia?

[4] Assuming that the last of authorisations for search/requisition was executed prior to previous year 2018-19.

Answer

If a person who is required to quote his permanent account number in any document referred to in section 139A(5)(c), quotes a number which is false, and which he either knows or believes to be false or does not believe to be true, the Assessing Officer may direct that such a person shall pay by way of penalty a sum of ₹ 10,000 under section 272B(2).

In the given case, if Mr. Raghav travels to Saudi Arabia and pays his travel agent cash in excess of ₹ 50,000, such a transaction is covered by section 139A(5)(c) read with Rule 114B and therefore, Mr. Raghav has to quote his PAN. Since Mr. Raghav has misquoted his PAN, penalty under section 272B(2) is leviable. Mr. Raghav has to be given an opportunity of being heard in the matter. If Mr. Raghav is not able to prove that there was a reasonable cause for the said failure, penalty under section 272B(2) would be imposable.

The answer would remain the same even if such cash payment was made for his travel to Nepal.

Question 9

For facilitating expeditious resolution of disputes relating to international transactions involving transfer pricing and foreign companies, the Income-tax Act, 1961, has provided for "alternate dispute resolution mechanism". In this context, you are required to answer the following:

(i) What meanings have been assigned to "dispute resolution panel" and the "eligible assessee" under this mechanism?

(ii) When can a grievance for resolution be filed by an assessee?

(iii) What evidences are being considered by the panel to redress the grievance of the assessee?

Answer

(i) The term "Dispute Resolution Panel" has been defined to mean a collegium comprising of three Principal Commissioners or Commissioners of Income-tax constituted by the Board for this purpose.

The term "Eligible Assessee" means any person in whose case the variation referred to in section 144C(1) in the income or loss returned arises as a consequence of the order of the Transfer Pricing Officer passed under section 92CA(3) and any foreign company.

(ii) The Assessing Officer shall forward a draft of the proposed order of assessment to the eligible assessee and on receipt of such order, the eligible assessee shall, within thirty days of the receipt of the draft order, file his acceptance of the variations to the Assessing Officer or file his objections, if any, to such variation, with the Dispute Resolution Panel and the Assessing Officer.

(iii) The Dispute Resolution Panel shall, in a case where any objections are received, take into consideration:-

(a) the draft order

(b) the objections filed by the assessee

(c) the evidence furnished by the assessee

(d) the report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority

(e) the records relating to the draft order

(f) the evidence collected by, or caused to be collected by it

(g) the result of any enquiry made by or caused to the made by it,

and issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

Question 10

The Assessing Officer has the power to make an assessment to the best of his judgment, in certain situations. What are they?

Answer

Under section 144, the Assessing Officer, after taking into account all relevant material which he has gathered, is under an obligation to make an assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee in the following cases –

(1) Where any person fails to make the return under section 139(1) and has not filed a belated return under section 139(4) or a revised return under section 139(5).

(2) Where any person fails to comply with all the terms of a notice issued under section 142(1) or fails to comply with a direction issued under section 142(2A) for getting the accounts audited.

(3) Where any person, having made a return, fails to comply with all the terms of a notice issued under section 143(2).

Further, section 145(3) of the Income-tax Act, 1961 permits the Assessing Officer to make an assessment in the manner provided in section 144:

(i) where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee; or

(ii) where the method of accounting under section 145(1) has not been regularly followed by the assessee;

(iii) where the income has not been computed in accordance with "Income Computation and Disclosure Standards" notified by the Central Government under section 145(2).

Question 11

The assessment of CNK Associates, a partnership firm, for the assessment year 2017-18 was made *under section 143(3) on 31st July, 2019. The Assessing Officer made two additions to the income of the assessee viz. (a) addition of ₹ 2 lacs under section 40(a)(ia) due to non-furnishing of evidence of payment of TDS and (ii) addition of ₹ 5 lacs on account of unexplained cash credit. The assessee contested addition on account of unexplained cash credit in appeal to the Commissioner (Appeals). The appeal was decided in January, 2020 against the assessee. The assessee approaches you for your suggestion as to whether it should apply for revision to the Commissioner under section 264 or rectification to the Assessing Officer under section 154 as regards disallowance under section 40(a)(ia). What should be your suggestion?*

Answer

The Commissioner cannot exercise his power of revision under section 264 where the order sought to be revised has been made the subject of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal [Section 264(4)], even if the relief claimed in the revision is different from the relief claimed in the appeal. This was the view of the Supreme Court in the case of *Hindustan Aeronautics Limited vs. CIT (2000) 243 ITR 808.* It is not open to the assessee to seek recourse to revision under section 264 after the appeal is decided. Therefore, although the matter of addition of ₹ 2 lacs under section 40(a)(ia) was not taken before the Commissioner (Appeals), the assessee, CNK Associates cannot apply for revision under section 264 in respect of the same.

Under section 154(1A), where any matter had been considered and decided in any proceeding by way of appeal or revision, rectification of such matter cannot be done by the Assessing Officer. However, in respect of the matter which has not been considered and decided in the appeal or revision, the order of the Assessing Officer can be rectified under section 154. Thus, the assessee can apply to the Assessing Officer for rectification of the order in respect of addition under section 40(a)(ia), as this matter has not been considered and decided in any proceeding by way of appeal or revision.

In view of above, the assessee, CNK Associates should seek rectification under section 154.

Question 12

Examine critically in the context of provisions of the Act "Can the Assessing Officer issue notice under section 148 to reopen the same assessment order on the same grounds for which the CIT had issued notice under section 263 of the Act"?

Answer

The Assessing Officer cannot issue notice under section 148 to reopen the same assessment order on the same grounds for which the Commissioner had issued notice under section 263 of the Income-tax Act, 1961, since the third proviso to section 147 specifically provides that the Assessing Officer may assess or reassess an income which is chargeable to tax and has escaped assessment, other than the income involving matters which are the subject matter of any appeal, reference or revision. Therefore, if the income relates to a matter which is the subject matter of revision under section 263, then the Assessing Officer cannot issue notice under section 148 to reopen the assessment order.

Question 13

Is the Assessing Officer empowered to assess or reassess an income which is chargeable to tax and has escaped assessment, in a case which is pending before the Appellate Tribunal? Discuss.

Answer

As per third proviso to section 147, the Assessing Officer may assess or reassess an income which is chargeable to tax and which has escaped assessment, other than the income involving matters which are the subject matter of any appeal, reference or revision. Therefore, in respect of the matters which are the subject matter of an appeal before the Appellate Tribunal, it is not possible for the Assessing Officer to initiate proceeding under section 147. However, in respect of other matters, which are not the subject matter of the appeal, the Assessing Officer can initiate proceeding under section 147.

Question 14

A search was conducted under section 132 in the business premises of Harish on 15th December, 2019. At that time, assessments under section 143(3) for A.Y. 2017-18 and A.Y. 2018-19 and reassessment proceeding under section 147 for A.Y. 2016-17 were pending before the Assessing Officer.

(i) What are the assessment years for which notice can be issued for making post-search assessment?

(ii) What would be the fate of pending assessments and reassessment?

(iii) What would be the effect, if the post-search assessment orders are annulled by the Income-tax Appellate Tribunal?

Answer

(i) The notice under section 153A can be issued for six assessment years preceding the assessment year relevant to the previous year in which the search is conducted. In this case, the search is conducted in the previous year 2019-20, the relevant assessment year for which is A.Y.2020-21. Therefore, notice can be issued for the six preceding assessment years i.e. for assessment years 2014-15 to 2019-20.

Further, notice for assessment or reassessment can be issued by Assessing Officer for the relevant assessment year or years (i.e. for A.Y.2010-11 to A.Y.2013-14) if the following conditions are satisfied:

(a) The Assessing Officer has in his possession, books of account or other documents or evidence which reveal that the income, represented in the form of asset, which has escaped assessment amounts to or is likely to amount ₹ 50 lakhs or more in the relevant assessment year or in aggregate in the relevant assessment years.

(b) The income so referred above has escaped assessment for such year or years; and

(c) The search under section 132 is initiated or requisition under section 132A is made on or after 01.04.2017 (This condition is satisfied since the search has taken place in December, 2019).

Note *- The expression "relevant assessment year" shall mean an assessment year preceding the assessment year relevant to the previous year in which search is conducted or requisition is made which falls beyond six assessment years but not later than ten assessment years from the end of the assessment year relevant to the previous year in which search is conducted or requisition is made.*

"Asset" shall include immovable property being land or building or both, shares and securities, loans and advances, deposits in bank account.

(ii) As per section 153A, the assessment or reassessment relating to any assessment year, falling within the above period of six assessment years and for the relevant assessment year or years, pending on the date of initiation of the search under section 132, shall abate. In other words, they will cease to be applicable. Therefore, the assessments under section 143(3) for assessment years 2017-18 and 2018-19 and the reassessment proceeding under section 147 for assessment year 2016-17 **shall abate.**

(iii) Section 153A provides that where the post-search assessment order is annulled in any appeal or any other legal proceeding, the abated assessment and reassessment proceedings shall stand revived. Therefore, the assessments under section 143(3) relating to assessment years 2017-18 and 2018-19 and the reassessment proceeding relating to assessment year 2016-17, which abated on initiation of search, **shall stand revived** with effect from the date of receipt of the order of such annulment by the Principal Commissioner or Commissioner.

Question 15

A search was conducted under section 132 in the business premises of Sanskar on 5th March, 2019. The search was concluded by executing last of authorisation for search on 21st March, 2019. Since the search is concluded in the financial year 2018-19, and other conditions are also fulfilled, the Assessing Officer issued notice under section 153A on Sanskar for preceding ten Assessment Years prior to the Assessment Year relevant to the previous year 2018-19. Thus, he issued the notice from A.Y. 2009-10 to A.Y.2018-19. Discuss the correctness of the action taken by Assessing Officer.

Answer

As per section 153A, the Assessing Officer can issue the notice to file a return in respect of six assessment years and for the relevant assessment year or years immediately preceding the assessment year relevant to the previous year in which the search was conducted under section 132 or requisition was made under section 132A.

However, no notice for assessment or reassessment shall be issued by Assessing Officer for the relevant assessment year or years unless:

(a) He has, in his possession, books of account or other documents or evidence which reveal that the income, represented in the form of assets, which has escaped assessment amounts to or is likely to amount ₹ 50 lakhs or more in the relevant assessment year or in aggregate in the relevant assessment years.

(b) The income so referred above has escaped assessment for such year or years.

(c) The search under section 132 is initiated or requisition under section 132A is made on or after 01.04.2017

The expression "relevant assessment year" shall mean an assessment year preceding the assessment year relevant to the previous year in which search is conducted or requisition is made which falls beyond six assessment years but not later than ten assessment years from the end of the assessment year relevant to the previous year in which search is conducted or requisition is made.

Thus, it is clear that the Assessing Officer can issue the notice in respect of four assessment years which falls beyond six assessment years, subject to fulfillment of aforesaid conditions. As per condition (c) above, search must be initiated on or after 01.04.2017.

In the given case, Assessing Officer has initiated the search on 5.03.2019 and concluded on 21.03.2019. Therefore, the condition given in (c) is satisfied. Assuming that conditions given in (a) and (b) are also satisfied, the Assessing Officer could issue the notice for ten assessment years from the end of the assessment year relevant to the previous year in which search is conducted. i.e. from A.Y.2013-14 to A.Y. 2018-19 as well as the relevant assessment years, namely, A.Y. 2009-10 to A.Y. 2012-13

Hence, the action of Assessing Officer in issuing the notice under section 153A for A.Y.2009-10 to A.Y.2018-19, is correct.

Question 16

Examine whether the Assessing Officer has the power to make any adjustment to income disclosed by the assessee in the return of income in course of processing the return under section 143(1)?

Answer

The procedure to be followed for summary assessment is contained in section 143(1). As per section 143(1), the total income or loss of an assessee shall be computed after making the following adjustments to the returned income:

(i) any arithmetical error in the return; or

(ii) an incorrect claim, if such incorrect claim is apparent from any information in the return.

(iii) disallowance of loss claimed, if return is filed beyond due date u/s 139(1)

(iv) disallowance of expenditure indicated in the audit report but not taken into account in computing the total income in the return

(v) disallowance of deduction claimed under section u/s 10AA, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID or 80-IE, if return is filed beyond due date u/s 139(1)

No such adjustment shall be made unless as intimation is given to the assessee of such adjustment either in writing or electronic mode. Further, Assessing Officer shall make any adjustment after considering the response received from the assessee, if any. Where no response is received with 30 days of the issue of such notice, the above adjustment can be made.

For the purpose of section 143(1), "an incorrect claim apparent from any information in the return" means such claim on the basis of an entry, in the return of income:

(i) of an item, which is inconsistent with another entry of the same or some other item in such return;

(ii) in respect of which, the information required to be furnished under the Income-tax Act, 1961 to substantiate such entry, has not been so furnished;

(iii) in respect of a deduction, where such deduction exceeds specified statutory limit which may be expressed as monetary amount or percentage or ratio or fraction.

Question 17

Can the Assessing Officer complete the assessment of income from international transactions in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of the assessee?

Answer

Section 92CA(4) provides that the order of the Transfer Pricing Officer determining the arm's length price of an international transaction is binding on the Assessing Officer and the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer.

Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer and on the basis of contention raised by the assessee.

Question 18

Tai Ltd. filed its return of income for assessment year 2019-20 on 26th September, 2019. The return is selected for regular assessment under section 143(3) for which notice under section 143(2) is served on the company on 3rd October, 2020. The company responded to the notice under section 143(2). Examine whether the service of the notice is within time and if not, whether the assessment order can be challenged by the assessee.

Answer

The time limit for service of notice under section 143(2) is six months from the end of the financial year in which the return of income was furnished by the assessee. The return of income for assessment year 2019-20 was filed by the assessee on 26th September, 2019. Therefore, the notice under section 143(2) has to be served by 30th September, 2020. However, the notice was served on the assessee only on 3rd October, 2020. Hence, the notice issued under section 143(2) is time-barred.

However, as per section 292BB, where an assessee had appeared in any proceedings or co-operated in any enquiry relating to an assessment or reassessment, it shall be deemed that any notice required to be served upon him, has been duly served upon him in time in accordance with the provisions of the Act and such assessee shall be precluded from raising any objection in any proceeding or enquiry that the notice was (a) not served upon him or (b) not served upon him in time or (c) served upon him in an improper manner.

The above provision shall not be applicable where the assessee has raised such objection before the completion of such assessment or reassessment. Therefore, in the instant case, if the assessee, Tai Limited, had raised an objection to the proceeding, on the ground of non-service of the notice under section 143(2) upon it on time, then, the validity of the assessment order can be challenged. In absence of such objection, the assessment order cannot be challenged.

Question 19

In the case of Mr. Rajesh, a summary assessment was made under section 143(1) for assessment year 2016-17 without calling him. Thereafter, Mr. Rajesh has received a notice under section 148 on 6th April, 2019 for reopening of assessment. Can Mr. Rajesh challenge the legality of the notice on the ground of change of opinion?

Answer

Under the scheme of section 143(1), only the adjustments relating to any arithmetical error in the return, incorrect claim which is apparent from any information in the return, disallowance of loss claimed where return of income for set-off of loss is claimed was filed beyond the due date under section 139(1), disallowance of expenditure indicated in the audit report but not taken into account in computing total income in the return and disallowance of deduction claimed under section 10AA, sections 80-IA to 80-IE, where return is furnished beyond due date. In short, what is permissible is only correction of errors apparent on the basis of the of the return and tax audit report filed. Therefore, the intimation given under section 143(1) is only a preliminary assessment, commonly referred to as a summary assessment without calling the assessee. The same cannot be treated as an order of assessment under section 143(3). Since there has been no assessment under section 143(3) in this case, the question of change of opinion does not arise.

Therefore, the assessee cannot challenge the legality of the notice issued under section 148 reopening the assessment on the ground of change of opinion in a case where no assessment is made under section 143(3). This inference is supported by the Supreme Court ruling in *ACIT vs. Rajesh Jhaveri Stock Brokers P. Ltd. (2007) 291 ITR 500.*

Question 20

Discuss the correctness or otherwise of the following proposition in the context of the Income-tax Act, 1961:

A fresh claim before the Assessing Officer can be made only by filing a revised return and not otherwise.

Answer

This proposition is correct. A return of income filed within the due date under section 139(1) or a belated return filed under section 139(4) may be revised by filing a revised return under section 139(5) where the assessee finds any omission or wrong statement in the original return subject to satisfying other conditions. There is no provision in the Income-tax Act, 1961, to make changes or modification in the return of income by filing a letter before the Assessing Officer. The revised return can be filed at any time before the end of the relevant assessment year or before completion of assessment, whichever is earlier. In a case where a return of income has been filed within the due date under section 139(1) or a belated return is filed under section 139(4), the only option available to the assessee to make an amendment to such return is by way of filing a revised return under section 139(5). Therefore, a fresh claim can be made before the Assessing Officer only by filing a revised return and not otherwise. The Supreme Court, in *Goetze (India) Ltd. vs. CIT (2006) 284 ITR 323,* has held that there is no provision in the Income-tax Act, 1961 to allow an amendment in the return of income filed except by way of filing a revised return.

Question 21

The Assessing Officer within the powers vested in him under section 142(2A), while examining the accounts of PNF Ltd., had ordered to get the same audited. The company challenges this order on the ground "that the opportunity was not provided to them by the Assessing Officer prior to passing of such an order". Decide the correctness of the action of the Assessing Officer.

Answer

As per the proviso to section 142(2A), the Assessing Officer shall not direct the assessee to get the accounts so audited unless the assessee has been given a reasonable opportunity of being heard.

Therefore, in this case, the order of the Assessing Officer is not valid, since the assessee was not given an opportunity of being heard prior to passing of such order.

Question 22

Smt. Kanti engaged in the business of growing, curing, roasting and grounding of coffee after mixing chicory had a total income of ₹ 6,00,000 from this business which was her only source of income during the year ended on 31.3.2020. She consults you to have an opinion whether she is required to file return of income for the A.Y. 2020-21 as per provisions of section 139(1).

Would your answer change if she had travelled to USA during the P.Y.2019-20 and incurred ₹ 2.20 lakhs for the same?

Answer

The clarification regarding filing of return of income by the coffee growers being individuals covered by Rule 7B of the Income-tax Rules, 1962 is given in *Circular No.10/2006 dated 16.10.2006*. According to the Circular, an individual deriving income from growing, curing, roasting and grounding of coffee with or without mixing chicory, would not be required to file the return of income if the aggregate of 40% of his or her income from growing, curing, roasting and grounding of coffee with or without mixing chicory and income from all other sources liable to tax in accordance with the provisions of this Act, is equal to or less than the basic exemption limit prescribed in the First Schedule of the Finance Act of the relevant year.

In this case, Smt. Kanti has a total income of ₹ 6,00,000 from this business, which was her only source of income for P.Y.2018-19. 40% of her total income works out to ₹ 2,40,000, which is less than the basic exemption limit of ₹ 2,50,000 in respect of an individual assessee. Therefore, Smt. Kanti is not required to file a return of income for the A.Y.2020-21 as per the provisions of section 139(1).

If Smt. Kanti had travelled to USA during the P.Y.2019-20 and incurred ₹ 2.20 lakhs on such travel, she would be required to mandatorily file a return of income for A.Y.2020-21 on or before the due date u/s 139(1), even though her total income does not exceed the basic exemption limit.

Question 23

Ram, an individual, filed his return of income for the assessment year 2020-21 on 15.6.2020. He later discovered that he had not claimed deduction under section 80C in the said return. He claimed the said deduction through a letter addressed to the Assessing Officer. The Assessing Officer completed the assessment without allowing the deduction claimed by Ram. Is the Assessing Officer justified in doing so?

Answer

The Supreme Court has, in *Goetze (India) Ltd. v. CIT (2006) 284 ITR 323,* ruled that the assessing authority has no power to entertain a claim for deduction made after filing of the return of income otherwise than by way of a revised return. In the instant case, Ram has claimed the deduction under section 80C, which he omitted to claim in the original return of income, through a letter addressed to the Assessing Officer and not by filing a revised return under section 139(5). In view of the decision of the Supreme Court cited above, the Assessing Officer was justified in completing the assessment without allowing the deduction under section 80C.

Question 24

Examine the correctness or otherwise of the following statements in the context of provisions contained in the Income-tax Act, 1961 and the decided case laws:

"The Assessing Officer is bound to allow the set-off of brought forward losses under section 72 even if the assessee has not claimed the same in the return filed".

Answer

The statement is correct.

The Supreme Court has, in *CIT v. Mahalakshmi Sugar Mills Co. Ltd. (1986) 160 ITR 920,* held that it is the duty of the Assessing Officer to apply the relevant provisions of the Act for the purpose of determining the true figure of the assessee's total income and consequential tax liability. Merely because the assessee has not claimed the set-off in the return filed, it cannot relieve the Assessing Officer of his duty to apply section 72 in the appropriate case.

As per *CBDT Circular No.14 (XL-35) of 1955 dated 11.04.1955*, it is the duty of the Assessing Officer to assist a taxpayer in every reasonable way, particularly in the matter of claiming and securing reliefs and in this regard, they should take the initiative in guiding a taxpayer where proceedings or other particulars before them indicate that some refund or relief is due to him.

Therefore, on the basis of the above Supreme Court ruling and the CBDT Circular, the Assessing Officer is bound to allow the set-off of brought forward losses under section 72, even if the assessee has not claimed the same in the return filed, provided the loss was determined in pursuance of a return filed under section 139(3) in any earlier previous year.

Moreover, the wording used in section 72 is “shall”, indicating that the provisions relating to set off of brought forward business loss are mandatory.

Therefore, the Assessing Officer is bound to allow the claim for set off of brought forward business losses even if the assessee has not claimed the same in the return filed.

Question 25

X, an individual, has got his books of account for the year ending 31.3.2020 audited under section 44AB. His total income for the assessment year 2020-21 is ₹ 5,20,000. He desires to know if he can furnish his return of income for the assessment year 2020-21 through a Tax Return Preparer.

Answer

Section 139B provides for submission of return of income through Tax Return Preparers. It empowers the Central Board of Direct Taxes (CBDT) to frame a scheme for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income through Tax Return Preparers. Specified class or classes of persons have been defined to mean any person, other than a company or a person whose accounts are required to be audited under section 44AB or under any other existing law, who is required to furnish a return of income under the Act. Thus, companies and persons whose accounts are liable for tax audit under section 44AB do not fall within the definition of ‘specified class or classes of persons’ and consequently, cannot furnish their returns of income through Tax Return Preparers. In the instant case, the books of account of X for the year ending 31.3.2020 have been audited under section 44AB. As such, he cannot furnish his return of income for the assessment year 2020-21 through a Tax Return Preparer.

Question 26

In April, 2019, the business premises of Priyanka Ravi were searched under section 132 by the DDI, Delhi. The search was concluded on 30.04.2019 and following assets/documents were found which were not recorded in her books of accounts:

- *Jewellery of ₹ 25 Lacs pertaining to P.Y. 2014-15*
- *Agreement for purchase of land which contains the payment of advance of ₹ 35 Lacs in cash in the P.Y.2013-14*
- *Shares purchased in the P.Y.2011-12 and in the P.Y.2012-13 totaling to ₹ 40 Lacs.*
- *Paper containing the payment of ₹ 15 Lacs in the P.Y.2009-10 and ₹ 10 Lacs in P.Y.2008-09 to a contractor for construction of residential house.*

Accordingly, Assessing Officer has issued the notice for all the previous years from P.Y.2008-09 to P.Y.2018-19 under section 153A.

However, Miss Priyanka Ravi contented that the Assessing Officer cannot issue the notice under section 153A beyond six assessment years immediately preceding the assessment year relevant to *the previous year in which the search was conducted under section 132 i.e. notice can be issued upto A.Y.2014-15 (P.Y. 2013-14).*

Discuss about the correctness of action of Assessing Officer and the contention of Miss Priyanka Ravi.

Answer

As per section 153A(1), issuance of notice and assessment or reassessment under the said section can also be made for an assessment year preceding the assessment year relevant to the previous year in which search is conducted or requisition is made which falls **beyond six assessment years** but **not beyond ten assessment years** from the assessment year relevant to the previous year in which search is conducted or requisition is made, provided that -

(i) the Assessing Officer has in his possession books of account or other documents or evidence which reveal that the income which has escaped assessment amounts to or is likely to amount to **fifty lakh rupees or more in one year or in aggregate in the relevant assessment years;**

(ii) such income escaping assessment is represented in the form of asset which **shall include immovable property being land or building or both, shares and securities, deposits in bank account, loans and advances;**

(iii) the income escaping assessment or part thereof relates to such year or years; and

(iv) search under section 132 is initiated or requisition under section 132A is made on or after 1-4-2017.

In the light of the above amended provision, the Assessing Officer can issue the notice u/s 153A beyond six assessment years but not beyond ten assessment years from the assessment year relevant to the previous year in which search is conducted or requisition is made. Thus, in the given case, the Assessing Officer can issue notice under section 153A upto A.Y.2010-11 as she,

a. has in his possession, documents or evidence which reveals the escaped assessment amounts to ₹ 55 lacs in aggregate during the relevant four assessment years i.e. from A.Y. 2010-11 to A.Y. 2013-14

b. such income escaping assessment represents in the form of assets which includes ₹ 40 lacs being Shares purchased in P.Y. 2011-12 and P.Y. 2012-13 ***plus*** ₹ 15 lacs being payment to contractor for construction of residential house in P.Y. 2009-10 (payment of ₹ 10 lacs relevant to P.Y. 2008-09 cannot be included as it is beyond ten assessment years)

c. search was conducted after 01.04.2017.

Hence, the contention of Miss. Priyanka Ravi that the Assessing Officer cannot issue the notice under section 153A beyond six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted under section 132 **is incorrect**.

The action of Assessing Officer is **partly correct** as it is possible to him to issue notice beyond six assessment years but not beyond ten assessment years from the assessment year relevant to the previous year in which search is conducted or requisition is made. Thus, he cannot issue the notice under section 153A for the A.Y.2009-10.

SIGNIFICANT SELECT CASES

1. **Whether the nature of an expenditure can be considered debatable for not invoking prima facie adjustment under section 143(1)(a), where the jurisdictional High Court has taken a view that the expenditure is capital in nature even though some other High Courts have held that the same is revenue in nature?**

Deputy Commissioner of Income Tax v Raghuvir Synthetics Ltd. [2017] 394 ITR 1 (SC)

Facts of the case: The assessee is a public limited company. For the relevant assessment year, it had filed its return claiming revenue expenditure of ₹ 65,47,448 on advertisement and public issue. The company claimed that if the sum cannot be considered as revenue expenditure, then, alternatively, the said expenditure may be allowed under section 35D by way treating such expenditure as preliminary expenses. The Assessing Officer issued an intimation under section 143(1)(a) disallowing a sum of ₹ 58,92,700 incurred on public issue.

Appellate Authorities' Views: The first appellate authority allowed the assessee's appeal by holding that the concept of "prima facie adjustment" under section 143(1)(a) cannot be invoked as there could be more than one opinion on whether public issue expenses were covered by section 35D or 37. The Tribunal as well as the Division Bench of the High Court dismissed the appeal of the Revenue on the ground that the issue was debatable and hence, the expenditure cannot be disallowed while processing return of income under section 143(1)(a).

Supreme Court's Observations: The Supreme Court noted that there was divergence of opinion amongst the various High Courts on the nature of the expenses incurred on raising share capital. While the High Courts of Madras, Andhra Pradesh and Karnataka had held the preliminary expenses to be revenue in nature, High Courts of Allahabad, Himachal Pradesh, Delhi, Calcutta, Bombay, Punjab and Haryana, Gujarat and Rajasthan had held the expenses to be capital in nature.

Supreme Court's Decision: The Supreme Court held that, in the case of the assessee, the issue was not debatable. Since the registered office of the assessee is in Gujarat, the law laid down by the Gujarat High Court is binding on the assessee.

2. **Whether the Assessing Officer is bound to consider the report of Departmental Valuation Officer (DVO) when it is available on record?**

Principal CIT v. Ravjibhai Nagjibhai Thesia (2016) 388 ITR 358 (Guj)

Facts of the case: The assessee sold his property for ₹ 16 lakhs. The State stamp valuation authority valued the property at ₹ 233.71 lakhs. During the course of assessment proceedings, at the request of the assessee, the Assessing Officer referred the matter of valuation to the DVO who valued the property at ₹ 24.15 lakhs. The Assessing Officer passed the order before the receipt of the report of the DVO by treating ₹ 217.71 lakhs (difference between ₹ 233.71 lakhs and ₹ 16 lakhs) as undisclosed income. The report of the DVO was received by the Assessing Officer after the date of assessment order but before the order was received by the assessee.

Appellate Authorities' Views: The Commissioner (Appeals) directed the Assessing Officer to compute the capital gain by taking the value given by the DVO. The Revenue carried the matter before Tribunal. The Tribunal agreed with the view of the CIT (Appeals) and dismissed the appeal. The Tribunal relied on CIT v. Dr. Indra Swaroop Bhatnagar (2012) 349 ITR 210 (All) which held that the DVO's valuation under section 50C(2) is binding on the Assessing Officer.

Issue: Whether the Assessing Officer having made reference to the DVO must consider the report of the DVO for the purpose of assessment?

High Court's Observations: The High Court observed that when the Assessing Officer has referred the matter to DVO, the assessment has to be completed in conformity with the estimate given by the DVO. As the DVO has estimated the value of the capital asset at an amount lower than the value assessed by the stamp valuation authority, as per 50C(2), it is such valuation which is required to be taken into consideration for the purposes of assessment.

High Court's Decision: The High Court held that capital gains has to be computed in conformity with the value so determined by the DVO.

3. **Can unabsorbed depreciation be allowed to be carried forward in case the return of income is not filed within the due date?**

CIT v. Govind Nagar Sugar Ltd. (2011) 334 ITR 13 (Delhi)

High Court's Observations: On this issue, the Delhi High Court observed that, the provisions of section 80 and section 139(3), requiring the return of income claiming loss to be filed within the due date, applies to, *inter alia,* carry forward of business loss and not for the carrying forward of unabsorbed depreciation. As per the provisions of section 32(2), the unabsorbed depreciation becomes part of next year's depreciation allowance and is allowed to be set-off as per the provisions of the Income-tax Act, 1961, irrespective of whether the return of earlier year was filed within due date or not.

High Court's Decision: Therefore, in the present case, the High Court held that the unabsorbed depreciation will be allowed to be carried forward to subsequent year even though the return of income of the current assessment year was not filed within the due date.

4. **Can an assessee revise the particulars filed in the original return of income by filing a revised statement of income?**

Orissa Rural Housing Development Corpn. Ltd. v. ACIT (2012) 343 ITR 316 (Orissa)

High Court's Decision: On this issue, the Orissa High Court held that the assessee can make a fresh claim before the Assessing Officer or make a change in the originally filed return of income only by filing revised return of income under section 139(5). There is no provision under the Income-tax Act, 1961 to enable an assessee to revise his income by filling a revised statement of income. Therefore, filling of revised statement of income is of no value and will not be considered by the Assessing Officer for assessment purposes.

The High Court, relying on the judgement of the Supreme Court in *Goetze (India) Ltd. v. CIT (2006) ITR 323,* held that the Assessing Officer has no power to entertain a fresh claim made by the assessee after filing of the original return except by way of filing a revised return.

5. **Is a person having income below taxable limit, required to furnish his PAN to the deductor as per the provisions of section 206AA, even though he is not required to hold a PAN as per the provisions of section 139A?**

Smt. A. Kowsalya Bai v. UOI (2012) 346 ITR 156 (Kar.)

As per the provisions of section 139A, *inter alia,* a person whose total income does not exceed the maximum amount not chargeable to income-tax is not required to apply to the Assessing Officer for the allotment of a permanent account number (PAN).

However, as per the provisions of section 206AA, notwithstanding anything contained in any other provision of this Act, any person who is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, i.e., the deductee, shall furnish his PAN to the deductor, otherwise tax shall be deducted as per the provisions section 206AA, which is normally higher. It is mandatory for an assessee to furnish his PAN, despite filing Form 15G as required under section 197A, to seek exemption from deduction of tax.

The provisions of section 139A are contradictory to section 197A, due to the fact that assessees whose income was less than the maximum amount not chargeable to income-tax, were not required to hold PAN, whereas their declaration furnished under section 197A was not accepted by the bank or financial institution unless PAN was communicated as per the provisions of section 206AA. The provisions of section 206AA creates inconvenience to small investors, who invest their savings from earnings as security for their future, since, in the absence of PAN, tax was deducted at source at a higher rate.

High Court's Decision: In order to avoid undue hardship caused to such persons, the Karnataka High Court, in the present case, held that it may not be necessary for such persons whose income is below the maximum amount not chargeable to income-tax to obtain PAN and in view of the specific provision of section 139A, section 206AA is not applicable to such persons. Therefore, the banking and financial institutions shall not insist upon such persons to furnish PAN while filing declaration under section 197A. However, section 206AA would continue to be applicable to persons whose income is above the maximum amount not chargeable to income-tax.

6. Can the Assessing Officer reopen an assessment on the basis of merely a change of opinion?

Aventis Pharma Ltd. v. ACIT (2010) 323 ITR 570 (Bom.)

The power to reopen an assessment is conditional on the formation of a reason to believe that income chargeable to tax has escaped assessment. The existence of tangible material is essential to safeguard against an arbitrary exercise of this power.

High Court's Observations and Decision: In this case, the High Court observed that there was no tangible material before the Assessing Officer to hold that income had escaped assessment within the meaning of section 147 and the reasons recorded for reopening the assessment constituted a mere change of opinion. Therefore, the reassessment was not valid.

7. Is it permissible under section 147 to reopen the assessment of the assessee on the ground that income has escaped assessment, after a change of opinion as to a loss being a speculative loss and not a normal business loss, consequent to a mere re-look of accounts which were earlier furnished by the assessee during assessment under section 143(3)?

ACIT v. ICICI Securities Primary Dealership Ltd. (2012) 348 ITR 299 (SC)

Facts of the case: In the above case, the Assessing Officer had completed the assessment of assessee under section 143(3) after taking into consideration the accounts furnished by assessee. After the lapse of four years from relevant assessment year, the Assessing Officer had reopened the assessment of assessee under section 147 on the ground that after re-look of the accounts of the relevant previous year, it was noticed that the assessee company had incurred a loss in trading in share, which was a speculative one. Therefore, such loss can only be set off against speculative income. Consequently, the loss represents income which has escaped assessment. Accordingly, the Assessing Officer came to a conclusion that income had escaped assessment and passed an order under section 147.

Supreme Court's Decision: The Supreme Court observed that the assessee had disclosed full details in the return of income in the matter of its dealing in stocks and shares. There was no failure on the part of assessee to disclose material facts as mentioned in proviso to section 147. Further, there is nothing new which has come to the notice of the Assessing Officer. The accounts had been furnished by the assessee when called upon. Therefore, re-opening of the assessment by the Assessing Officer is clearly a change of opinion and therefore, the order of re-opening the assessment is not valid.

8. Can a notice under section 148 for a particular assessment year be issued solely on the ground that survey under section 133A was carried on at the business premises of the assessee, where nothing had been found therein which would indicate escapement of income chargeable to tax for the said assessment year?

Hemant Traders v. ITO (2015) 375 ITR 167 (Bom)

Facts of the case: In the present case, the assessee is a partnership firm and registered as a Commission agent of the onion potato market under the Agricultural Produce Market, Committee, Navi Mumbai. The firm is regularly assessed to income-tax. The firm filed a return of income for A.Y.2010-11 on October 14, 2010 along with audit report, audited Balance Sheet and Profit & Loss Account for the year ended 31.3.2010. The return was processed and intimation under section 143(1) was issued on 20.02.2012, seeking clarification. No assessment order was passed. The assessee claimed that the profit as per the return of income was accepted. Meanwhile, a survey under section 133A was carried out at the business premises of the assessee on 7th January 2011 pertaining to A.Y.2011-12. However, the survey party did not find any discrepancy in the books of account. Further, the survey report did not contain any reference to any transactions for A.Y.2010-11. In March 2014, the assessee was issued a notice under section 148 for the A.Y.2010-11 based on the said survey.

The assessee preferred a writ challenging the issue of notice on the reasoning that no satisfaction was recorded of the escapement of income in the survey report or in any other relevant material. *Ex-facie,* the reassessment was bad in law.

High Court's Observations: The High Court perused the survey report which recorded that there was a group of assessees who were engaged in wholesale trading of potato on commission basis. The survey was conducted based on the allegations that these parties were resorting to hoarding of potatoes and making huge profits by fluctuating the day-to-day price of potatoes in the market. During survey, the assessee's books of account, cash balance and stocks were physically verified and inventory prepared. The report revealed cash difference of ₹ 5,020 and the explanation given was that the same pertained to the day-to-day and miscellaneous expenditure incurred on the day of survey. The report also revealed physical stock difference of 672 bags of potatoes. The explanation for such difference was recorded.

Neither the survey report nor any other material indicated escapement of income chargeable to tax for A.Y.2010-11. The Assessing Officer had nothing before him to record his belief or satisfaction that escapement of income had taken place.

Merely because survey had taken place cannot be a ground for reopening the assessment without valid material or evidence at the time of issue of notice. Whenever there was shortage of potatoes in the market, such powers of survey were invoked. Where nothing has been found during the survey operations to indicate that income chargeable to tax has escaped assessment, then the survey report ought not to be the basis for reopening of assessment. Something more was required in law for the Assessing Officer to exercise his powers.

High Court Decision: The High Court, accordingly, held that since there is absolutely no material to indicate escapement of income for the relevant assessment year, the issue of notice to initiate reassessment proceedings under section 148 on the basis of survey which had taken place is not valid. Therefore, the proceedings initiated under section 148 are quashed at the threshold itself.

9. Will the subsequent amendment of law with retrospective effect validate a reassessment notice issued on a different ground before the retrospective amendment was made?

Godrej Industries Ltd v. B.S. Singh Dy.CIT (2015) 377 ITR 1 (Bom)

Facts of the case: The assessee-company filed its return of income for the assessment year 2000-01 declaring total income as 'Nil' and a book profit of ₹ 52.70 crores. This resulted in 'book profit' being assessed to income-tax. Later, the Assessing Officer issued notice under section 148 for the reason that income chargeable to tax had escaped assessment on the ground that the provision for doubtful debts and provision for depletion of long-term investment debited to the profit and loss account were unascertained liabilities and, hence, in terms of clause (c) of the *Explanation* to section 115JA, i.e., they were to be added back to the net profit for arriving at the book profits.

The assessee preferred a writ challenging the maintainability of the notice issued under section 148.

Revenue's Contention: The Revenue contended that at the time of issuing the impugned notice on March 29, 2007, the position was not clear. The position became clear only when Parliament introduced/added clause (g) to the *Explanation* to section 115JA of the Act with retrospective effect from April 1, 1998, and which reads as under:

"(g) the amount or amounts set aside as provision for diminution in the value of any asset."

Thus, the Revenue submitted that the impugned notice is sustainable on the basis of above clause (g) of the *Explanation* to section 115JA, inserted by the Finance (No.2) Act, 2009 retrospectively with effect from 1st April, 1998.

High Court's Observations: The High Court observed that an identical issue had come up in *Rallis India Ltd. v. Asst. CIT [2010] 323 ITR 54 (Bom)* wherein a reopening notice was, *inter alia*, issued on the ground that the book profits have to be increased by the provision made for doubtful debts and for diminution in the value of investment in view of clause (c) of the *Explanation* to section 115JB. In the said case, the High Court recorded the fact that the Apex Court had, in *CIT v. HCL Comnet Systems and Services Ltd. [2008] 305 ITR 409*, held that the provision for doubtful debts is a provision made for diminution in the value of assets and is not a liability. Thus, it would not fall under clause (c) of the *Explanation* to section 115JA of the Act. Consequent to the aforesaid decision of the Apex Court, the Parliament has amended the *Explanation* both under section 115JA as well as section 115JB of the Act in 2009 by adding clause (g) and clause (i) with retrospective effect from April 1, 1998, and April 1, 2001, respectively. The Court held that though the amendment was made with the retrospective effect, the critical date is the date on which the Assessing Officer exercises jurisdiction under section 148 of the Act and the subsequent amendment could not have been and is in fact not a ground on which the Assessing Officer sought to reopen the assessment. It was held that the validity of a reopening notice of Assessing Officer is to be determined with reference to the reasons which are recorded in support of thereof and nothing else.

In this case also, it is clear that the reasons stated for reopening the assessment are that provision for doubtful debts and depletion in value of investments are both amounts set aside for meeting liabilities other than ascertained liabilities and hence, constitute income escaping assessment. The reasons recorded are not valid as the said items were not related to liabilities as perceived by the Assessing Officer. These provisions are made to take care of the likely fall in the value of assets.

The High Court observed that it is the Assessing Officer's belief at the time of issuing the reassessment notice that determines the validity of the notice. In this case, he wanted to apply clause (c) of the *Explanation* to section 115JA and whereas the issues got covered by subsequent amendment by means of insertion of clause (g) to the *Explanation* to section115JA by the Finance (No.2) Act, 2009 with retrospective effect from 1.4.1998. The subsequent event could not put life into the Assessing Officer's reason that income chargeable to tax had escaped assessment when the reasons as originally recorded are still born.

High Court's Decision: The position of law on the date of issue of notice under section 148 must be looked into and the retrospective amendment subsequent to issue of notice could not validate a notice issued earlier. It could only amount to change of opinion and the notice for reopening of assessment would become unsustainable.

The High Court, accordingly, allowed the writ and held that the reason for reopening the assessment cannot get validated by the retrospective amendment of law.

***Note** – It may be noted that section 115JA levying MAT was applicable from A.Y.1997-98 to A.Y.2000-01. From A.Y.2001-02, MAT is attracted under section 115JB. Clause (c) of Explanation 1 to section 115JB requires addition of amount set aside to provisions made for meeting liabilities, other than ascertained liabilities, to the net profit for arriving at the book profit for levy of MAT. Clause (i) was inserted by the Finance (No.2) Act, 2009 retrospectively with effect from 1st April, 2001 providing for addition of amount set aside as provision for diminution in the value of any asset, to the net profit for arriving at the book profit for levy of MAT. The rationale of the above ruling would, therefore, also apply in the context of examining the validity of notice issued for reopening an assessment on the basis of clause* *(c) of Explanation 1 to section 115JB, consequent to subsequent retrospective insertion of clause (i) in Explanation 1 to section 115JB.*

10. Can the Assessing Officer reassess issues other than the issues in respect of which proceedings were initiated under section 147 when the original "reason to believe" on the basis of which the notice was issued ceased to exist?

I Delhi High Court ruling in Ranbaxy Laboratories Ltd. v. CIT (2011) 336 ITR 136:

Facts of the case: In the present case, the assessee company was engaged in the business of manufacture and trading of pharmaceutical products. The Assessing Officer accepted the returned income filed by the assessee but initiated reassessment proceedings under section 147 in respect of the addition to be made on account of club fees, gifts and presents and provision for leave encashment. It was observed that the Assessing Officer had reason to believe that income has escaped assessment due to claim and allowance of such expenses and accordingly, he issued notice under section 148. However, after sufficient enquiries were made during reassessment proceedings, the Assessing Officer came to the conclusion that no additions are required to be made on account of these expenses. Therefore, while completing the reassessment he did not make additions on account of these items but instead made additions on the basis of other issues which were not the original "reason to believe" for the issue of notice under section 148. The Assessing Officer made such additions on the basis of *Explanation 3* to section 147 as per which the Assessing Officer may assess the income which has escaped assessment and which comes to his notice subsequently in the course of proceedings under section 147 even though the said issue did not find mention in the reasons recorded in the notice issued under section 148.

Issue: The issue under consideration is whether the Assessing Officer can make an assessment on the basis of an issue which came to his notice during the course of assessment, where the issues, which originally formed the basis of issue of notice under section 148, were dropped in its entirety.

High Court's Observations: As per section 147, the Assessing Officer may assess or reassess such income **and also** any other income chargeable to tax which has escaped assessment and which comes to his notice in the course of proceedings under this section. The Delhi High Court observed that the words "and also" used in section 147 are of wide amplitude.

The correct interpretation of the Parliament would be to regard the words **'and also'** as being "conjunctive and cumulative with" and not "in alternative to" the first part of the sentence, namely, "the Assessing Officer may assess and reassess *such income*". It is significant to note that Parliament has not used the word 'or' but has used the word 'and' together and in conjuction with the word 'also'. The words *'such income*' in the first part of the sentence refer to the income chargeable to tax which has escaped assessment and in respect of which the Assessing Officer has formed a reason to believe for issue of the notice under section 148.

Hence, the language used by the Parliament is indicative of the position that the assessment or reassessment must be in respect of the income, in respect of which the Assessing Officer has formed a reason to believe that the same has escaped assessment and also in respect of any other income which comes to his notice subsequently during the course of the proceedings as having escaped assessment.

High Court's Decision: If the income, the escapement of which was the basis of the formation of the "reason to believe" is not assessed or reassessed, it would not be open to the Assessing Officer to independently assess only that income which comes to his notice subsequently in the course of the proceedings under the section as having escaped assessment. If he intends to do so, a fresh notice under section 148 would be necessary.

II ***Punjab & Haryana High Court ruling in CIT v. Mehak Finvest P Ltd (2014) 367 ITR 769:***

Facts of the case: In the present case, reassessment proceedings were initiated against the assessee on the reason that various finance companies managed and controlled by certain persons were engaged in accommodation entries and the assessee-company was one among them. However, during the reassessment proceedings, the Assessing Officer noticed that fresh share application money amounting to ₹ 47 lakhs could not be explained by the assessee and hence invoked section 68 to bring to tax such sum. There was no addition on the basis of the original reason for which reassessment proceedings were initiated.

Issue: The issue under consideration is whether an addition can be made in reassessment when the original reasons on the basis of which notice for reassessment was issued did not survive.

Assessee's Contention *vis-a-vis* Revenue's Contention: The assessee contended that when the original reason prompting the initiation of reassessment proceedings did not survive, the question of making addition on some other fresh grounds was not possible. The basis of the assessee's contention was the Bombay High Court ruling in case of *CIT v. Jet Airways (I) Ltd (2011) 331 ITR 236 and Delhi High Court ruling in Ranbaxy Laboratories Ltd v. CIT (2011) 336 ITR 136.*

On the other hand, the Revenue placed reliance on the jurisdictional High Court decision in the case of *Majinder Singh Kang v. CIT (2012) 344 ITR 358* holding that reassessment can be made on the basis of additional grounds, even though the original reason forming the basis of issue of notice did not survive.

High Court's Observations: The High Court noted that *Explanation 3 to section 147* nowhere postulates or contemplates that the Assessing Officer cannot make any additions on any other ground unless some addition is made on the basis of the original ground for which reassessment proceeding was initiated. It cited the dismissal of special leave petition (SLP) against the High Court ruling in *Majinder Singh Kang's* case by the Supreme Court on 19.08.2011 as the binding precedent.

High Court's Decision: The High Court, accordingly, held that even though no addition is made on the original grounds which formed the basis of initiation of reassessment proceedings, the Assessing Officer is empowered to make additions on another ground for which reassessment notice might not have been issued but which came to his notice subsequently during the course of proceedings for reassessment.

III Karnataka High Court ruling in N. Govindaraju v. ITO (2015) 377 ITR 243

Facts of the case: The assessee, an individual, deriving income from house property, transport business, capital gains and other sources filed his return of income declaring total income of ₹ 4.82 lakhs and agricultural income of ₹ 1.62 lakhs. The return was processed under section 143(1). Subsequently, a notice under section 148 was issued stating that the assessee had converted agricultural land into non-agricultural purposes, formed sites and sold the same but while arriving at the indexation benefit it was taken up to the date of sale instead of the date of conversion as per section 45(2). Thus, the reason for reassessment was the excessive indexation benefit availed by the assessee. However, in reassessment, the Assessing Officer adopted fair market value which was less than what was adopted by the assessee and also sought to disallow 50% of the expenses incurred on transfer. The original reason which prompted the reassessment was dropped and based on fresh grounds, reassessment was completed.

Issue under consideration: One of the issues under consideration before the High Court was whether the reassessment based on fresh grounds would be valid when the original reason which prompted the reassessment, does not survive.

Assessee's contention *vis-s-vis* Revenue's contention: The assessee contended that the reason for which notice was issued has to survive and it is only thereafter that "any other income" which is found to have escaped assessment can also be assessed or reassessed in such proceeding. On the other hand, the Revenue claimed that section 147 is in two parts which have to be read independently; the phrase "such income" in the first part is with regard to reasons which have been recorded and the phrase "any other income" is with regard to cases where no reasons are recorded in the notice but they come to the notice of the Assessing Officer during the course of reassessment proceeding. Both being independent, once the satisfaction in the notice is found sufficient, addition can be made on all grounds i.e., for reasons which have been recorded and also for items for which no reasons were recorded. All that is necessary is that, during the course of the proceedings under section 147, income chargeable to tax must have escaped assessment.

High Court's Observations: The High Court observed that the controversy revolved around *Explanation 3* to section 147 inserted by the Finance (No.2) Act 2009 retrospectively with effect from 1.4.1989. The Court took note of Circular No.5/2010 issued by CBDT after the amendment in Paragraph 47 with caption 'Clarificatory amendment in respect of reassessment proceeding under section 147". Para 47.3 reads as under:

"Therefore, to articulate the legislative intention clearly *Explanation 3* has been inserted in section 147 to provide that the Assessing Officer may examine, assess or reassess any issue relevant to income which comes to his notice subsequently in the course of proceedings under this section, notwithstanding that the reason for such issue has not been included in the reasons recorded under section 148(2)".

The High Court observed that it is true that if the foundation goes, then, the structure cannot remain. Meaning thereby, if notice has no sufficient reason or is invalid, no proceedings can be initiated. However, this can be verified at the initial stage by challenging the notice. If the notice is challenged and found to be valid, or where the notice is not at all challenged, then, in either case, it cannot be said that notice is invalid. As such, if the notice is valid, then the foundation remains and the proceedings on the basis of such notice can continue. The High Court reiterated that once the proceedings have been initiated on a valid notice, it becomes the duty of the Assessing Officer to levy tax on the entire income (including "any other income") which may have escaped assessment and comes to his notice during the course of the proceedings initiated under section 147.

High Court's Decision: The High Court held that, in effect, once satisfaction of reasons for the notice is found sufficient i.e. if the notice under section 148(2) is found to be valid, then, the Assessing Officer may do reassessment in respect of any other item of income which may have escaped assessment, even though the original reason for issue of notice under section 148 does not survive.

This decision has dissented from the decisions in the case of *CIT v. Jet Airways (I) Ltd (2011) 331 ITR 236 (Bom); Ranbaxy Laboratories Ltd v. CIT (2011) 336 ITR 136 (Del).*

Note – *In this case, the reassessment on the basis of reasons, which did not form the original reasons to believe, but were subsequently discovered by the Assessing Officer, was held to be valid, even though the original reasons did not survive.*

However, the High Court further delved into the additional grounds, and held that the Tribunal was not justified in arriving at the fair market value of the property in question on 1.4.1981 without considering the material on record, including the valuation report, filed by the assessee. The matter was thus to be remanded to the Assessing Officer for determination of the fair market value of the property in question in accordance with law.

Further, without assigning any reason, the Assessing Officer had disallowed 50% of the total expenditure claimed by the assessee towards transfer and brokerage charges, even when the same had been paid by cheque and the receipt for which was obtained from the broker. When the specific case of the assessee was that heavy brokerage had to be paid because the property was under litigation and that it was occupied by unauthorised persons for which payment had to be made to get it vacated, disallowance could not be made on the ground that brokerage was generally being paid at the rate of 1-2%. The High Court opined that *when the said brokerage was paid by cheque and there was sufficient reason for paying higher brokerage, the entire amount ought to have been allowed and disallowance of 50% was not justified in law.*

Thus, in this case, though the High Court upheld that reassessment could be made on fresh grounds even when the original reasons recorded for reopening the assessment did not survive, additions made on the basis of such fresh grounds were turned down by the High Court, since the reasons were not justified to merit such additions.

11. Would the reassessment proceedings initiated under section 147 against the legal heirs of the deceased assessee be valid if notice of reassessment was sent to the legal heirs after the limitation period, though a notice addressed to the deceased assessee was sent prior to the limitation period?

Vipin Walia v. ITO (2016) 382 ITR 19 (Del)

Facts of the case: A notice under section 148 dated 27th March, 2015 was addressed to the assessee for the assessment year 2008-09. The notice got returned unserved with the postal authorities endorsing on it the remarks "addressee expired". Later, the Assessing Officer issued a letter dated 15.06.2015 to the petitioner seeking details of legal heirs/successors of the deceased (assessee) to complete the proceedings for the assessment year 2008-09.

The assessee, being one of the legal representatives of the deceased, wrote to the Assessing Officer pointing out that the proceedings initiated under section 148 were barred by limitation. The Assessing Officer proceeded to make the assessment under section 147 which the assessee challenged by means of a writ.

High Court's Observations: The High Court took note of section 159 which sets out the procedure to be adopted when the assessment is made on the legal representatives. Section 159(2)(a) states that any proceeding already taken against an assessee 'before his death' shall be deemed to have been taken against the legal representative. As per section 159(2)(b), any proceeding which could have been taken against the deceased if he had survived, may be taken against the legal representative of the deceased assessee, even if it had not been taken while the assessee was alive.

The Assessing Officer initiated proceedings under section 147 against the deceased for the assessment year 2008-09. The time limit for issue of notice was 31.03.2015, since the income escaping assessment exceeded ₹ 1 lakh. On March 27, 2015 when the notice was issued, the assessee was already dead. If the Department intended to proceed under section 147, it could have done so prior to 31.03.2015 by issuing a notice to the legal representatives of the deceased. Beyond that date, it could not have proceeded in the matter even by issuing notice to the legal representatives of the assessee.

High Court's Decision: The High Court, accordingly, held that issue of notice on the legal representatives beyond the limitation time would render the reassessment proceedings invalid.

12. Does the finding or direction in an appellate order that income relates to a different assessment year empower reopening of assessment for that assessment year, irrespective of the expiry of the six year time limit?

CIT v. PP Engineering Work (2014) 369 ITR 433 (Del)

Facts of the case: The Tribunal, in its order, directed that the cash credit of ₹ 32 lakhs found credited in the books of the assessee in the financial year 1999-2000 is chargeable to tax in the assessment year 2000-01 as against the assessment made by taxing the said amount in the assessment year 2001-02. In short, the Tribunal gave a finding that the cash credit under section 68 was assessable in a different assessment year than the assessment year in respect of which it heard the appeal. This prompted the Assessing Officer to issue a notice under section 148 in February, 2009 for reopening the proceedings for the A.Y. 2000-01. The issue is validity of notice issued after a lapse of 6 years from the end of the relevant assessment year.

The Commissioner (Appeals) held that the reassessment is barred by time limitation and the Tribunal also upheld the order of the Commissioner (Appeals) without making reference to section 150 read with *Explanation 2* to section 153.

High Court's Opinion: The High Court made reference to section 150 which overrides the time limitation specified in section 149. Also, *Explanation 2* to section 153 makes it clear that when an order in appeal, revision or reference is made whereby any income is excluded from the total income of an assessee for an assessment year, an assessment of such income for another assessment year shall be deemed to be one made in consequence of or to give effect to any finding or direction contained in the said order for the purposes of section 150 and section 153.

The High Court made reference to the Delhi High Court ruling in the case of *Rural Electrification Corporation Ltd v. CIT (2013) 355 ITR 345* and opined that the findings of Commissioner (Appeals) and Tribunal on the question of limitation as legally untenable and incorrect.

High Court's Decision: The High Court observed that in view of the order of the Tribunal that the credit entries related to the earlier assessment year i.e., A.Y.2000-01, the Assessing Officer initiated reassessment proceedings under section 147 by issue of notice under section 148 for the year and passed an order dated 29/12/2009 making an addition of ₹ 32 lakhs. The High Court held that by virtue of section 150 read with *Explanation 2* to section 153, the said order was not barred by limitation.

> ***Note –*** *Under section 149(1)(b), the time limit for issue for notice under section 148 is six years from the end of the relevant assessment year, where the income chargeable to tax which has escaped assessment amounts to or is likely to amount to ₹ 1 lakh or more for that year.*
>
> *Section 150(1) states that notwithstanding anything contained in section 149, notice under section 148 may be issued at any time for the purpose of making an assessment or reassessment or recomputation in consequence of or to give effect to any finding or direction contained in an appellate or revisionary order.*
>
> *Explanation 2 to section 153 provides that where by an order referred to in section 250, 254, 260, 262, 263 or 264, any income is excluded from the total income of the assessee for an assessment year, then, an assessment of such income for another assessment year shall, for the purposes of section 150 and section 153, be deemed to be one made in consequence of or to give effect to any finding or direction contained in the said order.*

13. Is initiation of reassessment beyond a period of 4 years on the basis of subsequent Tribunal and High Court ruling valid, if there is no failure on the part of the assessee to disclose fully and truly all materials facts?

Allanasons Ltd v. Dy. CIT (2014) 369 ITR 648 (Bom)

Facts of the case: The assessee-company filed its return of income in which a claim for deduction under Chapter VI-A was made. The case was subjected to scrutiny assessment and order under section 143(3) was passed reducing the claim for deduction under Chapter VI-A. After 4 years from the end of the assessment year, a notice under section 148 was issued ascribing reasons such as subsequent tribunal and other court decisions which show that the deduction was excessively allowed in this case. The assessee challenged the reassessment proceedings by means of a writ before the court, contending that it is a settled position in law that the decision rendered by court subsequent to the assessment order does not by itself amount to failure on the part of the assessee to fully and truly disclose all material facts necessary for assessment.

High Court's Opinion: The High Court observed that it is well settled in terms of the proviso to section 147, that where any assessment is sought to be opened beyond a period of four years from the end of the relevant assessment year, two conditions have to be fulfilled cumulatively. The first condition is that there must be reason to believe that income chargeable to tax has escaped assessment. The second condition is that such escapement of income should have arisen due to failure on the assessee's part to fully and truly disclose all material facts required for the assessment.

Thus, escapement of income prompting reopening of assessment beyond the period of 4 years from the end of the assessment year is not possible unless it is due to the failure of the assessee to disclose fully and truly all material facts necessary for assessment.

Even a subsequent change of law cannot be taken as income escaping assessment for triggering reassessment provisions beyond 4 years from the end of the assessment year unless there was a failure on the part of the assessee to disclose fully and truly all material facts necessary for assessment. The High Court observed that in this case, the reasons recorded, when read as a whole did not indicate even remotely any failure on the part of the assessee to disclose fully and truly any material fact necessary for assessment.

High Court's Decision: The High Court, accordingly, held that a subsequent decision of Tribunal or High Court by itself is not adequate for reopening the assessment completed earlier under section 143(3) unless there is a failure on the part of the assessee to disclose complete facts.

14. Is the notice for reassessment issued under section 148 on the basis of tax evasion report received from the Investigation Unit of the Income-tax department valid, if such notice has been issued erroneously in the name of the erstwhile company which has now been converted into an LLP?

Sky Light Hospitality LLP v. Assistant CIT [2018] 405 ITR 296 (Del)

Facts of the Case: Sky Light Hospitality (SH) LLP, a Limited Liability Partnership, had acquired the rights and liabilities of Sky Light Hospitality Private Limited (SHPL) upon conversion under the Limited Liability Partnership Act, 2008. The return for the relevant assessment year filed by SHPL was processed under section 143(1) and was not subjected to scrutiny assessment. However, upon further receipt of a tax evasion report, a reassessment notice had been issued under section 148. The petitioner-LLP has filed a writ petition to quash the notice and the reassessment proceedings.

Issue: The issue under consideration is whether a notice for reassessment issued under section 148 on the basis of tax evasion report received from the Investigation Unit of the Income-tax department can be treated as valid, if such notice has been issued erroneously in the name of the erstwhile company which has now been converted into an LLP.

Delhi High Court's Observations: The petitioner contended that the notice under section 148 was invalid because –

(i) the notice is not protected under section 292B as issuance of notice incorrectly in the name of SHPL had been done intentionally; and

(ii) the notice has been issued without a live nexus/reason to believe that the income had escaped assessment.

The High Court dismissed the contentions of the petitioner. Firstly, as long as there is "reason to believe" and not mere "reason to suspect", Courts should not interject to stop the adjudication process. In the notice for reassessment, reference was made to the tax evasion report received from the Investigation unit of the Income-tax department. The tax evasion report placed on record is detailed and elaborate. Peculiar and specific details relating to transactions between the assessee and a third party were mentioned in it. As per the tax evasion report, the assessee had not been able to satisfactorily explain source of ₹ 35 crores. Hence, there was evidence and material on record to justify issue of notice under section 148 of the Act.

Secondly, there is clear evidence that the notice was erroneously addressed to SHPL instead of SH LLP. The error or mistake was that the notice did not record the conversion of SHPL into SH LLP. However, it is clearly evident that the notice was meant for the assessee-LLP and no one else. When the assessee-LLP received the notice, it filed a letter, without prejudice, objecting to the notice being issued in the name of SHPL. However, the letter indicated that the assessee-LLP understood that the notice was for it. Section 292B was enacted to ensure that technical pleas (such as mistake, defect or omission) or procedural irregularities do not invalidate assessment proceedings. Courts have not proceeded on technical trivialities. The error here was only a technical issue on the part of the respondent. No prejudice was caused. The Court acknowledges the lapses in the litigation but observes that mere human errors cannot be used to nullify proceedings.

Delhi High Court's decision: The Delhi High Court held that the notice issued under section 148 on the basis of tax evasion report received from the Investigation unit of the Income-tax department is valid, since there was reason to believe on the basis of the said report that income had escaped assessment, even though the notice was erroneously issued in the name of the erstwhile company which has now been converted into LLP. The Court clarifies that it has passed no opinion on the merits of the case which will be duly dealt with, by the Assessing Officer. The petitioner-LLP is required to appear before the Assessing Officer to deal with the merits of the issues pertaining to the notice.

***Note** - The special leave petition filed against the aforementioned decision of the Delhi High Court was dismissed by the Supreme Court.*

15. Is recording of satisfaction and quantification of escaped income a pre-condition for issuing notice under section 148 after 4 years from the end of the relevant assessment year?

Amarnath Agrawal v. CIT (2015) 371 ITR 183 (All)

Facts of the case: The assessee along with four others had obtained a lease of land and was in possession of the same from 1953. Subsequently, the State Government introduced a policy for conversion of lease-hold to free-hold. The assessee applied for conversion before the District Magistrate in 1997 and a sale deed was executed. The assessee deposited the necessary charges as demanded by the State Government and a freehold sale deed dated 25th March, 1998 was executed. The assessee sold a portion of the land during the F.Y. 1999-2000 and admitted the same as long-term capital gain taking into account the lease hold period also. In the assessment, the admission of income as long-term capital gain was accepted. However, after the expiry of four years from the end of the relevant assessment year, proceeding for reassessment of such income as short-term capital gains was resorted to by the Revenue on the ground that the lease hold period should not be considered for determining the period of holding of freehold land transferred. The assessee filed a writ challenging the validity of notice issued under section 148 stating that the requirements of section 149 read with section 151 were not considered by the Revenue.

High Court's Opinion and Decision: The High Court observed that two distinct conditions must be satisfied for assuming jurisdiction to issue a notice under section 148 after a period of 4 years viz. (i) escapement of income; and (ii) omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment.

Under section 149(1)(b), it is imperative for the Assessing Officer, in his reasons, to state that the escaped income is likely to be ₹ 1 lakh or more. This is an essential ingredient for seeking approval and the basis on which satisfaction is to be recorded by the competent authority under section 151. If the condition precedent to substantiate the satisfaction of escapement of income is not made, the issuance of notice would be invalid.

In this case, since no reasons were recorded that the escaped income is likely to be ₹ 1 lakh or more so that the Chief Commissioner or Commissioner may record his satisfaction under section 151, the initiation of reassessment proceedings after four years was barred by time. The reasons recorded by the Assessing Officer were that the assessee had computed long-term capital gains tax liability, whereas he was liable to pay short-term capital gains tax, since he had sold a portion of the property within 3 years from the date of conversion of leasehold land into a freehold land.

The High Court observed that the property was held for more than 3 years and the conversion from leasehold to freehold being an improvement of the title did not have any effect on the taxability of profits. The reasons recorded by the Assessing Officer did not indicate any failure on the part of the assessee to disclose fully and truly all material facts at the time of assessment; it also did not indicate that the quantum of escapement of income exceeds ₹ 1 lakh. Accordingly, the High Court held that, in this case, the issue of notice under section 148 after the four year time period was not valid.

16. **In case of change of incumbent of an office, can the successor Assessing Officer initiate reassessment proceedings on the ground of change of opinion in relation to an issue, which the predecessor Assessing Officer who framed the original assessment had already applied his mind and come to a conclusion?**

H. K. Buildcon Ltd. v. Income-tax Officer (2011) 339 ITR 535 (Guj.)

High Court's Observations: On this issue, the Gujarat High Court referred to the ruling of the Apex Court in *CIT v. Kelvinator of India Ltd. (2010) 320 ITR 561*, wherein it was held that the Assessing Officer has the power only to reassess and not to review. Reassessment has to be based on fulfillment of certain precondition and if the concept of change of opinion is removed, then, in the garb of reopening the assessment, review would take place. The Apex Court further laid down that one must treat the concept of change of opinion as an in-built test to check abuse of power by the Assessing Officer. The Apex Court referred to *Circular No.549 dated 31.10.1989* explaining the amendment made by the Direct Tax Laws (Amendment) Act, 1989 with effect from 1.4.1989 to reintroduce the expression "reason to believe", and concluded that if the phrase "reason to believe" is omitted, the same would give arbitrary powers to the Assessing Officer to reopen the past assessment on mere change of opinion and this is not permissible even as per legislative intent.

High Court's Decision: The Gujarat High Court, applying the rationale of the Apex Court ruling, observed that in the entire reasons recorded in this case, there was nothing on record to show that income had escaped assessment in respect of which the successor Assessing Officer received information subsequently, from an external source. The reasons recorded themselves indicated that the successor Assessing Officer had merely recorded a different opinion in relation to an issue to which the Assessing Officer, who had framed the original assessment, had already applied his mind and come to a conclusion. The notice of reassessment was, therefore, not valid.

17. Would the doctrine of merger apply for calculating the period of limitation under section 154(7)?

CIT v. Tony Electronics Limited (2010) 320 ITR 378 (Del.)

Issue: The issue under consideration is whether the time limit of 4 years as per section 154(7) would apply from the date of original assessment order or the order of the Appellate Authority.

High Court's Decision: The High Court held that once an appeal against the order passed by an authority is preferred and is decided by the appellate authority, the order of the Assessing Officer merges with the order of the appellate authority**.** After merger, the order of the original authority ceases to exist and the order of the appellate authority prevails.

Thus, the period of limitation of 4 years for the purpose of section 154(7) has to be counted from the date of the order of the Appellate Authority.

***Note** - In this case, the Delhi High Court has followed the decision of the Supreme Court in case of Hind Wire Industries v. CIT (1995) 212 ITR 639.*

ANNEXURE

E-ASSESSMENT SCHEME, 2019

NOTIFICATION NO. 61, DATED 12.9.2019

S.O. 3264(E). – In exercise of the powers conferred by sub-section (3A) of section 143 of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby makes the following Scheme, namely:

1. **Short title and commencement. —** (1) This Scheme may be called the E-assessment Scheme, 2019.

   (2) It shall come into force on the date of its publication in the Official Gazette.

2. **Definitions** — (1) In this Scheme, unless the context otherwise requires, —

   (i) "Act" means the Income-tax Act, 1961 (43 of 1961);

   (ii) "addressee" shall have the same meaning as assigned to it in clause (b) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);

   (iii) "assessment" means assessment of total income or loss of the assessee under sub-section (3) of section 143 of the Act;

   (iv) "authorised representative" shall have the same meaning as assigned to it in sub-section (2) of section 288 of the Act;

   (v) "automated allocation system" means an algorithm for randomised allocation of cases, by using suitable technological tools, including artificial intelligence and machine learning, with a view to optimise the use of resources;

   (vi) "automated examination tool" means an algorithm for standardised examination of draft orders, by using suitable technological tools, including artificial intelligence and machine learning, with a view to reduce the scope of discretion;

   (vii) "Board" means Central Board of Direct Taxes constituted under the Central Board of Revenues Act, 1963 (54 of 1963);

   (viii) "computer resource" shall have the same meaning as assigned to them in clause (k) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);

   (ix) "computer system" shall have the same meaning as assigned to them in clause (l) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);

   (x) "computer resource of assessee" shall include assessee's registered account in designated portal of the Income-tax Department, the Mobile App linked to the registered mobile number of the assessee, or the email account of the assessee with his email service provider;

   (xi) "digital signature" shall have the same meaning as assigned to it in clause (p) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);

(xii) "designated portal" means the web portal designated as such by the Principal Chief Commissioner or Principal Director General, in charge of the National e-assessment Centre**;**

(xiii) "e-assessment" means the assessment proceedings conducted electronically in 'e-Proceeding' facility through assessee's registered account in designated portal;

(xiv) "electronic record" shall have the same meaning as assigned to it in clause (t) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of2000);

(xv) "electronic signature" shall have the same meaning as assigned to it in clause (ta) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);

(xvi) "email" or "electronic mail" and "electronic mail message" means a message or information created or transmitted or received on a computer, computer system, computer resource or communication device including attachments in text, image, audio, video and any other electronic record, which may be transmitted with the message.;

(xvii) "hash function" and "hash result" shall have the same meaning as assigned to them in the *Explanation* to sub-section (2) of section 3 of the Information Technology Act, 2000 (21 of 2000);

(xviii) "Mobile app" shall mean the application software of the Income-tax Department developed for mobile devices which is downloaded and installed on the registered mobile number of the assessee;

(xix) "originator" shall have the same meaning as assigned to it in clause (za) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);

(xx) "real time alert" means any communication sent to the assessee, by way of Short Messaging Service on his registered mobile number, or by way of update on his Mobile App, or by way of an email at his registered email address, so as to alert him regarding delivery of an electronic communication;

(xxi) "registered account" of the assessee means the electronic filing account registered by the assessee in designated portal;

(xxii) "registered e-mail address" means the e-mail address at which an electronic communication may be delivered or transmitted to the addressee, including-

(a) the email address available in the electronic filing account of the addressee registered in designated portal; or

(b) the e-mail address available in the last income-tax return furnished by the addressee; or

(c) the e-mail address available in the Permanent Account Number database relating to the addressee; or

(d) in the case of addressee being an individual who possesses the Aadhaar number, the e-mail address of addressee available in the database of Unique Identification Authority of India ;or

(e) in the case of addressee being a company, the e-mail address of the company as available on the official website of Ministry of Corporate Affairs; or

(f) any e-mail address made available by the addressee to the income-tax authority or any person authorised by such authority.

(xxiii) "registered mobile number" of the assessee means the mobile number of the assessee, or his authorised representative, appearing in the user profile of the electronic filing account registered by the assessee in designated portal;

(xxiv) "video telephony" means the technological solutions for the reception and transmission of audio-video signals by users at different locations, for communication between people in real-time.

(2) Words and expressions used herein and not defined but defined in the Act shall have the meaning respectively assigned to them in the Act.

3. Scope of the Scheme –– The assessment under this Scheme shall be made in respect of such territorial area, or persons or class of persons, or incomes or class of incomes, or cases or class of cases, as may be specified by the Board.

4. E-assessment Centres – (1) For the purposes of this Scheme, the Board may set up-

(i) a National e-assessment Centre to facilitate the conduct of e-assessment proceedings in a centralised manner, which shall be vested with the jurisdiction to make assessment in accordance with the provisions of this Scheme;

(ii) Regional e-assessment Centres as it may deem necessary to facilitate the conduct of e-assessment proceedings in the cadre controlling region of a Principal Chief Commissioner, which shall be vested with the jurisdiction to make assessment in accordance with the provisions of this Scheme;

(iii) assessment units, as it may deem necessary to facilitate the conduct of e-assessment, to perform the function of making assessment, which includes identification of points or issues material for the determination of any liability (including refund) under the Act, seeking information or clarification on points or issues so identified, analysis of the material furnished by the assessee or any other person, and such other functions as may be required for the purposes of making assessment;

(iv) verification units, as it may deem necessary to facilitate the conduct of e-assessment, to perform the function of verification, which includes enquiry, cross verification, examination of books of accounts, examination of witnesses and recording of statements, and such other functions as may be required for the purposes of verification.

(v) technical units, as it may deem necessary to facilitate the conduct of e-assessment, to perform the function of providing technical assistance which includes any assistance or advice on legal, accounting, forensic, information technology, valuation, transfer pricing, data analytics, management or any other technical matter which may be required in a particular case or a class of cases, under this Scheme; and

(vi) review units, as it may deem necessary to facilitate the conduct of e-assessment, to perform the function of review of the draft assessment order, which includes checking whether the relevant and material evidence has been brought on record, whether the relevant points of fact and law have been duly incorporated in the draft order, whether the issues on which addition or disallowance should be made have been discussed in the draft order, whether the applicable judicial decisions have been considered and dealt with in the draft order, checking for arithmetical correctness of modifications proposed, if any, and such other functions as may be required for the purposes ofreview**,** and specify their respective jurisdiction.

(2) All communication among the assessment unit, review unit, verification unit or technical unit or with the assesse or any other person with respect to the information or documents or evidence or any other details, as may be necessary for the purposes of making an assessment under this Scheme shall be through the National e-assessment Centre.

(3) The units referred to in sub-paragraphs (iii), (iv), (v) and (vi) of paragraph (1) shall have the following authorities, namely:–

(a) Additional Commissioner or Additional Director or Joint Commissioner or Joint Director, as the case may be;

(b) Deputy Commissioner or Deputy Director or Assistant Commissioner or Assistant Director, or Income-tax Officer, as the case may be;

(c) such other income-tax authority, ministerial staff, executive or consultant, as considered necessary by the Board.

5. Procedure for assessment —(1) The assessment under this Scheme shall be made as per the following procedure, namely:

(i) the National e-Assessment Centre shall serve a notice on the assessee under sub-section (2) of section 143, specifying the issues for selection of his case for assessment;

(ii) the assessee may, within fifteen days from the date of receipt of notice referred to in sub-clause (i), file his response to the National e-assessment Centre ;

(iii) the National e-assessment Centre shall assign the case selected for the purposes of e-assessment under this Scheme to a specific assessment unit in any one Regional e-assessment Centre through an automated allocation system;

(iv) where a case is assigned to the assessment unit, it may make a request to the National e-assessment Centre for

(a) obtaining such further information, documents or evidence from the assesse or any other person, as it may specify;

(b) conducting of certain enquiry or verification by verification unit; and

(c) seeking technical assistance from the technical unit;

(v) where a request for obtaining further information, documents or evidence from the assessee or any other person has been made by the assessment unit, the National e-assessment Centre shall issue appropriate notice or requisition to the assessee or any other person for obtaining the information, documents or evidence requisitioned by the assessment unit;

(vi) where a request for conducting of certain enquiry or verification by the verification unit has been made by the assessment unit, the request shall be assigned by the National e-assessment Centre to a verification unit through an automated allocation system;

(vii) where a request for seeking technical assistance from the technical unit has been made by the assessment unit, the request shall be assigned by the National e-assessment Centre to a technical unit in any one Regional e- assessment Centres through an automated allocation system;

(viii) the assessment unit shall, after taking into account all the relevant material available on the record, make in writing, a draft assessment order either accepting the returned income of the assessee or modifying the returned income of the assesse, as the case may be, and send a copy of such order to the National e- assessment Centre;

(ix) the assessment unit shall, while making draft assessment order, provide details of the penalty proceedings to be initiated therein, if any;

(x) the National e-assessment Centre shall examine the draft assessment order in accordance with the risk management strategy specified by the Board, including by way of an automated examination tool, whereupon it may decide to –

(a) finalise the assessment as per the draft assessment order and serve a copy of such order and notice for initiating penalty proceedings, if any, to the assessee, alongwith the demand notice, specifying the sum payable by, or refund of any amount due to, the assessee on the basis of such assessment; or

(b) provide an opportunity to the assessee, in case a modification is proposed, by serving a notice calling upon him to show cause as to why the assessment should not be completed as per the draft assessment order; or

(c) assign the draft assessment order to a review unit in any one Regional e-assessment Centre, through an automated allocation system, for conducting review of such order;

(xi) the review unit shall conduct review of the draft assessment order, referred to it by the National e-assessment Centre whereupon it may decide to

(a) concur with the draft assessment order and intimate the National e-assessment Centre about such concurrence; or

(b) suggest such modification, as it may deem fit, to the draft assessment order and send its suggestions to the National e-assessment Centre;

(xii) the National e-assessment Centre shall, upon receiving concurrence of the review unit, follow the procedure laid down in sub-paragraph (a) or sub-paragraph (b) of paragraph (x), as the case may be;

(xiii) the National e-assessment Centre shall, upon receiving suggestions for modifications from the review unit, communicate the same to the Assessment unit;

(xiv) the assessment unit shall, after considering the modifications suggested by the Review unit, send the final draft assessment order to the National e-assessment Centre;

(xv) The National e-assessment Centre shall, upon receiving final draft assessment order, follow the procedure laid down in sub-paragraph (a) or sub-paragraph (b) of paragraph (x),as the case may be;

(xvi) The assessee may, in a case where show-cause notice under sub-paragraph (b) of paragraph (x) has been served upon him, furnish his response to the National e-assessment Centre on or before the date and time specified in the notice;

(xvii) The National e-assessment Centre shall,-

(a) in a case where no response to the show-cause notice is received, finalise the assessment as per the draft assessment order,as per the procedure laid down in sub-paragraph (a) of paragraph (x); or

(b) in any other case, send the response received from the assessee to the assessment unit;

(xviii) The assessment unit shall, after taking into account the response furnished by the assessee, make a revised draft assessment order and send it to the National e-assessment Centre;

(xix) The National e-assessment Centre shall, upon receiving the revised draft assessment order,-

(a) in case no modification prejudicial to the interest of the assessee is proposed with reference to the draft assessment order, finalise the assessment as per the procedure laid down in sub-paragraph (a) of paragraph (x); or

(b) in case a modification prejudicial to the interest of the assessee is proposed with reference to the draft assessment order,provide an opportunity to the assessee, as per the procedure laid down in sub- paragraph (b) of paragraph (x);

(c) the response furnished by the assessee shall be dealt with as per the procedure laid down in paragraphs (xvi),(xvii), and (xviii);

(xx) The National e-assessment Centre shall, after completion of assessment, transfer all the electronic records of the case to the Assessing Officer having jurisdiction over such case**.,** for **–**

(a) imposition of penalty;

(b) collection and recovery of demand;

(c) rectification of mistake;

(d) giving effect to appellate orders;

(e) submission of remand report, or any other report to be furnished, or any representation to be made, or any record to be produced before the Commissioner (Appeals), Appellate Tribunal or Courts, as the case may be;

(f) proposal seeking sanction for launch of prosecution and filing of complaint before the Court;

(xxi) Notwithstanding anything contained in paragraph (xx), the National e-assessment Centre may at any stage of the assessment, if considered necessary, transfer the case to the Assessing Officer having jurisdiction over such case.

6. Penalty proceedings for non-compliance.– (1) Any unit may, in the course of assessment proceedings, for non- compliance of any notice, direction or order issued under this Scheme on the part of the assessee or any other person, send recommendation for initiation of any penalty proceedings under Chapter XXI of the Act, against such assesse or any other person, as the case may be, to the National e-assessment Centre, if it considers necessary or expedient to do so.

(2) The National e-assessment Centre shall, on receipt of such recommendation, serve a notice on the assessee or any other person, as the case may be, calling upon him to show cause as to why penalty should not be imposed on him under the relevant provisions of the Act.

(3) The response to show - cause notice furnished by the assessee or any other person, if any, shall be sent by the National e-assessment Centre to the concerned unit which has made the recommendation for penalty.

(4) The said unit shall, after taking into consideration the response furnished by the assesse or any other person, as the case may be, -

(a) make a draft order of penalty and send a copy of such draft to National e-assessment Centre; or

(b) drop the penalty after recording reasons, under intimation to the National e-assessment Centre.

(5) The National e-assessment Centre shall levy the penalty as per the said draft order of penalty and serve a copy of the same on the assessee or any other person, as the case may be.

7. Appellate Proceedings.– An appeal against an assessment made by the National e-assessment Centre under this Scheme shall lie before the Commissioner (Appeals) having jurisdiction over the jurisdictional Assessing Officer and any reference to the Commissioner (Appeals) in any communication from the National e-assessment Centre shall mean such jurisdictional Commissioner (Appeals).

8. Exchange of communication exclusively by electronic mode.— For the purposes of this Scheme,-

(a) all communications between the National e-assessment Centre and the assessee, or his authorised representative, shall be exchanged exclusively by electronic mode; and

(b) all internal communications between the National e-assessment Centre, Regional e-assessment Centres and various units shall be exchanged exclusively by electronic mode.

9. Authentication of electronic record — For the purposes of this Scheme, an electronic record shall be authenticated by the originator by affixing his digital signature in accordance with the provisions of sub-section (2) of section 3 of the Information Technology Act, 2000 (21 of2000):

Provided that in case of the originator, being the assesse or any other person, such authentication may also be done by electronic signature or electronic authentication technique in accordance with the provisions of sub-section (2) of section 3A of the said Act:

10. Delivery of electronic record.—(1) Every notice or order or any other electronic communication under this Scheme shall be delivered to the addressee, being the assessee, by way of-

(a) placing an authenticated copy thereof in the assessee's registered account; or

(b) sending an authenticated copy thereof to the registered email address of the assessee or his authorised representative; or

(c) uploading an authenticated copy on the assessee's Mobile App; and followed by a real time alert.

(2) Every notice or order or any other electronic communication under this Scheme shall be delivered to the addressee, being any other person, by sending an authenticated copy thereof to the registered email address of such person, followed by a real time alert.

(3) The Assessee shall file his response to any notice or order or any other electronic communication, under this Scheme, through his registered account, and once an acknowledgement is sent by the National e-assessment Centre containing the hash result generated upon successful submission of response, the response shall be deemed to be authenticated.

(4) The time and place of dispatch and receipt of electronic record shall be determined in accordance with the provisions of section 13 of the Information Technology Act, 2000 (21 of 2000).

11. No personal appearance in the Centres or Units.—(1) A person shall not be required to appear either personally or through authorised representative in connection with any proceedings under this Scheme before the income-tax authority at the National e-assessment Centre or Regional e-assessment Centre or any unit set up under this Scheme.

(2) In a case where a modification is proposed in the draft assessment order, and an opportunity is provided to the assessee by serving a notice calling upon him to show-cause as to why the assessment should not be completed as per the such draft assessment order, the assessee or his authorised representative, as the case may be, shall be entitled to seek personal hearing so as to make his oral submissions or present his case before the income-tax authority in any unit under this Scheme, and such hearing shall be conducted exclusively through video conferencing, including use of any telecommunication application software which supports video telephony, in accordance with the procedure laid down by the Board.

(3) Any examination or recording of the statement of the assessee or any other person (other

than statement recorded in the course of survey under section 133A of the Act) shall be conducted by an income-tax authority in any unit under this Scheme, exclusively through video conferencing, including use of any telecommunication application software which supports video telephony in accordance with the procedure laid down by the Board.

(4) The Board shall establish suitable facilities for video conferencing including telecommunication application software which supports video telephony at such locations as may be necessary, so as to ensure that the assessee, or his authorised representative, or any other person referred to in sub-paragraph (2) or sub-paragraph (3) is not denied the benefit of this Scheme merely on the consideration that such assessee or his authorised representative, or any other person does not have access to video conferencing at his end.

12. Power to specify format, mode, procedure and processes.—(1) The Principal Chief Commissioner or the Principal Director General, in charge of the National e-assessment Centre shall lay down the standards, procedures and processes for effective functioning of the National e-assessment Centre , Regional e-assessment Centres and the unit set-up under this Scheme, in an automated and mechanised environment, including format, mode, procedure and processes in respect of the following, namely:—

(i) service of the notice, order or any other communication;

(ii) receipt of any information or documents from the person in response to the notice, order or any other communication;

(iii) issue of acknowledgment of the response furnished by the person;

(iv) provision of "e-proceeding" facility including login account facility, tracking status of assessment, display of relevant details, and facility of download;

(v) accessing, verification and authentication of information and response including documents submitted during the assessment proceedings;

(vi) receipt, storage and retrieval of information or documents in a centralised manner;

(vii) general administration and grievance redressal mechanism in the respective Centres and units.

NOTIFICATION NO. 62/2019, DATED 12.9.2019

S.O. 3265(E) — In exercise of the powers conferred by sub-section (3B) of section 143 of the Income-tax Act, 1961 (43 of 1961), for the purposes of giving effect to the E-assessment Scheme, 2019 made under sub-section (3A) of section 143 of the Act, the Central Government hereby makes the following directions, namely:-

1. The provisions of clause (7A) of section 2, section 92CA, section 120, section 124, section 127, section 129, section 131, section 133, section 133A, section 133C, section 134, section 142, section 142A, section 143, section 144A, section 144BA section 144C and Chapter XXI of the Act shall apply to the assessment made in accordance with the said Scheme subject to the following exceptions, modifications and adaptations, namely: -

"A. (1) The assessment shall be made as per the following procedure, namely:—

(i) the National e-assessment Centre shall serve a notice on the assessee under sub-section (2) of section 143, specifying the issues for selection of his case for assessment;

(ii) the assessee may, within fifteen days from the date of receipt of notice referred to in sub-clause (i), file his response to the National e-assessment Centre;

(iii) the National e-assessment Centre shall assign the case selected for the purposes of assessment under this Scheme to a specific assessment unit in any one Regional e-assessment Centre through an automated allocation system;

(iv) where a case is assigned to the assessment unit, it may make a request to the National e-assessment Centre for

a. obtaining such further information, documents or evidence from the assesse or any other person, as it may specify;

b. conducting of certain enquiry or verification by verification unit; and

c. seeking technical assistance from the technical unit;

(v) where a request for obtaining further information, documents or evidence from the assessee or any other person has been made by the assessment unit, the National e-assessment Centre shall issue appropriate notice or requisition to the assessee or any other person for obtaining the information, documents or evidence requisitioned by the assessment unit;

(vi) where a request for conducting of certain enquiry or verification by the verification unit has been made by the assessment unit, the request shall be assigned by the National e-assessment Centre to a verification unit through an automated allocation system;

(vii) where a request for seeking technical assistance from the technical unit has been made by the assessment unit, the request shall be assigned by the National e-assessment Centre to a technical unit in any one Regional e-assessment Centre through an automated allocation system;

(viii) the assessment unit shall, after taking into account all the relevant material available on the record, make in writing, a draft assessment order either accepting the returned income of the assessee or modifying the returned income of the assesse, as the case may be, and send a copy of such order to the National e- assessment Centre;

(ix) the Assessment unit shall, while making draft assessment order, provide details of the penalty proceedings to be initiated therein, if any;

(x) the National e-assessment Centre shall examine the draft assessment order in accordance with the risk management strategy specified by the Board, including by way of an automated examination tool, whereupon it may decide to –

a. finalise the assessment as per the draft assessment order and serve a copy of such order and notice for initiating penalty proceedings, if any, to the assessee, alongwith the demand notice, specifying the sum payable by, or refund of any amount due to, the assessee on the basis of such assessment; or

b. provide an opportunity to the assessee, in case a modification is proposed, by serving a notice calling upon him to show cause as to why the assessment should not be completed as per the draft assessment order; or

c. assign the draft assessment order to a review unit in any one Regional e-assessment Centre, through an automated allocation system, for conducting review of such order;

(xi) the review unit shall conduct review of the draft assessment order, referred to it by the National e-assessment Centre whereupon it may decide to

a. concur with the draft assessment order and intimate the National e-assessment Centre about such concurrence; or

b. suggest such modification, as it may deem fit, to the draft assessment order and send its suggestions to the National e-assessment Centre;

(xii) the National e-assessment Centre shall, upon receiving concurrence of the review unit, follow the procedure laid down in sub-paragraph (a) or sub-paragraph (b) of paragraph (x), as the case may be;

(xiii) the National e-assessment Centre shall, upon receiving suggestions for modifications from the Review unit, communicate the same to the Assessment unit;

(xiv) the assessment unit shall, after considering the modifications suggested by the Review unit, send the final draft assessment order to the National e-assessment Centre;

(xv) The National e-assessment Centre shall, upon receiving final draft assessment order, follow the procedure laid down in sub-paragraph (a) or sub-paragraph (b) of paragraph (x), as the case may be;

(xvi) The assessee may, in a case where show-cause notice under sub-paragraph (b) of paragraph (x) has been served upon him, furnish his response to the National e-assessment Centre on or before the date and time specified in the notice;

(xvii) The National e-assessment Centre shall, -

a. in a case where no response to the show-cause notice is received, finalise the assessment as per the draft assessment order, as per the procedure laid down in sub-paragraph (a) of paragraph (x); or

b. in any other case, send the response received from the assessee to the assessment unit;

(xviii) The assessment unit shall, after taking into account the response furnished by the assessee, make a revised draft assessment order and send it to the National e-assessment Centre;

(xix) The National e-assessment Centre shall, upon receiving the revised draft assessment order, -

a. in case no modification prejudicial to the interest of the assessee is proposed with reference to the draft assessment order, finalise the assessment as per the procedure laid down in sub-paragraph (a) of paragraph (x); or

b. in case a modification prejudicial to the interest of the assessee is proposed with reference to the draft assessment order, provide an opportunity to the assessee, as per the procedure laid down in sub-paragraph (b) of paragraph (x);

c. the response furnished by the assessee shall be dealt with as per the procedure laid down in paragraphs (xvi), (xvii) and (xviii);

(xx) The National e-assessment Centre shall, after completion of assessment, transfer all the electronic records of the case to the Assessing Officer having jurisdiction over such case**.**, for **–**

(a) imposition of penalty;

(b) collection and recovery of demand;

(c) rectification of mistake;

(d) giving effect to appellate orders;

(e) submission of remand report, or any other report to be furnished, or any representation to be made, or any record to be produced before the Commissioner (Appeals), Appellate Tribunal or Courts, as the case may be;

(f) proposal seeking sanction for launch of prosecution and filing of complaint before the Court**;**

(xxi) Notwithstanding anything contained in paragraph (xx), the National e-assessment Centre may at any stage of the assessment, if considered necessary, transfer the case to the Assessing Officer having jurisdiction over such case.

B. (1) A person shall not be required to appear either personally or through authorised representative in connection with any proceedings under this Scheme before the income-tax authority at the National e-assessment Centre or Regional e- assessment Centre or in any unit set-up under this Scheme**.**

(2) In a case where a modification is proposed in the draft assessment order, and an opportunity is provided to the assessee by serving a notice calling upon him to show cause as to why the assessment should not be completed as per the such draft assessment order, the assessee or his authorised representative, as the case may be, shall be entitled to seek personal hearing so as to make his oral submissions or present his case before the income-tax authority in any unit under this Scheme, and such hearing shall be conducted exclusively through video conferencing, including use of any telecommunication application software which supports video telephony, in accordance with the procedure laid down by the Board.

(3) Any examination or recording of the statement of the assessee or any other person (other than statement recorded in the course of survey under section 133A of the Act) shall be conducted by an income-tax authority in any unit under this Scheme, exclusively through video conferencing, including use of any telecommunication application software which supports video telephony in accordance with the procedure laid down by the Board.

(4) The Board shall establish suitable facilities for video conferencing including telecommunication application software which supports video telephony at such locations as may be necessary, so as to ensure that the assessee, or his authorised representative, or any other person referred to in sub-paragraph (2) or sub-paragraph (3) is not denied the benefit of this Scheme merely on the consideration that such assessee or his authorised representative, or any other person does not have access to video conferencing at his end**.**".

2. The provisions of section 246A of the Act shall apply to appealable orders arising out of assessments made in accordance with the Scheme subject to the following, exceptions, modifications and adaptations, namely: -

   "An appeal against an assessment made by the National e-assessment Centre under the Scheme shall lie before the Commissioner (Appeals) having jurisdiction over the jurisdictional Assessing Officer and any reference to the Commissioner (Appeals) in any communication from the National e-assessment Centre shall mean such jurisdictional Commissioner (Appeals).".

3. The provisions of section 140, section 142 and section 282A of the Act shall apply to assessments made in accordance with the Scheme subject to the following, exceptions, modifications and adaptations, namely: -

   "an electronic record shall be authenticated by the originator by affixing his digital signature in accordance with the provisions of sub-section (2) of section 3 of the Information Technology Act, 2000 (21 of 2000):

   Provided that in case of the originator, being the assesse or any other person, such authentication may also be done by electronic signature or electronic authentication technique in accordance with the provisions of sub-section (2) of section 3A of the said Act.".

4. The provisions of Chapter XXI of the Act shall apply to penalties imposable in accordance with the Scheme subject to the following, exceptions, modifications and adaptations, namely: -

“(1) Any unit may, in the course of assessment proceedings, for non-compliance of any notice, direction or order issued under this Scheme on the part of the assessee or any other person, send recommendation for initiation of any penalty proceedings under Chapter XXI of the Act, against such assesse or any other person, as the case may be, to the National e-assessment Centre, if it considers necessary or expedient to do so.

(2) The National e-assessment Centre shall, on receipt of such recommendation, serve a notice on the assessee or any other person, as the case may be, calling upon him to show cause as to why penalty should not be imposed on him under the relevant provisions of the Act.

(3) The response to show - cause notice furnished by the assessee or any other person, if any, shall be sent by the National e-assessment Centre to the concerned unit which has made the recommendation for penalty.

(4) The said unit shall, after taking into consideration the response furnished by the assesse or any other person, as the case may be, -

a. make a draft order of penalty and send a copy of such draft to National e-assessment Centre; or

b. drop the penalty after recording reasons, under intimation to the National e-assessment Centre.

(5) The National e-assessment Centre shall levy the penalty as per the said draft order of penalty and serve a copy of the same on the assessee or any other person, as the case may be.”.

5. The provisions of section 282, section 283 and section 284 of the Act shall apply to assessment made in accordance with the Scheme subject to the following, exceptions, modifications and adaptations, namely: -

“**A** (1) Every notice or order or any other electronic communication under this Scheme shall be delivered to the addressee, being the assessee, by way of-

(a) placing an authenticated copy thereof in the assessee's registered account; or

(b) sending an authenticated copy thereof to the registered email address of the assessee or his authorised representative; or

(c) uploading an authenticated copy on the assessee’s Mobile App; and followed by a real time alert.

(2) Every notice or order or any other electronic communication under this Scheme shall be delivered to the addressee, being any other person, by sending an authenticated copy thereof to the registered email address of such person, followed by a real time alert.

(3) The Assessee shall file his response to any notice or order or any other electronic communication, under this Scheme, through his registered account, and once an acknowledgement is sent by the National e-assessment Centre containing the hash result

generated upon successful submission of response, the response shall be deemed to be authenticated.

(4) The time and place of dispatch and receipt of electronic record shall be determined in accordance with the provisions of section 13 of the Information Technology Act, 2000 (21 of 2000).

B. The Principal Chief Commissioner or the Principal Director General, in charge of the National e-assessment Centre shall lay down the standards, procedures and processes for effective functioning of the National e-assessment Centre, Regional e-assessment Centre and the units set-up under this Scheme, in an automated and mechanised environment, including format, mode, procedure and processes in respect of the following, namely: —

(i) service of the notice, order or any other communication;

(ii) receipt of any information or documents from the person in response to the notice, order or any other communication;

(iii) issue of acknowledgment of the response furnished by the person;

(iv) provision of "e-proceeding" facility including login account facility, tracking status of assessment, display of relevant details, and facility of download;

(v) accessing, verification and authentication of information and response including documents submitted during the assessment proceedings;

(vi) receipt, storage and retrieval of information or documents in a centralised manner;

(vii) general administration and grievance redressal mechanism in the respective Centres and units.".

6. This notification shall come into force on the date of its publication in the Official Gazette.

CHAPTER 18

APPEALS AND REVISION

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **identify** the orders appealable before different appellate authorities;
- **recall** the time limit for filing appeals before different appellate authorities;
- **appreciate** the powers of different appellate authorities;
- **comprehend and appreciate** the provision in law for avoiding repetitive appeals;
- **appreciate** the procedure for appeal by Revenue when an identical question of law is pending before Supreme Court;
- **identify** the circumstances when an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the Revenue, for initiation of revision proceedings under section 263;
- **appreciate** the procedure for revision of other orders under section 264;
- **recall** the time limit for revision of orders;
- **identify** the cases where doctrine of total merger and doctrine of partial merger are applicable;
- **analyse and apply** the above provisions to determine whether an order is appealable before a particular appellate authority, the time limit for filing of appeal and address other issues in non-complex to moderately complex scenarios.

The assessee is given a right of appeal by the Act where he feels aggrieved by the order of the assessing authority. However, the assessee has no inherent right of appeal unless the statute specifically provides that a particular order is appealable. There are four stages of appeal under the Income-tax Act, 1961 as shown hereunder –

Assessment Order

↓

First Appeal

Commissioner (Appeals)

↓

Second Appeal

Appellate Tribunal

↓

Third Appeal

High Court

↓

Final Appeal

Supreme Court

18.1 APPEALS BEFORE COMMISSIONER (APPEALS)

(1) Appealable Orders before Commissioner (Appeals) [Section 246A]: An assessee or any deductor or any collector aggrieved by any of the following orders may appeal to the Commissioner (Appeals) against such orders under section 246A -

(a) (i) an order passed by a Joint Commissioner under section 115VP(3)(ii) refusing to approve the option for tonnage tax scheme; or

(ii) an order against the assessee where the assessee denies his liability to be assessed under this Act; or

(iii) an intimation under section 143(1)/(1B) or section 200A(1) or section 206CB(1), where the assessee or the deductor or the collector objects to the making of adjustments; or

(iv) any order of assessment under section 143(3) except an order passed in pursuance of the directions of Dispute Resolution Panel or an order of assessment or reassessment passed by the Assessing Officer with the prior approval of Principal Commissioner or Commissioner, where tax consequences have been determined in the order under the provisions of Chapter X-A relating to General Anti Avoidance Rules] or a best judgement order under section 144, in relation to the income assessed, or to the amount of tax determined, or to the amount of loss computed, or to the status under which he is assessed;

(b) an order of assessment, reassessment or recomputation under section 147 [except an order passed in pursuance of the directions of Dispute Resolution Panel or an order of assessment or reassessment passed by the Assessing Officer with the prior approval of Principal Commissioner or Commissioner, where tax consequences have been determined in the order under the provisions of Chapter X-A relating to General Anti Avoidance Rules or section 150;

(c) an order of assessment or reassessment under section 153A, except an order passed in pursuance of the directions of the Dispute Resolution Panel or an order of assessment or reassessment passed by the Assessing Officer with the prior approval of Principal Commissioner or Commissioner, where tax consequences have been determined in the order under the provisions of Chapter X-A relating to General Anti Avoidance Rules;

(d) an order of assessment or reassessment passed by the Assessing Officer under section 92CD(3) in accordance with the Advance Pricing Agreement pursuant to a modified return filed in accordance with section 92CD(1);

However, with effect from 1.9.2019, an order made under section 92CD(3) would be appealable. This is consequent to the amendment in section 92CD(3) with effect from 1.9.2019 requiring the Assessing Officer to pass an order modifying the total income of the relevant assessment year in accordance with the arm's length price (ALP) determined as per the Advance Pricing Agreement (APA) entered into.

Prior to 1.9.2019, the Assessing Officer was required to assess or reassess or recompute the total income of the relevant assessment year, due to which the Assessing Officer may start fresh assessment or reassessment of completed assessments of the assessees who have modified the returns of income in accordance with the APA entered into by them, while the legislative intent was to require the Assessing Officer to merely modify the total income consequent to modification of return of income in pursuant to APA.

(e) an order made under section 154 or section 155 having the effect of enhancing the assessment or reducing a refund or an order refusing to allow the claim made by the assessee under either of the said sections except an order of assessment or reassessment passed by the Assessing Officer with the prior approval of Principal Commissioner or Commissioner, where tax consequences have been determined in the order under the provisions of Chapter X-A relating to General Anti Avoidance Rules;

(f) an order made under section 163 treating the assessee as the agent of a non-resident;

(g) an order made under section 170(2)/(3) assessing income of business prior to succession in the hands of the successor;

(h) an order made under section 171 relating to assessment after partition of HUF;

(i) an order made under section 201 deeming a person to be an assessee-in-default for failure to deduct the whole or any part of the tax deductible at source;

(j) an order made under section 206C(6A) deeming a person to be an assessee-in-default for failure to collect or pay tax;

(k) a refund order made under section 237;

(l) an order imposing a penalty under

(i) Section 221; or

(ii) Section 271A, section 271AAB, section 272AA or section 272BB;

(n) an order imposing penalty under section 271B;

(o) an order imposing a penalty under section 271C, section 271CA, section 271D, or section 271E;

(p) an order imposing a penalty under section 272A;

(q) an order imposing a penalty under section 272AA;

(r) an order imposing or enhancing penalty under section 275(1A);

(s) an order imposing a penalty under Chapter XXI;

(t) an order made by an Assessing Officer other than a Deputy Commissioner under the provisions of this Act in the case of such person or class of persons, as the Board may, having regard to the nature of the cases, the complexities involved and other relevant considerations direct.

It is also provided that the aforesaid provision will apply to all orders whether made before or after the appointed date which has been defined in the section as "the day appointed by the Central Government by notification in the Official Gazette."

It is further provided that every appeal which is pending before the appointed day before the Deputy Commissioner (Appeals) and any matter arising out of or connected with such appeal and which is so pending shall stand transferred on that day to the Commissioner (Appeals) and the Commissioner (Appeals) may proceed with such appeal or matter from the stage in which it was on that day.

It is also provided that an appellant may demand that before proceeding further with the appeal and the matter, the previous proceedings or any part thereof be re-opened or the appellant be re-heard.

(2) Appeal by person denying liability to deduct tax under section 195 [Section 248]: This section provides that where under an agreement or other arrangement, the tax deductible on any income, other than interest, under section 195 is to be borne by the person by whom the income is payable, and such person having paid such tax to the credit of the Central Government, claims that no tax was required to be deducted on such income, he may appeal to the Commissioner (Appeals) for a declaration that no tax was deductible on such income.

This section restricts the eligibility of filing an appeal only to cases where the tax is borne by the assessee. Therefore, the cases where the tax is to be borne by the non-resident is outside the scope of section 248 and no appeal can be filed in such cases.

(3) Form of appeal and prescribed fees [Section 249(1)]: Every appeal shall be in the prescribed form and shall be verified in the prescribed manner.

Prescribed fees - In case of an appeal made to the Commissioner (Appeals), irrespective of the date of initiation of the assessment proceedings, the appeal shall be accompanied by a fee of:

	Case	Prescribed fees
(i)	where the total income of the assessee as computed by the Assessing Officer is ₹ 1,00,000 or less	₹ 250
(ii)	where the total income of the assessee computed as above is more than ₹ 1,00,000 but not more than ₹ 2,00,000	₹ 500
(iii)	where the total income of the assessee computed as above is more than ₹ 2,00,000	₹ 1,000
(iv)	in any case other than (i), (ii) and (iii) above	₹ 250

(4) Time limit [Section 249(2) & (3)]: An appeal to the Commissioner (Appeals) against any order which is appealable is to be presented within 30 days from the dates specified below in the particular cases. However, the Commissioner (Appeals) may admit an appeal even after the expiry of the said period of thirty days, if he is satisfied that the appellant had sufficient cause for not presenting the appeal within the specified time. The dates from which the limitation period of 30 days has to be reckoned are as follows:

	Appeal relating to	30 days to be reckoned from
1.	Section 248	Date of payment of tax
2.	Assessment/penalty	Date of service of notice of demand
3.	Any other case	Date on which intimation of the order sought to be appealed against is served.

Period to be excluded while computing 30 days in case of appeal relating to assessment/penalty

	Application	Period to be excluded	
		From	To
1.	Under section 146 for reopening an assessment	The date on which application is made	The date on which the order passed on the application is served on the assessee
2.	Under section 270AA(1)	The date on which the application is made	The date on which the order rejecting the application is served on the assessee

(5) Exemption in respect of tax to be paid at the time of filing the appeal [Section 249(4)]: No appeal to the Commissioner (Appeals) shall be admitted for consideration unless, at the time of filing the appeal, the assessee has paid the tax on the amount of income returned by him in cases where a return has been filed by the assessee. If, however, no return has been filed by the assessee and an assessment has been made on him by the Assessing Officer, then, the assessee must pay an amount equal to the amount of advance tax which was payable by him before filing the appeal. The Commissioner (Appeals) is, however, empowered for good and sufficient reasons to be recorded in writing, to exempt an appellant from the operation of the requirement in regard to payment of advance tax, on receipt of an application from the appellant made specifically for this purpose, giving the reasons for the non-payment of the tax. The concerned authority is also required to pass an order in writing while granting the exemption indicating also the reasons on account of which the exemption is granted to the assessee.

(6) Procedure in appeal [Section 250]: On account of an appeal, the Commissioner (Appeals) shall fix a day and place for the hearing of the appeal and shall give notice of the same to the assessee and to the Assessing Officer, against whose order the appeal is made. Both the assessee and the Assessing Officer have the right to be heard at the hearing of the appeal either in person or by an authorised representative. The Commissioner (Appeals) has the power to adjourn the hearing of the appeal from time to time.

The Commissioner (Appeals), before passing an order on an appeal, may make such further enquiries as he thinks fit or direct the Assessing Officer to make further enquiries and report the result of the same to him. He may also allow the appellant to go into any grounds of appeal not specified previously by the appellant if he is satisfied that the omission of that ground was not wilful or unreasonable.

The order of the Commissioner (Appeals) disposing of the appeal shall be in writing and shall state the points for determination, the decision thereon and the reasons for the decision. On disposal of the appeal the Commissioner (Appeals) must communicate the order passed by him to the assessee as well as to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

In every appeal the Commissioner (Appeals), where it is possible, may hear and decide such appeal within a period of one year from the end of the financial year in which such appeal is filed under section 246A(1).

(7) Powers of the Commissioner (Appeals) [Section 251]: While disposing of an appeal the Commissioner (Appeals) is vested with the following powers viz.,

(i) In an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment.

(ii) In an appeal against the assessment order in respect of which the proceeding before the Settlement Commission abates under section 245HA, to confirm, reduce, enhance or annul the assessment after taking into consideration the following -

(1) all the material and other information produced by the assessee before the Settlement Commission;

(2) the results of the inquiry held by the Settlement Commission;

(3) the evidence recorded by the Settlement Commission in the course of the proceeding before it; and

(4) such other material as may be brought on his record.

(iii) In an appeal against an order imposing a penalty he may confirm or cancel such order or vary it in such a way as to enhance or reduce the penalty.

(iv) In any other case, the Commissioner (Appeals) may pass such orders in the appeal as he deems fit.

The Commissioner (Appeals), however, is not empowered to enhance an assessment or a penalty or to reduce a refund due to the assessee without giving the assessee a reasonable opportunity of showing cause against such an enhancement or reduction. In disposing of an appeal, the Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which the order appealed against was passed even if such matters were not raised before the Commissioner (Appeals) by the appellant.

18.2 APPEALS TO THE APPELLATE TRIBUNAL [SECTIONS 252 TO 255]

(1) Constitution [Section 252(1)] - The Central Government shall constitute an Appellate Tribunal consisting of judicial and accountant members to exercise the powers and discharge the functions conferred on the Tribunal by the Act.

Judicial Member – qualification [Section 252(2)]

1. Must have held at least for 10 years a judicial office in the territory of India; or
2. Must have been a member of the Indian Legal Service in Grade II or any equivalent or higher post for at least three years; or
3. Must have been an advocate for at least 10 years.

Accountant Member – qualification [Section 252(2A)]

1. Minimum 10 years in the practice of accountancy as a Chartered Accountant; or as a registered accountant under any law formerly in force; or partly as such registered accountant and partly as a Chartered Accountant; or
2. Must have been a member of the Indian Income-tax Service, Group A and must have held the post of Additional Commissioner of Income-tax or any equivalent or higher post for at least three years.

The Central Government shall appoint –

(i) a person who is a sitting or retired Judge of a High Court and who has completed not less than 7 years of service as a Judge in a High Court; or

(ii) one of the Vice Presidents of the Appellate Tribunal

to be the President thereof **[Section 252(3)].**

The Government may appoint one or more members of the Tribunal to be the Vice-President or Vice-Presidents thereof. The Vice-President shall exercise such of the powers and perform such of the functions of the President as may be delegated to him by the President by a general or special order in writing **[Section 252(4) & (5)].**

(2) Qualifications, terms and conditions of service of President, Vice President and Member [Section 252A]: Part XIV of Chapter VI to the Finance Act, 2017 contains amendments to certain Acts to provide for merger of tribunals and other authorities and conditions of service of chairpersons, members, etc. Section 184 of the Finance Act, 2017 lays down the qualifications, appointment, term and conditions of service, salary and allowances, etc., of Chairperson, Vice Chairperson and Members, etc., of the Tribunal, Appellate Tribunal and other Authorities.

Section 252A has been inserted in the Income-tax Act, 1961 to provide that the qualifications, appointment, term of office, salaries and allowances, resignation, removal and the other terms and conditions of service of the President, Vice-President and other Members of the Appellate Tribunal appointed after the commencement of Part XIV of Chapter VI of the Finance Act, 2017 would be governed by the provisions of section 184 of the Finance Act, 2017.

However, the President, Vice-President and Member appointed before the commencement of Part XIV of Chapter VI of the Finance Act, 2017, shall continue to be governed by the provisions of this Act i.e., section 252 and the rules made thereunder as if the provisions of section 184 of the Finance Act, 2017 had not come into force.

Section 156 of the Finance Act, 2017 provides the provisions of Part XIV of Chapter VI of the Finance Act, 2017 shall come into force on such date as the Central Government may, by notification in the Official Gazette appoint.

Accordingly, the Central Government has, vide Notification No. SO 1696(E) [F.No.A.-50050/9/2016-Ad1C(CESTAT) Pt. I], dated 26.05.2017, appointed 26.05.2017 as the date on which the provisions of the Part XIV of Chapter VI of the Finance Act, 2017 shall come into force.

Accordingly, the Central Government had notified "Tribunal, Appellate Tribunal and other Authorities (Qualifications, Experience and other Conditions of Service of Members) Rules, 2017", to specify the qualifications, appointment, term of office, salaries and allowances, resignation, removal and the other terms and conditions of service of the President, Vice-President and other Members of the Tribunal. Qualifications for appointment of President, Vice-President and other Members of the Tribunal are same as specified in section 252(1).

(3) Orders appealable before the Appellate Tribunal [Section 253]: Section 253(1) provides that an assessee aggrieved by any of the following orders may appeal to the Appellate Tribunal against such order –

Order passed by	Section	Particulars
Assessing Officer	115VZC(1)	Power of Assessing Officer to exclude a tonnage tax company from the tonnage tax scheme if such company is a party to any transaction or arrangement which amounts to an abuse of such scheme.
	143(3)/147/153A/153C	An order of assessment passed by an Assessing Officer in pursuance of the directions of Dispute Resolution Panel or an order passed under section 154 in respect of such order.
	143(3)/147/153A/153C	An order of assessment passed by an Assessing Officer with the approval of Principal Commissioner or Commissioner as referred to in section 144BA(12), where tax consequences have been determined under the provisions of Chapter X-A relating to general anti-avoidance rules, or an order passed under section 154 or section 155 in respect of such order.
Commissioner (Appeals)	250	Order of the Commissioner (Appeals) disposing of the appeal
	270A	Order levying penalty for under-reporting and misreporting of income.
	271A	Order imposing penalty for failure to keep, maintain or retain books of account, documents etc.
	271J	Order imposing penalty for furnishing incorrect information in any report or certificate by an accountant, merchant banker or registered valuer.
	272A	Order imposing penalty for failure to answer questions, sign statements, furnish information returns or statements, allow inspections etc.
	154	Order rectifying a mistake

Principal Commissioner or Commissioner	12AA	Order refusing/canceling registration of trust or institution
	80G(5)(vi)	Refusal to grant approval to the Institutions or Fund
	263	Revision of erroneous order passed by Assessing Officer
	270A	Order imposing penalty for under-reporting of income and mis-reporting of income.
	272A	Order imposing penalty for failure to answer questions, sign statements, furnish information returns or statements, allow inspections etc.
	154	Amending the order passed under section 263
Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Principal Director or Director	272A	Order imposing penalty for failure to answer questions, sign statements, furnish information returns or statements, allow inspections etc.
CIT (Exemptions)	10(23C)(iv)/(v)/(vi)/(via)	Order passed by the prescribed authority refusing approval of a fund/ institution for charitable purposes or trust or institution for public religious purposes or wholly for public religious and charitable purposes, university or other educational institution solely for educational purposes and not for purposes of profit or hospital or other institution solely for philanthropic purposes and not for purposes of profit under section 10(23C)(iv)/(v)/(vi)/(via).

Section 253(2) provides that the Principal Commissioner or Commissioner may, if he objects to any order passed by the Commissioner (Appeals) under section 154 or section 250, direct the Assessing Officer to appeal to the Appellate Tribunal against such order.

(4) Time limit for filing appeal or memorandum of cross objection under section 253(1) & (2) [Section 253(3), (4) & (5)]

(i) Every appeal to the Appellate Tribunal has to be filed within 60 days from the date on which the order sought to be appealed against is communicated to the assessee or the Principal Commissioner or Commissioner, as the case may be.

(ii) Further, on receipt of notice that appeal against order of Commissioner (Appeals) has been preferred by the Assessing Officer or the assessee, as the case may be, the other party can file memorandum of cross objections within 30 days of receipt of notice against any part of the order of Commissioner (Appeals). The Appellate Tribunal has to dispose of the memorandum of cross objections as if it were an appeal filed within the given time limit.

(iii) However, the Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross objection even after expiry of the prescribed time limit, if he is satisfied that there was sufficient cause for not presenting it within that period.

(5) Fees

	Case	Prescribed fees
(i)	Where the total income of the assessee as computed by the Assessing Officer in the case to which the appeal relates is ₹ 1,00,000 or less	₹ 500
(ii)	Where the total income exceeds ₹ 1,00,000 but is not more than ₹ 2,00,000	₹ 1,500
(iii)	Where the total income is more than ₹ 2,00,000	1% of the assessed income, subject to a maximum of ₹ 10,000.
(iv)	In any other case	₹ 500
(v)	Where appeal is filed to the Appellate Tribunal by an Assessing Officer on the direction of the Commissioner or Principal Commissioner, against the order of the Commissioner (Appeals) under section 154 or 250	No fees
(vi)	Filing of memorandum of cross-objections.	No fees
(vii)	Application for stay of demand	₹ 500

The Appellate Tribunal may, after giving both the parties to the appeal a reasonable opportunity of being heard, pass such orders on any appeal as it thinks fit. Such orders passed by the Appellate Tribunal shall be final unless appeal is made to the High Court under section 260A.

(6) **Rectification:** The Appellate Tribunal may, at any time within **6 months from the end of the month in which order is passed**, with a view to rectifying any mistake apparent from records, amend any order passed by it. However, if the mistake is brought to its notice by the assessee or the Assessing Officer, the Tribunal is bound to rectify the same. In cases where the amendment has the effect of enhancing the assessment or reducing a refund or otherwise increasing the liability of the assessee, the Tribunal shall not pass any order of amendment unless it has given notice to the assessee of its intention to do so and has allowed him a reasonable opportunity of being heard. The

Tribunal must send a copy of any orders passed by it to the assessee and to the Principal Commissioner or Commissioner.

(7) Fees for rectification: Any application for rectification filed by the assessee shall be accompanied by a fee of ₹ 50.

(8) Time limit: In every appeal, the Appellate Tribunal, where it is possible, may hear and decide such appeal within a period of four years from the end of the financial year in which such appeal is filed under sub-section (1)/(2) of section 253.

Under section 254(2A), the Appellate Tribunal can grant stay of demand of tax which can extend only up to 180 days from the date of granting such stay. If the appeal is not disposed of within 180 days, the stay order shall stand vacated after the expiry of the said period.

Where an order of stay has been passed and the appeal has not been disposed of within the specified period of 180 days from the date of such order, the Appellate Tribunal may extend the period of stay or pass an order of stay for a further period or periods, as it thinks fit, on an application made in this behalf by the assessee and on being satisfied that the delay in disposing of the appeal is not attributable to the assessee.

However, the aggregate of the period originally allowed and the period or periods so extended or allowed shall not, in any case, exceed 365 days, even if the delay in disposing of the appeal is not attributable to the assessee. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

(9) Cost of appeal: The cost of any appeal to the Appellate Tribunal shall be at the discretion of that Tribunal.

(10) Final authority on facts: On all questions of fact the orders passed by the Appellate Tribunal on appeal shall be final and binding on the assessee as well as the Department [Section 255].

(11) Benches:

(i) Section 255(1) provides that the powers and functions of the Appellate Tribunal may be exercised and discharged by Benches constituted by the President of the Appellate Tribunal among the members thereof.

(ii) As per section 255(2), a Bench should normally consist of one judicial member and one accountant member.

(iii) However, section 255(3) provides for constitution of a single member bench and a Special Bench.

(iv) Section 255(3) provides that the President or any other member of the tribunal authorized by the Central Government in this behalf may dispose of any case which pertains to an assessee whose total income as computed by the Assessing Officer in the said case does not exceed **₹ 50 lakh**.

(v) The President may, for the disposal of any particular case constitute a special Bench consisting of three or more members, one of whom must necessarily be a judicial member and one an accountant member.

Where members differ - If the member of a Bench differ in opinion on any point the point shall be decided according to the opinion of the majority, if there is a majority. However, if the members are equally divided, they should state the points on which they differ and the case shall be referred by the President of the Tribunal for hearing on such point by one or more of the other members of the Tribunal: then, such points shall be decided according to the opinion of the majority of the members of the Tribunal who have heard the case, including those who first heard it.

Regulating power - The Appellate Tribunal is empowered to regulate its own procedure and the procedure of its Benches in all matters arising out of the exercise of its power of the discharge of its functions, including the places at which the Benches shall hold their sittings. The Tribunal is vested with all the powers which are exercisable by Income-tax authorities under section 131 for the purpose of discharging its functions. Any proceeding before the Appellate Tribunal shall be deemed to be a judicial proceeding for the purpose of the Income-tax Act, 1961 and the Indian Penal Code and that Appellate Tribunal shall be deemed to be a Civil Court for all the purposes of the Income-tax Act, 1961 and the Code of Criminal Procedure, 1898.

18.3 APPEALS TO HIGH COURT [SECTIONS 260A & 260B]

Section 260A provides for direct appeal to the High Court against the orders of the Appellate Tribunal.

(1) Appeal - Section 260A(1) provides that an appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal, if the High Court is satisfied that the case involves a substantial question of law. If the High Court is so satisfied, it shall formulate that question.

The Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner or an assessee aggrieved by any order passed by the Appellate Tribunal may file an appeal to the High Court under this section.

(2) Form for appeal - The appeal shall be in the form of a memorandum of appeal, precisely stating in it the substantial question of law involved.

(3) Time limit for appeal - The appeal shall be filed within 120 days from the date on which the order appealed against is received by the assessee, or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

The High Court has and always had the power to condone the delay and admit an appeal after the expiry of the period of 120 days, if it is satisfied that there was sufficient cause for not filing the appeal within that period.

(4) Matters on which appeal can be heard - The appeal shall be heard only on the question formulated. However, the respondent shall at the hearing of appeal, be allowed to argue that the case does not involve such question. Further, the Court shall also have power to hear the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question. However, such power shall be exercised by the Court only after recording the reasons for hearing such other question.

Further, the High Court may determine any issue which -

(a) has not been determined by the Appellate Tribunal; or

(b) has been wrongly determined by the Appellate Tribunal, by reason of a decision on such question of law as is referred to in section 260A(1).

(5) Delivery of judgment - After the appeal is heard, the High Court shall decide the question of law so formulated and deliver such judgment thereon, but such judgment should contain the grounds on which such decision is founded.

(6) Award of costs - The High Court is empowered to award such costs as it deems fit.

(7) Code of Civil Procedure - Unless otherwise provided in this Act, the Code of Civil Procedure, 1908, relating to appeals to the High Court, shall apply to appeals under this section.

(8) Case before High Court to be heard by not less than two judges [Section 260B]

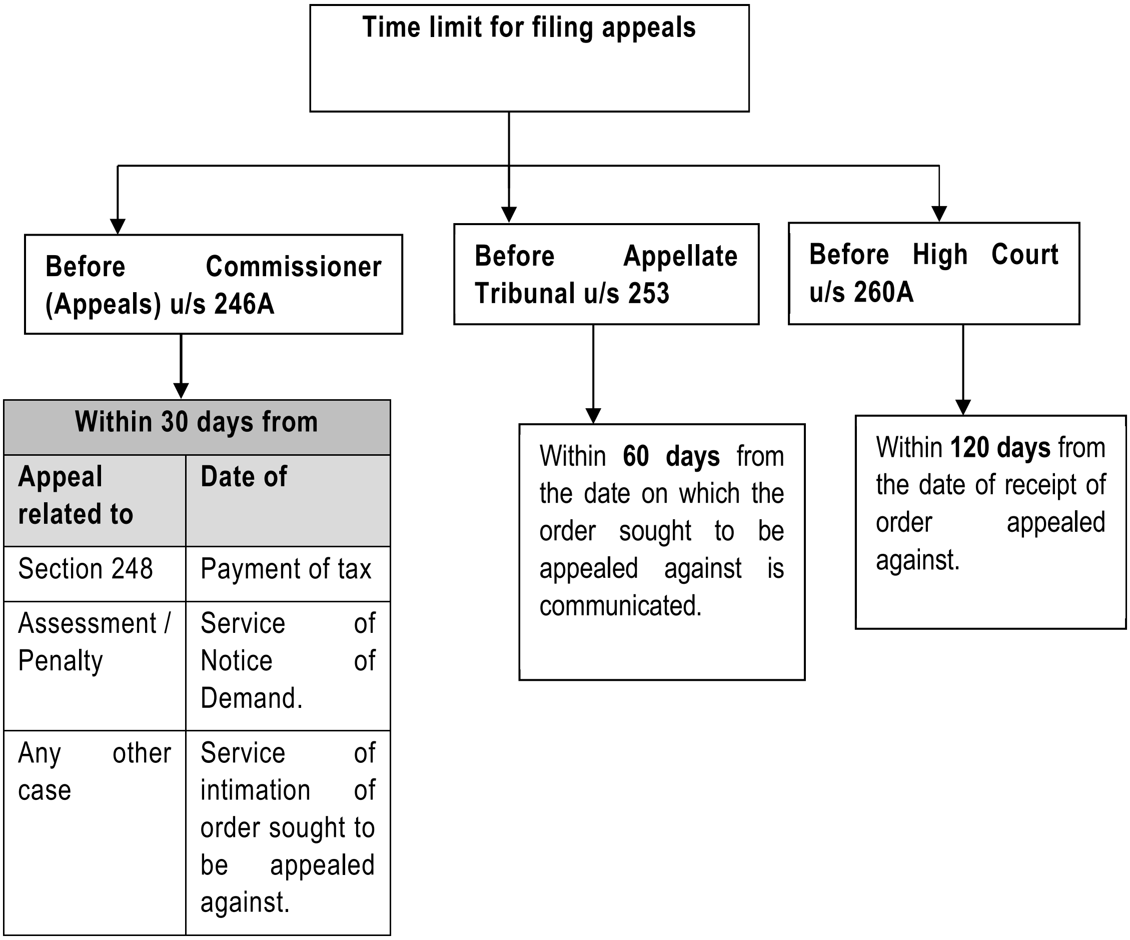
Strength of the bench hearing the appeal - The appeal shall be heard by a bench of not less than 2 judges of the High Court.

Decision of the majority - The appeal shall be decided in accordance with the opinion of the judges or the majority, if any.

Where there is no such majority, the point of law upon which the judges differ shall be referred to one or more of the other judges of the High Court and such point shall be decided according to the opinion of the majority of the Judges who have heard the case, including those who first heard it.

18.4 APPEAL TO THE SUPREME COURT [SECTION 261]

According to section 261, an appeal shall lie to the Supreme Court from any judgment of the High Court, in a case which the High Court certifies to be a fit one for appeal to the Supreme Court. The provisions of the Code of Civil Procedure, 1908 in regard to appeal shall apply in the case of all appeals to the Supreme Court in the same manner as in the case of all appeals from decrees of a High Court. The cost of appeal shall be decided at the discretion of the Supreme Court. Where the judgment of a High Court is varied in the appeal, effect should be given to the order of the Supreme Court in the same manner as provided in the case of a judgment of the High Court.



Time limit for filing appeals

Before Commissioner (Appeals) u/s 246A

Within 30 days from	
Appeal related to	**Date of**
Section 248	Payment of tax
Assessment / Penalty	Service of Notice of Demand.
Any other case	Service of intimation of order sought to be appealed against.

Before Appellate Tribunal u/s 253

Within **60 days** from the date on which the order sought to be appealed against is communicated.

Before High Court u/s 260A

Within **120 days** from the date of receipt of order appealed against.

Note: The above time period can be extended by the Appellate Authority if the appellant shows sufficient cause for not presently the appeal within the specified time.

18.5 PROVISION FOR AVOIDING REPETITIVE APPEALS [SECTION 158A]

(1) Identical question of law pending before High Court/Supreme Court: Section 158A makes provision for avoiding repetitive appeals when identical question of law is pending before High Court or Supreme Court. This is applicable to a situation where an assessee claims that any question of law arising in his case for an assessment year which is pending before the Assessing Officer or any appellate authority is identical with a question of law arising in his case for another assessment year which is pending in appeal under section 260A before the High Court or in appeal under section 261 before the Supreme Court.

(2) Assessee to furnish declaration: In such a situation, notwithstanding anything contained in the Act, the assessee may furnish a declaration in the prescribed form that if the Assessing Officer or the appellate authority, as the case may be, agrees to apply in the present case, the final decision passed on the other case, the assessee shall not raise again the same question of law in appeal before any appellate authority or in appeal before the High Court under section 260A or in appeal before the Supreme Court under section 261.

(3) Assessing Officer's report on correctness of claim: Where such a declaration is furnished by the assessee to an appellate authority, the appellate authority shall call for a report from the Assessing Officer on the correctness of the claim. Where the Assessing Officer makes a request to the appellate authority to give him an opportunity of being heard, it shall allow him such opportunity.

(4) Admission or rejection of claim by order in writing: The Assessing Officer or the appellate authority, as the case may be, may, by order in writing –

(i) admit the claim if satisfied that the question of law is identical in the present as well as the other case; or

(ii) reject the claim, if not so satisfied.

(5) Consequences where claim is admitted: Where a claim is admitted, -

(i) the Assessing Officer or appellate authority, as the case may be, may make an order disposing of the present case without waiting for the final decision on the other case.

(ii) the assessee would then not be entitled to raise in relation to the relevant case, such question of law in appeal before any appellate authority or in appeal before the High Court under section 260A or the Supreme Court under section 261.

(6) Final decision of Supreme Court/High Court to be applied to the case: When the final decision on the question of law is passed in the other case, the Assessing Officer or the appellate authority, as the case may be would apply it to the present case and amend the order passed, if necessary, in order to conform to such decision.

(7) Finality of the order: An order admitting or rejecting the claim of the assessee, as the case may be, would be final. Such order cannot be called in question in any proceeding by way of appeal, reference, revision under the Act.

(8) Meaning of certain terms:

Term	Meaning
Appellate authority	The Deputy Commissioner (Appeals), the Commissioner (Appeals) or the Appellate Tribunal.
Case	Any proceeding under the Act for assessment of the total income of the assessee or for the imposition of any penalty or fine on him.

18.6 PROCEDURE FOR APPEAL BY REVENUE WHEN AN IDENTICAL QUESTION OF LAW IS PENDING BEFORE SUPREME COURT [SECTION 158AA]

(1) Assessing Officer to make an application within prescribed period: Section 158AA provides that irrespective of anything contained in the Act, where any question of law arising in the case of an assessee for any assessment year is identical with a question of law arising in his case for another assessment year which is pending before the Supreme Court, in an appeal or in a special leave petition under Article 136 of the Constitution filed by the revenue, against the order of the High Court in favour of the assessee, the Commissioner or Principal Commissioner may, instead of directing the Assessing Officer to appeal to the Appellate Tribunal under section 253(2) or section 253(2A), direct the Assessing Officer to make an application to the Appellate Tribunal in the prescribed form within sixty days from the date of receipt of order of the Commissioner (Appeals) stating that an appeal on the question of law arising in the relevant case may be filed when the decision on the question of law becomes final in the earlier case.

(2) Application to be made only if assessee accepts that the question of law is identical: The Commissioner or Principal Commissioner shall direct the Assessing Officer to make an application under section 158AA(1), only if an acceptance is received from the assessee to the effect that the question of law in the other case is identical to that arising in the relevant case. However, in case no such acceptance is received, the Commissioner or Principal Commissioner shall proceed in accordance with the provisions contained in section 253(2) or section 253(2A). Accordingly, the Commissioner or Principal Commissioner may, if he objects to the order passed by the Commissioner (Appeals), direct the Assessing Officer to appeal to the Appellate Tribunal.

(3) Consequences where CIT(Appeals) order is not in conformity with Supreme Court's decision: Where the order of the Commissioner (Appeals) is not in conformity with the final decision on the question of law in the other case (if the Supreme Court decides the earlier case in favour of the Department), the Commissioner or Principal Commissioner may direct the Assessing Officer to appeal to the Appellate Tribunal against such order within 60 days from the date on which the order of the Supreme Court is communicated to the Commissioner or Principal Commissioner.

Unless otherwise provided in section 158AA, all other provisions of Part B of Chapter XX "Appeals to Appellate Tribunal" shall apply accordingly.

18.7 REVISION BY THE PRINCIPAL COMMISSIONER OR COMMISSIONER [SECTIONS 263 AND 264]

(1) Revision of Orders prejudicial to the Revenue [Section 263]

(i) Under section 263(1), if the Principal Commissioner or Commissioner considers that any order passed by the Assessing Officer is **erroneous in so far as it is prejudicial**

to the interests of the Revenue, he may, after giving the assessee an opportunity of being heard and after making an enquiry, pass an order enhancing or modifying the assessment made by the Assessing Officer or cancelling the assessment and directing fresh assessment.

(ii) An order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the Revenue, if, in the opinion of the Principal Commissioner or Commissioner,—

(a) the order is passed without making inquiries or verification which should have been made;

(b) the order is passed allowing any relief without inquiring into the claim;

(c) the order has not been made in accordance with any order, direction or instruction issued by the CBDT under section 119;

(d) the order has not been passed in accordance with any decision which is prejudicial to the assessee, rendered by the jurisdictional High Court or Supreme Court in the case of the assessee or any other person.

(iii) The term 'record' shall include and shall be deemed always to have included all records relating to any proceedings under the Act available at the time of examination by the Principal Commissioner or Commissioner.

(iv) Where any order referred to in section 263(1) passed by the Assessing Officer had been the subject-matter of any appeal, the powers of the Principal Commissioner or Commissioner under section 263(1) shall extend and shall be deemed always to have extended to such matters as had not been considered and decided in such appeal.

(v) No order shall be made after the expiry of 2 years from the end of the financial year in which the order sought to be revised was passed.

(vi) In computing the period of 2 years, the time taken in giving an opportunity to the assessee to be reheard under section 129 and any period during which the revision proceeding is stayed by an order or injunction of any court shall be excluded.

(vii) The time limit, however, does not apply in case where the Principal Commissioner or Commissioner has to give effect to a finding or direction contained in the order of the Appellate Tribunal, High Court or the Supreme Court.

(2) Revision of other orders [Section 264]

(i) In the case of any other order (not being an order prejudicial to the Revenue) passed by any subordinate authority including the Deputy Commissioner (Appeals), the Principal Commissioner or Commissioner may either on his own motion or on receipt of an application from the assessee, call for the record of any proceedings under the Act in the course of which the order was passed. After making such enquiries as may be necessary the Principal Commissioner or Commissioner may pass such order as he thinks fit.

(ii) The Principal Commissioner or Commissioner is not empowered to revise any order on his own motion if a period of more than one year has expired from the date of the order sought to be revised.

(iii) If the application for revision is made by the assessee, it must be made within one year from the date on which the order in question was communicated to him or the date on which he otherwise comes to know of it, whichever is later.

(iv) However, the Principal Commissioner or Commissioner may admit an application even after the expiry of one year, if he is satisfied that the assessee was prevented by sufficient cause from making the application within that period.

(v) The application to the Principal Commissioner or Commissioner for revision must be accompanied by a fee of ₹ 500.

(vi) If an order is passed by the Principal Commissioner or Commissioner declining to interfere in any proceeding, it shall not be deemed to be an order prejudicial to the assessee.

(vii) However, the Principal Commissioner or Commissioner is not empowered to revise any order in the following cases, viz.,

(a) where an appeal against the order lies to the Commissioner (Appeals) or the Tribunal but has not been made and the time within which the appeal may be made has not expired or in the case of an appeal to the Tribunal the assessee has not waived his right of appeal;

(b) where the order is pending on an appeal before the Commissioner (Appeals);

(c) where the order has been made subject to an appeal to the Commissioner (Appeals) or the Appellate Tribunal.

(3) Limitation of time for revision of orders by Principal Commissioner or Commissioner of Income-tax under section 264

Under section 264, the Principal Commissioner or Commissioner of Income-tax is empowered to revise an order passed by the subordinate authority where no appeal has been filed. There is a limitation of one year for filing the application.

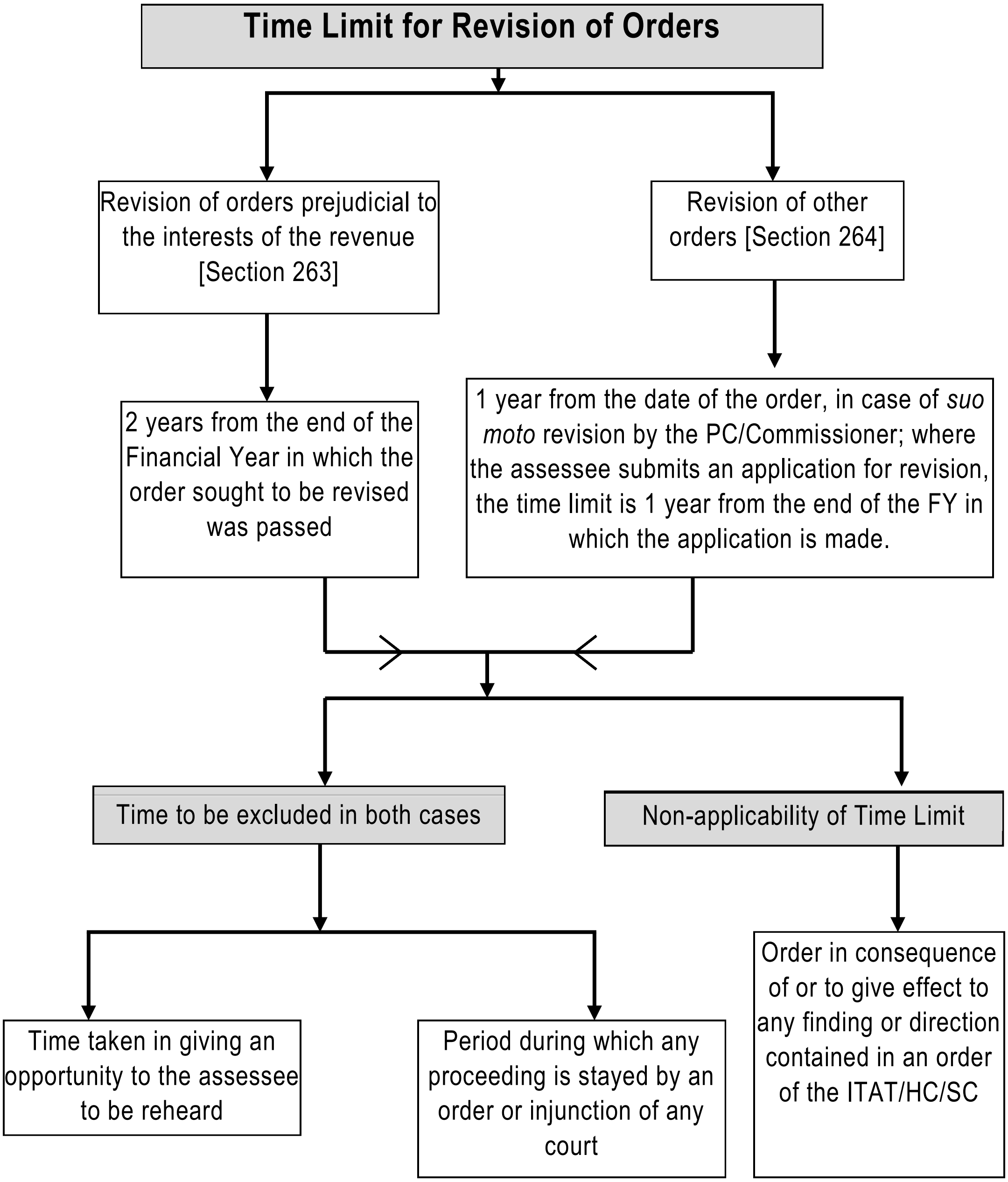
(a) It shall be obligatory on the Principal Commissioner or Commissioner to pass an order within a period of one year from the end of financial year in which such application is made by the assessee for revision.

(b) In computing the above referred period of limitation, the time taken in giving an opportunity to the assessee to be re-heard under the proviso to section 129 and any period during which any proceeding under this section is stayed by an order or injunction of any Court shall be excluded [*Explanation* to section 264(6)].

(c) The aforesaid time limit shall not apply to any order which has been passed in consequence of or to give effect to any finding or direction contained in an order of the Appellate Tribunal, High Court or the Supreme Court.

The assessee is bound to pay the tax due from him in accordance with the assessment made on him irrespective of the fact that a reference to the High Court or an appeal to the Supreme Court has been made to him [Section 265]. The High Court may, on a petition made to it for the execution of the order to the Supreme Court in respect of any costs awarded, thereby transmit the order for execution to any Court subordinate to it [Section 266]. Where as a result of an appeal under section 246 or section 246A or section 253, any change is made in the assessment of a body of individuals or an association of persons or a new assessment of a body of individuals or an association of persons is ordered to be made, the Commissioner (Appeals) or the Appellate Tribunal, as the case may be, shall pass an order authorizing the Assessing Officer either to amend the assessment made on any member of the body or association or make a fresh assessment on any member of the body or association [Section 267].

Section 268 - In computing the period of limitation prescribed for an appeal under this Act, the day on which the order complained of was served and, if the assessee was not furnished with a copy of the order when the notice of the order was served upon him, the time requisite for obtaining a copy of such order, should be excluded.



Time Limit for Revision of Orders

Revision of orders prejudicial to the interests of the revenue [Section 263]

Revision of other orders [Section 264]

2 years from the end of the Financial Year in which the order sought to be revised was passed

1 year from the date of the order, in case of *suo moto* revision by the PC/Commissioner; where the assessee submits an application for revision, the time limit is 1 year from the end of the FY in which the application is made.

Time to be excluded in both cases

Non-applicability of Time Limit

Time taken in giving an opportunity to the assessee to be reheard

Period during which any proceeding is stayed by an order or injunction of any court

Order in consequence of or to give effect to any finding or direction contained in an order of the ITAT/HC/SC

(4) Consequence of non-filing of appeal in respect of cases where the tax effect is less than the prescribed monetary limit [Section 268A]

(i) As per section 268A(1), the CBDT is empowered to issue orders, instructions or directions to other income tax authorities, fixing such monetary limits as it may deem fit. Such fixing of monetary limit is for the purpose of regulating filing of appeal or application for reference by any income tax authority.

(ii) Where an income-tax authority has not filed any appeal or application for reference on any issue in the case of an assessee for any assessment year, due to abovementioned order/instruction/direction of the CBDT, such authority shall not be precluded from filing an appeal or application for reference on the same issue in the case of –

(1) the same assessee for any other assessment year; or

(2) any other assessee for the same or any other assessment year.

(iii) Further, in such a case, it shall not be lawful for an assessee to contend that the income-tax authority has acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.

(iv) The Appellate Tribunal or Court should take into consideration the above mentioned orders/instructions/directions of the CBDT and the circumstances under which such appeal or application for reference was filed or not filed in respect of any case.

(v) Every order/instruction/direction which has been issued by the CBDT fixing monetary limits for filing an appeal or application for reference shall be deemed to have been issued under sub-section (1) and all the provisions of this section shall apply accordingly.

18.8 MONETARY LIMITS FOR FILING OF APPEALS BY THE DEPARTMENT BEFORE INCOME TAX APPELLATE TRIBUNAL, HIGH COURTS AND SLPS/APPEALS BEFORE SUPREME COURT

The CBDT has specified the monetary limits and other conditions for filing departmental appeals before Income Tax Appellate Tribunal, High Courts and SLPs/ appeals before Supreme Court vide Circular No. 3/2018, Dated 11-7-2018, F. No. 279/Misc. 142/2007-ITJ (Pt), Dated 20-8-2018, Circular No. 17/2019, Dated 8-8-2019 and F. No. 279/Misc./M-93/2018-ITJ (Pt), Dated 16-9-2019.

It has been decided by the CBDT that departmental appeals may be filed on merits before Income Tax Appellate Tribunal and High Courts and SLPs/ appeals before Supreme Court keeping in view the monetary limits and conditions specified below.

Monetary Limits specified:

Appeals/ SLPs shall not be filed in cases where the tax effect does not exceed the monetary limits given hereunder:

S. No.	***Appeals/ SLPs in Income-tax matters***	***Monetary Limit (₹)***
1.	*Before Appellate Tribunal*	*50,00,000*
2.	*Before High Court*	*1,00,00,000*
3.	*Before Supreme Court*	*2,00,00,000*

It is clarified that an appeal should not be filed merely because the tax effect in a case exceeds the monetary limits prescribed above. Filing of appeal in such cases is to be decided on merits of the case.

Meaning of Tax Effect:

	Case	***Tax Effect***
i.	*In case not covered in ii, iii and iv below*	*The tax on the total income assessed* *(-)* *The tax that would have been chargeable had such total income been reduced by the amount of income in respect of the issues against which appeal is intended to be filed ("disputed issues").* ***Note** – However, the tax will not include any interest thereon, except where chargeability of interest itself is in dispute.*
ii.	*In case the chargeability of interest is the issue under dispute*	*The amount of interest*
iii.	*In case where returned loss is reduced or assessed as income*	*The tax effect would include notional tax on disputed additions*
iv.	*In case of penalty orders*	*Quantum of penalty deleted or reduced in the order to be appealed against*
Note – Tax effect shall be tax including applicable surcharge and cess.		

Computation of tax on the total income assessed where income is computed under the provisions of section 115JB or section 115JC:

In such case, tax on the total income assessed would be computed as given below -

(A - B) + (C - D)

Where,

A = the total income assessed as per the provisions other than the provisions contained in section 115JB or section 115JC (i.e., the general provisions)

B = the total income that would have been chargeable had the total income assessed as per the general provisions been reduced by the amount of the disputed issues under general provisions

C = the total income assessed as per the provisions contained in section 115JB or section 115JC

D = the total income that would have been chargeable had the total income assessed as per the provisions contained in section 115JB or section 115JC was reduced by the amount of the disputed issues under said provisions

However, where the amount of disputed issues 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.

Manner of calculation of tax effect of different assessment years:

The Assessing Officer has to calculate the tax effect separately for every assessment year in respect of the disputed issues in the case of every assessee. If, in the case of an assessee, the disputed issues arise in more than one assessment year, appeal can be filed in respect of such assessment year or years in which the tax effect in respect of the disputed issues exceeds the specified monetary limit. No appeal shall be filed in respect of an assessment year or years in which the tax effect is less than the monetary limit specified. Further, even in case of a composite order of any High Court or appellate authority, which involves more than one assessment year and common issues in more than one assessment year, no appeal shall be filed in respect of an assessment year or years in which the 'tax effect' is less than the prescribed monetary limit. In case where a composite order/judgement involves more than one assessee, each assessee shall be dealt with separately.

Department not precluded from filing an appeal against disputed issues for subsequent assessment years if the tax effect exceeds the specified monetary limits in those years

In a case where appeal before a Tribunal or a Court is not filed only on account of the tax effect being less than the monetary limit specified above, the Principal Commissioner or Commissioner of Income-tax shall specifically record that "even though the decision is not acceptable, appeal is not being filed only on the consideration that the tax effect is less than the monetary limit specified in the Circular". Further, in such cases, there will be no presumption that the Income-tax Department has acquiesced in the decision on the disputed issues. The Income-tax Department shall not be precluded from filing an appeal against the disputed issues in the case of the same assessee for any other assessment year, or in the case of any other assessee for the same or any other assessment year, if the tax effect exceeds the specified monetary limits.

Cases in respect of which appeal is not filed due to tax effect being less than specified monetary limit not to have any precedent value

In the past, a number of instances have come to the notice of the Board, whereby an assessee has claimed relief from the Tribunal or the Court only on the ground that the Department has implicitly accepted the decision of the Tribunal or Court in the case of the assessee for any other assessment year or in the case of any other assessee for the same or any other assessment year, by not filing an appeal on the same disputed issues. The Departmental representatives/counsels must make every effort to bring to the notice of the Tribunal or the Court that the appeal in such cases was not filed or not admitted only for the reason of the tax effect being less than the specified monetary limit and, therefore, no inference should be drawn that the decisions rendered therein were acceptable to the Department. Accordingly, they should impress upon the Tribunal or the Court that such cases do not have any precedent value and also bring to the notice of the Tribunal/ Court the provisions of section 268A(4) of the Act. As the evidence of not filing appeal due to this Circular may have to be produced in courts, the judicial folders in the office of Pr CsIT/ CsIT must be maintained in a systemic manner for easy retrieval.

Cases where adverse judgments should be contested on merits even if tax effect is less than the specified monetary limits

Adverse judgments relating to the issues enumerated hereunder should be ***contested on merits*** *notwithstanding that the tax effect entailed is less than the specified monetary limits or there is no tax effect:*

(a) Where the Constitutional validity of the provisions of an Act or Rule is under challenge, or

(b) Where Board's order, Notification, Instruction or Circular has been held to be illegal or ultra vires, or

(c) Where Revenue Audit objection in the case has been accepted by the Department, or

(d) Where addition relates to undisclosed foreign income/undisclosed foreign assets (including financial assets)/undisclosed foreign bank account.

(e) Where addition is based on information received from external sources in the nature of law enforcement agencies such as CBI/ED/DRI/SFIO/Directorate General of GST Intelligence (DGGI).

(f) Cases where prosecution has been filed by the Department and is pending in the Court.

Specified monetary limit not to apply to writ matters and direct tax matters other than income-tax

Filing of appeals in other direct tax matters shall continue to be governed by the relevant provisions of statute and rules. Further, filing of appeal in cases of income-tax, where the tax effect is not quantifiable or not involved, such as the case of registration of trusts or institutions under section 12A/ 12AA, filing of appeal shall not be governed by the specified monetary limits and decision to file appeal in such cases may be taken ***on merits*** *of a particular case.*

Retrospective applicability of specified monetary limits

This Circular would apply to SLPs/appeals/cross objections/reference to be filed henceforth in SC/HCs/Tribunal and it shall also apply retrospectively to pending SLPs/appeals/cross objections/reference. Pending appeals below the specified tax limits may be withdrawn/ not pressed.

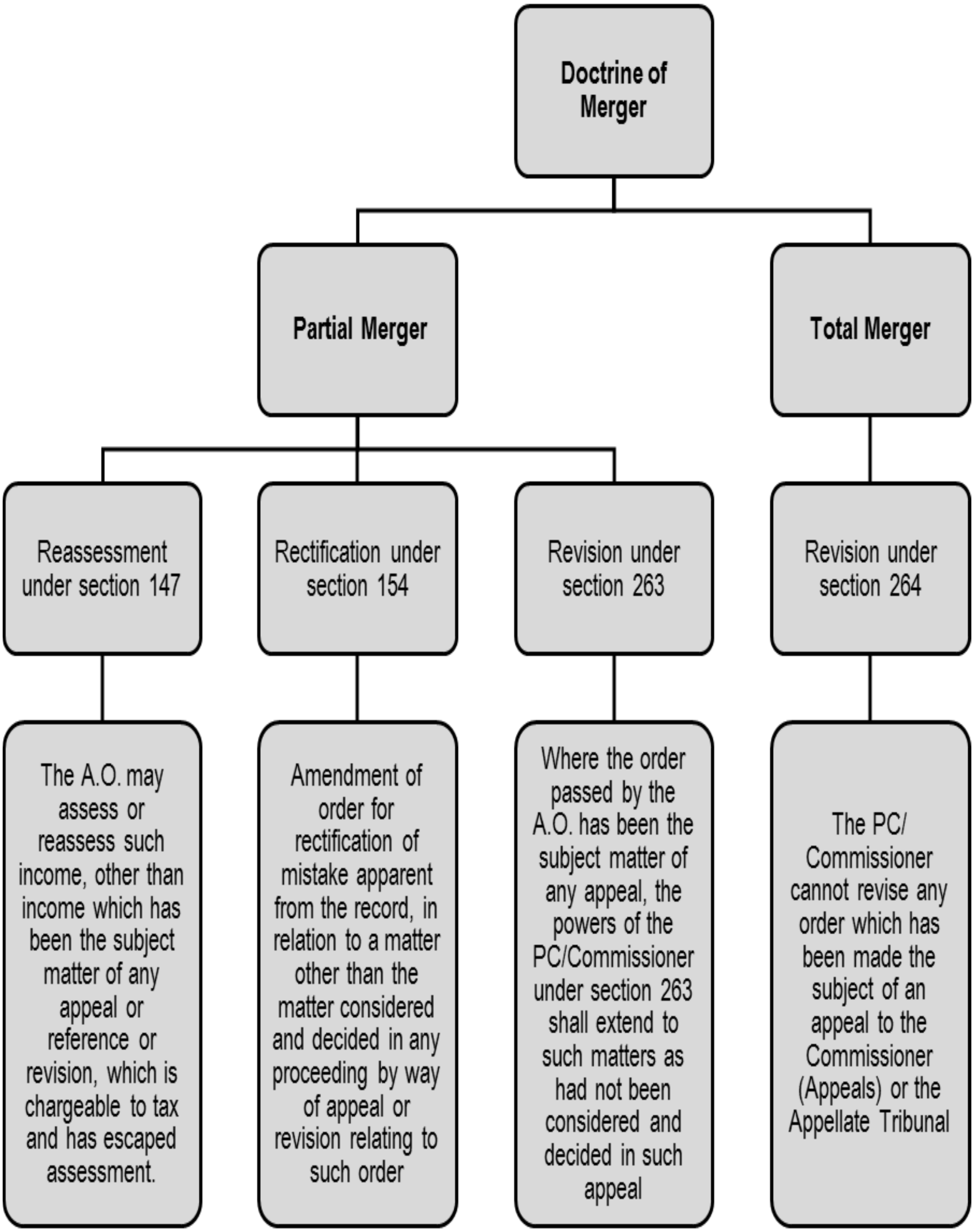
Non-applicability of specified monetary limits in case involving bogus LTCG/ STCG through penny stocks

However, in exercise of power conferred by section 268A, CBDT has clarified that the above monetary limits shall not apply in case of assessee claiming bogus LTCG/ STCG through penny stocks and appeals/ SLPs in such cases shall be filed on merits.

18.9 DOCTRINE OF PARTIAL MERGER AND DOCTRINE OF TOTAL MERGER

The third proviso in section 147, provides that the doctrine of partial merger shall apply to reopening in a case where an assessee has filed an appeal etc. for an assessment year. It has been provided that the Assessing Officer may assess or reassess such income, other than income which has been the subject matter of any appeal or reference or revision, which is chargeable to tax and has escaped assessment. The doctrine of partial merger also holds good for section 154 and section 263.

However, the concept of total merger would apply in the case of section 264. The Principal Commissioner or Commissioner of Income-tax has no power to revise any order under section 264, if the order has been made subject to an appeal to the Appellate Tribunal, even if the relief claimed in the revision is different from the relief claimed in the appeal and irrespective of the fact whether the appeal is by the assessee or by the Department as the concept of total/complete merger is applicable for section 264.



Doctrine of Merger

Partial Merger

Total Merger

Reassessment under section 147

Rectification under section 154

Revision under section 263

Revision under section 264

The A.O. may assess or reassess such income, other than income which has been the subject matter of any appeal or reference or revision, which is chargeable to tax and has escaped assessment.

Amendment of order for rectification of mistake apparent from the record, in relation to a matter other than the matter considered and decided in any proceeding by way of appeal or revision relating to such order

Where the order passed by the A.O. has been the subject matter of any appeal, the powers of the PC/Commissioner under section 263 shall extend to such matters as had not been considered and decided in such appeal

The PC/ Commissioner cannot revise any order which has been made the subject of an appeal to the Commissioner (Appeals) or the Appellate Tribunal

EXERCISE

Question 1

"SVS Propcon" did not make a claim of ₹ 20 lacs in the return of income filed for A.Y. 2020-21 which was disallowed in the previous assessment year under section 43B. However, the said claim was also not considered by the Assessing Officer during assessment proceedings on the ground that no revised return was filed. Can the assessee now make such claim before the appellate authority?

Answer

Yes, the assessee is entitled to raise additional claims before the appellate authorities.

The restriction that an additional claim has to be made by filing a revised return applies only in respect of a claim made before the Assessing Officer. An assessee cannot make a claim before the Assessing Officer otherwise than by filing a revised return. It was so held by the Supreme Court in *Goetze (India) Ltd v. CIT (2006) 284 ITR 323.*

However, this restriction does not apply to an additional claim made before an appellate authority. The appellate authorities have jurisdiction to permit additional claims before them, though, the exercise of such jurisdiction is entirely the authorities' discretion. It was so held by the Bombay High Court in *CIT v. Pruthvi Brokers & Shareholders (2012) 349 ITR 336.*

Thus, an additional claim can be raised before the Appellate Authority even if no revised return is filed.

Question 2

Examine the correctness or otherwise of the following statements with reference to the provisions of the Income-tax Act, 1961:

(i) An appeal before Income-tax Appellate Tribunal cannot be decided in the event of difference of opinion between the Judicial Member and the Accountant Member on a particular ground.

(ii) A High Court does not have an inherent power to review an earlier order passed by it on merits.

Answer

(i) **The statement given is not correct.** As per the provisions of section 255, in the event of difference in opinion between the members of the Bench of the Income-tax Appellate Tribunal, the matter shall be decided on the basis of the opinion of the majority of the members. In case the members are equally divided, they shall state the point or points of difference and the case shall be referred by the President of the Tribunal for hearing on such points by one or more of the other members of the Tribunal. Such point or points shall be decided according to the opinion of majority of the members of the Tribunal who heard the case, including those who had first heard it.

(ii) **The statement given is not correct.** The Supreme Court, in *CIT v. Meghalaya Steels Ltd. (2015) 377 ITR 112*, observed that the power of review would inhere on High Courts, being courts of record under article 215 of the Constitution of India. There is nothing in article 226 of the Constitution to preclude a High Court from exercising the power of review which inheres in every court of plenary jurisdiction to prevent miscarriage of justice or to correct grave and palpable errors committed by it. The Supreme Court further observed that section 260A(7) does not purport in any manner to curtail or restrict the application of the provisions of the Code of Civil Procedure. Section 260A(7) only states that all the provisions that would apply qua appeals in the Code of Civil Procedure would apply to appeals under section 260A. The Supreme Court opined that this does not in any manner suggest either that the other provisions of the Code of Civil Procedure are necessarily excluded or that the High Court's inherent jurisdiction is in any manner affected.

Question 3

Does the Income-tax Appellate Tribunal have the following powers?

(i) Power to allow the assessee to urge any ground of appeal which was not raised by him before the Commissioner (Appeals);

(ii) Power to recall its own order.

Answer

(i) The Income-tax Appellate Tribunal has the power to entertain question raised for the first time. The Tribunal is not confined only to the issues arising out of the appeal before the Commissioner (Appeals). It has the power to allow the assessee to urge any ground not raised before the Commissioner (Appeals). However, the relevant facts in respect of such ground should be on record. The decision of the Supreme Court in the case of *National Thermal Power Company Limited vs. CIT (1998) 229 ITR 383 (SC)* supports this view.

(ii) The Delhi High Court, in *Lachman Dass Bhatia Hingwala (P) Ltd. v. ACIT (2011) 330 ITR 243 (Delhi)(FB)* observed that the justification of an order passed by the Tribunal recalling its own order is required to be tested on the basis of the law laid down by the Apex Court in *Honda Siel Power Products Ltd. v. CIT (2007) 295 ITR 466,* dealing with the Tribunal's power under section 254(2) to recall its order where prejudice has resulted to a party due to an apparent omission, mistake or error committed by the Tribunal while passing the order. Such recalling of order for correcting an apparent mistake committed by the Tribunal has nothing to do with the doctrine or concept of inherent power of review. It is a well settled provision of law that the Tribunal has no inherent power to review its own judgment or order on merits or reappreciate the correctness of its earlier decision on merits. However, the power to recall has to be distinguished from the power to review. While the Tribunal does not have the inherent power to review its order on merits, it can recall its order for the purpose of correcting a mistake apparent from the record.

> When prejudice results from an order attributable to the Tribunal's mistake, error or omission, then it is the duty of the Tribunal to set it right. The Delhi High Court observed that the Tribunal, while exercising the power of rectification under section 254(2), can recall its order in entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal's mistake, error or omission and the error committed is apparent.

Question 4

Can a rectification order under section 254 of the Income-tax Act, 1961 be passed by the Income-tax Appellate Tribunal beyond 6 months from the end of the month in which the order sought to be rectified was passed?

Answer

The issue as to whether a rectification order can be passed by the Income-tax Appellate Tribunal under section 254 beyond six months from the end of the month in which order sought to be rectified was passed, has been addressed in *Sree Ayyanar Spinning and Weaving Mills Ltd. v. CIT (2008) 301 ITR 434 (SC)*. Section 254(2), dealing with the power of the Appellate Tribunal to pass an order of rectification of mistakes, is in two parts. The first part refers to the *suo motu* exercise of the power of rectification by the Appellate Tribunal, whereas the second part refers to rectification on an application filed by the assessee or Assessing Officer bringing any mistake apparent from the record to the attention of the Appellate Tribunal.

If Income-tax Appellate Tribunal, *suo moto,* makes the rectification of its order, then the order has to be passed within 6 months from the end of the month in which the order sought to be rectified was passed. Where the application for rectification is made by the Assessing Officer or the assesse within 6 months from the end of the month in which the order sought to be rectified was passed, the Appellate Tribunal is bound to decide the application on merits and not on the ground of limitation i.e. order can be passed after expiry of 6 months from the end of the month in which the order sought to be rectified was passed. However, the application for rectification cannot be filed belatedly after 6 months from the end of the month in which the order sought to be rectified was passed. [*Ajith Kumar Pitaliya vs ITO (2009) 318 ITR 182 (M.P.)]*

Question 5

What do you mean by substantial question of law? Examine.

Answer

The expression "substantial question of law" has not been defined anywhere in the Act. However, it has acquired a definite meaning through various judicial pronouncements. The tests are:

(1) whether directly or indirectly it affects substantial rights of the parties; or

(2) the question is of general public importance; or

(3) whether it is an open question in the sense that issue is not settled by the pronouncement of the Supreme Court or Privy Council or by the Federal Court; or

(4) the issue is not free from difficulty; or

(5) it calls for a discussion for alternative view.

Question 6

Examine the correctness of the following statement:

"The Appellate Tribunal is empowered to grant indefinite stay for the demand disputed in appeals before it."

Answer

Section 254(2A) provides that the Appellate Tribunal, where it is possible, may hear and decide an appeal within a period of four years from the end of the financial year in which such appeal is filed.

The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose off the appeal within this period of stay.

Where the appeal has not been disposed off within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. However, the aggregate of period originally allowed and the period so extended should not exceed 365 days even if the delay in disposing of the appeal is not attributable to the assessee. The Appellate Tribunal is required to dispose off the appeal within this extended period. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Therefore, the statement given in the question is not correct.

Question 7

Is Commissioner (Appeals) empowered to consider an appeal filed by an assessee challenging the order of assessment in respect of which the proceedings before the Settlement Commission abates? Examine.

Answer

Section 251(1) lists the powers of the Commissioner (Appeals) in disposing of an appeal. Clause (aa) of section 251(1) empowers the Commissioner (Appeals), in an appeal against the assessment order in respect of which the proceeding before the Settlement Commission abates under section 245HA, to confirm, reduce, enhance or annul the assessment after taking into consideration the following -

(1) all the material and other information produced by the assessee before the Settlement Commission;

(2) the results of the inquiry held by the Settlement Commission;

(3) the evidence recorded by the Settlement Commission in the course of the proceeding before it; and

(4) such other material as may be brought on his record.

Question 8

An Income-tax authority did not file an appeal to the Income-tax Appellate Tribunal against an order of the Commissioner (Appeals) decided against the Income-tax department on a particular issue in case of one assessee, Alpi for assessment year 2019-20 on the ground that the tax effect of such dispute was less than the monetary limit prescribed by CBDT. In assessment year 2020-21, similar issue arose in the assessments of Alpi and her sister Palki, which was decided by the Commissioner (Appeals) against the Department. Can the Income-tax department move an appeal to the Tribunal in respect of A.Y. 2020-21 against the orders of the Commissioner (Appeals) for Alpi and her sister Palki?

Answer

Under section 268A(1), the CBDT is empowered to issue orders, instructions or directions to the other income-tax authorities, fixing such monetary limits, as it may deem fit, to regulate filing of appeal or application for reference by any income-tax authority.

Under section 268A(2), where an income-tax authority has not filed any appeal or application for reference on any issue in the case of an assessee for any assessment year, due to above-mentioned order/instruction/direction of the CBDT, such authority shall not be precluded from filing an appeal or application for reference on the same issue in the case of the same assessee for any other assessment year or any other assessee for the same or any other assessment year. Further, in such a case, it shall not be lawful for an assessee to contend that the income-tax authority has acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.

In view of above provision, it would be in order for the Income-tax Department to move an appeal to the Tribunal against the orders of the CIT(A) in respect of A.Y. 2020-21 both for Alpi and Palki.

Question 9

A petition for stay of demand was filed before ITAT by XYZ Ltd. in respect of a disputed demand for which appeal was pending before it, on which stay was granted by the ITAT vide order dated 1.1.2019. The bench could not function thereafter till 1.2.2020 and therefore, the disputed matter could not be disposed off. The Assessing Officer attached the bank account on 16.2.2020 and recovered the amount of ₹ 15 lacs against the arrear demand of ₹ 25 lacs. The assessee requested the Assessing Officer to refund back the amount as it holds stay over it. The Assessing Officer rejected the contention of the assessee. Now the assessee seeks your opinion.

Answer

The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose off the appeal within this period of stay. Where the appeal has not been disposed off within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. Section 254(2A) provides that the aggregate of the period originally allowed and the period or periods so extended or allowed shall not, in any case, exceed 365 days, even if the delay in disposing of the appeal is not attributable to the assessee. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Accordingly, even if an appeal is not heard by the bench, say, due to the bench not functioning or due to the department seeking adjournment, the stay granted by the Appellate Tribunal shall stand vacated after the period of 365 days, inspite of the assessee having taken all steps to ensure speedy disposal of the appeal and having a good prima facie case.

In the present case, the period of 365 days has expired on 31.12.2019, after which date the order of stay stands vacated. Accordingly, the recovery of ₹ 15 lacs against the arrear demand of ₹ 25 lacs made by the Assessing Officer on 16.2.2020 is in order.

Question 10

An assessee who had been served with an order of assessment passed under section 143(3) on 1.1.2020 had filed an application against this order before the CIT as per section 264 on 11.1.2020. However, the CIT refused to entertain the application on the pretext of premature application. Assessee seeks your opinion.

Answer

An assessee, who is aggrieved by the order of the Assessing Officer under section 143(3) passed on 1.1.2020, had moved an application for revision of order under section 264 on 11.1.2020. The order passed by the Assessing Officer under section 143(3) is an order appealable before the Commissioner (Appeals). The time limit for filing an appeal is 30 days from the date of order i.e., upto 31.1.2020. This time limit had not expired on 11.1.2020 and the assessee had also not waived his right of appeal while filing the application for revision on 11.1.2020 before the Commissioner of Income-tax. The application filed before the Commissioner of Income-tax for revision under section 264 by the assessee will only be considered when the conditions specified under section 264(4) have been complied with. One of the conditions is that the Commissioner shall not revise any order where an appeal against the order lies to the Commissioner (Appeals) or Appellate Tribunal and the time within which such appeal may be made has not expired, unless the assessee has waived his right of appeal. In the present case, the time limit had not expired on 11.1.2020 and the assessee had also not waived the right of appeal while filing the application for revision before the Commissioner of Income-tax on 11.1.2020 under section 264. Therefore, the Commissioner's refusal to entertain such application is correct.

Note : *In practical situations, the Commissioner could have kept the proceedings in abeyance till the expiry of the time prescribed for filing appeal by the assessee and thereafter, could have assumed jurisdiction for making revision besides taking an undertaking from the assessee for waiving his right of appeal. In reality, taxpayers usually will not prefer revision in such short time period nor would the Commissioner reject the application, the moment it is received by him.*

Question 11

(a) *The Commissioner of Income-tax issued notice to revise the order passed by an Assessing Officer under section 143. During the pendency of proceedings before the Commissioner, on the basis of material gathered during survey under section 133A after issue of the first notice, the Commissioner of Income-tax issued a second notice, the contents of which were different from the contents of the first notice. Examine whether the action of the Commissioner is justified as to the second notice.*

(b) *Examine the circumstances where the appellant shall be entitled to produce additional evidence, oral or documentary, before the Commissioner of Income-tax (Appeals) other than the evidence produced during the proceedings before the Assessing Officer.*

Answer

(a) The action of the Commissioner in issuing the second notice is not justified. The term "record" has been defined in clause (b) of *Explanation* to section 263(1). According to this definition "record" shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of examination by the Commissioner. In other words, the information, material, report etc. which were not in existence at the time the assessment was made and came into existence afterwards can be taken into consideration by the Commissioner for the purpose of invoking his jurisdiction under section 263(1). However, at the same time, in view of the express provisions contained in clause (b) of the *Explanation* to section 263(1), such information, material, report etc. can be relied upon by the Commissioner only if the same forms part of record when the action under section 263 is taken by the Commissioner,

Issuance of a notice under section 263 succeeds the examination of record by Commissioner. In the present case, the Commissioner initially issued a notice under section 263, after the examination of the record available before him. The subsequent second notice was on the basis of material collected under section 133A, which was totally unrelated and irrelevant to the issues sought to be revised in the first notice. Accordingly, the material on the basis of which the second notice was issued could not be said to be "record" available at the time of examination as emphasized in *Explanation (b)* to section 263(1).

(b) As per Rule 46A(1) of the Income-tax Rules 1962, an appellant shall be entitled to produce before the Commissioner (Appeals), evidence, either oral or documentary, other than the evidence produced by him during the course of proceedings before the Assessing Officer, only in the following circumstances -

(a) where the Assessing Officer has refused to admit evidence which ought to have been admitted; or

(b) where the appellant was prevented by sufficient cause from producing the evidence which he was called upon to produce by the Assessing Officer; or

(c) where the appellant was prevented by sufficient cause from producing before the Assessing Officer any evidence which is relevant to any ground of appeal; or

(d) where the Assessing Officer has made the order appealed against without giving sufficient opportunity to the appellant to adduce evidence relevant to any ground of appeal.

Further, no evidence shall be admitted unless the Commissioner (Appeals) records in writing the reasons for its admission.

Question 12

Examine the correctness or otherwise of the following propositions in the context of the Income-tax Act, 1961:

(a) The powers of the Commissioner of Income-tax (Appeals) to enhance the assessment are plenary and quite wide.

(b) At the time of hearing of rectification application, the Income-tax Appellate Tribunal can re-appreciate the evidence produced during the proceedings of the appeal hearing.

(c) The High Court cannot interfere with the factual finding recorded by the lower authorities and the Tribunal, without any valid reasons.

Answer

(a) The proposition is correct in law. The Supreme Court has, in *CIT vs. McMilan & Co. (1958) 33 ITR 182 and CIT vs. Kanpur Coal Syndicate (1964) 53 ITR 225*, held that in disposing of an appeal before him, the appellate authority can travel over a whole range of the assessment order. The scope of his powers is co-terminus with that of the Assessing Officer. He can do what the Assessing Officer can do and can also direct him to do, what he has failed to do. He can assess income from sources which have been considered by the Assessing Officer but not brought to tax. He can consider every aspect of the assessment order and give appropriate relief.

The Allahabad High Court has, in *CIT v. Kashi Nath Chandiwala (2006) 280 ITR 318*, held that the appellate authority is empowered to consider and decide any matter arising out of the proceedings in which the order appealed against was passed notwithstanding the fact that such matter was not raised before him by the assessee. The Commissioner (Appeals) is entitled to direct additions in respect of items of income not considered by the Assessing Officer.

Further, the Apex Court has, in the case of *Jute Corporation of India Ltd. vs. CIT (1991)* 187 *ITR* 688, held that the appellate authority is vested with all the plenary powers which the subordinate authority may have in the matter.

Thus, the powers of the Commissioner of Income-tax (Appeals) in enhancing the assessment are very wide and plenary.

(b) The proposition is not correct as per law. This is because section 254(2) specifically empowers the Appellate Tribunal to amend any order passed by it, either *suo-moto* or on an application made by the assessee or Assessing Officer, with a view to rectify any mistake apparent from record, at any time within **6 months** from the end of the month of the order sought to be amended.

The powers of the Tribunal under section 254(2) relating to rectification of its order are very limited. Such powers are confined to rectifying any mistake apparent from the record. The mistake has to be such that for which no elaborate reasons or inquiry is necessary. Accordingly, the re-appreciation of evidence placed before the Tribunal during the course of the appeal hearing is not permitted. It cannot re-adjudicate the issue afresh under the garb of rectification *[CIT vs. Vardhman Spinning (1997) 226 ITR 296 (P & H), CIT v. Ballabh Prasad Agarwalla (1998) 233 ITR 354 (Cal.) & Niranjan & Co. Ltd. v. ITAT (1980) 122 ITR 519 (Cal.)]*

(c) The proposition is correct in law. A finding of fact cannot be disturbed by the High Court in exercise of its powers under section 260A. The Income-tax Appellate Tribunal is the final fact finding authority and the findings of fact recorded by the Tribunal can be interfered with by the High Court under section 260A only on the ground that the same were without evidence or material, or if the finding is contrary to the evidence, or is perverse or there is no direct nexus between conclusion of fact and the primary fact upon which that conclusion is based.

In *CIT vs. P. Mohanakala (2007) 291 ITR 278 and M. Janardhana Rao v. Joint CIT (2005) 273 ITR 50*, the Apex Court observed that the High Court had set aside the factual findings of the lower authorities and the Tribunal without any valid reason. The Apex Court held that the findings of fact could not be interfered with by the High Court without carefully considering the facts on record, the surrounding circumstances and the material evidence. There is no scope for interference with the factual findings, unless the findings are *per se* without reason or basis, perverse and/or contrary to the material on record.

Hence, only if the issue gives rise to a substantial question of law, an appeal shall lie before the High Court.

Question 13

Answer the following in the context of provisions contained in the Income-tax Act, 1961:

The assessment for A.Y. 2016-17 was completed as per section 143(3) considering the various claims so made by the assessee on 23.12.2017. Subsequently, this was reopened under section 147 on certain issues, but excluding the claim of the assessee as to "Lease Equalisation Fund". The order of reassessment was passed on 18.11.2018. The Commissioner within the powers vested under section 263 passed an order on 11.4.2020 rejecting the claim of assessee as to "Lease Equalisation Fund". The assessee challenges that the action of the CIT is not sustainable because the same was barred by limitation.

Answer

This issue was settled by the Supreme Court in *CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1.*

The Supreme Court observed that though there was no doubt that once an order of assessment is reopened, the previous assessment will be held to be set aside and the whole proceedings would start afresh, however, it would not mean that even when the subject-matter of reassessment is distinct and different, the entire proceeding would be deemed to have been reopened. The doctrine of merger would apply only in a case where the subject-matter of reassessment and the subject-matter of assessment are the same. However, in this case, the revision proceedings related to Lease Equalisation Fund, which was not the subject matter of reassessment. Therefore, the doctrine of merger does not apply in this case.

Section 263(2) provides no order shall be made under section 263(1) after the expiry of two years from the end of the financial year in which the order sought to be revised was passed. The period of limitation as referred to in section 263(2) relates to the assessment in which the claim of the assessee as to Lease Equalisation Fund was considered by the Assessing Officer. This issue was not the subject matter of reassessment proceedings.

Accordingly, the period of limitation shall be reckoned with reference to the original assessment order and not from the date of the order of reassessment. Therefore, in this case, the revision proceedings are barred by limitation since the original assessment order was made on 23.12.2017 and the revision should have been made by 31.3.2020.

Question 14

An assessee, who is aggrieved by all or any of the following orders, is desirous to know the available remedial recourse and the time limit against each order under the Income-tax Act, 1961:

(i) passed under section 143(3) by the Assessing Officer.

(ii) passed under section 263 by the Commissioner of Income-tax.

(iii) passed under section 272A by the Director General.

(iv) passed under section 254 by the ITAT.

Answer

(i) An assessee, aggrieved by the order passed under section 143(3) by the Assessing Officer, can file an appeal before the Commissioner of Income-tax (Appeals) under section 246A(1) within 30 days of the date of service of the notice of demand relating to the assessment. However, where the assessee does not want to prefer an appeal, then he can move a revision petition before the Principal Commissioner or Commissioner of Income-tax under section 264 within a period of one year from the date of on which the order was communicated to him or the date on which he otherwise came to know of it, whichever is earlier.

(ii) An assessee, aggrieved by the order passed under section 263 by the Commissioner of Income-tax, can file an appeal to Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.

(iii) An assessee, aggrieved by the order passed under section 272A by the Director General, can file an appeal before the Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.

(iv) An assessee, aggrieved by the order passed under section 254 by the Income-tax Appellate Tribunal, can file an appeal before the High Court under section 260A within 120 days from the date of receipt of order of Income-tax Appellate Tribunal, only where the order gives rise to a substantial question of law.

Question 15

Who can file memorandum of cross-objections before the Income-tax Appellate Tribunal? What is the time limit? What is the fee for filing memorandum of cross objections?

Answer

Section 253(4) of the Income-tax Act, 1961 gives the respondent (assessee or the Assessing Officer), in every appeal filed before the Income-tax Appellate Tribunal, a right to file a memorandum of cross-objections against any order of the Commissioner (Appeals). This right of filing a memorandum of cross-objections is an independent right given to the respondent in an appeal and is in addition to the right of appeal which may or may not be exercised by the assessee or the Assessing Officer under section 253(1) or section 253(2). The memorandum of cross-objections has to be in the prescribed form and verified in the prescribed manner and has to be filed within 30 days of the receipt of notice of the appeal. The Tribunal is empowered to permit filing of memorandum of cross-objections after the expiry of the prescribed period if sufficient cause is shown. Such memorandum of cross-objections will be disposed of by the Appellate Tribunal as if it were an appeal presented within the time specified in section 253(3). There is no fee for filing a memorandum of cross-objections.

SIGNIFICANT SELECT CASES

1. Does the CIT (Appeals) have the power to change the status of assessee?

***Mega Trends Inc. v. CIT (2016) 388 ITR 16 (Mad)*.**

Facts of the case: The assessee filed its return of income as a partnership firm for the relevant assessment year admitting a total income of ₹ 174.36 lakhs. The firm consisted of thirteen individuals and two firms. The return of income was selected for scrutiny which led to disallowance of certain deductions to the tune of ₹ 262.50 lakhs. The assessee preferred an appeal. The CIT (Appeals) invoked section 251 and issued a show cause notice proposing to change the assessee's status to AOP on the reasoning that a partnership firm cannot be a partner in another firm. The assessee filed writ of *certiorari* to quash the show cause notice.

Note: 'Certiorari' is "a writ issued by a superior court calling up the record of a proceeding in a lower court for review".

High Court's Observations: The Revenue contended that the CIT(Appeals) has power to modify assessee's status, since a partnership firm is a relationship between persons who have agreed to share the profits of the business carried on by all or any of them acting for all, and the term persons only connotes natural persons. Since some of the partners are other firms, the assessment cannot be carried out as a firm. They relied on the Supreme Court's ruling in *Dhulichand Laxminarayan v. CIT (1956) 29 ITR 535 (SC)* to argue this point.

The High Court observed that, under section 251(1), the powers of the first appellate authority are coterminous with those of the Assessing Officer and the appellate authority can do what the Assessing Officer ought to have done and also direct him to do what he had failed to do. If the Assessing Officer had erred in concluding the status of the assessee as a firm, it could not be said that the Commissioner (Appeals) had no jurisdiction to go into the issue. The appeal was in continuation of the original proceedings and unless fetters were placed upon the powers of the appellate authority by express words, the appellate authority could exercise all the powers of the original authority.

High Court's Decision: The High Court held that the power to change the status of the assessee is available to the assessing authority and when it is not used by him, the appellate authority is empowered to use such power and change the status. The Court relied on a full bench decision of the Madras High Court in *State of Tamil Nadu v. Arulmurugan and Co. reported in [1982] 51 STC 381* to come to such conclusion.

2. **Can an assessee make an additional/new claim before an appellate authority, which was not claimed by the assessee in the return of income (though he was legally entitled to), otherwise than by way of filing a revised return of income?**

CIT v. Pruthvi Brokers & Shareholders (2012) 349 ITR 336 (Bom.)

High Court's Observations: While considering the above mentioned issue, the Bombay High Court observed the decision of the Supreme Court, in the case of *Jute Corporation of India Ltd. v. CIT (1991) 187 ITR 688* and *National Thermal Power Corporation. Ltd v. CIT (1998) 229 ITR 383*, that an assessee is entitled to raise additional claims before the appellate authorities. The appellate authorities have jurisdiction to permit additional claims before them, however, the exercise of such jurisdiction is entirely the authorities' discretion.

Also, the High Court considered the decision of the Apex Court in the case of *Addl. CIT v. Gurjargravures (P.) Ltd. (1978) 111 ITR 1,* wherein it was held that in case an additional ground was raised before the appellate authority which could not have been raised at the stage when the return was filed or when the assessment order was made, or the ground became available on account of change of circumstances or law, the appellate authority can allow the same.

The Supreme Court, in the case of *Goetze (India) Ltd v. CIT (2006) 157 Taxmann 1,* held that the assessee cannot make a claim before the Assessing Officer otherwise than by filing an application for the same. The additional claim before the Assessing Officer can be made only by way of filing revised return of income.

The decision in the above mentioned case, however, does not apply in this case, since the Assessing Officer is not an Appellate Authority.

High Court's Decision: Therefore, in the present case, the Bombay High Court, considering the above mentioned decisions, held that additional grounds can be raised before the Appellate Authority even otherwise than by way of filing return of income. However, in case the claim has to be made before the Assessing Officer, the same can only be made by way of filing a revised return of income.

3. **Does the Appellate Tribunal have the power to review or re-appreciate the correctness of its earlier decision under section 254(2)?**

CIT v. Earnest Exports Ltd. (2010) 323 ITR 577 (Bom.)

High Court's Observations: In this case, the High Court observed that the power under section 254(2) is limited to rectification of a mistake apparent on record and therefore, the Tribunal must restrict itself within those parameters. **Section 254(2) is not a carte blanche for the Tribunal to change its own view by substituting a view which it believes should have been taken in the first instance.** Section 254(2) is not a mandate to unsettle decisions taken after due reflection.

High Court's Decision: In this case, the Tribunal, while dealing with the application under section 245(2), virtually reconsidered the entire matter and came to a different conclusion. This amounted to a reappreciation of the correctness of the earlier decision on merits, which is beyond the scope of the power conferred under section 254(2).

4. **Can the Tribunal exercise its power of rectification under section 254(2) to recall its order in entirety, where there is a mistake apparent from record?**

Lachman Dass Bhatia Hingwala (P) Ltd. v. ACIT (2011) 330 ITR 243 (Delhi)(FB)

High Court's Observations: On this issue, the Delhi High Court observed that the justification of an order passed by the Tribunal recalling its own order is required to be tested on the basis of the law laid down by the Apex Court in *Honda Siel Power Products Ltd. v. CIT (2007) 295 ITR 466,* dealing with the Tribunal's power under section 254(2) to recall its order where prejudice has resulted to a party due to an apparent omission, mistake or error committed by the Tribunal while passing the order. Such recalling of order for correcting an apparent mistake committed by the Tribunal has nothing to do with the doctrine or concept of inherent power of review. It is a well settled provision of law that the Tribunal has no inherent power to review its own judgment or order on merits or reappreciate the correctness of its earlier decision on merits. However, the power to recall has to be distinguished from the power to review. While the Tribunal does not have the inherent power to review its order on merits, it can recall its order for the purpose of correcting a mistake apparent from the record.

The Apex Court, while dealing with the power of the Tribunal under section 254(2) in *Honda Siel Power Products Ltd.,* observed that one of the important reasons for giving the power of rectification to the Tribunal is to see that no prejudice is caused to either of the parties appearing before it by its decision based on a mistake apparent from the record. When prejudice results from an order attributable to the Tribunal's mistake, error or omission, then it is the duty of the Tribunal to set it right. In that case, the Tribunal had not considered the material which was already on record while passing the judgment. The Apex Court took note of the fact that the Tribunal committed a mistake in not considering material which was already on record and the Tribunal acknowledged its mistake and accordingly, rectified its order.

The above decision of the Apex Court is an authority for the proposition that the Tribunal, in certain circumstances can recall its own order and section 254(2) does not totally prohibit so. In view of the law laid down by the Apex Court in that case, the decisions rendered by the High Courts in certain cases to the effect that the Tribunal under no circumstances can recall its order in entirety do not lay down the correct statement of law.

High Court's Decision: Applying the above-mentioned decision of the Apex Court to this case, the Delhi High Court observed that the Tribunal, while exercising the power of rectification under section 254(2), can recall its order in entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal's mistake, error or omission and the error committed is apparent.

Note - *In deciding whether the power under section 254(2) can be exercised to recall an order in entirety, it is necessary to understand the true principle laid down in the Apex Court decision. A decision should not be mechanically applied treating the same as a precedent without appreciating the underlying principle contained therein. In this case, the Apex Court decision was applied since prejudice had resulted to the party on account of the mistake of the Tribunal apparent from record.*

5. **Does the High Court have an inherent power under the Income-tax Act, 1961 to review an earlier order passed on merits?**

CIT v. Meghalaya Steels Ltd. (2015) 377 ITR 112 (SC)

Facts of the case: In this case, the High Court had considered whether deduction is allowable under section 80-IB on transport subsidy and interest subsidy and on the central excise duty refund received by it. Finally, after stating that two substantial questions of law arose under section 260A, the High Court proceeded to answer the two questions. Against this judgement, the assessee filed a review petition whereupon the Division Bench of the High Court recalled its entire order for adjudication on the ground that it had not formulated the substantial questions of law before hearing of the appeal and had not invited the parties to have their say in the matter which amounted to denial of opportunity of effective hearing to the parties concerned, particularly, the review petitioners. Further, it had on an earlier occasion prior to passing the order, reserved the judgement on whether substantial questions of law in fact existed at all.

Revenue's contention *vis-à-vis* Assessee's contention: The Revenue contended that, by virtue of section 260A(7), only those provisions of the Civil Procedure Code could be looked into for the purposes of section 260A as were relevant to the disposal of appeals, and since the review provision contained in the Code of Civil Procedure is not so referred to, the High Court would have no jurisdiction under section 260A to review such judgment. The assessee-petitioner, however, contended that High Courts being courts of record under article 215 of the Constitution of India, the power of review would in fact inhere in them.

Supreme Court's Observations: The Supreme Court concurred with the assessee's submission that High Courts being courts of record under article 215 of the Constitution of India, the power of review would inhere in them. Further, it noted that in another case[1], in a slightly different context while dealing with power of review of writ petitions filed under article 226, the Supreme Court had observed that there is nothing in article 226 of the Constitution to preclude a High Court from exercising the power of review which inheres in every court of

[1] *Shivdeo Singh v. State of Punjab AIR 1963 SC 1909*

plenary jurisdiction to prevent miscarriage of justice or to correct grave and palpable errors committed by it. In that case, the High Court had entertained the second petition since the interested parties were not given an effective opportunity of being heard, before passing the judgement; therefore, keeping in mind the requirement of the principles of natural justice, the High Court had exercised its inherent power of review.

Supreme Court's Decision: The Supreme Court went ahead to further observe that it is clear on a cursory reading of section 260A(7), that it does not purport in any manner to curtail or restrict the application of the provisions of the Code of Civil Procedure. Section 260A(7) only states that all the provisions that would apply qua appeals in the Code of Civil Procedure would apply to appeals under section 260A. That does not in any manner suggest either that the other provisions of the Code of Civil Procedure are necessarily excluded or that the High Court's inherent jurisdiction is in any manner affected.

6. Whether delay in filing appeal under section 260A can be condoned where the stated reason for delay is the pursuance of an alternate remedy by way of filing an application before the ITAT under section 254(2) for rectification of mistake apparent on record?

Spinacom India (P.) Ltd. v. CIT [2018] 258 Taxman 128 (SC)

Facts of the Case: The appellants have approached the Supreme Court under a special leave petition. There has been a delay of 439 days in filing the appeal under section 260A for which reason the appellants requested for a condonation of delay under section 14 of Limitation Act, 1963. The appellants submitted that the delay was on account of pursuing an alternate remedy of filing a miscellaneous application before the Income-tax Appellate Tribunal (ITAT) under section 254(2).

Issue: The issue under consideration is whether delay in filing appeal under section 260A can be condoned where the stated reason for delay is the pursuance of an alternate remedy by way of filing an application before the ITAT under section 254(2) for rectification of mistake apparent on record.

Supreme Court's Observations: The Court rejected the question of invoking section 14 of the Limitation Act 1963 which allows condonation of delay on demonstration of sufficient cause. The Court refused to accept the submission that the application before the ITAT under section 254(2) was an alternate remedy to filing of the application under section 260A. The former is an application for rectifying a 'mistake apparent from the record' which is much narrower in scope than the latter. Under section 260A, an order of the ITAT can be challenged on substantial questions of law. The Court stated that the appellant had the option of filing an appeal under section 260A while also mentioning in the Memorandum of Appeal that its application under section 254(2) was pending before the ITAT. The time period for filing an appeal under section 260A does not get suspended on account of the pendency of an application before the ITAT under section 254(2) of the Act.

Supreme Court's Decision: Since no satisfactory reason has been provided by the Appellant for the extraordinary delay of 439 days in filing the appeal, the Supreme Court dismissed the application for condonation of delay.

7. **Can High Court exercise its inherent power to recall its order by exercising jurisdiction under section 260A(7) read with the relevant Rule of the Code of Civil Procedure, 1908 even if that order is not an ex-parte order?**

CIT v. Subrata Roy (2016) 385 ITR 570 (SC)

Facts of the case: In the present case, the High Court of Allahabad has recalled its final order dated August 27, 2013 by exercising jurisdiction under section 260A(7) read with the relevant rule of the Code of Civil Procedure,1908. The High Court, while recalling its order, took note that section 260A(7) inserted by the Finance Act, 1999 provides that the provisions of the Code of Civil Procedure, 1908 relating to appeals to the High Court shall apply in the case of appeal under section 260A of the Income-tax Act, 1961. The relevant rule of the Code of Civil Procedure,1908 provides that where an appeal is heard ex-parte and the judgment is pronounced against the respondent, he may apply to the court to re-hear the appeal. Also, where the notice is not served or the defendant was prevented by the sufficient cause from appearing, the court shall re-hear the appeal on such terms as to costs or otherwise as it thinks fit to impose upon him.

The High Court contended that it is empowered to exercise this inherent power. Therefore, vide order dated 21.2.2014, the High Court had recalled its order dated August 27, 2013, on the ground that it had passed its order rejecting the request of the assessee for a day's adjournment since the senior advocate on behalf of the assessee, was to come from Mumbai next day and thus, the applicant could not advance any argument.

Supreme Court's Observations and Decision: The Apex Court noted that the assessee had participated in the hearing of the appeals before High Court which is apparent from the various parts of the order dated 27.08.2013.

The Apex Court held that the order passed by the High Court is not an *ex-parte* order for invoking the provisions of the Code of Civil Procedure, 1908, since the order of the High Court contains the submissions of the counsel of the assessee (though not that of the senior counsel for whose presence a short adjournment was prayed). Therefore, the High Court did not have the jurisdiction to recall the order passed by it previously. The inherent power under the Code of Civil Procedure, 1908 is hedged by certain pre-conditions and unless the pre-conditions are satisfied the power thereunder cannot be exercised. Accordingly, the Supreme Court set aside the order dated 21.2.2014 of the High Court.

8. **Can revision under section 263 be made on the ground that the order is passed without making inquiries or verification which should have been made?**

CIT v. Amitabh Bachchan (2016) 384 ITR 200 (SC)

Facts of the case: The assessee filed his return of income and subsequently, filed a revised return in which he claimed 30% of gross professional receipts amounting to ₹ 3.17 crore as expenditure towards his personal security. When the Assessing Officer asked for the details of expenditure, the assessee replied that the expenses were for security for the personal safety of the assessee and the payments were made out of cash balances. Thereafter, by way of a letter, the assessee informed the Assessing Officer that the claim was made on a belief that it was allowable but as it is not feasible to substantiate the claim, the revised return may be taken to be withdrawn. The Assessing Officer had proposed to treat the expenditure claim as unexplained expenditure under section 69C but after considering the assessee's reply, did not pursue the matter.

After the assessment was finalized, the Commissioner issued show cause notice under section 263 containing the grounds on which the assessment order was proposed to be revised. On getting the replies to the show cause notice, the Commissioner set aside the order of assessment and directed a fresh assessment on the principal ground that requisite and due enquiries were not made by the Assessing Officer prior to finalization of the assessment. On this basis, the Commissioner came to the conclusion that the assessment order in question was erroneous and prejudicial to the interests of the Revenue warranting exercise of power under section 263. In his order, the Commissioner of Income-tax did not record any finding on the several issues mentioned in the show cause notice whereas he recorded conclusions adverse to the assessee in respect of issues which were not specifically mentioned in the show cause notice. However, few of the issues, including the claim of additional expenses in the revised return were common to the show cause notice as well as the revisionary order.

Appellate Authorities' view: The Tribunal opined that in respect of the issues not mentioned in the show-cause notice, the findings as recorded in the revisional order under section 263 would be considered as breach of principles of natural justice, since the Commissioner of Income-tax cannot go beyond the issues mentioned in the show-cause notice. Accordingly, the Tribunal reversed the order of the *suo motu* revision of order under section 263.

The High Court also dismissed the appeal of the Revenue holding that as the Commissioner had gone beyond the scope of the show cause notice and had dealt with issues not covered or mentioned in the notice the revisional order which was in violation of the principles of natural justice. The Court also observed that the question whether the Assessing Officer had made sufficient enquiries about the assessee's claim made in the revised return was a pure question of fact and cannot be examined under section 260A.

Supreme Court's Observations: The Apex Court noted that to exercise jurisdiction under section 263 the requirement is that the order passed by the assessing authority is erroneous and prejudicial to the interests of the revenue. Section 263 does not require any specific show cause notice to be served on the assessee. What is required is granting of opportunity to the assessee of being heard before making the revision order. Failure to give such an opportunity would render the revisionary order legally fragile not on the ground of lack of jurisdiction but on the ground of violation of principles of natural justice.

The Supreme Court observed that the Tribunal had not recorded any finding that in course of the *suo moto* revisionary proceedings, the opportunity of hearing was not afforded to the assessee and that the assessee was denied an opportunity to contest the facts on the basis of which the Commissioner had come to the conclusions as recorded in the order under section 263.

In the course of revision, the documents and books of accounts overlooked in the assessment proceedings were considered and at every stage of revisionary proceeding, the authorized representative of the assessee had appeared and had full opportunity to contest the basis on which the revisionary authority was proceeding in the matter.

Where the Commissioner had come its conclusions on the basis of the record of the assessment proceedings which was open for scrutiny by the assessee and available to his authorized representative at all times, there is no breach of the requirement to give a reasonable opportunity of being heard as required under section 263.

Further, it also observed that when the Assessing Officer has dropped the investigation of the claim of expenses, it does not preclude the Commissioner of Income-tax from looking in to the same. Making a claim which would prima facie disclose that the expenses in respect of which deduction had been claimed had been incurred and thereafter, withdrawing the claim gave rise to the necessity of further enquiry in the interests of the Revenue. The notice issued under section 69C of the Act could not have been simply dropped on the ground that the claim had been withdrawn.

Supreme Court's Decision: The Apex Court, accordingly, held that the order of the Tribunal setting aside the revisional order on the ground that it went beyond the show cause notice was not sustainable. It further held that the High Court having failed to fully deal with the matter, its order was not tenable.

Note – *As per Explanation 2 to section 263(1), inserted by the Finance Act, 2015, with effect from 01.06.2015, an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interest of the revenue, if in the opinion of the Principal Commissioner or Commissioner, the order is passed without making inquiries or verification which should have been made. The rationale of the above court ruling is, thus, also in line with Explanation 2 to Section 263(1).*

9. Can mere non-mention or non-discussion of enquiry made by the Assessing Officer in the assessment order justify invoking revisionary jurisdiction under section 263?

CIT v. Krishna Capbox (P) Ltd (2015) 372 ITR 310 (All)

Facts of the case: The assessee filed its return of income declaring total income of ₹ 8.15 lakhs. The return was processed under section 143(1) and later, the case was selected for scrutiny and statutory notice under section 143(2) was issued. During the course of scrutiny, the Assessing Officer raised certain queries which were answered by the assessee. The Assessing Officer, after being satisfied with the replies given, completed the assessment by accepting the declared income. Subsequently, the Commissioner invoked revisionary jurisdiction under section 263 by holding that the Assessing Officer had not made enquiry on certain aspects, such as -

(i) Non-verification of source of investment in respect of addition in fixed assets;

(ii) Non-confirmation of sundry creditors by the assessee;

(iii) Non-enquiry of unsecured loan by the Assessing Officer;

(iv) Not obtaining the copy of bank statements;

(v) Non-verification of genuineness of shareholders;

(vi) Deduction of freight paid without deduction of tax at source.

Assessee's contention *vis-a-vis* Revenue's Contention: The assessee contended that all the aspects contested by the Commissioner were enquired by the Assessing Officer. The Revenue took the defence that no enquiry was made by the Assessing Officer in respect of the issues set out in the notice issued under section 263 and hence, revisionary jurisdiction was correctly assumed.

Tribunal's view: The Tribunal noted that all necessary enquiries were made and all the requisite documents were placed in the paper book. Once enquiry was made, mere non-discussion or non-mention in the assessment order cannot lead to the assumption that the Assessing Officer did not apply his mind or that he had not made any enquiry on the subject for invoking section 263.

High Court's Observations: The High Court noted the Bombay's High Court's view in *Cellular Ltd. v. DCIT (2008) 301 ITR 407* that if a query is raised during the assessment proceedings and responded to by the assessee, the mere fact that it is not dealt with in the assessment order would not lead to a conclusion that no mind had been applied to it.

High Court's Decision: The High Court concurred with the decision of the Tribunal and held that since the relevant enquiries and replies are available on 'record' (i.e., the paper book), the Commissioner cannot invoke revisionary jurisdiction merely because there was no mention of such enquiry and verification in the assessment order.

Note - *The Finance Act, 2015 inserted Explanation 2 to section 263(1) to clarify, inter alia, that an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, if in the opinion of the Principal Commissioner or Commissioner, the order is passed without making inquiries or verification which should have been made.*

The rationale of this ruling would hold good even after insertion of Explanation 2 to section 263(1), since in this case, the Tribunal has recorded a finding of fact that necessary enquiries have been made by the Assessing Officer even though the same was not specifically mentioned in the assessment order. Mere non-discussion or non-mention about the enquiry made by the Assessing Officer in the assessment order cannot be a ground for invoking revisionary jurisdiction under section 263.

10. Can the Commissioner invoke revisionary jurisdiction under section 263, when the subject matter of revision (i.e., whether the manner of allocation of revenue amongst the members of AOP would affect the allowability and/or quantum of deduction under section 80-IB) has been decided by the Commissioner (Appeals) and the same is pending before the Tribunal?

CIT v. Fortaleza Developers (2015) 374 ITR 510 (Bom)

Facts of the case: The assessee, an Association of Person (AOP) consisting of promoters and builders, was constituted by means of an agreement dated April 29, 2003 between M/s Raviraj Kothari and Co. (RRK) and M/s Sanand Properties Pvt. Ltd. (SPPL). The AOP filed its return of income for the assessment year 2007-08 declaring total income of ₹ 4.14 lakhs after claiming deduction under section 80-IB(10) of ₹ 1454.47 lakhs. The assessment was completed under section 143(3) disallowing fully the claim of deduction under section 80-IB(10). The assessee preferred an appeal before Commissioner (Appeals) who held that the assessee had fulfilled all the conditions laid down in section 80-IB(10) and hence, directed the Assessing Officer to allow the deduction.

The order of Commissioner (Appeals) was challenged before the Tribunal by the Revenue. During the pendency of the appeal before the Tribunal, the Commissioner issued a notice under section 263 asking the assessee to show cause as to why the assessment order should not be set aside. The notice under section 263 specified that the method of allocation of revenue gave the assessee undue benefit by way of a higher claim of deduction under section 80-IB(10) contrary to clause (7) of the AOP agreement.

Clause (7) of the agreement laid down that SPPL shall be entitled to 35% of the amount received from the purchasers of the housing units. Out of the balance 65% of the said receipts, all required and relevant expenditure for the purpose of the business of the AOP shall be met with and whatever net balance remains thereafter, shall be determined as the share of income of RRK.

On perusal of clause (7) of the agreement, the Commissioner contended that share of revenue pertaining to SPPL was not eligible for deduction under section 80-IB(10). Accordingly, the Commissioner set aside the assessment order of the assessee and directed to recompute the income on the basis of the clause (7) of the AOP agreement. The assessee challenged the revision order passed by the Commissioner under section 263 before the Tribunal.

Appellate Authorities' Views: The Tribunal observed that the quantum of deduction under section 80-IB(10) will depend upon the income earned from the project in question. The quantum of deduction will not depend on the mode of distribution of shares amongst members of the association of persons as income of association of persons is taxable at the maximum marginal rate. It is also observed by the Tribunal that the allowability or otherwise of deduction under section 80-IB(10) is not dependent upon the manner in which the profit has been distributed amongst the members of the AOP but is dependent upon the income earned from an eligible project and the fulfilment of the conditions laid down in the section. Also, the deduction is available to an undertaking and not to the individual constituent of an undertaking. The Tribunal further held that the Commissioner cannot exercise jurisdiction under section 263 in respect of deduction under section 80-IB, which was the subject matter of appeal.

High Court's Views: The High Court took note of all the facts and sequence of events with regard to the matter in appeal. The Court was of the view that the contract between the two parties was self-explanatory and the interpretation placed by the assessee on clause (7) and claiming deduction under section 80-IB(10) is in order.

High Court's Decision : When the order of the first appellate authority is complete and the appeal is pending before the Tribunal, the Commissioner is precluded from invoking section 263 for revision of the very same matter decided by the first appellate authority since clause (c) of the Explanation 1 to section 263 debars the same.

Accordingly, the High Court held that the order passed by the Assessing Officer got merged with the order of the first appellate authority. The very same issue cannot be revised by invoking revisionary jurisdiction under section 263.

11. **Can an assessee, objecting to the reassessment notice issued under section 148, directly approach the High Court in the normal course contending that such reassessment proceedings are apparently unjustified and illegal?**

Samsung India Electronics P. Ltd. v. DCIT (2014) 362 ITR 460 (Del.)

Facts of the case: In the present case, Samsung Electronics Co. Ltd., the Korean Company was subjected to regular assessment for the assessment year 2006-07. The assessment order was passed, pursuant to the directions under section 144C(5) made by the Disputes Resolution Panel. For the same assessment year, i.e., A.Y.2006-07, assessee was issued a reassessment notice dated March 30, 2013 under section 148. Against this reassessment notice, assessee filed a writ petition before the High Court.

High Court's Observations: The High Court observed the Apex court ruling in the case of *GKN Driveshafts (India) Ltd. v. ITO [2003] 259 ITR 19 (SC)*, wherein, it was laid down that when a notice under section 148 is issued, the proper course of action for the noticee is to file a return and if he so desires, to seek reasons for issuing notices. The Assessing Officer is bound to furnish reasons within a reasonable time. On receipt of the reasons, the noticee is entitled to file objections to issuance of notice and the Assessing Officer is bound to dispose of the objections by passing a speaking order.

The High Court noted that the assessee has not filed objections before the Assessing Officer and has directly approached the court by way of the writ petition. On this issue, the assessee contended that they were justified in approaching the High Court directly as the reassessment proceedings *ex facie* were unjustified and illegal. The assessee relied upon the decision of the Delhi High Court in *Techspan India P. Ltd. v. ITO [2006] 283 ITR 212 (Delhi)* in which reference was made to the decision of the Gujarat High Court in *Garden Finance Ltd. v. Asst. CIT [2004] 268 ITR 48 (Guj),* wherein it was observed that the exercise of the powers under section 148 may be so arbitrary or *mala fide* that the court may entertain the petition without requiring the assessee to approach the Assessing Officer, but such a case was an exception and not a rule. In *Techspan India P. Ltd.'s* case, the High Court had given concurrent reasons and made observations when a writ court should interfere. However, there is no need to go into the said question and controversy in the present case, since it does not occasion or require a different treatment from the procedure followed in other cases in which re-assessment proceedings were/are initiated.

High Court's Decision: The High Court, thus, held that it will not be appropriate and proper in the facts of the present case to permit and allow the petitioner to bypass and forgo the procedure laid down by the Supreme Court in *GKN Driveshafts (India) Ltd. (supra),* since the said procedure has been almost universally followed and has helped cut down litigation and crystallise the issues, if and when the question comes up before the Court.

12. Should time limit under section 263 to be reckoned with reference to the date of assessment order or the date of reassessment order, where the revision is in relation to an item which was not the subject matter of reassessment?

I Bombay High Court ruling in CIT v. Lark Chemicals Ltd (2014) 368 ITR 655

Facts of the case: The assessee-company, for the assessment year 2002-03, filed its return of income declaring a total income of ₹ 30.98 lakhs. This was accepted and the return was processed under section 143(1). Subsequently, it was reopened by issue of notice under section 148 and the order of reassessment was passed in June, 2006. The Commissioner assumed jurisdiction for revision of order by invoking section

263 in March, 2009. The subject matter of revision, however, was not related to any of the issues dealt with in the reassessment.

Issue under consideration: The issue before the High Court was whether the revision under section 263 is barred by limitation in view of the fact that the issues dealt with therein were not the subject matter of reassessment.

Tribunal's view: The Tribunal opined that jurisdiction under section 263 cannot be exercised in respect of those issues which were not the subject matter of consideration while passing the order of reassessment but were a part of the original assessment, the time limit for which had since expired. It relied on the Apex Court decision in the case of *CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1,* wherein it was held that in such cases, the doctrine of merger would not apply and the period of limitation would commence from the date of original assessment and not from the date of reassessment.

High Court's Opinion: The High Court observed that if the revision happened to be in relation to issues dealt with in the reassessment proceedings, then, it would not be barred by limitation as the time limit would expire only on 31st March, 2009 i.e., two years from the end of the financial year in which the order sought to be revised under section 263, was passed. However, in this case, the revision proposed under section 263 was in respect of issues, other than the issues dealt with in the order of reassessment. The issues on which the Commissioner sought to exercise jurisdiction under section 263 were concluded by virtue of intimation issued under section 143(1). The time period for revision under section 263 is two years from the end of the financial year in which order sought to be revised was passed [i.e., two years from the end of the financial year in which the intimation was issued under section 143(1)] and that time period has expired long ago.

High Court's Decision: The High Court, thus, held that the jurisdiction under section 263 could not be assumed on issues which were not the subject matter of issues dealt with in the order of reassessment but were part of the original assessment, for which the period of limitation expired long ago.

II Bombay High Court ruling in CIT v. ICICI Bank Ltd. (2012) 343 ITR 74

Facts of the case: In the present case, an order of assessment was passed under section 143(3) allowing the deduction under section 36(1)(vii), 36(1)(viia) and foreign exchange rate difference. Further, two notices of reassessment were issued under section 148 and an order of reassessment was passed under section 147 which did not deal with the above deductions.

Later, the Commissioner passed an order under section 263 for disallowing the deduction under section 36(1)(vii), 36(1)(viia) and in respect of foreign exchange rate difference which have not been taken up in the reassessment proceedings under section 147 but which was decided in the original order of assessment passed under section 143(3).

Assessee's contention *vis-à-vis* Revenue's contention: The assessee claimed that the order passed by the Commissioner under section 263 is barred by limitation since the period of 2 years from the end of the financial year in which the order sought to be revised was passed, had lapsed. However, the Revenue gave a plea that period of limitation shall be reckoned from the date of order under section 147 and not from the date of the original assessment order under section 143(3), applying the doctrine of merger.

The Revenue pointed out that as per the provisions of *Explanation 3* to section 147, the Assessing Officer is entitled to assess or reassess the income in respect of any issue which has escaped assessment though the reasons in respect of such issue have not been included in the reasons recorded under section 148(2).

High Court's Decision: Considering the above mentioned facts, the Bombay High Court held that the order of assessment under section 143(3) allowed deduction under section 36(1)(vii), 36(1)(viia) and in respect of foreign exchange rate difference. The order of reassessment, however, had not dealt with these issues. Therefore, the doctrine of merger cannot be applied in this case. The order under section 143(3) cannot stand merged with the order of reassessment in respect of those issues which did not form the subject matter of the reassessment.

Therefore, the period of limitation in respect of the order of the Commissioner under section 263 with regard to a matter which does not form the subject matter of reassessment shall be reckoned from the date of the original order under section 143(3) and not from the date of the reassessment order under section 147.

13. Can the original assessment order under section 143(3), which was subsequently modified to give effect to the revision order under section 264, be later on subjected to revision under section 263?

CIT v. New Mangalore Port Trust (2016) 382 ITR 434 (Karn)

Facts of the case: The assessee-trust, a government undertaking carrying on commercial activities in one of the major ports was enjoying exemption under section 10(20) since its inception. On March 27, 2006, the assessee applied for registration under section 12A. However, the said application for registration was rejected by the Commissioner. On appeal before the Appellate Tribunal, the Commissioner was directed to grant registration under section 12AA to the assessee w.e.f. 1 April, 2003. To give effect to the order of the Tribunal, the Commissioner granted registration on July 27, 2009. Subsequent to the registration, an assessment order was passed by the Assessing Officer under section 143(3) on December

27, 2009. The assessee filed a revision petition under section 264 which was allowed and the matter was remanded to the Assessing Officer to compute the income of the assessee in terms of the order of revision under section 264. The Assessing Officer gave effect to the revision order vide order dated May 27, 2011. Thereafter, the original order passed under section 143(3), dated December 27, 2009 was revised by the Commissioner under section 263 on March 22, 2012.

The revision order under section 263 passed by Commissioner was challenged by the assessee before the Appellate Tribunal. The Tribunal set aside the revision order of the Commissioner passed under section 263.

Assessee's Contentions: The assessee contended before the High Court that the order passed by the Assessing Officer under section 143(3) on December 27, 2009 does not exist subsequent to the order of Commissioner passed under section 264, being given effect to by the Assessing Officer vide order dated May 27, 2011. The said order dated December 27, 2009 which no longer subsists, was revised by the Commissioner under section 263. In this case, invoking of *suo motu* revision powers by the Commissioner under section 263 is not justifiable.

High Court's Observations: The High Court took note of the sequence of events and undisputed facts that the assessment order dated 27 December 2009 passed by the Assessing Officer was no longer in existence. The High Court concluded that the Tribunal arrived at the conclusion only after considering the factual position that Commissioner had no jurisdiction to revise the order which was not in existence.

High Court's Decision: The High Court, accordingly, held that the order passed by the Commissioner under section 263, revising the non-existing order is *void ab initio* and is a nullity in the eyes of law

14. Can an assessee file a revision petition under section 264, if the revised return to correct an inadvertent error apparent from record in the original return, is filed after the time limit specified under section 139(5) on account of the error coming to the notice of the assessee after the specified time limit?

Sanchit Software and Solutions Pvt. Ltd. v. CIT (2012) 349 ITR 404 (Bom.)

Facts of the case: The assessee-company had electronically filed its return of income. It committed a mistake by including dividend income [exempt under section 10(34)] in its return of income, though the same was correctly disclosed in the Schedule containing details of exempt income. The return was processed under section 143(1) denying the exemption under section 10 and therefore, intimation under section 143(1) was served on the assessee raising a demand of tax. The assessee, on receiving the intimation, noticed the error committed and filed a revised return rectifying the error. However, the revised return was not sustainable as the same was filed beyond the period of limitation as provided under section 139(5). Later, the assessee filed an application for rectification under section 154 and also a revision petition under section 264.

Commissioner's contention: The Commissioner of income-tax, while considering the revision petition, contended that the intimation under section 143(1) was based on the return of the assessee, in which the claims under section 10(34) were not made by the assessee. Hence, it cannot be said that the intimation under section 143(1) was erroneous, since the same was squarely based on the return filed by the assessee. Secondly, the power of Commissioner under section 264 is only restricted to the record available before the Assessing Officer which can be examined by the Commissioner. In the circumstances, the other evidence sought to be brought on record to establish the mistake committed by the assessee cannot be considered by the Commissioner under section 264. The revision petition under section 264 was rejected by the Commissioner on the above grounds.

High Court's Observations: The High Court observed that the entire object of administration of tax is to secure the revenue for the development of the country and not to charge the assessee more tax than which is due and payable by the assessee. In this context, the High Court referred to the CBDT Circular issued as far back as 11th April, 1955 directing the Assessing Officer not to take advantage of the assessee's mistake. The High Court opined that the said Circular should always be borne in mind by the officers of the Revenue while administering the Act.

The High Court observed that, in this case, the Commissioner of income-tax had committed a fundamental error in proceeding on the basis that no deduction on account of dividend income and long-term capital gains under section 10 was claimed from the total income, without considering that the assessee had specifically sought to exclude the same as is evident from the entries in the relevant Schedule. Therefore, this was an error on the face of the order and hence, the same was not sustainable.

High Court's Decision: The High Court, accordingly, set aside the order of Commissioner and remanded the matter for fresh consideration.

The High Court further directed the Assessing Officer to consider the rectification application filed by the assessee under section 154 as a fresh application received on the date of service of this order and dispose of the rectification application on its own merits, without awaiting the result of the revision proceedings before the Commissioner of Income-tax on remand, at the earliest.

CHAPTER 19

SETTLEMENT OF TAX CASES

LEARNING OUTCOMES

After studying this chapter, you would be able to:

❑ **appreciate** the meaning of "case" and "applicant", for making an application before the Settlement Commission;

❑ **comprehend** the constitution of Settlement Commission and its jurisdiction and powers;

❑ **appreciate** the procedures of Settlement Commission on receipt of application for settlement of a case;

❑ **appreciate** the powers of the Settlement Commission to order provisional attachment to protect revenue, to reopen completed proceedings, to grant immunity from prosecution and penalty;

❑ **comprehend** when the proceedings before Settlement Commission shall abate;

❑ **appreciate** the bar on subsequent application for settlement by the applicant and any related person.

19.1 INTRODUCTION

The Wanchoo Committee felt that in the administration of fiscal laws, where the primary objective is to raise revenue, there has to be room for compromise and settlement. A rigid attitude would not only inhibit a one-time tax evader or an unintending defaulter from making a clean breast of his affairs but would also unnecessarily strain the investigational resources of the Department in cases of doubtful benefit to revenue, while needlessly proliferating litigation and holding up collections. Even in the United Kingdom, the 'confession' method has been in vogue since 1923. In the U.S. Law also, there is a provision for compromise with the tax payer as to his tax liabilities. A provision of this type facilitating settlement in individual cases will have this advantage over general disclosure schemes. Hence, the Committee recommended the setting up of a high level settlement machinery. Accordingly, Chapter XIX-A incorporating the recommendations of the Wanchoo Committee was enacted by Taxation Laws (Amendment) Act, 1975 with effect from April 1, 1976. The provisions relating to Settlement Commission are discussed below.

(1) The Central Government has constituted a Settlement Commission. It shall consist of a Chairman and as many Vice-Chairmen and other members as the Central Government thinks fit. Where a member of the Central Board of Direct Taxes is appointed as the chairman or a member of the commission, he ceases to be a member of the Board.

(2) The Chairman, Vice-Chairman and other members of the Settlement Commission are to be appointed by the Central Government from amongst persons of integrity and outstanding ability, having special knowledge of, and experience in, problems relating to direct taxes and business accounts.

(3) The Commission functions within the Department of Revenue and Banking of the Central Government.

19.2 DEFINITION OF 'CASE' [SECTION 245A(B)]

For the purpose of settlement of cases, the term 'case' has been defined to mean any proceeding for assessment under the Income-tax Act 1961, of any person in respect of any assessment year or years which may be pending before an Assessing Officer on the date on which an application under section 245C(1) is made.

The deemed date of commencement of these proceedings are shown in the following table -

Proceeding	Deemed date of commencement of proceeding
Proceeding for assessment or re-assessment or re-computation under section 147	Date on which notice under section 148 was issued. Where a notice under section 148 is issued for any assessment year, a proceeding under

	section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years has not been issued but could have been issued on that date. However, a return of income for such other assessment years should have been furnished under section 139 or in response to notice under section 142.
Proceeding for making fresh assessment in pursuance of an order under section 254 or 263 or 264, setting aside or cancelling an assessment.	Date on which order under section 254 or 263 or 264 setting aside or cancelling an assessment was passed.

Note - In the case of a person whose income is being assessed or reassessed as a result of search or as a result of requisition of books of account or other documents or any assets, the proceedings for assessment or reassessment shall be deemed to have commenced on the date of issue of notice initiating such proceedings and concluded on the date on which the assessment is made.

Any other proceeding for assessment, other than those referred to in the table and note above, shall be deemed to have

commenced from –

the date on which the return of income for that assessment year is furnished under section 139 or in response to a notice served under section 142

and

concluded on -

In a case where assessment is made	In a case where no assessment is made
the date on which the assessment is made	on the expiry of time specified for making assessment under section 153(1)

19.3 APPLICATION FOR SETTLEMENT OF CASES [SECTION 245C]

(1) **Application by assessee [Section 245C(1)]:** An assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner, containing a full and true disclosure of his income which has not been disclosed before the Assessing Officer.

(2) **Information to be disclosed [Section 245C(1)]:** He should also disclose the following to the Settlement Commission for settlement of his case–

(i) the manner in which such income has been derived,

(ii) the additional amount of income-tax payable on such income and

(iii) other particulars as may be prescribed.

(3) **Pre-conditions for filing of application:** As per section 245C, an application can be filed before the Settlement Commission, only if the additional amount of income-tax payable on the income disclosed in the application exceeds the specified limit.

(a) **Specified limit in search cases:** Section 245A provides that the proceedings for assessment or reassessment resulting from search/requisition would fall within the definition of a "case" which can be admitted by the Settlement Commission. Consequently, section 245C provides that the additional amount of income-tax payable on income disclosed in the application should exceed ₹ 50 lakh, for an application to be made before the Settlement Commission in such cases.

Therefore, if proceedings have been initiated against the applicant (hereinafter referred to as specified person) under section 153A or under section 153C as a result of search or a requisition of books of account, an application can be made before the Settlement Commission if the additional amount of income-tax payable on the income disclosed in the application exceeds ₹ 50 lakh.

(b) **Specified limit in other cases:** An application can also be made, where the applicant is related to the specified person, and in whose case also proceedings have been initiated as a result of search, provided the additional income-tax payable on the income disclosed in the application exceeds ₹ 10 lakh.

Therefore, the limit of ₹ 50 lakh would be applicable to the tax payer who is the subject matter of search and the limit of ₹ 10 lakh would be applicable to entities related to such a tax payer, who are also the subject matter of search.

(4) **Tax and interest to be paid before making application:** Such tax and interest thereon, which would have been payable had such income been disclosed in the return of income before the Assessing Officer on the date of application, should be paid on or before the date of making the application. Further, proof of such payment should be attached with the application.

(5) **Applicant, in relation to the Specified Person:** The applicant, in relation to the specified person, means –

	Specified person		Related entity
(i)	Individual	(1)	Relative of the individual
		(2)	Where the individual or his relative has a substantial interest in a business or profession carried on by any other person, the person who carries on such business or profession.
(ii)	HUF	(1)	Member of HUF or relative of such member
		(2)	Where the HUF or its member or relative of such member has a substantial interest in a business or profession carried on by any other person, the person who carries on such business or profession.
(iii)	Company	(1)	Director of the company or any relative of such director
		(2)	Any person who has substantial interest in the business or profession of the company. In addition, the following are also considered as related entity - • If such person is an individual, any relative of such individual. • If such person is a company, any director of such company or any relative of such director. • If such person is a firm, any partner of such firm, or any relative of such partner. • If such person is an AOP or HUF, any member of the AOP or HUF, or any relative of such member.
		(3)	A company, whose director has a substantial interest in the business or profession of this company; Any director of such company; Any relative of such director.
		(4)	A firm, whose partner has a substantial interest in the business or profession of the company; Any partner of such firm; Any relative of such partner.
		(5)	An AOP, whose member has a substantial interest in the business or profession of the company; Any member of such AOP; Any relative of such member.
		(6)	A HUF, whose member has a substantial interest in the business or profession of the company; Any member of such HUF;

			Any relative of such member.
		(7)	Where the company or its director or relative of such director has a substantial interest in a business or profession carried on by any other person, the person who carries on such business or profession.
(iv)	Firm	(1)	Partner of the firm or any relative of such partner
		(2)	Any person who has substantial interest in the business or profession of the firm. In addition, the following are also considered as related entity - • If such person is an individual, any relative of such individual. • If such person is a company, any director of such company or any relative of such director. • If such person is a firm, any partner of such firm, or any relative of such partner. • If such person is an AOP or HUF, any member of the AOP or HUF, or any relative of such member.
		(3)	A company, whose director has a substantial interest in the business or profession of the firm; Any director of such company; Any relative of such director.
		(4)	A firm, whose partner has a substantial interest in the business or profession of this firm; Any partner of such firm; Any relative of such partner.
		(5)	An AOP, whose member has a substantial interest in the business or profession of the firm; Any member of such AOP; Any relative of such member.
		(6)	A HUF, whose member has a substantial interest in the business or profession of the firm; Any member of such HUF; Any relative of such member.
		(7)	Where the firm or its partner or relative or such partner has a substantial interest in a business or profession carried on by any other person, the person who carries on such business or profession.

(v)	AOP	(1)	Member of AOP or any relative of such member
		(2)	Any person who has substantial interest in the business or profession of the AOP. In addition, the following are also considered as related entity - • If such person is an individual, any relative of such individual. • If such person is a company, any director of such company or any relative of such director. • If such person is a firm, any partner of such firm, or any relative of such partner. • If such person is an AOP or HUF, any member of the AOP or HUF, or any relative of such member.
		(3)	A company, whose director has a substantial interest in the business or profession of the AOP; Any director of such company; Any relative of such director.
		(4)	A firm, whose partner has a substantial interest in the business or profession of the AOP; Any partner of such firm; Any relative of such partner.
		(5)	An AOP, whose member has a substantial interest in the business or profession of this AOP; Any member of such AOP; Any relative of such member.
		(6)	A HUF, whose member has a substantial interest in the business or profession of the AOP; Any member of such HUF; Any relative of such member.
		(7)	Where the AOP or its member or relative of such member has a substantial interest in a business or profession carried on by any other person, the person who carries on such business or profession.

(6) Cases where a person shall be deemed to have a substantial interest in a business or profession:

	Case	Condition
(i)	Where the business or profession is carried on by a company	Such person is, on the date of search, the beneficial owner of shares (not being shares entitled to a fixed rate of dividend, whether with or without a right to participate in profits) carrying not less than 20% of the voting power.

(ii)	In any other case	Such person is, on the date of search, beneficially entitled to not less than 20% of the profits of such business or profession. Such beneficial ownership/beneficial entitlement may be at any time during the previous year.

(7) **Manner of calculation of additional amount of income-tax:** The additional amount of income-tax has to be calculated in the following manner as provided in sub-section (1B) read with sub-section (1C), in a case where the income disclosed in the application relates to only one previous year–

(i)	If the applicant has not furnished a return in respect of the total income of that year.	Tax should be calculated on the income disclosed in the application as if such income is the total income. Such tax represents the additional amount of income-tax.
(ii)	If the applicant has furnished a return in respect of the total income of that year.	The tax should be calculated on the aggregate of total income returned and the income disclosed in the application i.e. as if the aggregate represents the total income. The additional amount of income-tax is the amount calculated on such aggregate as reduced by the amount of tax calculated on the total income returned for that year.

Where the income disclosed in the application relates to more than one previous year, then the above procedure is to be adopted in respect of each previous year and the aggregate of tax payable is to be calculated [Sub-section (1D)].

(8) **Prescribed fees [Section 245C(2)]:** Every settlement application made under sub-section (1) should be accompanied by the prescribed fees of ₹ 500.

(9) **Withdrawal not permissible [Section 245C(3)]**: The settlement application made under sub-section (1) cannot be withdrawn by the applicant [Sub-section (3)].

(10) **Intimation to Assessing Officer [Section 245C(4)]:** The assessee should also intimate to the Assessing Officer in the prescribed manner that he has made an application to the Settlement Commission. Such intimation should be made on the same date when he makes an application to the Settlement Commission.

19.4 PROCEDURE ON RECEIPT OF APPLICATION [SECTION 245D]

(1) **Admission of Petition [Section 245D(1)]**

(i) On receipt of the settlement application, the Settlement Commission shall issue a notice to the applicant, requiring him to explain as to why the application made by him be allowed to be proceeded with, within 7 days from the date of receipt of application.

(ii) After hearing the applicant, the Settlement Commission shall pass an order either rejecting or allowing the application to be proceeded with within 14 days from the date of application.

(iii) Application not disposed off within 14 days shall be treated as admitted.

(2) Copy of every order under section 245D(1) has to be sent to the applicant and to the Principal Commissioner or Commissioner [Sub-section (2)].

(3) Time limit for furnishing report by Principal Commissioner or Commissioner and passing order by the Settlement Commission [Section 245D(2B) & (2C)]

(i) The Settlement Commission shall call for a report from the Principal Commissioner or Commissioner within 30 days from the date of application.

(ii) The Principal Commissioner or Commissioner is required to furnish the report within 30 days from the receipt of communication from the Settlement Commission.

(iii) The Settlement Commission can also pass an order declaring the application as invalid on the basis of the report of the Principal Commissioner or Commissioner.

(iv) Such order should be passed in writing within 15 days of the receipt of report after giving the applicant an opportunity of being heard.

(v) A copy of the order should be sent to the applicant and the Principal Commissioner or Commissioner.

(vi) However, in a case where the Principal Commissioner or Commissioner has not furnished the report within the prescribed time, the Settlement Commission shall proceed further in the matter without the report of the Principal Commissioner or Commissioner.

(4) Proceedings after admission [Section 245D(3)]

(i) The Settlement Commission may call for records from the Principal Commissioner or Commissioner in respect of an application which has not been declared invalid under sub-section (2C) or an application which has been allowed to be further proceeded with under sub-section (2D).

(ii) After examination of such records, the Settlement Commission may require the Principal Commissioner or Commissioner to make further enquiry or investigation and furnish a report on the matters covered by the application and any other matter relating to the case.

(iii) The Principal Commissioner or Commissioner shall furnish the report within a period of 90 days of the receipt of communication from the Settlement Commission.

(iv) If the Principal Commissioner or Commissioner fails to furnish the report within the said period of 90 days, the Settlement Commission may proceed to pass an order under sub-section (4) without such report.

(5) Final order of settlement [Section 245D(4) and (4A)]

(i) The Settlement Commission may pass such order as it thinks fit on the matters covered by the application and any other matter relating to the case not covered by the application but referred to in the report of the Principal Commissioner or Commissioner.

(ii) Such order should be passed by the Settlement Commission after –

(1) examining the records and report of the Principal Commissioner or Commissioner, if any, received at the time of admission or on investigation or enquiry conducted as per the instructions of the Settlement Commission;

(2) giving an opportunity of being heard to the applicant and the Principal Commissioner or Commissioner;

(3) examining such further evidence as may be placed before it or obtained by it.

(iii) The time limit for passing such order is –

(1)	In respect of an application made on or after 1.6.2010	Within 18 months from the end of the month in which the application was made.
(2)	In respect of an application made between 1.6.2007 and 31.5.2010.	Within 12 months from the end of the month in which the application was made.

(6) Order of Settlement Commission to express views of majority [Section 245D(5)]: Before passing any order and subject to the provisions dealing with the jurisdiction of Settlement Commission, the various materials brought on record before the Settlement Commission must be considered by the members of the concerned Bench and in cases where there is any difference of opinion among the members, the opinion of the majority shall prevail and the order of the Settlement Commission must also be expressed in terms of the views of the majority.

(7) Order to provide for terms of Settlement [Section 245D(6)]: All the orders passed by the Settlement Commission under section 245D(4) must provide for the terms of the settlement including any demand by way of tax, penalty, the manner in which any amount due as a result of the settlement should be paid and all other matters which are essential to make the settlement of the case effective.

(8) Order to be void if obtained by fraud or misrepresentation [Section 245D(6)/(7)]: The order should also provide that the settlement shall be void if it is subsequently found by the Settlement Commission that the settlement order was obtained by fraud or any misrepresentation of facts by the applicant. In cases where the settlement becomes void, the proceeding, in respect of which the settlement order was passed, must be deemed to have been revived from the stage at which the application was allowed to be proceeded with by the Settlement Commission and the Income-tax authority concerned may complete the proceedings for assessment or re-assessment of income or the levy of penalty, fine, etc., at any time before the completion of two years from the end of the financial year in which the settlement becomes void.

(9) **Interest leviable if tax not paid within prescribed time [Section 245D(6A)]:** Where the tax payable in pursuance of an order passed by the Settlement Commission is not paid by the assessee within 35 days of receipt of a copy of final order, the assessee shall be liable to pay simple interest @ 1¼% for every month or part of a month on the outstanding amount from the date of expiry of 35 days. Such liability will arise even in cases where the Commission extended the time allowed for such payment or permitted payment by installment.

(10) **Time limit for amendment of Settlement Order [Section 245D(6B)]:** The Settlement Commission may amend any order passed by it under section 245D(4) to rectify any mistake apparent from the record.

The Settlement Commission may, with a view to rectifying any mistake apparent from the record, amend any order passed by it under section 245D(4), at any time within a period of six months from the end of month in which -

(a) the order was passed; or

(b) an application for rectification has been made by the Principal Commissioner or Commissioner or the applicant, as the case may be.

However, no application for rectification can be made by the Principal Commissioner or the Commissioner or the applicant after the expiry of 6 months from the end of the month in which an order under section 245D(4) is passed by the Settlement Commission.

(11) **Time limit under section 153 not applicable in respect of Settlement Order [Section 245D(8)]:** The time limit for completion of assessments and re-assessments contained in section 153 shall have no application to any order passed by the Settlement Commission or to any order of assessment or re-assessment or recomputation required to be made by the Assessing Officer in pursuance of any directions contained in an order passed by the Settlement Commission.

19.5 POWER OF SETTLEMENT COMMISSION TO ORDER PROVISIONAL ATTACHMENT TO PROTECT REVENUE [SECTION 245DD]

(1) Under section 245DD, the Settlement Commission is empowered to provisionally attach the property belonging to the applicant for protecting the interest of the revenue. The manner in

which such provisional attachment is to be effected is provided in the Second Schedule. Such provisional attachment is valid for a period of 6 months, after which it ceases to have effect.

(2) The Settlement Commission may, for reasons to be recorded in writing, extend the aforesaid period by such further period or period as it thinks fit.

19.6 RE-OPENING OF COMPLETED PROCEEDINGS [SECTION 245E]

The Settlement Commission shall not have any power to reopen the proceedings in respect of an application made on or after 1.6.2007.

19.7 JURISDICTION AND POWERS OF THE SETTLEMENT COMMISSION [SECTION 245BA]

The jurisdiction, powers and authority of the Settlement Commission may be exercised by benches thereof.

(1) **Constitution of Benches:** A bench shall be presided over by the Chairman or a Vice-chairman and shall consist of two other members.

The bench for which the Chairman is the presiding officer shall be the principal bench and the other benches shall be known as additional benches.

The Chairman may authorise the Vice-chairman or other Member appointed to one bench to discharge also the functions of the Vice-chairman or other member of another bench.

The Vice-chairman has been empowered to act as chairman and discharge his functions under certain circumstances as vacancy, death, resignation etc.

(2) **Constitution of Special Bench:** Where the presiding officer or other member of a bench is unable to discharge his functions owing to absence, illness or any other cause or where a vacancy occurs in the office of the presiding officer or a member the remaining two persons may function as the bench and if the presiding officer is not one of the members, the senior member will be the presiding officer. However, if it is felt that the case is such that it should be heard by a bench of three members the chairman has powers to transfer the case to such a bench. The chairman for the disposal of a particular case, constitute a Special Bench consisting of more than three members.

(3) **Benches to sit at notified places:** The places at which the Principal Bench and the Additional Benches shall ordinarily sit shall be notified by the Central Government. The Central Government has specified that New Delhi is the place where the Principal Bench and Bombay, Calcutta and Madras as the places where Additional Benches of the Settlement Commission shall ordinarily sit.

(4) **Transfer of cases:** On the application of the assessee or the Principal Commissioner or Commissioner and after notice to them and hearing, the chairman may transfer any case pending before one bench, for disposal, to another bench.

(5) **Decision based on opinion of majority members:** If the members of a bench differ in opinion on any point the point shall be decided according to the opinion of the majority. If they are equally divided they shall state the point on which they differ and make a reference to the chairman who shall either hear the point himself or refer the point to one or more of the other members and such point shall be decided according to the opinion of the majority of the members who have heard the case including those who first heard it.

(6) **Exclusive Jurisdiction of Settlement Commission:** The Settlement Commission has been vested with all the powers which are vested in an Income-tax authority under the Income-tax Act, 1961.

Accordingly, in cases where an application made by the assessee under section 245C has been allowed by the Settlement Commission to be proceeded with under section 245D, the Settlement Commission is empowered to exercise exclusively the jurisdiction and powers and perform the functions allotted to an Income-tax authority under the Income-tax Act until an order for settlement of the case is passed.

Such exclusive jurisdiction would begin with the date of filing of application with the Settlement Commission.

The exclusive jurisdiction of the Settlement Commission would end on –

(a) the date of passing an order under section 245D(4); or

(b) the date of passing the order rejecting the application under section 245D(1); or

(c) the date on which the application is not allowed to be proceeded with under section 245D(2A); or

(d) the date on which the application is declared invalid under section 245D(2C); or

(7) **Certain provisions of Income-tax Act, 1961 to apply in the absence of contrary directions by the Settlement Commission:** However, in the absence of any express direction to the contrary by the Settlement Commission, the operation of any other provision of the Income-tax Act, 1961 requiring the applicant to pay the tax on the basis of self-assessment shall continue to be applicable in relation to matters which are before the Settlement Commission for consideration. Further, in the absence of any express directions by the Settlement Commission to the contrary, the provisions of sections 245A to 245L would not affect the operation of any other provision of the Income-tax Act, 1961 insofar as those provisions relate to any matters other than those covered by the case before the Settlement Commission.

(8) **Settlement Commission to regulate its own procedure:** The Commission shall subject to the provisions of this Chapter have power to regulate its own procedure and the procedure of benches thereof in all matters arising out of the exercise of its powers or of the discharge of its functions including the places at which the Board shall hold their sittings.

(9) **Inspection of reports:** According to section 245G, no person is entitled to inspect or obtain copies of any reports made by any Income-tax authority to the Settlement Commission in relation to the case, but, the Settlement Commission may, in its discretion, furnish copies thereof to any person or receipt of an application made to it in this behalf and on payment of the prescribed fee. However, in order to enable any person whose case is under consideration to rebut any evidence which has been brought on record against him in any such report, the Settlement Commission shall, on receipt of an application in this behalf and on payment of the prescribed fee, furnish to the applicant, a certified copy of any such report or particular thereof which may be relevant for the purpose.

19.8 POWER TO GRANT IMMUNITY FROM PROSECUTION AND PENALTY [SECTION 245H]

(1) **Recording of reasons in order granting immunity:** The Settlement Commission may, if it is satisfied that any person who made the application for settlement under section 245C has co-operated with the Settlement Commission in the conduct of the proceedings before it and has made a true disclosure of his income, and the manner in which such income has been derived, grant to such person immunity from prosecution for any offence under the Income-tax Act, 1961 or under the Wealth-tax Act, 1957. However, the Settlement Commission, while granting immunity to any person from prosecution shall record the reasons in writing in the order passed by it.

Such an immunity may also be granted in the matter of imposition of any penalty under the Income-tax Act, 1961 in respect of the case which is covered by the settlement.

(2) **Grant of partial immunity:** The Commission can grant partial immunity from imposition of penalty to the applicant.

(3) **Immunity to be subject to conditions:** The power of the Settlement Commission to grant immunity from prosecution and the imposition is, however, subject to such conditions as the Commission may think fit to impose in the circumstances of the case.

(4) **No immunity if prosecution proceedings have been initiated before receipt of application:** No such immunity shall be granted by the Commission in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of the application for settlement.

(5) **Restriction on power to grant immunity:** Under section 245H, the Settlement Commission may grant immunity from prosecution for any offence under the Indian Penal

Code, Income-tax Act, 1961 and any other Central Act. This power has now been restricted in respect of application made under section 245C on or after 1.6.2007. In respect of such cases, the Settlement Commission shall not grant immunity from prosecution for any offence under the Indian Penal Code or under any Central Act other than the Income-tax Act, 1961 and Wealth-tax Act, 1957. However, in respect of applications pending as on 1.6.2007, the Settlement Commission has the power to grant immunity from prosecution for any offence under the Indian Penal Code and other Central Acts also.

(6) Withdrawal of immunity:

(a) An immunity granted under this section shall stand withdrawn if such person fails to pay any sum specified in the order of settlement within the time specified in the order or within such further time as may be allowed by the Commission or fails to comply with any other 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.

(b) An immunity granted by the Settlement Commission to any person may, at any time, be withdrawn by it in cases where it is satisfied that the person concerned had, in the course of the settlement proceedings concerned may be tried for the offence with respect to which the immunity was granted or for any other offence in respect of which he has been found guilty in connection with the settlement.

(c) After the withdrawal of the immunity from prosecution, the person concerned may also become liable to the imposition of the penalty under the Income-tax Act, 1961 to which he would otherwise have been liable in the absence of the immunity given to him under section 245H.

19.9 ABATEMENT OF PROCEEDING BEFORE THE SETTLEMENT COMMISSION [SECTIONS 245HA & 245HAA]

(1) Specified date of abatement in different cases: In the following cases, the proceedings before the Settlement Commission shall abate on the specified date as given below –

	Case	Specified date
(i)	where an application made to the Settlement Commission on or after 1.6.2007 has been rejected under section 245D(1).	The date on which the application was rejected.
(ii)	where an application has been declared invalid under section 245D(2C).	The last day of the month in which the application was declared invalid.
(iii)	Where an order under section 245D(4) has	The day on which the order under

	been passed not providing for the terms of settlement.	section 245D(4) was passed not providing for the terms of settlement.
(iv)	Where an order under section 245D(4) has not been passed within the time allowed under section 245D(4A).	The date on which the time or period specified in section 245D(4A) expires.

(2) **Cases to revert to jurisdictional Assessing Officer:** On abatement of proceedings, the case would revert back to the Assessing Officer having jurisdiction or any other income-tax authority before whom the proceedings were pending at the time of making the application. Such income-tax authority shall dispose of the case in accordance with the provisions of the Act.

(3) **Assessing Officer entitled to use the material, information and results of enquiry:** For completing the proceedings, the Assessing Officer or other Income-tax authority shall be entitled to use the material and information produced by the assessee before the Settlement Commission as if such material and information had been produced before the Assessing Officer or other income-tax authority. Similarly, the Assessing Officer or other Income-tax authority shall be entitled to use the results of the inquiry held or evidence recorded by the Settlement Commission in the course of the proceedings before it, as if such inquiry or evidence had been held or recorded by him in the course of the proceedings before him.

(4) **Exclusion of time period:** The period from the date on which the application was made before the Commission up to the date on which proceedings get abated shall be excluded from the time limit for completion of proceedings by the Assessing Officer and for payment of interest under section 243, 244 or 244A.

(5) **Credit for tax and interest paid [Section 245HAA]:** In case of abatement of settlement proceedings, the Assessing Officer is required to give credit for the tax and interest paid on or before the date of making the application or during the pendency of the case before the Settlement Commission.

19.10 ORDER OF SETTLEMENT COMMISSION TO BE CONCLUSIVE [SECTION 245-I]

Section 245-I provides that every order of the Settlement Commission passed under section 245D(4) shall be conclusive in respect of the matters contained therein. Consequently, no matter covered by the Settlement Order shall be liable to be reopened in any proceeding under the Income-tax Act or under any other law for the time being in force. The only exception is the reopening of the case by the Settlement Commission itself under section 245D(7) where the settlement becomes void.

However, the Supreme Court has held in *CIT vs. B.N. Bhattacharjee (1979) 118 ITR 461* that Article 136 of the Constitution was wide enough to bring within the Supreme Court's jurisdiction orders passed by the Settlement Commission.

19.11 RECOVERY OF SETTLED AMOUNT [SECTION 245J]

According to section 245J, any amount specified in an order of settlement passed by the Settlement Commission under section 245D(4), may be recovered and any penalty for default in making the payment may be imposed and recovered from the person concerned in accordance with the provisions of the Income-tax Act, 1961. The power for making the recovery if any, as may be specified by the Settlement Commission in the order passed by it. The right of recovery may be exercised by the Assessing Officer having jurisdiction over the person who has made the application for settlement under section 245C.

19.12 BAR ON SUBSEQUENT APPLICATION FOR SETTLEMENT [SECTION 245K]

(1) In the event of occurrence of any of the following, the person concerned or any person related to such person shall not be entitled to apply for settlement in relation to any other matter –

(i) the order of settlement passed under section 245D(4) provides for imposition of penalty for concealment of income; or

(ii) after the passing of order under section 245D(4) in relation to a case, the person is convicted of an offence under Chapter XXII in relation to that case; or

(2) The case of such person was sent back to the Assessing Officer by the Settlement Commission on or before 1.6.2002.

(3) Further, with effect from 1.6.2007, the option of going to the Settlement Commission would be available only once in the lifetime of a person. Therefore, where an application for settlement is made on or after 1.6.2007 and such application has been allowed to be proceeded with, then such person will not be subsequently entitled to make any application under section 245C.

Note – Any person related to the person who has already approached the Settlement Commission once, also cannot approach the Settlement Commission subsequently. The related person with respect to a person means -

Person	Related person
Individual	• any company in which such person holds more than 50% of the shares or voting rights at any time; or • any firm or AOP or BOI in which such person is entitled to

	more than 50% of the profits at any time; or • any HUF in which such person is a karta
Company	• any individual who held more than 50% of the shares or voting rights in such company at any time before the date of application before the Settlement Commission by such person
Firm or AOP or BOI	• any individual who was entitled to more than 50% of the profits in such firm, AOP or BOI, at any time before the date of application before the Settlement Commission by such person
HUF	• The karta of that HUF

The restriction of not approaching the Settlement Commission again was so far applicable only to the concerned person. Therefore, an individual who has approached the Settlement Commission once can subsequently approach again through an entity controlled by him. This defeats the purpose of restricting the opportunity of approaching the Settlement Commission only once for any person. Therefore, section 245K has been amended with effect from 1st June, 2015 to apply the restriction to the related persons as well.

19.13 PROCEEDINGS TO BE JUDICIAL PROCEEDINGS [SECTION 245L]

All the proceedings under the Income-tax Act, 1961 before the Settlement Commission shall be deemed to be judicial proceedings within the meaning of sections 193, 196 and 228 of the Indian Penal Code.

EXERCISE

Question 1

X & Co Ltd. had made an application to the Settlement Commission. The issue in the said application related to cash credits in the books of account. The Commission passed an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income-tax. Discuss the validity of the order of the Settlement Commission.

Answer

The issue under consideration is whether the Settlement Commission can pass an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income-tax.

Section 245D(4) provides that the Settlement Commission, after examination of records and the report of the Commissioner and after examining such further evidence as may be placed before it or obtained by it, may, in accordance with the provisions of the Act, pass such order as it thinks fit.

Further, section 245D(5) provides that the materials brought on record before the Settlement Commission shall be considered by the Members of the concerned Bench before passing any order under section 245D(4).

"Consideration" means independent examination of the evidence and material brought on record before the Settlement Commission by the members and application of mind thereto with a view to independently assess the materials and evidence, whether adduced by the applicant or by the Commissioner, and come to a conclusion by themselves.

This view has been upheld in case of *Supreme Agro Foods P Ltd. v. Income-tax Settlement Commission (2013) 353 ITR 385 (P&H)*

The Settlement Commission, therefore, has to consider the material brought on record before it and "consideration" means independent examination of the evidence and material on record.

In this case, since the material was available before the Settlement Commission and such material has been taken into consideration for returning a finding which is relevant for determining the undisclosed income of the applicant, the addition made on the basis of difference in gross profit rate adopted is justified.

Therefore, the order of the Settlement Commission is valid.

Question 2

On an application made by Mr. Pandey, an order was passed by the Settlement Commission on 03-01-2020 under Section 245D(6B). The said order had a mistake apparent on record. The Settlement Commission suo moto passed an amended order dated 30-07-2020 which resulted in modifying the liability of Mr. Pandey.

Mr. Pandey is of the view that order of the Settlement Commission is final and conclusive and it has no power to rectify the said mistake.

You are required to examine the following:

(i) Correctness of claim made by Mr. Pandey

(ii) Validity of the order amended by the Settlement Commission

Answer

(i) Under section 245F(1), the Settlement Commission has been conferred all the powers which are vested in an income-tax authority under the Act. Under section 154, an income-tax authority has the power to amend any order passed by it in order to rectify any mistake apparent from the record. Therefore, the Settlement Commission's power to amend an order to rectify any mistake apparent from the record is embedded in section 245F(1).

Further, in order to reflect the correct intention of the legislature, section 245D(6B) specifically provides that the Settlement Commission may, at any time within a period of six months from the end of the month in which the order was passed, amend any order passed by it under section 245D(4) to rectify any mistake apparent from the record. In this case, the rectification order was passed by the Settlement Commission within six months from the end of the month in which the order was passed (i.e. by 31.7.2020)

Therefore, Mr. Pandey's view is not correct.

(ii) In this case, the rectification has the effect of modifying the liability of Mr. Pandey. Therefore, as per the second proviso to section 245D(6B), the Settlement Commission, before passing the amended order, should have –

(1) given a notice to the applicant and the Principal Commissioner/Commissioner of its intention to make such an amendment; and

(2) allowed the applicant and the Principal Commissioner/Commissioner an opportunity of being heard.

If these conditions are fulfilled, the order amended by the Settlement Commission would be a valid order, since the amended order is passed by the Settlement Commission within the permitted time limit i.e., within six months from the end of the month in which the original order was passed.

However, if the Settlement Commission has not given notice of its intention to make such an amendment or has not allowed the applicant and the Principal Commissioner/ Commissioner an opportunity of being heard, then, the amended order passed by it will not be valid.

Question 3

Seizures were made from Mr. Sunder pursuant to a search conducted in his premises. He filed an application for settlement by claiming to have received the amount by way of loans from several persons. The Settlement Commission accepted his statement and made an order. The CBI, however, conducted enquiry at the instance of the Revenue regarding the claimed amount of loans and opined that the alleged lenders had no means or financial capacity to advance such huge loans to Mr. Sunder and were mere name lenders only. The Commissioner filed an application under section 245D(6) praying for the order to be declared void and for withdrawal of benefit granted. Mr. Sunder, however, contended that the order of the Settlement Commission was final and any fresh analysis would amount to sitting in judgement over an earlier decision, for which the Settlement Commission was not empowered. Discuss the correctness of Mr. Sunder's contention.

Answer

The Apex Court, in *CIT vs. Om Prakash Mittal (2005) 273 ITR 326*, observed that a plain reading of section 245D(6) shows that every order passed under sub-section (4) has to provide for:-

(i) the terms of settlement; and

(ii) that the settlement would become void, if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.

The decision that the order has been obtained by fraud or misrepresentation is that of the Settlement Commission. However, there is no requirement that the action be initiated by the Settlement Commission, suo moto. The Revenue can move the Settlement Commission for decision on an issue if it has material to show that the order was obtained by fraud or misrepresentation of facts.

The Supreme Court observed that the foundation for settlement is an application which an assessee can file at any stage of a case relating to him in such form and manner as may be prescribed. The fundamental requirement of the application under section 245C is that there must be full and true disclosure of the income along with the manner in which it has been derived. If an order is obtained by fraud or misrepresentation of facts, it cannot be said that there is a full and true disclosure and therefore, the Legislature has prescribed the condition relating to declaration of the order void when it is obtained by fraud or misrepresentation of facts.

The Supreme Court held that merely because section 245-I provides that the order of settlement is conclusive, it does not take away the power of the Settlement Commission to decide whether the settlement order has been obtained by fraud or misrepresentation of facts. If the Commissioner is able to establish that the earlier decision was void because of misrepresentation of facts, then it is open for the Settlement Commission to decide the issue. It cannot be called by any stretch of imagination to be a review of the earlier judgment or the subsequent Bench sitting in appeal over the earlier Bench's decision.

Mr. Sunder's contention is, therefore, not correct.

Question 4

Does the Settlement Commission have the power to reduce or waive interest levied under sections 234A, 234B and 234C of the Income-tax Act? Discuss.

Answer

The matter concerning the power of the Settlement Commission to reduce or waive interest chargeable under section 234A, 234B or 234C has been settled by the Supreme Court in *CIT v. Anjum M.H.Ghaswala (2001) 252 ITR 1*.

According to the judgment, the provisions of section 245D(6) are only procedural in nature providing for fixing the term by which the amounts settled under sub-section (4) will have to be paid. It does not empower the Commission either to reduce or waive the interest. Any settlement made by the Commission must be in accordance with the provisions of the Act.

The Settlement Commission does not have the power to reduce or waive the interest levied under sections 234A, 234B and 234C. It does not authorize the waiver or deduction of tax. The levy of interest under sections 234A, 234B or 234C is mandatory in nature and therefore any settlement made must include the interest under these sections. However, as per provisions of section 245F, the Settlement Commission shall have all the powers which are vested in an income-tax authority. Therefore, Settlement Commission can grant relief from the aforesaid interest to the extent of the powers given vide the circulars issued by CBDT under section 119.

Question 5

(a) Does the Settlement Commission have jurisdiction to entertain an application made under section 245C(1) in respect of a case covered by Chapter XIV-B (Search and seizure case).

(b) Discuss the power of the Settlement commission to grant immunity from prosecution and penalty.

Answer

(a) Section 245A(b) defines the term `case' to mean any proceeding for assessment under the Act of any person in respect of any assessment year or years which is pending before the Assessing Officer on the date on which an application is made to the Settlement Commission.

Search cases are eligible for settlement through the Settlement Commission. *Explanation* to section 245A(b), provides that in case of a person referred to in section 153A or section 153C, a proceeding for assessment or reassessment shall be deemed to have been commenced on the date of issue of notice initiating such proceeding for assessment under section 153A or section 153C and concluded on the date on which the assessment is made. During this period, application for settlement of the case could be filed by the assessees.

Further, section 245C provides that an application before the settlement commission in cases falling under section 153A and 153C can be made, where the additional amount of income-tax payable on income disclosed in the application exceeds ₹ 50 lakh, in respect of the tax payer who is the subject matter of search and ₹ 10 lakh, in respect of entities related to such a tax payer, who are also the subject matter of search.

Moreover, such tax and interest thereon, which would have been payable had such income been disclosed in the return of income before the Assessing Officer on the date of application, should be paid on or before the date of making the application. Further, proof of such payment should be attached with the application.

(b) The power of Settlement Commission to grant immunity from prosecution and penalty is provided for in section 245H.

In respect of an application made on or after 1st June, 2007, the Settlement Commission's power to grant immunity from prosecution is restricted to offences under the Income-tax Act, 1961. The Settlement Commission can also grant immunity from penalty imposed under the Income-tax Act, 1961. Such immunity from prosecution and penalty may be granted subject to conditions as it may think fit to impose.

However, the Settlement Commission may grant immunity only if the person who has made the application has co-operated with the Settlement Commission and made a full and true disclosure of his income and the manner in which it was derived. Further, the Settlement Commission while granting immunity to any person from prosecution shall record the reasons in writing in the order passed by it.

Also, the Settlement Commission cannot grant immunity if the prosecution proceeding for any such offence has been instituted before the date of receipt of application for settlement under section 245C.

Question 6

The business premises of Mr. Amit was subjected to a survey under section 133A of the Act. There were some incriminating materials found at the time of survey. The assessee apprehends reopening of assessments of the earlier years. He wants to know whether he can approach the Settlement Commission.

Explain briefly the basic conditions to be satisfied and the benefits that may accrue to Mr. Amit by approaching the Settlement Commission.

Answer

An assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission under section 245C. "Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made. Thus, the basic condition for making an application before the Settlement Commission under section 245C is that there must be a proceeding for assessment pending before an Assessing Officer on the date on which the application is made.

A proceeding for assessment or reassessment or recomputation under section 147 shall be deemed to have commenced from the date on which a notice under section 148 is issued.

In this case, Mr. Amit cannot approach the Settlement Commission merely due to his apprehension that assessment of earlier years may be reopened, since there is no case pending before an Assessing Officer.

Therefore, he has to wait for the Assessing Officer to issue notice under section 148. Thereafter, he can make an application to the Settlement Commission under section 245C, since there would be a "case pending" before the Assessing Officer on that date.

Another basic condition to be satisfied for making an application is that the additional amount of income-tax payable on the income disclosed in the application should exceed ₹ 10 lakh, and such tax and interest thereon which would have been paid had the income disclosed in the application been declared in the return of income should be paid on or before the date of making the application and proof of such payment should be attached with the application.

If the Settlement Commission is satisfied that Mr. Amit has co-operated in the proceedings and made true and full disclosure of his income and the manner in which it has been derived, it may, subject to such conditions as it may think fit to impose, grant to Mr. Amit -

(i) immunity from prosecution for any offence under the Income-tax Act, 1961, where the proceedings for such prosecution have been instituted on or after the date of receipt of application under section 245C; and

(ii) immunity from imposition of penalty under the Income-tax Act, 1961, either wholly or in part, with respect to the case covered by the settlement.

This is the benefit that may accrue to Mr. Amit, if he approaches the Settlement Commission.

Note: *Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years has not been issued but could have been issued on date. However, a return of income for such other assessment years should have been furnished under section 139 or the response to notice under section 142.*

Question 7

Explain the powers of Settlement Commission to amend its order.

Answer

As per the section 245D(6B), the Settlement Commission may amend any order passed by it under section 245D(4) to rectify a mistake apparent from the record, within six months from the end of the month in which order was passed.

In case where an application for rectification is made by the Principal Commissioner or the Commissioner or the applicant within 6 months from the end of the month in which order under section 245D(4) was passed, the Settlement Commission may amend the order within six months from the end of the month in which an application for rectification has been made by the Principal Commissioner or Commissioner or the applicant.

However, an amendment which has the effect of modifying the liability of the applicant shall not be made unless the Settlement Commission –

(1) has given notice to the applicant and the Principal Commissioner or Commissioner of its intention to do so; and

(2) has allowed the applicant and the Principal Commissioner or Commissioner an opportunity of being heard.

Question 8

M/s. A Ltd. has received a notice under section 148 for the Assessment Year 2017-18 on 02-02-2019. They also anticipate similar notices for the Assessment Years 2015-16 and 2016-17 for which they have already furnished return of income. On examination of the books of account produced, you have noticed huge amounts of concealed income. As a consultant, what is your advice to A Ltd.?

Answer

As per section 245C, an assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission.

"Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made.

A proceeding for assessment or reassessment or recomputation under section 147 is deemed to have commenced from the date of issue of notice under section 148. Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years have not been issued but could have been issued on that date. However, a return of income for such other assessment years should have been furnished under section 139 or in response to notice under section 142.

In the case on hand, M/s A Ltd. has received a notice under section 148 for the A.Y.2017-18 and also anticipates similar notices for the A.Y.2015-16 and A.Y.2016-17, for which return of income has been furnished. Thus, a proceeding for assessment is pending before an Assessing Officer i.e., the basic condition for approaching Settlement Commission is satisfied.

Moreover, since after examination of the books of account, huge amount of concealed income is also noticed, it is presumed that the second condition that the additional amount of income-tax payable on the income disclosed in the application should exceed ₹ 10 lakhs has also been satisfied.

Based on these facts, assuming that the necessary conditions are fulfilled, our advice as consultant to M/s A Ltd. would be to approach the Settlement Commission to have his case settled and apply for grant of immunity from penalty and prosecution.

SIGNIFICANT SELECT CASES

Is an assessee receiving refund consequent to waiver of interest under sections 234A to 234C of the Income-tax Act, 1961 by the Settlement Commission, also entitled to interest on such refund under section 244A?

K. Lakshmansa and Co. v. Commissioner of Income-tax and Anr [2017] 399 ITR 657(SC)

Facts of the case: The assessee had approached the Settlement Commission for waiver of interest under sections 234A to 234C of the Income-tax Act, 1961. The Settlement Commission partially waived the interest but refused to grant interest on refund on the grounds that section 244A does not provide for payment of interest in such cases. Further, the Settlement Commission's power to waive interest does not enable the Commission to provide for payment of interest under section 244A.

The High Court held that since waiver of interest was at the discretion of the Settlement Commission, no right flowed to the assessee to claim refund as a matter of right under law.

Issue: When refund is awarded by the Settlement Commission at its discretion under section 244A, is there a right to receive interest on the same?

Supreme Court's observations: The Supreme Court observed that the right to claim refund is automatic once the statutory provisions have been complied with. The statutory obligation to refund, being non-discretionary, carries with it the right to interest. Section 244A is clear and plain – it grants a substantive right of interest and is not procedural.

Under section 244A, it is enough if the refund becomes due under the Income-tax Act, 1961 in which case the assessee shall, subject to the provisions of that section, be entitled to receive simple interest. The expression "due" only means that a refund becomes due pursuant to an order under the Act which either reduces or waives tax or interest. It does not matter that the interest being waived is discretionary in nature; the moment that discretion is exercised and refund becomes due consequently, a concomitant right to claim interest springs into being in favour of the assessee.

The Supreme Court, thus, did not agree with the High Court opinion that when discretionary power has been exercised, no concomitant right to claim interest on refund arises in favour of the assessee.

Supreme Court's Decision: Overruling the High Court Decision, the Supreme Court held that the assessee has a right to interest on refund under section 244A.

CHAPTER 20

PENALTIES

LEARNING OUTCOMES

After studying this chapter, you would be able to -

❑ **identify and examine** the cases where penalty is leviable;

❑ **determine** the quantum of penalty for defaults under various provisions of the Income-tax Act, 1961;

❑ **list** the conditions to be fulfilled by an assessee for making an application for grant of immunity from penalty and prosecution and the time limit for making such application;

❑ **appreciate** the powers of the Commissioner to waive penalty in certain cases or grant immunity from penalty in certain cases;

❑ **comprehend** the procedure to be complied with for imposing penalty under the Act;

❑ **recall** the limitation period, beyond which penalty cannot be imposed.

20.1 INTRODUCTION

The Income-tax Act, 1961 provides for the imposition of a penalty on an assessee who commits any offence under the provisions of the Act. Penalty is levied over and above the amount of any tax or interest payable by the assessee and thus, penalty is distinct and different from the tax payable. Penalty proceedings, however, are a part of the assessment proceedings. The authority concerned is entitled to levy penalty only if he is satisfied in the course of any proceedings under the Act that a person has been found guilty of any default in complying with the provisions of the Act. If the order of the penalty is set aside in appeal on the ground the assessee was not given a reasonable opportunity of being heard, the Assessing Officer would be entitled to levy a penalty again after rectifying the mistakes in proceedings. The penalty to be levied on an assessee is to be based upon the law as it stood at the time the default was committed and not the law as it stands in the financial year for which the assessment is made.

20.2 PENALTIES

The various sections prescribe the minimum and the maximum penalty that can be levied in certain cases though the Principal Commissioner or Commissioner is empowered to waive or reduce the penalty in some cases. The authority concerned has been given the discretion to levy or not to levy a penalty. But if a penalty is levied, it cannot be less than the prescribed minimum nor can it exceed the maximum amount prescribed by the Act. The quantum of penalty levied by a lower authority can be modified by a higher authority on appeal, reference of revision. The various defaults in respect of which penalty can be levied under the Act are discussed as follows:

Section	Nature of Default	Penalty Leviable	Remarks
221(1)	Default in making payment of tax u/s 220	As directed by Assessing Officer. Total amount of penalty cannot exceed the amount of tax in arrears.	1. This is in addition to arrears and interest payable u/s 220(2) 2. Where the assessee proves to the satisfaction of Assessing Officer that the default was for good and sufficient reasons, no penalty is leviable 3. Even if tax is paid after default, it makes no difference
270A	Under-reporting of income	50% of tax payable on under reported income	See para 20.3

	Where under-reporting of income results from misreporting of income by any person	200% of tax payable on such under-reported income	See para 20.3
271A	Failure to keep or maintain or retain books of account, document etc. as required u/s 44A	₹ 25,000	
271AA	Failure to keep and maintain any information and document as required under sub-section (1) or (2) of section 92D; Failure to report such transaction which he is required to do so; Maintaining or furnishing an incorrect information or document.	2% of the value of each international transaction or specified domestic transaction entered into by such person	
271AAB (1A)	In case of search initiated under section 132 on or after 15.12.2016		
(a)	If undisclosed income is admitted during the course of search in the statement furnished under section 132(4), and the assessee explains the manner in which such income was derived, pays the tax, together with interest if any, in respect of the undisclosed income, and furnishes the return of income for the specified previous year declaring such undisclosed income on or before the specified date (i.e., the due date	30% of undisclosed income	

	of filing return of income or the date on which the period specified in the notice issued under section 153A expires, as the case may be).		
(b)	In any other case	60% of undisclosed income	
271AAC	In a case where income determined includes any income referred to in sections 68, 69, 69A to 69D for any previous year.	Penalty@10% of tax payable under section 115BBE	However, no such penalty would be levied on such income to the extent the same has been included by the assessee in return of income furnished u/s 139 and tax in accordance with section 115BBE has been paid on or before the end of the relevant previous year. The provisions of section 271AAC are not withstanding anything contained in the Income-tax Act, 1961, other than the provisions for levy of penalty under section 271AAB on undisclosed income detected in search cases. No penalty under section 270A for under-reporting of income is leviable in respect of income on which penalty is leviable under this section.
271B	Failure to get accounts audited or obtain audit report under section 44AB or to furnish the report of such auditor with return of income.	½% of total sales, turnover or gross receipts of business/ gross receipts of profession or ₹ 1,50,000, whichever is less.	

271BA	Failure to furnish audit report as required under section 92E	₹ 1,00,000	
271C	Failure to deduct tax at source as per chapter XVII-B or to pay any part of the tax as required by – (i) Section 115-O(2) or (ii) the proviso to section 194B.	A sum equal to the amount of tax which he failed to deduct or pay.	Penalty imposable by Joint Commissioner.
271CA	Failure to collect the whole or any part of the tax as required by or under the provisions of Chapter XVII-BB	A sum equal to the amount of tax which he failed to collect.	Penalty imposable by Joint Commissioner.
271D	Failure to comply with the provisions of section 269SS.	Penalty of a fixed sum equal to amount of loan or deposit or specified sum taken or accepted otherwise than by way of account payee cheque/ bank draft or use of ECS through a bank A/c	Penalty imposable by Joint Commissioner.
271DA	Failure to comply with the provisions of section 269ST	Penalty of sum received in contravention of the provisions of section 269ST i.e., sum of ₹ 2 lakh or more received in aggregate from a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion from a person, otherwise than by an account payee cheque/ bank draft or use of ECS through a bank A/c.	Penalty imposable by Joint Commissioner.

271DB	***Failure to comply with the provisions of section 269SU [w.e.f. 1.11.2019]***	***Penalty of ₹ 5,000 per day of continuing default, if the person who is required to provide facility for accepting payment through the prescribed electronic modes of payment referred to in section 269SU, fails to provide such facility***	***Penalty imposable by Joint Commissioner.*** ***No penalty imposable if the person proves that there were good and sufficient reasons for such failure***
271E	Failure to comply with the provisions of section 269T	A sum equal to the amount of loan or deposit or specified advance repaid otherwise than by an account payee cheque/bank draft or use of ECS through a bank A/c.	Penalty imposable by Joint Commissioner.
271FA	Failure to furnish Statement of financial transaction or reportable account within the time prescribed u/s 285BA(2).	A sum of **₹ 500** for every day during which failure continues.	
	Failure to furnish Statement of financial transaction or reportable account within the time prescribed u/s 285BA(5).	A sum of **₹ 1,000** for every day during which failure continues.	
271FAA	Furnishing inaccurate Statement of financial transaction or reportable account	₹ 50,000	
271FAB	Failure to furnish within the prescribed time, a statement or any information or document as required u/s 9A(5) by an eligible investment fund	₹ 5,00,000	Leviable by the income-tax authority prescribed under section 9A(5)

271G	Failure to furnish information or document under section 92D(3)	2% of the value of the international transaction or specified transaction for each such failure	**Competent Authority to levy penalty:** Assessing Officer/ Transfer Pricing Officer/ Commissioner (Appeals).
271GA	Failure to furnish information or document by an Indian concern under section 285A	2% of the value of the transaction in respect of which such failure has taken place, if such transaction has the effect of directly or indirectly transferring the right of management or control in relation to the Indian concern; ₹ 5,00,000, in any other case.	Penalty imposable by an income-tax authority prescribed under section 285A.
271GB	**Non-furnishing of the report by any reporting entity which is obligated to furnish Country-by-Country report as required under section 286**		For details refer to section 286 discussed in the Chapter on Transfer Pricing
	Period of delay/ default	Penalty	
	Not more than a month	₹ 5,000 per day	
	Beyond one month	₹ 15,000 per day for the period exceeding one month	
	Continuing default even after service of order levying penalty	₹ 50,000 per day of continuing failure beginning from the date of service of order	
	Failure to produce information and documents within prescribed time		
	Failure to produce information before prescribed authority within the period allowed u/s 286(6)	₹ 5,000 per day of continuing failure, from the day immediately following the day on which the period for	

		furnishing the information and document expires.	
	Continuing default even after service of penalty order	₹ 50,000 per day for the period of default beyond the date of service of penalty order.	
	Penalty for submission of inaccurate information in the CBC report	₹ 5,00,000	Penalty would be leviable on the reporting entity, if,- (a) the entity has knowledge of the inaccuracy at the time of furnishing the report but does not 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 notice of the prescribed authority under section 286(6).
271H			**Competent Authority to levy penalty:** Assessing Officer
(a)	Failure to furnish TDS/TCS statements within the prescribed time.	₹ 10,000 to ₹ 1,00,000	No penalty would be leviable if the person proves that after paying tax deducted or collected along with the fee under section 234E and interest, if any, to the credit of the Central Government, he had delivered or caused to be delivered the TDS/TCS statements before the expiry of one year from the time

			prescribed for delivering or causing to be delivered such statements.
(b)	Furnishing incorrect information in the said statements in respect of tax deducted or collected	₹ 10,000 to ₹ 1,00,000	
271-I	Failure to furnish information or furnishing inaccurate information by a person who is required to furnish information under section 195(6)	₹ 1,00,000	
271J	Furnishing of incorrect information in reports or certificates furnished by an accountant, merchant banker or a registered valuer	₹ 10,000 for each such report or certificate	Penalty leviable by Assessing Officer or Commissioner (Appeals) who, in the course of proceedings under the Act, finds that the accountant, merchant banker or registered valuer has furnished incorrect information in reports or certificates
272A(1)	- Refusal to answer questions put by income tax authority - Refusal to sign statements made in the course of income tax proceedings. - Non-compliance with summons issued under section 131(1) to give evidence or produce books of accounts.	₹ 10,000 for each such default or failure	

	- Failure to comply with a notice issued under section 142(1) or section 143(2) or failure to comply with a direction issued under section 142(2A)	→	Penalty imposable by the income-tax authority who had issued the notice or direction after giving the person an opportunity of being heard in the matter.
272A(2)	**Failure:** – To comply with notice u/s 94(6) – To give notice of discontinuance of business/ profession u/s 176(3) – To furnish in due time returns statements mentioned in sections 133, 206, 206C or 285B. – To allow inspection of register referred in section 134 – To furnish returns of income u/s 139(4A)/(4C) – To furnish a certificate as required in section 203 or 206C – To deduct and pay tax u/s 226(2) – To furnish a statement as required by section 192(2C)	₹ 100 for everyday during which default continues. However, the amount of penalty for failure in relation to a declaration u/s197A, a certificate u/s 203 and a returns u/s 206 and 206C and statements u/s 200(2A)/(3) or proviso to section 206C(3)/(3A) shall not exceed the amount of tax deductible or collectible.	Section 272A(3) specifies that for the default committed u/s 272(A)(1) and (2), where the contravention occurs in the course of any proceeding before an income-tax authority not lower in rank than a Joint Director or a Joint Commissioner, penalty can be imposed by such income-tax authority. In any other case, by the Joint Director or the Joint Commissioner. In either case, the penalty order can be passed only after the person concerned is given an opportunity of being heard in the matter.

	– To deliver or cause to be delivered in due time a copy of the declaration referred to in section 206C(1A)		
	– To deliver or cause to be delivered the statements within the time specified in section 206A(1)/ 200(2A)/ 206C(3A)		
	– To deliver or cause to be delivered copy of the declaration u/s 197A	→	Penalty is imposable by the PCC/CC/PC or Commissioner of Income-tax after giving the person an opportunity of being heard in the matter.
272AA	Failure to comply with the provision of section 133B	Any amount upto ₹ 1,000	Penalty imposable by Joint Commissioner/Asst. Director/ Dy. Director/ Assessing Officer after giving the person an opportunity of being heard in the matter.
272B	Failure to comply with the provisions of section 139A	₹ 10,000	Penalty imposable by Assessing Officer No penalty imposable unless the person on whom penalty is to be imposed in given an opportunity of being heard in the matter.
	Failure to quote/ intimate PAN/***Aadhaar No.***[1] in any document referred to in section 139(5)(c) or to intimate such no. as required u/s 139A(5A) or 139A(5C) or quoting/intimating false PAN/***Aadhaar No.***	***₹ 10,000 for each such default***	
w.e.f. 1.9.2019	***Failure to quote PAN/Aadhaar No. in documents referred to in section 139A(6A)***	***₹ 10,000 for each such default***	

[1] Reference to Aadhar no. included w.e.f.1.9.2019

	Failure to authenticate PAN/Aadhaar No. in accordance with section 139A(6A)	***₹ 10,000 for each such default***	Penalty imposable by Assessing Officer No penalty imposable unless the person on whom penalty is to be imposed in given an opportunity of being heard in the matter.
	Failure to ensure that PAN/Aadhaar No. has been - ***- duly quoted in documents relating to transactions referred to in section 139A(5)(c) or 139A(6A); or*** ***- duly authenticated in respect of transactions referred to u/s 139A(6A).***	***₹ 10,000 for each such default***	
272BB	Failure to comply with the provisions of section 203A Quoting false TAN willfully in challans/ certificates/ statements/ other documents referred to in section 203A(2)	₹ 10,000	Penalty imposable by Assessing Officer No penalty imposable unless the person on whom penalty is to be imposed in given an opportunity of being heard in the matter.

20.3 PENALTY LEVIABLE FOR UNDER REPORTING OF INCOME [SECTION 270A]

Upto A.Y. 2016-17, section 271(1)(c) provided for penalty on account of concealment of particulars of income or furnishing inaccurate particulars of income.

For the purpose of ensuring objectivity, certainty and clarity in the penalty provisions, section 270A provides for levy of penalty in cases of under reporting and misreporting of income with effect from A.Y.2017-18. Consequently, the penal provisions under section 271 shall not apply in relation to A.Y.2017-18 and onwards.

(1) **Authorities empowered to levy penalty**: Section 270A(1) empowers the Assessing Officer, Commissioner (Appeals) or the Principal Commissioner or Commissioner to direct levy of penalty, during the course of proceedings under the Income-tax Act, 1961, if a person has under reported his income. Such penalty shall be imposed by an order in writing by such authority.

(2) **Cases of under-reporting of income [Section 270A(2)]**: A person shall be considered to have under reported his income if, A>B in the cases given hereunder–

is greater than

	Case	(A)	(B)
(i)	Return of income has been filed	Income assessed	Income determined in the return processed under section 143(1)(a);
(ii)	No return of income has been filed ***or where return is furnished for the first time u/s 148***	Income assessed	Basic exemption limit
(iii)	Reassessment	Income reassessed	Income assessed or reassessed immediately before such re-assessment
(iv)	Return of income has been filed and assessment/ reassessment is made on the basis of MAT/AMT provisions	The amount of deemed total income assessed or reassessed as per the provisions of section 115JB or 115JC	The deemed total income determined in the return processed u/s 143(1)(a)
(v)	No return of income is filed ***or where return has been furnished for the first time u/s 148*** and assessment/ reassessment is made on the basis of MAT/AMT provisions	the amount of deemed total income assessed as per the provisions of section 115JB or 115JC	The basic exemption limit, in case of an assessee being an individual, HUF, AOP, BOI, in respect of whom the provisions of AMT are applicable.
(vi)	Reassessment as per the provisions of the sections 115JB or 115JC	The amount of deemed total income reassessed as per the provisions of sections 115JB or 115JC	The deemed total income assessed or reassessed immediately before such reassessment.
Further, a person would be considered to have under-reported his income if the income assessed or reassessed has the effect of reducing the loss or converting such loss into income.			

(3) **Calculation of under-reported income in different scenarios [Section 270A(3)]:**

<table>
<tr><th></th><th>Case</th><th>Manner of computation of under-reported income</th></tr>
<tr><td>(i)</td><td>Where return is furnished and assessment is made for the first time.</td><td>Assessed income
(-)
Income determined under section 143(1)(a)
[in case of all persons]</td></tr>
<tr><td>(ii)</td><td>Where no return has been furnished <i>or where return has been furnished for the first time u/s 148</i> and the assessment is made for the first time</td><td><table><tr><th>Person</th><th>Under-reported income</th></tr><tr><td>Company, firm or local authority</td><td>Assessed income</td></tr><tr><td>Other persons</td><td>Assessed income
(-)
Basic exemption limit</td></tr></table></td></tr>
<tr><td>(iii)</td><td>Where income is not assessed for the first time</td><td>Income reassessed or recomputed
(-)
Income assessed or reassessed or recomputed in the order immediately preceding the order during the course of which penalty u/s 270A(1) has been initiated.</td></tr>
<tr><td>(iv)</td><td>Where under reported income arises out of determination of deemed total income in accordance with the provisions of section 115JB or section 115JC</td><td>(A - B) + (C - D)
where,
A = Total income assessed as per the general provisions i.e., provisions other than the provisions contained in section 115JB or section 115JC;
B = The total income that would have been chargeable had the total income assessed as per the general provisions been reduced by the amount of under reported income;
C = The total income assessed as per the provisions contained in section 115JB or section 115JC;
D = The total income 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 under reported income.
However, where the amount of under reported income 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.</td></tr>
</table>

(v)	Where an assessment or reassessment has the effect of reducing the loss declared in the return or converting that loss into income	The loss claimed **(-)** The income or loss, as the case may be, assessed or reassessed.

(4) Meaning of Under-reported income in a case where the source of any receipt, deposit or investment is linked to an earlier year [Section 270A(4) & (5)]:

In a case where the source of any receipt, deposit or investment appearing in the current assessment year is claimed to be an amount added to income or deducted while computing loss, as the case may be, in the assessment of such person in any earlier assessment year and no penalty was levied for such preceding year, under-reported income shall include such amount as is sufficient to cover such receipt, deposit or investment.

***Note** – Such amount shall be deemed to be the amount of income under-reported for the preceding year in the following order –*

(i)	*The preceding year immediately before the year in which the receipt, deposit or investment appears, being the first preceding year; and*
(ii)	*Where the amount added or deducted in the first preceding year is not sufficient to cover the receipt, deposit or investment, the year immediately preceding the first preceding year and so on.*

(5) Cases not included within the scope of under-reported income under section 270A [Section 270A(6)]:

	Case	Condition
(i)	The amount of income in respect of which the assessee offers an explanation	The Assessing Officer/CIT/PC/ Commissioner (Appeals) is satisfied that the explanation is *bona fide* and all the material facts have been disclosed to substantiate the explanation.
(ii)	The amount of under-reported income determined on the basis of an estimate	If the accounts are correct and complete to the satisfaction of the income-tax authority but the method employed is such that the income cannot properly be deduced therefrom
(iii)	The amount of under-reported income determined on the basis of an estimate	If the assessee has, on his own, estimated a lower amount of addition or disallowance on the same issue and has included such amount in the computation of his income and disclosed all the facts material to the addition or disallowance

(iv)	The amount of under-reported income represented by any addition made in conformity with the arm's length price determined by the Transfer Pricing Officer	Where the assessee had maintained information and documents as prescribed under section 92D, declared the international transaction under Chapter X and disclosed all the material facts relating to the transaction
(v)	The amount of undisclosed income on account of a search operation	Where penalty is leviable under section 271AAB in respect of such undisclosed income.

(6) Cases of misreporting of income [Section 270A(9)]:

(i) misrepresentation or suppression of facts;

(ii) failure to record investments in books of account;

(iii) claim of expenditure not substantiated by any evidence;

(iv) recording of any false entry in books of account;

(v) failure to record any receipt in books of account having a bearing on total income; and

(vi) failure to report any international transaction or deemed international transaction or specified domestic transaction under Chapter X.

(7) Quantum of penalty leviable:

	Section	Case	Penalty
(i)	270A(7)	Under reporting of income	50% of tax payable on under-reported income
(ii)	270A(8)	Where under reporting of income results from misreporting of income by any person.	200% of tax payable on such under-reported income

(8) Manner of computation of tax payable on under-reported income [Section 270A(10)]:

	Case	Manner of computation of tax payable on under-reported income
(i)	Where no return of income has been furnished ***or where return has been furnished for the first time u/s 148*** and the income has been assessed for the first time	The tax payable on under-reported income shall be the amount of tax calculated on the under-reported income as increased by the basic exemption limit as if it were the total income.
(ii)	Where the total income determined u/s 143(1)(a) or assessed or reassessed or recomputed in a preceding order is a loss	The tax payable in respect of the under-reported income shall be the amount of tax calculated on the under-reported income as if it were the total income.

(iii)	In any other case	The amount of tax calculated on the under-reported income as increased by the total income determined under section 143(1)(a) or total income assessed, reassessed or recomputed in a preceding order as if it were the total income ***Minus*** The amount of tax calculated on the total income determined under section 143(1)(a) or total income assessed, reassessed or recomputed in a preceding order.

(9) No addition or disallowance of an amount shall form the basis for imposition of penalty, if such addition or disallowance has formed the basis of imposition of penalty in the case of the person for the same or any other assessment year [Section 270A(11)].

(10) **Consequential amendments in other provisions:**

Consequential amendments have been made in sections 119, 253, 271A, 271AA, 271AAB, 273A, 276C and 279 to provide reference to section 270A.

	Section	Provision	Amendment
(i)	119(2)(a)	Power of CBDT to relax certain provisions, by way of a general or special order, for the purpose of proper and efficient management of the work of assessment and collection of revenue.	The CBDT has been empowered to relax the provisions for levy of penalty section 270A also.
(ii)	253(1)	Enlists the orders appealable to the Appellate Tribunal.	The order passed by the Commissioner (Appeals), Principal Commissioner or Commissioner under section 270A would also be appealable to the Appellate Tribunal.
(iii)	271A	Levy of penalty of ₹ 25,000 for failure to keep, maintain or retain books of account as required under section 44AA.	The penalty under this section would be without prejudice to the provisions of section 270A.
(iv)	271AA	Levy of penalty of 2% of value of international transaction or specified domestic transaction, where the person fails to maintain information and documents required u/s 92D or report such transaction or maintains or	The penalty under this section would be without prejudice to the provisions of section 270A.

		furnishes an incorrect information or document.	
(v)	271AAB	Levy of penalty where search is initiated under section 132 on or after 15.12.2016.	No penalty under section 270A would be imposable in respect of undisclosed income on which penalty has been levied under section 271AAB(1A).
(vi)	273A(1)	Power of Principal Commissioner or Commissioner to reduce or waive penalty in certain cases.	Reduction or waiver of penalty imposable on a person u/s 270A, if prior to detection by the Assessing Officer, the person has voluntarily and in good faith made full and true disclosure of particulars of income i.e., where the excess of income assessed over the income returned is of such a nature as not to attract the penal provisions u/s 270A.
(vii)	273A(2)	Order reducing or waiving penalty under section 273A(1) to be made by the PC/CIT only with the previous approval of the PCC/CC/PDG/DG, as the case may be.	Previous approval of higher authorities also required if, in a case falling u/s 270A, the amount of income in respect of which the penalty is imposed or imposable for the relevant A.Y., or where such disclosure relates to more than one A.Y., the aggregate amount of such income for those years exceed ₹ 5 lakh.
(viii)	276C	Prosecution to be instituted if a person willfully attempts in any manner to evade any tax, penalty or interest chargeable or imposable under the Income-tax Act, 1961.	Prosecution to also be instituted if a person under-reports his income under the Income-tax Act, 1961
		Rigorous imprisonment for a period of 6 months to 7 years and fine would be attracted in a case where the amount sought to be evaded exceeds ₹ 25 lakhs.	Rigorous imprisonment for a period of 6 months to 7 years and fine would also be attracted in a case where the tax on under-reported income exceeds ₹ 25 lakhs.
(ix)	279(1A)	Prosecution not to be instituted against a person u/s 276C or 277 in relation to the assessment for an assessment year in respect of which penalty imposed or imposable u/s 271(1)(iii) has been reduced or waived by an order u/s 273A.	Prosecution not to be instituted against a person u/s 276C or 277 in relation to the assessment for an AY in respect of which penalty imposed or imposable u/s 270A or u/s 271(1)(iii) has been reduced or waived by an order u/s 273A.

ILLUSTRATION 1

M/s. XYZ is a firm liable to tax@30%. The following are the particulars furnished by the firm for A.Y.2020-21:

	Particulars of total income	₹
(1)	*As per the return of income furnished u/s 139(1)*	*50,00,000*
(2)	*Determined under section 143(1)(a)*	*60,00,000*
(3)	*Assessed under section 143(3)*	*75,00,000*
(4)	*Reassessed under section 147*	*95,00,000*

Can penalty be levied u/s 270A on M/s. XYZ? If the answer is in the affirmative, compute the penalty leviable u/s 270A.

SOLUTION

M/s. XYZ is deemed to have under-reported its income since:

(1) its income assessed u/s 143(3) exceeds its income determined in a return processed u/s 143(1)(a); and

(2) the income reassessed under section 147 exceeds the income assessed u/s 143(3).

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3) Under-reported income:		
Total income assessed under section 143(3)	75,00,000	
(-) Total income determined u/s 143(1)(a)	60,00,000	
	15,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of ₹ 15 lakhs *plus* tax on total income of ₹ 60 lakhs determined u/s 143(1)(a) ***[30% of ₹ 75 lakh + HEC@4%]***	23,40,000	
Less: Tax on total income determined u/s 143(1)(a) ***[30% of ₹ 60 lakh +HEC@4%]***	18,72,000	
	4,68,000	
Penalty leviable@50% of tax payable		2,34,000
Reassessment under section 147 Under-reported income:		
Total income reassessed under section 147	95,00,000	
(-) Total income assessed under section 143(3)	75,00,000	
	20,00,000	

Tax payable on under-reported income:		
Tax on under-reported income of ₹ 20 lakhs *plus* tax on total income of ₹ 75 lakhs assessed u/s 143(3) ***[30% of ₹ 95 lakh + HEC@4%]***	29,64,000	
Less: Tax on total income assessed u/s 143(3) ***[30% of ₹ 75 lakh + HEC@4%]***	23,40,000	
	6,24,000	
Penalty leviable@50% of tax payable		3,12,000

Note – *The following assumptions have been made -*

(1) *None of the additions or disallowances made in assessment or reassessment qualifies under section 270A(6); and*

(2) *The under-re*ported income is not on account of misreporting.

ILLUSTRATION 2

Mr. Ram, a resident individual of the age of 55 years, has not furnished his return of income for A.Y.2020-21. However, the total income assessed in respect of such year under section 144 is ₹ 12 lakh. Is penalty u/s 270A attracted in this case, and if so, what is the quantum of penalty leviable?

SOLUTION

Mr. Ram is deemed to have under-reported his income since he has not filed his return of income and his assessed income exceeds the basic exemption limit of ₹ 2,50,000. Hence, penalty under section 270A is leviable in his case.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 144		
Under-reported income:		
Total income assessed under section 144	12,00,000	
(-) Basic exemption limit	2,50,000	
	9,50,000	
Tax payable on under-reported income as increased by the basic exemption limit [30% of ₹ 2 lakhs + ₹ 1,12,500]	1,72,500	
Add: HEC@4%	6,900	
	1,79,400	
Penalty leviable@50% of tax payable		89,700

Note – *It is assumed that the under-reported income is not on account of misreporting.*

ILLUSTRATION 3

ABC Ltd. is a domestic company liable to tax@25%. The following are the particulars furnished by the company for A.Y.2020-21:

	Particulars of total income	₹
(1)	*As per the return of income furnished u/s 139(1)*	*(15,00,000)*
(2)	*Determined under section 143(1)(a)*	*(8,00,000)*
(3)	*Assessed under section 143(3)*	*(5,00,000)*
(4)	*Reassessed under section 147*	*4,00,000*

Is penalty leviable under section 270A on ABC Ltd., and if so, what is the quantum of penalty?

SOLUTION

ABC Ltd. is deemed to have under-reported its income since:

(1) the assessment u/s 143(3) has the effect of reducing the loss determined in a return processed u/s 143(1)(a); and

(2) the reassessment u/s 147 has the effect of converting the loss assessed u/s 143(3) into income.

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3) Under-reported income:		
Loss assessed u/s 143(3)	(5,00,000)	
(-) Loss determined under section 143(1)(a)	(8,00,000)	
	3,00,000	
Tax payable on under-reported income@25%	75,000	
Add: HEC@4%	3,000	
	78,000	
Penalty leviable@50% of tax payable		39,000
Reassessment under section 147 Under-reported income:		
Total income reassessed under section 147	4,00,000	
(-) Loss assessed under section 143(3)	(5,00,000)	
	9,00,000	
Tax payable on under-reported income@25%	2,25,000	
Add: HEC@4%	9,000	
	2,34,000	
Penalty leviable@50% of tax payable		1,17,000

***Notes** – The following assumptions have been made -*

(1) None of the additions or disallowances made in assessment or reassessment qualifies u/s 270A(6); and

(2) The under-reported income is not on account of misreporting.

20.4 IMMUNITY FROM IMPOSITION OF PENALTY AND PROSECUTION [SECTION 270AA]

(1) **Application to be made by the assessee to Assessing Officer for grant of immunity from penalty and prosecution [Section 270AA(1)]**

An assessee may make an application to the Assessing Officer for grant of immunity from imposition of penalty under section 270A and initiation of proceedings under section 276C or section 276CC, if he -

(i) **pays the tax and interest payable** as per the order of assessment under section 143(3) or reassessment under section 147, within the period specified in such notice of demand; and

(ii) **does not prefer an appeal** against such assessment/ reassessment order.

(2) **Time limit for making application [Section 270AA(2)]**

The assessee can make such application in the prescribed form and verified in the prescribed manner **within one month from the end of the month** in which the order of assessment or reassessment is received

(3) **Circumstances in which the Assessing Officer cannot grant immunity from penalty and prosecution [Section 270AA(3)]**

The Assessing Officer shall grant immunity from initiation of penalty under section 270A and prosecution under section 276C or section 276CC, on fulfilment of the conditions specified in (1) above, and after the expiry of period of filing appeal as specified in section 249(2)(b).

However, immunity shall be granted by the Assessing Officer only if the penalty proceedings under section 270A have not been initiated on account of the following, namely:—

(a) misrepresentation or suppression of facts;

(b) failure to record investments in the books of account;

(c) claim of expenditure not substantiated by any evidence;

(d) recording of any false entry in the books of account;

(e) failure to record any receipt in books of account having a bearing on total income; or

(f) failure to report any international transaction or any transaction deemed to be an international transaction or any specified domestic transaction to which the provisions of Chapter X apply.

(4) **Time limit for passing order accepting or rejecting application for immunity from penalty and prosecution [Section 270AA(4)]**

The Assessing Officer shall pass an order accepting or rejecting the application for immunity from penalty under section 270A or prosecution under section 276C or section 276CC within a period of **one month from the end of the month in which such application is received**. However, in the interest of natural justice, no order rejecting the application shall be passed by the Assessing Officer **unless the assessee has been given an opportunity of being heard**.

(5) **Finality of order passed by the Assessing Officer under section 270AA(4) [Section 270AA(5)]**

The order of the Assessing Officer passed under section 270AA(4) accepting or rejecting the application made by the assessee for immunity from penalty under section 270A or prosecution under section 276C or section 276CC shall be final.

(6) **Order of assessment/reassessment, in respect of which application for immunity is accepted, is neither appealable before Commissioner (Appeals) nor can the same be admitted by Commissioner for revision under section 264 [Section 270AA(6)]**

No appeal under section 246A or an application for revision under section 264 shall be admissible against the order of assessment or reassessment referred to in section 270AA(1)(a), in a case where an order under section 270AA(4) has been made accepting the application.

(7) **Exclusion of period when application for immunity is pending before Assessing Officer from the time limit for filing of appeal before Commissioner (Appeals), in a case where such application is rejected [Second Proviso to section 249(2)(b)]**

As per section 249(2)(b), an appeal before the Commissioner (Appeals) is to be made within 30 days of the receipt of the notice of demand relating to an assessment or penalty, where the appeal relates to such assessment or penalty.

In a case where the assessee makes an application under section 270AA seeking immunity from penalty, then, the following period has to be excluded for calculation of the aforesaid thirty day period –

Exclusion of period	
beginning from	**ending with**
the date on which application under section 270AA for immunity from penalty under section 270A is made	the date on which the order rejecting the application is served on the assessee.

20.5 PENAL PROVISIONS ON UNDISCLOSED INCOME FOUND DURING THE COURSE OF SEARCH [SECTION 271AAB]

(1) **Penalty where search is initiated on or after 15.12.2016:** Section 271AAB(1A) provides for penalty in cases where search has been initiated on or after 15th December, 2016, being the date on which the Taxation Laws (Second Amendment) Act, 2016 received the assent of the President.

Accordingly, under section 271AAB, the following would be the rate of penalty on undisclosed income in each of the following circumstances:

	Circumstance	Rate of penalty
(1)	**(2)**	**(3)**
(1)	If undisclosed income is admitted during the course of search in the statement furnished under section 132(4), and the assessee explains the manner in which such income was derived, pays the tax, together with interest if any, in respect of the undisclosed income, and furnishes the return of income for the specified previous year declaring such undisclosed income on or before the specified date (i.e., the due date of filing return of income or the date on which the period specified in the notice issued under section 153A expires, as the case may be).	30%
(2)	In all other cases	60%

(2) **Meaning of Undisclosed income:** Undisclosed income, for the purpose of this section, means:

(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 Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or 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.

(3) **Other points:**

(a) No penalty under section 270A is leviable in respect of such undisclosed income.

(b) An order imposing penalty under section 271AAB would be appealable under section 246A before the Commissioner (Appeals).

(c) Section 274 providing for the procedure for imposing penalties and section 275 providing for a bar of limitation for imposing penalties, shall, to the extent relevant apply to penalty under section 271AAB.

20.6 COMMENCEMENT OF LIMITATION FOR PENALTY PROCEEDINGS UNDER SECTIONS 271D AND 271E [CIRCULAR NO.9/2016 DATED 26.4.2016]

There are conflicting interpretations of various High Courts on the issue whether the limitation for imposition of penalty under sections 271D and 271E commences at the level of the Assessing Officer (below the rank of Joint Commissioner of Income-tax) or at level of the Range authority i.e., the Joint Commissioner of Income-tax/Additional Commissioner of Income-tax.

The Kerala High Court, in *Grihalaxmi Vision v. Addl. CIT*, observed that the question to be considered is whether proceedings for levy of penalty are initiated with the passing of the order of assessment by the Assessing Officer or whether such proceedings have commenced with the issuance of the notice by the Joint Commissioner. From the statutory provisions, it is clear that the competent authority to levy penalty is the Joint Commissioner. Therefore, only the Joint Commissioner can initiate proceedings for levy of penalty. Such initiation of proceedings could not have been done by the Assessing Officer. The statement in the assessment order that the proceedings under section 271D and 271E are initiated is inconsequential. On the other hand, if the assessment order is taken as the initiation of penalty proceedings, such initiation is by an authority who is incompetent and the proceedings thereafter would be proceedings without jurisdiction. If that be so, the initiation of the penalty proceedings is only with the issuance of the notice by the Joint Commissioner to the assessee to which he has filed his reply.

The CBDT Circular clarifies that the above judgement reflects the "Departmental View". Accordingly, the Assessing Officers (below the rank of Joint Commissioner of income-tax) have to make a reference to the Range Head, regarding any violation of the provisions of section 269SS and section 269T, as the case may be, in the course of the assessment proceedings (or any other proceedings under the Act). The Assessing Officer (below the rank of Joint Commissioner of Income-tax) shall not issue the notice in this regard. The Range Head will issue the penalty notice and shall dispose/complete the proceedings within the limitation prescribed under section 275(1)(c).

The Circular further clarifies that where any High Court decides this issue contrary to the "Departmental View", the "Departmental View" thereon shall not be operative in the area falling in the jurisdiction of the relevant High Court. However, the CCIT concerned should immediately bring the judgment to the notice of the Central Technical Committee (CTC). The CTC shall examine the said judgment on priority to decide as to whether filing of SLP to the Supreme Court will be adequate response for the time being or some legislative amendment is called for.

20.7 LIMITATION FOR PENALTY PROCEEDINGS UNDER SECTION 271D AND 271E – WHETHER TO BE DETERMINED U/S 275(1)(A) OR U/S 275(1)(C) [CIRCULAR NO.10/2016 DATED 26.4.2016]

The issue whether the limitation for imposition of penalty under sections 271D and 271E, is determined under section 275(1)(a) or section 275(1)(c), has given rise to considerable litigation.

The Delhi High Court, in *CIT v. Worldwide Township Projects Ltd*., has considered this issue and observed that is well settled that a penalty under this provision is independent of the assessment. The action inviting imposition of penalty is granting of loans above the prescribed limit otherwise than through banking channels and as such infringement of section 269SS is not related to the income that may be assessed or finally adjudicated. In this view, section 275(1)(a) would not be applicable and the provisions of section 275(1)(c) would be attracted. The judgment has been accepted by the CBDT.

In view of the above, it is a settled position that the period of limitation of penalty proceedings under section 271D and section 271E is governed by the provisions of section 275(1)(c). Therefore, the limitation period for the imposition of penalty under these provisions would be the expiry of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed, or six months from the end of the month in which action for imposition of penalty is initiated, whichever period expires later. The limitation period is not dependent on the pendency of appeal against the assessment or other order referred to in section 275(1)(a).

20.8 PENALTY FOR FAILURE TO FURNISH STATEMENT OF FINANCIAL TRANSACTION OR REPORTABLE ACCOUNT [SECTION 271FA]

Section 271FA provides that if a person who is required to furnish a statement of financial transaction or reportable account, as required under section 285BA(1), fails to furnish such statement within the time prescribed under section 285BA(2), the prescribed income-tax authority [i.e., Director of Income-tax (Central Information Branch)] may direct that such person shall pay, by way of penalty, a sum of **₹ 500** for every day during which the failure continues.

Further, where such person fails to furnish the statement of financial transaction or reportable account within the period specified in the notice under section 285BA(5), he shall pay, by way of penalty, a sum of ₹ 1,000 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.

The penal provisions under section 271FA are summarized below -

Non-compliance of section	Penalty under section 271FA	Period
285BA(1)	₹ 500 per day of continuing default	1st June immediately following the financial year in which the transaction is registered or recorded till the date of furnishing the statement of financial transaction or reportable account or the date of expiry of the time specified in the notice under section 285BA(5), whichever is earlier.
285BA(5)	₹ 1,000 per day of continuing default	The day immediately following the day on which the time specified in notice under section 285BA(5) for furnishing the statement expires till the date of furnishing of statement.

ILLUSTRATION 4

A private bank has not filed its statement of financial transaction or reportable account in relation to the specified financial transactions for the financial year 2019-20. A notice was issued by the prescribed income-tax authority on 1st October, 2020 requiring the bank to furnish the statement by 31st October, 2020. The bank, however, furnished the statement only on 15th November, 2020. What would be the penalty leviable under section 271FA?

SOLUTION

(1)	(2)	(3)	(4)	
Non-compliance of section	Penalty under section 271FA	Period	Quantum of penalty under section 271FA	
			(2) × (3)	(₹)
285BA(1)	₹ 500 per day of continuing default	1.6.2020 to 31.10.2020	153 days × ₹ 500	76,500
285BA(5)	₹ 1,000 per day of continuing default	1.11.2020 to 15.11.2020	15 days × ₹ 1,000	15,000
				91,500

20.9 PENALTY FOR FURNISHING INACCURATE STATEMENT OF FINANCIAL TRANSACTION OR REPORTABLE ACCOUNT [SECTION 271FAA]

Section 271FAA provides for levy of penalty in case of ***a person referred to in section 285BA(1)***[2] who is required to furnish a statement of financial transaction or reportable account, where such person provides inaccurate information in the statement.

In such a case, the prescribed income-tax authority may direct levy of penalty of ₹ 50,000, subject to further satisfaction of any one of the following conditions –

(1) The inaccuracy is due to a failure to comply with the due diligence requirement prescribed under section 285BA(7) or is deliberate on the part of that person; or

(2) The person is aware of the inaccuracy at the time of furnishing the statement of financial transaction or reportable account, but does not inform the prescribed income-tax authority or such other authority or agency; or

(3) The person discovers the inaccuracy after furnishing the statement of financial transaction or reportable account but fails to inform and furnish correct information within ten days, being the time specified under section 285BA(6).

20.10 PENALTY NOT LEVIABLE IN CERTAIN CASES [SECTION 273B]

No penalty is leviable under sections 271A, 271AA, 271B, 271BA, 271C, 271CA, 271D, 271E, 271FA, 271FAB, 271G, 271GA, 271GB, 271H, 271-I, 271J, 272A(1)(c) or 272(A)(1)(d), 272A(2), 272AA(1), 272B, 272BB(1)/(1A), if the assessee proves that there was reasonable cause for the said failure.

20.11 PROCEDURE FOR ASSESSMENT OF PENALTIES [SECTION 274]

Section 274 provides that no order imposing a penalty shall be made

- by Income-tax Officer, where the penalty exceeds ₹ 10,000
- by Assistant Commissioner or Deputy Commissioner, where the penalty exceeds ₹ 25,000

except with the prior approval of the Joint Commissioner.

[2] *w.e.f. 1.9.2019, penalty u/s 271FAA is attracted in case of default by any person referred to in section 285BA(1) who is required to file a statement of financial transaction or reportable account. Prior to 1.9.2019, penalty u/s 271FAA was attracted only in case of default by a person, being a prescribed reporting financial institution referred to in clause (k) of section 285BA(1).*

In all cases before a penalty is imposed, the assessee should be given a reasonable opportunity of being heard.

Further, where the authority imposing penalty is not the Assessing Officer, a copy of the penalty order should be sent to the Assessing Officer.

20.12 REDUCTION OR WAIVER OF PENALTY [SECTION 273A]

(1) Power to reduce/ waive penalty under section 270A

(a) **Exercise of** p**ower to reduce/waive penalty under section 270A** - Section 273A(1) authorises the Principal Commissioner or Commissioner of Income-tax to reduce or waive the amount of penalty imposed or imposable on a person under section 270A. The exercise of this power by the Principal Commissioner or Commissioner is purely at his discretion and may be done either on his own motion or otherwise, that is on receipt of an application from the assessee.

(b) **Conditions to be satisfied -** The Principal Commissioner or Commissioner can reduce or waive the penalty payable by any person only if the following conditions are satisfied:

(i) **Full and true disclosure -** The reduction or waiver by the Principal Commissioner or Commissioner would be permissible only, if, prior to the detection of the concealment of income by the Assessing Officer, the assessee has made a full and true disclosure of all the particulars in respect of his income and, that, too voluntarily and in good faith.

For this purpose, a person would be deemed to have made a full and true disclosure of his income or of all 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 imposition of any penalty under section 270A.

(ii) **Co-operation in enquiry -** It is essential that the assessee must have co-operated with the department in any enquiry relating to the assessment of his income

(iii) **Payment of tax or interest -** He must also have either paid or made satisfactory arrangements for the payment of any tax or interest, which may become payable in consequence of any order passed under the Income-tax Act, 1961 in respect of the assessment year.

(c) **Prior approval of higher authorities required in certain cases -** If, in a case falling under section 270A, 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 ₹ 5,00,000, the Principal Commissioner or Commissioner of Income-tax can exercise his power to reduce or waive penalty, only after getting the previous approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General.

(d) **Relief available only once in life time -** Where an order has been made under section 273A(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.

(2) Power to reduce/ waive any penalty

(a) **Exercise of power to reduce/ waive any penalty** - Section 273A(4) authorises the Principal Commissioner or Commissioner of Income-tax, without prejudice to the powers conferred on him by any other provision of the Act, to reduce or waive the amount of any penalty payable by the assessee. The Principal Commissioner or Commissioner may exercise this power on an application made by the assessee, after recording his reason in writing for so doing. He is also empowered to stay or compound any proceedings for the recovery of any penalty in cases where he is satisfied that:

(i) to do otherwise would cause genuine hardship to the assessee having due regard to all the facts and circumstances of the case; and

(ii) the assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

(b) **Prior approval of higher authorities required in certain cases -** In case the quantum of bpenalty exceeds ₹ 1 lakh or the application relates to more than one penalty and the aggregate amount of such penalties exceeds ₹ 1 lakh, the Principal Commissioner or Commissioner can grant relief only with the previous approval of the Principal Chief Commissioner or Chief Commissioner or the Principal Director General or Director General, as the case may be.

(3) **Finality of order**

The Principal Commissioner or Commissioner's order under section 273A for reduction or waiver of penalty is final and cannot be challenged in any court or before any authority.

20.13 POWER OF PRINCIPAL COMMISSIONER OR COMMISSIONER TO GRANT IMMUNITY FROM PENALTY [SECTION 273AA]

Section 273AA empowers the Principal Commissioner or Commissioner to grant immunity from penalty.

(1) **Eligible applicant** - The application for the immunity has to be made by the assessee

(person whose case has been abated under section 245HA) to the Principal Commissioner or Commissioner of Income-tax.

(2) **Time within which application for immunity can be made** - Where penalty was levied before or during the pendency of settlement proceedings, then the assessee can approach the Principal Commissioner or Commissioner for immunity at any time.

However, if no penalty was levied till the time of abatement of proceedings before Settlement Commission, then the assessee must make an application for immunity before the imposition of penalty by the Income-tax authority.

(3) **Grant of immunity subject to satisfaction of conditions** - The Principal Commissioner or Commissioner can grant immunity, subject to such conditions as he may think fit to impose, on being satisfied that the assessee has –

(i) co-operated in the proceedings after abatement; and

(ii) made a full and true disclosure of his income and the manner in which such income has been derived.

(4) **Withdrawal of immunity: Circumstances** -

(a) The immunity granted shall stand withdrawn, if such assessee fails to comply with any condition subject to which the immunity was granted.

(b) The immunity granted to a person may, at any time, be withdrawn by the Principal Commissioner or Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement,

(i) concealed any particulars material to the assessment from the income-tax authority; or

(ii) given false evidence.

Consequently, such person would become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

20.14 TIME LIMIT FOR PASSING AN ORDER FOR WAIVER OF INTEREST AND PENALTY [SECTIONS 220(2A), 273A, 273AA]

The time limit within which the order for waiver of interest and penalty has to be passed by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner of Income-tax, as the case may be is as given hereunder. Further, no order rejecting the application of the assessee, either in full or in part, under section 220 or 273A(4), 273AA shall be passed without giving the assessee an opportunity of being heard.

	Section	Powers of Principal Commissioner/CIT	Time limit
(1)	220(2A)	To reduce or waive the amount of interest paid or payable section 220(2). ***Note** – Section 220(1) requires payment of amount specified in the notice of demand under section 156 within 30 days of service of notice. In case of default, interest is leviable @1% per month or part of the month under section 220(2) for the period during which the default continues.*	An order accepting or rejecting application of an assessee in full or part has to be passed within a period of **12 months from the end of the month in which such application is received by the PCC/ CC/ PC or CIT**.
(2)	273A(4A)	To reduce or waive the amount of any penalty payable by an assessee or stay or compound any proceeding for recovery of the penalty amount in certain circumstances, on an application made by the assessee in this behalf.	An order accepting or rejecting application of an assessee in full or part has to be passed within a period of **12 months from the end of the month in which such application is received by the PC or CIT**.
(3)	273AA	To grant immunity from penalty, if penalty proceedings have been initiated in case of a person who has made application for settlement before the Settlement Commission and the proceedings for settlement had abated under the circumstances contained in section 245HA.	

20.15 TIME LIMIT FOR IMPOSITION OF PENALTY [SECTION 275]

Section 275(1) provides the time limit for imposing penalty under Chapter XXI of the Income-tax Act, 1961, as under –

Section	Circumstance	Time limit for passing penalty order
275(1)(a)	Where the relevant assessment or other order is the subject matter of an appeal to the Commissioner (Appeals) under section 246 or section 246A, and the Commissioner (Appeals) passes the order on or after 1st June, 2003 disposing of such appeal,	An order imposing penalty shall be passed– (a) **before the expiry of the financial year** in which the proceedings, in the course of which action for imposition of penalty has been initiated, are completed; or (b) within **one year from the end of the financial year** in which the order of the Commissioner (Appeals) is received by the Principal Chief Commissioner or Chief Commissioner or Principal

		Commissioner or Commissioner, whichever is later.
(b)	Where the relevant assessment or other order is the subject matter of revision under section 263 or section 264	An order imposing penalty shall not be passed after the expiry **of six months** from the end of the month in which such order of revision is passed
(c)	In any other case	An order imposing penalty shall not be passed (a) **after the expiry of the financial year** in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed, or (b) **six months from the end of the month** in which action for imposition of penalty is initiated **whichever period expires later**
275(1A)	Sub-section (1A) facilitates the revision of an order for the imposition of penalty or dropping the proceedings for the imposition of penalty, on the basis of subsequent revision of assessment by Commissioner (Appeals) or Appellate Tribunal or High Court or Supreme Court or by the Principal Commissioner or Commissioner under section 263 or section 264. In a case where the relevant assessment or other order is the subject-matter of - (1) an appeal to the Commissioner (Appeals) under section 246 or section 246A; or (2) an appeal to the Appellate Tribunal under section 253; or (3) an appeal to the High Court under section 260A; or (4) an appeal to the Supreme	(1) An order imposing or enhancing or reducing penalty or dropping the proceedings for the imposition of penalty may be passed on the basis of assessment as revised by giving effect to such order of the Commissioner (Appeals) or, the Appellate Tribunal or, the High Court, or the Supreme Court or order of revision under section 263 or 264. A revision order under this sub-section can again be revised under this sub-section. (2) No such order can be passed after the expiry of six months from the end of the month in which - (i) the order of the Commissioner (Appeals) or the Appellate Tribunal or the High Court or the Supreme Court is received by the Principal Chief Commissioner or Chief Commissioner or the Principal Commissioner or Commissioner; or (ii) the order of revision under section 263 or section 264 is passed. **Note:** (1) No such order imposing or enhancing or

	Court under section 261; or (5) revision under section 263 or section 264 and an order imposing or enhancing or reducing penalty or dropping the proceedings for the imposition of penalty is passed before the order of the Commissioner (Appeals) or the Appellate Tribunal or the High Court or the Supreme Court is received by the Principal Chief Commissioner or Chief Commissioner or the Principal Commissioner or Commissioner, or the order of revision under section 263 or 264 is passed.	reducing or canceling penalty or dropping the proceedings shall be passed without hearing the assessee or giving him a reasonable opportunity of being heard. (2) The provisions of section 274(2) shall apply in respect of such order imposing or enhancing or reducing penalty. **Note** - *Section 274(2) provides that for passing an order imposing penalty exceeding ₹ 10,000, the Income-tax authority has to take the prior approval of the Joint Commissioner. Also, for passing an order imposing penalty exceeding ₹ 20,000, the Assistant Commissioner or the Deputy Commissioner should take the prior approval of the Joint Commissioner.*

Note - *In computing the period of limitation, the time taken to give the assessee a reasonable opportunity of being heard or reheard under section 129 and any period during which he proceedings for the levy of the penalty are stayed by an order or injunction of the Court or any period during which the immunity granted under section 245H received in force will be excluded.*

EXERCISE

Question 1

A search under section 132 was initiated in the premises of Mr. X on 30.4.2019 and undisclosed money and jewellery belonging to Mr. X was found in his premises. Examine the penal provisions under the Income-tax Act which are attracted in this case, assuming that the undisclosed assets were acquired out of his undisclosed income of previous year 2019-20.

Answer

In order to deter the practice of non-disclosure of income, section 271AAB(1A) provides for levy of penalty on undisclosed income found during the course of a search, which relates to specified previous year, i.e.-

- the previous year which has ended before the date of search, but the due date of filing return of income for the same has not expired before the date of search and the return has not yet been furnished (P.Y. 2018-19);
- the previous year in which search is conducted (P.Y. 2019-20).

Accordingly, under section 271AAB(1A), in respect of searches initiated on or after 15.12.2016,

- penalty@30% would be attracted, if undisclosed income is admitted during the course of search in the statement furnished under section 132(4), and the assessee explains the manner in which such income was derived, pays the tax, together with interest if any, in respect of the undisclosed income, and furnishes the return of income for the specified previous year declaring such undisclosed income on or before the specified date (i.e., the due date of filing return of income or the date on which the period specified in the notice issued under section 153A expires, as the case may be).
- In all other cases, penalty @60% of undisclosed income would be attracted.

Question 2

What is the quantum of penalty that could be levied in each of the following cases -

(i) Failure to get books of accounts audited as required under section 44AB within the time prescribed under the Act.

(ii) Failure to comply with a direction issued under section 142(2A).

(iii) Failure to furnish report from an accountant as required under section 92E.

Answer

The penalty that could be levied in each case is:

(i) **Failure to get books of accounts audited as required under section 44AB of the Income-tax Act, 1961 -** a sum equal to ½% of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years, or a sum of ₹ 1,50,000, whichever is less [Section 271B].

(ii) **Failure to comply with a direction issued under section 142(2A) –** a sum of ₹ 10,000 [Section 272A(1)(d)].

(iii) **Failure to furnish report from an accountant as required by section 92E -** a sum of ₹ 1,00,000 [Section 271BA].

Question 3

X, an individual whose total sales in the business of food grains for the year ending 31.3.2020 was ₹ 205 lakhs, did not maintain books of account for P.Y.2019-20, even though his turnover was ₹ 28 lakhs in the P.Y.2018-19. The Assessing Officer levied penalty of ₹ 25,000 under section 271A for non-maintenance of books of account and penalty of ₹ 1,02,500 under section 271B for not getting the books audited as required by section 44AB. Is the Assessing Officer justified in levying penalty under section 271B?

Answer

X is required to maintain books of account as per section 44AA for the P.Y.2019-20 since his turnover exceeded ₹ 25 lakhs in the P.Y.2018-19. He also has to get them audited under section 44AB, since his gross sales in the P.Y.2019-20 exceeds ₹ 1 crore. He is liable to pay penalty under section 271A for not maintaining his books of account as per section 44AA. Accordingly, the action of the Assessing Officer in levying penalty of ₹ 25,000 under section 271A is correct. However, where books of account have not been maintained, there cannot be a question of getting them audited. Audit of books of account presupposes maintenance of books of account. When admittedly X has not maintained books, he cannot obviously get the audit done.

In *Surajmal Parsuram Todi v. CIT (1996) 222 ITR 691*, the Gauhati High Court has held that when a person commits an offence by not maintaining books of accounts as contemplated by section 44AA, the offence is complete and after that there can be no possibility of any offence as contemplated by section 44AB and, therefore, the imposition of penalty under section 271B is erroneous.

Therefore, in this case, the Assessing Officer is not justified in levying penalty under section 271B.

Question 4

State the conditions, if any, to be satisfied by an assessee in order to get relief under section 273A(4) regarding the waiver of penalty. Can the Principal Commissioner or Commissioner refuse to grant relief, when the conditions laid down in the section was complied with, by the assessee?

Answer

There are two conditions to be satisfied by an assessee in order to get relief in the form of a waiver or reduction of penalty by the Principal Commissioner or Commissioner of Income-tax under section 273A(4) of the Act. These conditions are:

(i) The payment of penalty would cause "genuine hardship" to the assessee and the Commissioner is satisfied about the existence of genuine hardship having regard to the circumstances of the case. The existence of genuine hardship would entitle the assessee to relief. The CBDT in its *Circular No 784 dated 22-11-1999* has clarified that “genuine hardship” referred to in the provisions of section 273A(4) should exist both at the time at which the application under section 273A(4) is made by the assessee before the Principal Commissioner or Commissioner and at the time of passing of order under section 273A(4) by the Principal Commissioner or Commissioner.

(ii) The assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

As per the decision of Andhra Pradesh High Court in *K.S.N. Murthy v. Chairman, CBDT (2001) 252 ITR 269,* if the above conditions laid down for exercise of the discretion are satisfied, the Principal Commissioner or Commissioner cannot refuse to exercise the discretion. Though the power given to the Commissioner under section 273A is discretionary, the exercise of discretion cannot be either arbitrary or capricious and has to be judicious and objective, once the conditions required for exercise of discretion in any judicial or quasi-judicial proceedings are satisfied. Such discretion must be exercised taking into consideration all relevant facts. The satisfaction for exercise of discretionary power under the section must be based on objective consideration and not on subjective satisfaction.

Also, as per the proviso to section 273A(4), in case the quantum of penalty exceeds ₹ 1 lakh, the Principal Commissioner or Commissioner can grant relief only with the previous approval of the Principal Chief Commissioner or Chief Commissioner or the Principal Director General or Director General, as the case may be.

Note - *The Principal Commissioner or Commissioner has to pass an order under section 273A(4), either accepting or rejecting the application in full or in part, within a period of 12 months from the end of the month in which the application is received. Further, 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.*

Question 5

An assessee had credited a sum of ₹ 50,000 in cash in the account of Madan, said to represent a loan obtained from him. The Assessing Officer, having gone into the genuineness of the transaction, disbelieved the story of loan and treated the sum of ₹ 50,000 as the income of the assessee from undisclosed sources. He also started proceedings under section 271D and levied a penalty of ₹ 60,000 on the assessee for having accepted the loan in contravention of section 269SS. Examine the correctness of the levy.

Answer

There are several flaws in the penalty levied by the Assessing Officer. Firstly, the penalty leviable under section 271D cannot exceed the sum equal to the loan taken. Hence, the maximum penalty leviable would be ₹ 50,000. Secondly, any penalty imposable under section 271D shall be imposed by the Joint Commissioner. Hence, unless the Assessing Officer happens to be a Joint

Commissioner the levy of penalty will be invalid. Thirdly, the Assessing Officer cannot, on the one hand, treat the loan as undisclosed income of the assessee and on the other, treat it as a loan for the purpose of section 269SS read with section 271D. Such a treatment will be self-contradictory. The moment the amount of ₹ 50,000 is treated as undisclosed income, it ceases to bear the character of loan and therefore, the foundation for the levy of penalty under section 271D disappears. *[Diwan Enterprises v. CIT and Others (2000) 246 ITR 571]*.

Question 6

Examine the following cases and state whether the same are liable for penalty as per the provisions of the Income-tax Act, 1961.

(i) *Raman & Associates had made payment in excess of the limits prescribed to the contractors for carrying out labour job work at various sites, but had not deducted tax at source as per section 194C.*

(ii) *Hotels and Hotels were asked by Income-tax Officer (CIB) to furnish details of all such tourists who stayed in their hotels and had paid bill amount in excess of ₹ 10,000. They have not furnished the requisite information in spite of various reminders.*

Answer

(i) Penalty under section 271C is attracted for failure to deduct tax at source. The penalty would be a sum equal to the amount of tax which such person has failed to deduct. Such penalty can be imposed only by the Joint Commissioner. Therefore, Raman & Associates shall be liable for penalty under section 271C equal to the amount of tax which they have failed to deduct under section 194C from the payments made to the contractors. The penalty would be in addition to the disallowance of 30% of expenditure/payment under section 40(a)(ia).

(ii) Section 133(6) empowers the Income-tax authority to require any person to furnish information in relation to such points or matters which will be useful for or relevant to any enquiry or proceeding under the Act. Failure on the part of an assessee to furnish the information in relation to such points or matters as required makes him liable for penalty under section 272A(2) of ₹ 100 for every day during which the failure continues.

Note – *In a case where no proceeding is pending, the Income-tax authority can exercise this power only after obtaining the approval of the Principal Director/Director or Principal Commissioner/Commissioner as the case may be. In this case, it is presumed that the Income-tax authority has obtained the approval of the Principal Director/Director or Principal Commissioner/ Commissioner before exercising this power.*

Question 7

Fox Limited failed to furnish information and documents sought by the Transfer Pricing Officer (TPO). Can TPO levy penalty for such failure? How much would be the quantum of penalty imposable for the said failure?

Answer

Under section 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 section 92D(3) sought for by the Transfer Pricing Officer, then, such person shall be liable to a penalty which may be levied by the Assessing Officer or the Transfer Pricing Officer or the Commissioner (Appeals). Thus, the Transfer Pricing Officer is a competent authority to levy penalty.

Penalty would be a sum equal to 2% of the value of international transaction or specified domestic transaction for each such failure.

Question 8

What would be the penalty leviable under section 270A in case of the following assessees, if none of the additions or disallowances made in the assessment or reassessment qualify under section 270A(6) and the under-reported income is not on account of misreporting?

	Particulars of total income of A.Y.2020-21	*M/s. Alpha, a resident firm*	*Beta Ltd., an Indian company*
		(₹)	*(₹)*
(1)	*As per the return of income furnished u/s 139(1)*	*35,00,000*	*(12,00,000)*
(2)	*Determined under section 143(1)(a)*	*45,00,000*	*(6,00,000)*
(3)	*Assessed under section 143(3)*	*62,00,000*	*(2,00,000)*
(4)	*Reassessed under section 147*	*81,00,000*	*6,00,000*

Note – *Beta Ltd. is a trading company. The total turnover of Beta Ltd. for the P.Y.2017-18 was ₹ 401 crore and the company has not exercised option under section 115BAA.*

Answer

Penalty leviable under section 270A in case of M/s. Alpha, a resident firm

M/s. Alpha is deemed to have under-reported its income since:

(1) its income assessed under 143(3) exceeds its income determined in a return processed under section 143(1)(a); and

(2) the income reassessed under section 147 exceeds the income assessed under section 143(3).

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3)		
Under-reported income:		
Total income assessed under section 143(3)	62,00,000	
(-) Total income determined u/s 143(1)(a)	45,00,000	
	17,00,000	

Tax payable on under-reported income:		
Tax on under-reported income of ₹ 17 lakhs *plus* total income of ₹ 45 lakhs determined u/s 143(1)(a) ***[30% of ₹ 62 lakh + HEC@4%]***	19,34,400	
Less: Tax on total income determined u/s 143(1)(a) ***[30% of ₹ 45 lakh + HEC@4%]***	14,04,000	
	5,30,400	
Penalty leviable@50% of tax payable		2,62,200
Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	81,00,000	
(-) Total income assessed under section 143(3)	62,00,000	
	19,00,000	
Tax payable on under-reported income		
Tax on under-reported income of ₹ 19 lakhs *plus* total income of ₹ 62 lakhs assessed u/s 143(3) ***[30% of ₹ 81 lakh + HEC@4%]***	25,27,200	
Less: Tax on total income assessed u/s 143(3) ***[30% of ₹ 62 lakh + HEC@4%]***	19,34,400	
	5,92,800	
Penalty leviable@50% of tax payable		2,96,400

Penalty leviable under section 270A in the case of Beta Ltd., an Indian company

Beta Ltd. is deemed to have under-reported its income since:

(1) the assessment under 143(3) has the effect of reducing the loss determined in a return processed under section 143(1)(a); and

(2) the reassessment under section 147 has the effect of converting the loss assessed under section 143(3) into income.

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3)		
Under-reported income:		
Loss assessed u/s 143(3)	(2,00,000)	
(-) Loss determined under section 143(1)(a)	(6,00,000)	
	4,00,000	
Tax payable on under-reported income@30%	1,20,000	

Add: HEC@4%	4,800	
	1,24,800	
Penalty leviable@50% of tax payable		62,400
Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	6,00,000	
(-) Loss assessed under section 143(3)	(2,00,000)	
	8,00,000	
Tax payable on under-reported income@30%	2,40,000	
Add: HEC@4%	9,600	
	2,49,600	
Penalty leviable@50% of tax payable		1,24,800

Note – The applicable rate of tax for Beta Ltd., a trading company, for A.Y.2020-21 is 30%, since its turnover for the P.Y.2017-18 exceeded ₹ 400 crores.

SIGNIFICANT SELECT CASES

1. **Is penalty under section 271D imposable for cash loans/deposits received from partners?**

CIT v. Muthoot Financiers (2015) 371 ITR 408 (Del)

Facts of the case: The assessee-firm, engaged in business of banking and money lending, had received huge amounts from the partners in the assessment years 1996-97 and 1998-99 by way of cash. The Assessing Officer levied penalty under section 271D. The Commissioner (Appeals) upheld the levy of penalty. The Tribunal observed that the advance made to the firm by the partners cannot be regarded as loan accepted by the firm. It held that the amount advanced and accepted is capital of the firm and not loans which cannot be subjected to penalty under section 271D. The Revenue filed an appeal before High Court.

The assessee contended before the High Court that the amount advanced by the partners cannot be regarded as loan but is a capital of the firm. As the partnership firm has no separate legal entity, nor is there a separate identification between the firm and the partners, there is no violation of section 269SS in this case.

High Court's Opinion & Decision: The High Court referred to the case *CIT v. R.M. Chidambaram Pillai (1977) 106 ITR 292*, where the Apex Court was of the view that the firm is not a legal person even though it has some of the attributes of a personality. It held that the 'firm' is a collective noun, a compendious expression to designate an entity not a person. It also referred to *CIT v. Sivakumar. V (2013) 354 ITR 9 (Mad)*, where the High Court upheld the conclusion of the Tribunal to hold that there is no separate legal entity for the partnership firm and the partner is entitled to use the funds of the firm. In *CIT v. Lokhpat Film Exchange (Cinema) (2008) 304 ITR 172 (Raj)*, it was held that a partnership firm not being a juristic person, the *inter se* transaction between the firm and partners are not governed by the provisions of sections 269SS and 269T.

The High Court also noted the different view expressed by the Supreme Court in *CIT v. A.W. Figgies & Co. (1953) 24 ITR 405*, where it was held that the partners of the firm are distinct as civil entities while the firm as such is a separate and distinct unit for the purpose of assessment.

The High Court observed that the position that emerges is that there are three different Courts, which have held that section 269SS would not be violative when money is exchanged *inter se* between the partners and the firm.

The High Court further observed that, in this case, there was no dispute as regards the money brought in by the partners of the assessee-firm. The source of money was also not doubted. The transaction was bona fide and not aimed to avoid any tax liability. The credit worthiness of the partners and genuineness of the transactions coupled with relationship between the 'two persons' and two different legal interpretations put forward, could constitute a reasonable cause in a given case for not invoking sections 271D /271E read with section 273B.

The High Court held that the issue being a debatable one, there was reasonable cause for not levying penalty.

2. Can loan, exceeding the specified limit, advanced by a partnership firm to the sole-proprietorship concern of its partner be viewed as a violation of section 269SS to attract levy of penalty?

CIT v. V. Sivakumar (2013) 354 ITR 9 (Mad.)

Facts of the case: In the present case, the assessee was a partner in four firms and also had a sole-proprietary business. In the relevant previous year, the partnership firms had advanced loan to the assessee in cash exceeding the specified amount mentioned in section 269SS. The Assessing Officer initiated penalty proceedings under section 271D in view of violation of section 269SS. The Assessing Officer recorded a factual finding that the said money had been advanced by the partnership firm as a loan and were debited to the accounts of the proprietary concern; therefore, it was evident that the assessee had taken loan from the firms in cash in the capacity of the proprietor and not as a partner. Consequently, the provisions of section 269SS had been violated.

Assessee's contention: The assessee contended that the amount is taken in the capacity of the partner and it cannot be taken as an independent transaction and therefore, there is no violation of section 269SS. Also, the assessee contended that the partnership firm has no separate legal entity and there is no separate identification between the firm and the partner.

Tribunal's view: The Tribunal, relying upon the various court decisions, confirmed the finding of the Commissioner (Appeals) that partnership firm is not a juristic person and there is no separate identity for the firm and the partners; Being a partner, the assessee had withdrawn amounts from the firms and there were no reasons to doubt the genuineness of the transactions. Consequently, the transactions between the firm and the partner cannot be brought within the meaning of section 269SS.

High Court's Decision: The High Court, relying upon the various court decisions, upheld the decision of the Tribunal holding that there is no separate identity for the partnership firm and that the partner is entitled to use the funds of the firm. In the present case, the assessee has acted *bona fide* and that there was a reasonable cause within the meaning of section 273B. Therefore, the transaction cannot be said to be in violation of section 269SS and no penalty is attracted in this case.

3. **Where an assessee repays a loan merely by passing adjustment entries in its books of account, can such repayment of loan by the assessee be taken as a contravention of the provisions of section 269T to attract penalty under section 271E?**

CIT v. Triumph International Finance (I.) Ltd. (2012) 345 ITR 270 (Bom.)

Facts of the case: In the present case, the assessee is a public limited company, registered as category-I merchant banker with SEBI, engaged in the business of stock broking, investment and trading in shares and securities. The assessee had taken a loan from the Investment Trust of India. During the previous year in question, the assessee had transferred shares of a company held by it to the Investment Trust of India. Therefore, in the current assessment year, the assessee was liable to pay the loan amount to the Investment Trust of India and had a right to receive the sale price of the shares transferred to Investment Trust of India. In order to avoid the unnecessary circular transfer of shares, both the parties agreed to set-off the amount payable and receivable by way of passing journal entries and the balance loan amount was paid by the assessee by way of an account payee cheque. The amount of loan settled by way of passing journal entries exceeds ₹ 20,000.

Assessing Officer's contentions: The Assessing Officer passed the assessment order levying penalty under section 271E for the contravention of the provisions of section 269T on the argument that since section 269T put an obligation on the assessee to pay loan only by way of an account payee cheque or an account payee draft, the settlement of a portion of the loan by passing journal entry would be a mode otherwise than by way of an account payee cheque or an account payee draft and therefore, the penal provisions under section 271E shall be attracted.

Assessee's contentions: The assessee argued that the transaction of repayment of loan or deposit by way of adjustment through book entries was carried out in the ordinary course of business and the genuineness of the assessee's transaction with the Investment Trust of India was also accepted by the Tribunal. It is a bonafide transaction. The assessee further contended that section 269T mentions that in a case where the loan or deposit is repaid by an outflow of funds, the same has to be by an account payee cheque or an account payee demand draft. However, in case the discharge of loan or deposit is in a manner otherwise than by an outflow of funds, as is the situation in the present case, the provisions of section 269T would not apply.

High Court's Observations: Considering the above mentioned facts and arguments, the Bombay High Court observed that, the obligation to repay the loan or deposit by account payee cheque/bank draft as specified in section 269T is mandatory in nature. The contravention of the said section will attract penalty under section 271E.

The argument of the assessee cannot be accepted since section 269T does not make a distinction between a *bonafide* or a *non-bonafide* transaction neither does it require the fulfillment of the condition mentioned therein only in case where there is outflow of funds. It merely puts a condition that in case a loan or deposit is repaid, it should be by way of an account payee cheque/draft. Therefore, in the present case the assessee has repaid a portion of loan in contravention of provisions of section 269T.

However, the cause shown by the assessee for repayment of the loan otherwise than by account payee cheque/bank draft was on account of the fact that the assessee was liable to receive amount towards the sale price of the shares sold by the assessee to the person from whom loan was received by the assessee. It would have been mere formality to repay the loan amount by account payee cheque/draft and receive back almost the same amount towards the sale price of the shares. Also, neither the genuineness of the receipt of loan nor the transaction of repayment of loan by way of adjustment through book entries carried out in the ordinary course of business has been doubted in the regular assessment. Therefore, there is nothing on record to suggest that the amounts advanced by Investment Trust of India to the assessee represented the unaccounted money of the Investment Trust of India or the assessee and also it cannot be said that the whole transaction was entered into to avoid tax. This is accepted as a reasonable cause under section 273B.

High Court's Decision: In effect, the assessee has violated the provisions of section 269T by repaying the loan amount by way of passing book entries and therefore, penalty under section 271E is applicable. However, since the transaction is bona fide in nature being a normal business transaction and has not been made with a view to avoid tax, it was held that the assessee has shown reasonable cause for the failure under section 269T, and therefore, as per the provisions of section 273B, no penalty under section 271E could be imposed on the assessee for contravening the provisions of section 269T.

Note: *In order to mitigate the hardship caused by certain penalty provisions in case of genuine business transactions, section 273B provides that no penalty under, inter alia, section 271E shall be imposed on a person for any failure referred to in the said section, if such person proves that there was* ***reasonable cause*** *for such failure.*

CHAPTER 21

OFFENCES AND PROSECUTION

LEARNING OUTCOMES

After studying this chapter, you would be able to

- **appreciate** the provisions of Income-tax law relating to offences and prosecution;
- **determine** the quantum of fine and term of imprisonment for a particular offence;
- **examine** the power of Commissioner to grant immunity from prosecution;
- **appreciate** the presumption with respect to books of account, assets found in the possession or control of a person;
- **comprehend** the provisions relating to constitution of special courts and offences triable by Special Courts.

21.1 SUMMARY OF OFFENCES AND PROSECUTION

The punishable offences as well as the prosecution for such offences under the Income-tax Act, 1961 are discussed under Chapter XXII. Prosecution provisions under the Income-tax Act, 1961 are used as a tool for effective enforcement of tax laws and deterring tax avoidance and tax evasion.

While penalties may be imposed by the income-tax authorities, the imposition of a fine or the launching of prosecution for any offence under the Act can be made only by the Magistrate of a Court under sections 275A to 280. In respect of the same default of an assessee, penalty may be imposed and a prosecution also may be launched against him.

Section	Nature of default	Rigorous imprisonment	Quantum of Fine
275A	Contravention of order made under the second proviso to sub-section (1) or sub-section (3) of section 132 regarding search and seizure	Upto 2 Years **(+) fine**	No limit specified
275B	Failure to afford the authorized officer the necessary facility to inspect the books of account or other documents as required under section 132(1)(iib)	Upto 2 years **(+) fine**	No limit specified
276	Removal, concealment, transfer or delivery of property to thwart tax recovery	Upto 2 years **(+) fine**	No limit specified
276A	Failure to comply with the provisions of section 178(1) and (3) regarding company in liquidation or parting with any of the assets of the company or the properties in his hands in contravention of the provision of sections 178(1) and (3).	6 months to 2 years	-
276AB	Failure to comply with the provisions of section 269UC or 269UE or 269UL relating surrendering of property to Central Government	6 months to 2 years	-
276B	Failure to pay to the Central Government, tax deducted under the provisions of Chapter XVII-B or the tax payable by him, as required by (i) section 115-O(2); or (ii) Second proviso to section 194B	3 months to 7 years **(+) fine**	No limit specified
276BB	Failure to pay to the Central Government tax collected under section 206C	3 months to 7 years **(+) fine**	No limit specified

276C(1)	Wilful attempt to evade tax, penalty or interest chargeable or imposable or under reports his income	Evaded amount/Tax on under reported income exceeding ₹ 25 lakh: 6 months to 7 years (**+**) **fine** Other cases : 3 months to 2 years (**+**) **fine**	No limit specified
276C(2)	Wilful attempt to evade payment of tax, penalty or interest.	3 months to 2 years (**+**) **fine, at the discretion of the court.**	No limit specified
276CC	Wilful failure to furnish in due time a return of income u/s 139(1) or u/s 142(1)(i) or u/s 148 or u/s 153A. **Note:** If return of income u/s 139(1) is furnished before expiry of the assessment year or the tax payable by a person, not being a company, on the total income determined on regular assessment, as reduced by advance tax ***or self-assessment tax, if any, paid before the expiry of the assessment year, and any TDS/TCS does not exceed ₹ 10,000***[1] - No prosecution.	Evaded tax exceeding ₹ 25 lakh : 6 months to 7 years (**+**) **fine** Other cases: 3 months to 2 years (**+**) **fine**	No limit specified
276D	Willful failure to produce accounts and documents under section 142(1)/ 142(2A)	Up to one year (**+**) **fine**	No limit specified
277	False statements in verification.	Evaded tax exceeding ₹ 25 lakh: 6 months to 7 years (**+**) **fine** In other cases: 3 months to 2 years (**+**) **fine**	No limit specified

[1] *The enhanced total income limit of ₹ 10,000 for not attracting prosecution proceedings u/s 276CC is effective in respect of total income of A.Y.2020-21 and subsequent assessment years. In respect of earlier assessment years, the total income limit for not attracting prosecution proceedings u/s 276CC is ₹ 3,000. In respect of those years, the tax payable on regular assessment can be reduced by only by advance tax paid and TDS.*

277A	Falsification of books or documents, etc. to induce or abet any person to evade any tax, penalty or interest chargeable or imposable under the Act. It is not necessary to prove that the other person has actually evaded any tax, penalty or interest chargeable or imposable under the Act for the purpose of establishing the charge under this section.	Imprisonment of 3 months to 2 years (**+**) **fine**	No limit specified
278	Abetment of false return etc. (relating to any income chargeable to tax)	Evaded tax exceeding ₹ 25 lakh: 6 months to 7 years(**+**) **fine** In other cases: 3 months to 2 years (**+**) **fine**	No limit specified
278A	Second and subsequent offences under section 276B, 276C(1), 276CC, 277, 278.	6 months to 7 years for every subsequent offence(**+**) **fine**	No limit specified
280(1)	Disclosure of particulars by public servants in contravention of Section 138(2). Prosecution after previous sanction of Central Government under section 280(2).	Up to 6 months(**+**) **fine**	No limit specified

Section 278AA provides that where a reasonable cause for the failure is proved, punishment shall not be imposed for offences specified in sections 276A, 276AB and 276B.

For the purposes of offences and prosecutions, the following individuals will be deemed to be guilty of the offence committed by the respective person

Person	Section	Individual
Company	278B	Every person in charge of affairs; Director, Manager, Secretary and every officer who is guilty of offence
Firm	278B	Partner
AOP/BOI	278B	Members controlling the affairs
HUF	278C	Karta or member either by acquiescence or negligence.

Section 278B(3) provides that if an offence under the Act has been committed by a person being a company, it shall be punished with fine. Every other person who was in charge of and was responsible for the conduct of business of the company, or any director, manager, secretary or other officer of the company (with whose consent or connivance or due to whose neglect the offence was committed) would be liable for punishment of imprisonment and fine wherever so provided.

21.2 POWER OF PRINCIPAL COMMISSIONER OR COMMISSIONER TO GRANT IMMUNITY FROM PROSECUTION [SECTION 278AB]

Section 278AB empowers the Principal Commissioner or Commissioner to grant immunity from prosecution -

(1) **Eligible applicant** - The application for the immunity must be made by the assessee (person whose case has been abated under section 245HA) to the Principal Commissioner or Commissioner of Income-tax before institution of the prosecution proceedings after abatement.

(2) **Time limit for filing application** - The assessee can approach the Principal Commissioner or Commissioner for immunity any time if prosecution proceedings were instituted before or during the pendency of settlement proceedings. However, if the assessee has received any notice etc. from the Income-tax authority for institution of prosecution, then he must apply to the Principal Commissioner or Commissioner for immunity, before actual institution of prosecution.

(3) **Granting of immunity subject to conditions** - The Principal Commissioner or Commissioner can grant immunity, subject to such conditions as he may think fit to impose, on being satisfied that the assessee has –

(i) co-operated in the proceedings after abatement; and

(ii) made a full and true disclosure of his income and the manner in which such income has been derived.

(4) **Withdrawal of immunity: Circumstances** –

(a) If the assessee fails to comply with any condition subject to which the immunity was granted, the same would be withdrawn.

(b) The immunity granted to a person may, at any time, be withdrawn by the Principal Commissioner or Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, -

(i) concealed any particulars material to the assessment from the income-tax authority; or

(ii) given false evidence.

Consequently, the person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the proceedings.

21.3 PRESUMPTION WITH REGARD TO ASSETS, BOOKS OF ACCOUNT [SECTION 278D]

(1) **Presumption with regard to books of account and other documents in search cases -** Section 278D provides that in case where, during the course of any search made under section 132, any money, bullion, jewellery or other valuable articles or things or any books of account or other documents had been found in the possession or control of any person and such assets or books of account or other documents are tendered by the prosecution in evidence against such person and/or against any person who is convicted of an offence under section 278, the provisions of section 132(4A) would apply, in relation to all such books of account and other documents. Accordingly, it would be presumed that such books of account or other documents and assets belong to the person in whose control or possession they were found, at the time of search and also that the contents of such books of account and other documents are true.

(2) **Presumption with regard to books of account and documents in case of requisition -** Similarly, in cases where any books of accounts or other documents and assets are taken into custody from the possession or control of any person by the officer or authority specified in section 132A(1)(a) or (c) and these are delivered to the requisitioning officer under section 132A(2), it would be presumed that the presumption similar to the one mentioned earlier would operate in these cases as well.

(3) **Presumption rebuttable -** It would be for assessee to rebut the presumption wherever necessary by producing cogent and reliable evidence.

21.4 PRESUMPTION AS TO CULPABLE MENTAL STATE [SECTION 278E]

(1) **Onus of proof on accused -** In any prosecution for any offence under this Act which requires a culpable mental state on the part of the accused, the court shall presume the existence of such mental state but it shall be a defence for the accused to prove the fact that he had no such mental state with respect to the act charged as an offence in that prosecution.

It may be noted that penalty proceedings being quasi-criminal in nature, it has been judicially held in the context of various penalty and prosecution proceedings, that the burden is on the department to establish that the assessee concealed the particulars of his income or deliberately furnished inaccurate particulars thereof and it is not enough for the revenue merely to show that a certain amount was received by the assessee. Section 278E has clearly overruled this view and has specifically placed the burden of proof on the assessee.

It specifically provided that where any prosecution requires a culpable mental state (mens rea) the court shall presume the existence of such mental state but the assessee is entitled to prove that he had no such mental state with respect to the act charged with. Thus, the burden to prove the non-existence of mens rea has been effectively placed on the assessee in prosecution cases.

(2) **Meaning of 'Culpable mental state'** - Culpable mental state includes intention, motive or knowledge of a fact or belief in, or reason to believe, a fact.

(3) **Proof of fact** - For the purposes of this section a fact is said to be proved only when the court believes it to exist beyond reasonable doubt and not merely when its existence is established by a preponderance of probability.

21.5 PROSECUTION TO BE MADE AT THE INSTANCE OF THE PRINCIPAL CHIEF COMMISSIONER OR CHIEF COMMISSIONER OR PRINCIPAL COMMISSIONER OR COMMISSIONER [SECTIONS 279 AND 279A]

(1) **Prior sanction of higher authorities** - Section 279(1) provides that the proceedings to punish a person for an offence under sections 275A, 275B, 276, 276A, 276B, 276BB, 276C, 276CC, 276D, 277, 277A and 278 can be initiated only after previous sanction of the Principal Commissioner or Commissioner or the Commissioner (Appeals) or the appropriate authority. However, the Principal Chief Commissioner or the Chief Commissioner or the Principal Director General or Director General may issue such instructions or directions to the said authorities for institution of proceedings under section 279(1).

(2) **Cases were prosecution cannot be initiated** - Section 279(1A) provides that the proceedings to punish a person for an offence under section 276C or 277 cannot be initiated in relation to the assessment of an assessment year in respect of which the penalty imposed or imposable on him under section 270A has been waived or reduced under section 273A.

(3) **Compounding of offences** - An offence may either before or after the institution of prosecution proceedings be compounded by the concerned authorities under section 279(2).

(4) **Admissibility of statement made or books of account produced as evidence** - If a person is proceeded against under section 279(1), then a statement made or account or documents produced before any authority under Act shall not be inadmissible as evidence for purpose of the prosecution proceedings merely on the ground that such account or document was produced or statement was made in the belief that the penalty imposed or imposable under section 270A would be reduced or waived under section 273A or that the offence would be compounded.

(5) **Non-cognizable offences** - Section 279A provides that offences punishable under sections 276B, 276C, 276CC, 277 and 278 shall be deemed to be non-cognizable offences.

21.6 PROOF OF ENTRIES IN RECORDS OR DOCUMENTS [SECTION 279B]

(1) **Admissibility of entries in records as evidence in prosecution proceedings** - Entries in the records or other documents in the custody of an income-tax authority shall be admitted in evidence in any proceedings for the prosecution of any person for an offence under this Chapter

(2) **Proof of entries** - All such entries may be proved either:-

(i) by the production of the records or other documents in the custody of the income-tax authority containing such entries; or

(ii) by the production of a copy of the entries certified by the income-tax authority having custody of the records; or

(iii) other documents under its signature and stating that it is a true copy of the original entries and that such original entries are contained in the records of other documents in its custody.

21.7 DISCLOSURE OF PARTICULARS BY PUBLIC SERVANTS [SECTION 280]

(1) **Imprisonment and fine for contravention of section 138(2)** - If a public servant furnishes any information or produces any document in contravention of section 138(2), he shall be punishable with imprisonment which may extend to 6 months and shall also be liable to pay fine.

Under section 138(2), the Central Government is empowered to issue notification directing that no information or document shall be furnished or produced by a public servant in respect of specified matters in relation to certain class of assessees. While issuing such notification, the Central Government takes into account the practices and usage customary or other relevant factors.

(2) **Prior sanction of the Central Government required** - No prosecution shall, however, be instituted under this section except with the previous sanction of the Central Government.

21.8 CONSTITUTION OF SPECIAL COURTS & OFFENCES TRIABLE BY SPECIAL COURT [SECTIONS 280A & 280B]

(1) Under section 280A, for the purpose of trial of offences under Chapter XXII i.e. Offences & Prosecution, one or more courts of Magistrate of the first class may be designated by the Central Government, in consultation with the Chief Justice of the High Court, by way of a notification as Special Court for such area or areas or for such cases or class or group of cases as may be specified in the notification.

(2) A Special Court, while trying an offence punishable under the Act, shall also try any other offence with which the accused may be charged, under the Code of Criminal Procedure, 1973.

(3) Under section 280B, the offences punishable under Chapter XXII, shall be triable only by the Special Court, if so designated, for the area or areas or for cases or class or group of cases, as the case may be, in which the offence has been committed. This is notwithstanding anything containing in the Code of Criminal Procedure, 1973

(4) However, a court competent to try offences under section 292 which has been designated as a Special Court under this section, shall continue to try the offences before it or offences arising under the Act after such designation. Further, a court competent to try offences under section 292, which has not been designated as a Special Court under this section, may continue to try such offence pending before it till its disposal.

(5) Further, notwithstanding anything contained in the Code of Criminal Procedure, 1973, a Special Court may take cognizance of the offence for which the accused is committed for trial, upon a complaint made by an authority authorized in this behalf under the Act.

21.9 TRIAL OF OFFENCES AS SUMMONS CASE [SECTION 280C]

(1) The Special Court shall, notwithstanding anything contained in the Code of Criminal Procedure, 1973, try an offence under Chapter XXII punishable with imprisonment not exceeding two years or with fine or with both, as a summons case.

(2) When an offence is so tried as a summons case, the provisions of the Code of Criminal Procedure, 1973, as applicable in the case of trial of summons case, would be applicable.

21.10 APPLICATION OF CODE OF CRIMINAL PROCEDURE, 1973 TO PROCEEDINGS BEFORE SPECIAL COURT [SECTION 280D]

(1) The provisions of the Code of Criminal Procedure, 1973, including the provisions regarding bails and bonds, would apply to proceedings before a Special Court, unless otherwise provided under the Income-tax Act, 1961.

(2) The person conducting the prosecution before the Special Court shall be deemed to be a Public Prosecutor.

(3) The Central Government may also appoint a Special Public Prosecutor for any case or class or group of cases.

(4) A person shall be qualified for appointment as a Public Prosecutor or a Special Public Prosecutor only if he has been in practice as an advocate for at least seven years, requiring special knowledge of law.

(5) Every person appointed as Public Prosecutor or Special Public Prosecutor under this section shall be deemed to be a Public Prosecutor within the meaning of section 2(u) of the Code of Criminal Procedure, 1973. The provisions of the Code of Criminal Procedure, 1973, would have effect accordingly.

EXERCISE

Question 1

Can prosecution be launched for each of the following actions or defaults committed? If yes, then explain the relevant provisions of the Act and the quantum of prescribed punishment.

(i) The assessee had restrained and not allowed the officer authorized as per section 132(1)(iib) of the Act to inspect the documents maintained in the form of electronic record and the books of accounts.

(ii) The assessee deliberately has failed to comply with the requirement of section 142(1) and/or 142(2A).

(iii) The assessee deliberately has failed to make the payment of the tax collected under section 206C.

Answer

(i) Failure to afford facility to the officer authorized as per section 132(1)(iib) is a case for which **prosecution can be launched under section 275B** and such person shall be punishable with rigorous imprisonment **for a term which may extend to two years and shall also be liable to fine.**

(ii) Willful failure to produce books of account and documents as required under section 142(1) or willful failure to comply with a direction to get the accounts audited under section 142(2A) is a case for which **prosecution can be launched under section 276D** and such person shall be **punishable with rigorous imprisonment for a term which may extend to one year and with fine.**

(iii) Deliberate failure to deposit the tax collected under section 206C to the credit of the Central Government is a case for which **prosecution can be launched under section 276BB** and such person shall be **punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine.**

Question 2

The Assessing Officer lodged a complaint against M/s. KLM, a firm, under section 276CC of the Income-tax Act, 1961 for failure to furnish its return of income for the A.Y.2018-19 within the due date under section 139(1). The tax payable on the assessed income, as reduced by the advance tax paid and tax deducted at source, was ₹ 60,000. The appeal filed by the firm against the order of assessment was allowed by the Commissioner (Appeals). The Assessing Officer passed an order giving effect to the order of the Commissioner (Appeals). The tax payable by the firm as per the said order of the Assessing Officer was ₹ 2,900. The Assessing Officer has accepted the order of the Commissioner (Appeals) and has not preferred an appeal against it to the Income Tax Appellate Tribunal. The firm desires to know of the maintainability of the prosecution proceedings in the facts and circumstances of the case.

Would your answer change if the person against whom complaint was lodged was KLM Ltd., a company, instead of a firm?

Answer

(i) Section 276CC provides for prosecution for wilful failure to furnish a return of income within the prescribed time, in a case where tax would have been evaded had the failure not been discovered. Since the amount of tax which would have been evaded does not exceed ₹ 25 lakh, the imprisonment would be for a term of 3 months to 2 years. In addition, fine would also be attracted.

However, in a case where the return of income is not filed within the due date, prosecution proceedings will not be attracted if the tax payable by a person, other than a company, on the total income determined on regular assessment, as reduced by the advance tax, if any, paid and any tax deducted at source, does not exceed ₹ 3,000.

In this case, even though the tax liability of the firm as per the original order of assessment exceeded ₹ 3,000, however, as a result of the order of the Commissioner (Appeals), it got reduced to ₹ 2,900, which is less than ₹ 3,000. Therefore, since the tax liability of the firm on final assessment was determined at ₹ 2,900, the prosecution proceedings are not maintainable.

In *Guru Nanak Enterprises v. ITO (2005) 279 ITR 30*, where the facts were similar, the Supreme Court held that prosecution was unwarranted.

(ii) Yes, in case of a company, the answer would be different and prosecution proceedings would be maintainable.

Question 3

Explain section 278C applicable in respect of offences committed by Hindu undivided families.

Answer

As per section 278C(1) of the Income-tax Act, 1961, where an offence under the Income-tax Act, 1961 has been committed by a Hindu undivided family (HUF), the karta shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. However, the karta shall not be liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

As per section 278C(2), where an offence under the Income-tax Act, 1961 has been committed by a HUF and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of any member of the HUF, such member shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Question 4

Can the Department launch prosecution in a case where they have accepted the revised return filed by the assessee, rectifying a mistake in the original return of income?

Answer

This question came up before the Karnataka High Court in *K.E. Sunil Babu, Asst. CIT v. Steel Processors (2006) 286 ITR 315***.** The High Court observed that since the Department had accepted the revised returns filed under section 139(5), it was clear that there was a *bona fide* mistake in the original return and there was no element of *mens rea.* Therefore, the High Court held that the Department cannot launch prosecution under sections 276C, 277 and 278.

SIGNIFICANT SELECT CASES

1. **Whether payment of sums due, after the deadline stipulated by the Settlement Commission, would save the petitioner from withdrawal of immunity from prosecution?**

Sandeep Singh v Union of India [2017] 393 ITR 77 (SC)

Facts of the case: The petitioner is a dealer in real estate at Amritsar. A search was conducted on August 21, 2009 at his business and residential premises under section 132(1) subsequent to which the assessee filed an application before the Settlement Commission under section 245C(1). The case was settled before the Settlement Commission on December 12, 2014. Pursuant to the assessment after settlement, the petitioner was unable to pay the amount due by the stipulated date. He sought an extension for 14 months but was only given time until July 31, 2015.

The assessee filed a writ petition before the High Court seeking quashing/ modification of the Settlement Commission's order granting partial extension of time. By the time the matter was heard by the Supreme Court, he had paid off all pending amounts.

Supreme Court's Observations: The Supreme Court explained that in case payments are not made within the time granted by the Settlement Commission or in case the person fails to comply with any other condition, subject to which the immunity was granted, the immunity shall stand withdrawn.

It is not in dispute that all payments were made by the assessee on January 20, 2016 before approaching the Supreme Court. Though the time originally granted was only up to July 31, 2015, all sums having been paid now, there is no need to relegate the assessee to the Settlement Commission. Settlement Commission has the power to extend the timelines. Hence, in the instant case, it shall be taken that the assessee has made the payments within the time granted under section 245H(1A).

Supreme Court's Decision: The Supreme Court held that the assessee having cleared all taxes due vide order of Settlement Commission, albeit after stipulated deadline, is immune from prosecution.

2. Would prosecution proceedings under section 276CC be attracted where the failure to furnish return in time was not willful?

Union of India v. Bhavecha Machinery and Others (2010) 320 ITR 263 (MP)

High Court's Observation and Decision: In this case, the High Court observed that for the provisions of section 276CC to get attracted, there should be a willful delay in filing return and not merely a failure to file return in time. There should be clear, cogent and reliable evidence that the failure to file return in time was 'willful' and there should be no possible doubt of its being 'wilful'. The failure must be intentional, deliberate, calculated and conscious with complete knowledge of legal consequences flowing from them.

In this case, it was observed that there were sufficient grounds for delay in filing the return of income and such delay was not willful. Therefore, prosecution proceedings under section 276CC are not attracted in such a case.

CHAPTER 22

LIABILITY IN SPECIAL CASES

LEARNING OUTCOMES

After studying this chapter, you would be able to

❑ **comprehend** the manner in which assessment is made in the hands of the legal representative;

❑ **explain** the extent of liability of the legal representative in respect of tax dues of the deceased person;

❑ **comprehend** the meaning of "Representative assessee";

❑ **explain** the right of a representative assessee to recover the tax paid from the person on behalf of whom he has paid tax;

❑ **explain** the manner of taxation of discretionary trusts;

❑ **discuss** the chargeability of income in the hands of the executor;

❑ **explain** the liability of successor to business in respect of tax chargeable from the predecessor;

❑ **identify** the cases where income earned during a financial year is assessed in the same financial year;

❑ **discuss** the obligations of the liquidator of a company in liquidation;

❑ **examine** the liability of directors of a private limited company in liquidation.

22.1 LEGAL REPRESENTATIVES [SECTION 159]

(1) **Meaning [Section 2(29)**: "Legal representative'' in the Income-tax Act, 1961 has the meaning assigned to it in section 2(11) of the Code of Civil Procedure, 1908 i.e., a person who in law represents the estate of a deceased person and includes any person who intermeddles with the estate of the deceased and where a party sues or is sued in a representative character, the person on whom the estate devolves on the death of the party so suing or sued.

It is not necessary that the legal representative should be the beneficial owner of the estate. Nor need he be in possession of any property of the deceased. It is sufficient that the estate devolves on him. So far as HUF is concerned it continues to exist as an assessable unit despite change in its composition including the change of its Karta by death or otherwise and consequently there is no scope or necessity for involving this section when a Karta dies. Where a person leaves a will appointing executors, the executors are the legal representative. The Act expressly declares that the legal representative is deemed to be an assessee for the purpose of this Act.

(2) **Assessment on legal representative:** This section applies irrespective of whether the assessment proceedings has not been started, or were pending, or were completed and the assessment made, before the death of the deceased.

For the purpose of making an assessment and for the purpose of levying any sum in the hands of the legal representative –

- any proceeding taken against the deceased before his death shall be deemed to have been taken against the legal representative and may be continued against the legal representative from that stage.
- any proceedings which could have been taken against the deceased for a default committed by him, can be started against the legal representative.
- all the provisions of the Act shall apply accordingly.

If at the date of death of the deceased, a return of income had not been made under section 139(1) and a notice under section 142(1)(i) or section 148, as the case may be, had not been served on him, the Assessing Officer should first issue the notice under appropriate section to the legal representative of the deceased and then proceed to assess the income of the deceased in the hands of the representative as if the representative were the assessee.

It is obligatory upon the representative to comply with the notices appropriately served. Assessment may be made on the representative under section 147 in respect of income of the deceased which had escaped assessment in the relevant years.

(3) **Penalty on legal representative:** Similarly, penalty proceedings which could have been taken against the deceased for a default committed by him, can be started against the legal representative. He, being an assessee, is also liable to a penalty for his own default.

(4) **Income upto the date of death and the end of the accounting year:** Students should carefully note that section 159 applies in respect of the income of the deceased only upto the date of death and not upto the end of the accounting year in which the death occurs. The income of the estate for the period from the date of death upto the end of the accounting year in which the death occurs should be assessed under section 168 in the hands of the executor. Thus in respect of the year of death two separate and distinct assessments would have to be made, the prior one on the legal representative under section 159 and the latter one on the 'executors' under section 168. This may even lower the incidence of tax for the year. The position will be the same even if the representative and the 'executor' are one and the same.

(5) **Apportionment:** As a consequence of two separate assessments as mentioned above apportionment of income between the two periods becomes necessary. Here it is to be noted that certain incomes like dividends or interest if they become payable after the death cannot be apportioned to the period upto the date of death because they do not accrue from day to day.

(6) **Liability of legal representative:** The Act imposes a liability on the legal representative not only in respect of tax but also any other sum (penalty, fine or interest) which the deceased would have been liable to pay if he had not died. This liability is limited to the extent to which the estate is capable of meeting the liability. But if the legal representative, while his tax liability remains undischarged, creates a charge on or disposes off or parts with any of the assets of the estate of the deceased which are, or may, come into his possession, this personal liability shall, however, be limited to the value of the assets so charged, disposed of or parted with. This personal liability is imposed by sub-section (4) only in respect of tax and not in respect of penalty, fine or interest.

The provisions of section 161(2), 162 and 167 (discussed later in this chapter) shall apply to legal representative to the extent they are not inconsistent with the provisions of this section.

22.2 REPRESENTATIVE ASSESSEE

(1) **Meaning [Section 160]:** Besides the legal representatives mentioned above, in certain cases, the income received by one person can be assessed in the hands of another. Persons who are liable to be assessed on behalf of other because of their association with the real recipient of the income are known as representative assessees. The expression 'representative assessee' means:

	In respect of	Representative assessee
1.	Income of a non-resident which is deemed to accrue or arise to him in India	Agent of a non-resident including a person who is treated as an agent under section 163
2.	Income of a minor, a lunatic or an idiot	Guardian or a manager of such person who is entitled to receive or is in receipt of income on such person.
3.	Income for which the Court of Wards, Administrator-General, Official Trustee, Receiver or Manager appointed by or under any order of a court, to receive such income on behalf of or for the benefit of any person	Such Court of Wards, Administrator-General, Official Trustee, Receiver or Manager so appointed
4.	Income for which a trustee is appointed under a trust deed by a duly executed instrument in writing, whether, testamentary or otherwise, to receive such income on behalf of or for the benefit of any person	Such trustee or trustees so appointed
5.	Income for which a trustee is appointed under an oral trust to receive such income on behalf of or for the benefit of any person	Such trustee or trustees so appointed

Every representative assessee is deemed to be an assessee under the Income-tax Act.

A trust which is not declared by a duly executed instrument in writing (including a Wakf deed which is valid under the Mussalman Wakf Validating Act, 1913) shall be deemed to be a trust declared by a duly executed instrument in writing if a statement in writing signed by the trustee or trustees and setting out the purpose or purposes of the trust, particulars of the trustee or trustees, the beneficiary or beneficiaries and the trust property, is prepared and forwarded to the Assessing Officer within the specified time limit. The specified time-limit will be three months from date of the declaration of the trust. [*Explanation 1*]

For this purpose, the item 'oral trust' means a trust which is not declared by a duly executed instrument in writing including any Wakf deed and which is also not deemed under *Explanation* 1 to be a trust declared by a duly executed instrument in writing. [*Explanation 2*]

Clarification regarding liability and status of Official Assignees under the Income-tax Act, 1961 [Circular No. 4/2019, dated 28-01-2019]

Under provisions of the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920, where an order of Insolvency is passed against a debtor by the concerned Court, property of the debtor gets vested with the Court appointed Official Assignee. The Official Assignee then realizes property of the insolvent and allocates it amongst the creditors of the insolvent. Consequentially, Official Assignee has the responsibility to handle income-tax matters of the estate assigned to him.

In this regard, a clarification has been sought regarding applicability of section 160(1)(iii) which applies on a 'Representative Assessee' in the case of an Official Assignee. Further, clarity regarding status of the Official Assignee's i.e. their fallibility in the appropriate category of 'persons', as defined in section 2(31), has also been sought.

As per provisions of section 160(1)(iii), a 'Representative Assessee' amongst other situations specified therein, becomes liable in respect of any income which the Assignee receives or is entitled to receive while managing the property for benefit of any person. As per the two insolvency Acts, Official Assignee manages the property of the debtor for the benefit of the creditors. Further, the Insolvency Act, 1909, in unambiguous terms, provides that an insolvent ceases to have an ownership interest in the estate once an order of adjudication is made under section 17 of the Insolvency Act.

Thus, it is clarified by the CBDT that since Official Assignee does not receive the income or manage the property on behalf of the debtor, they cannot be considered as a 'Representative Assessee' of the debtor under the Act while computing the tax-liability arising from the estate of the debtor.

As property of the insolvent is vested with the Official Assignee as per specific provisions of the Act/Law regulating functioning of the Official Assignee's, they have to be treated as a 'juristic entity' for purposes of the Income-tax Act. Hence, it is clarified by the CBDT that for purpose of discharge of tax-liability under the Act, the status of Official Assignees is that of an 'artificial juridical person' as prescribed in section 2(31)(vii), not being one of the 'persons' falling in section 2(31)(i) to (vi).

Therefore, Official Assignee is required to file income-tax return electronically in the ITR Form applicable to 'artificial juridical person' separately for each of the estate of the insolvent and the income shall be taxed as per the rates applicable in a particular year to an 'artificial juridical person'.

In view of the above position, Official Assignees would have to obtain a separate PAN for each of the estate of the insolvent.

(2) **Liability of representative assessee [Section 161]:** Every representative assessee has the same responsibilities, duties and liabilities as if the income were being received by or

accruing to or in favour of him beneficially. He is liable to be assessed in his own name in respect of such income but the assessment is deemed to have been made upon him in his representative capacity. The tax is levied on and is recovered from such an assessee, in like manner and to the same extent as it would have been levied upon and recovered from the person represented by him.

Where any income in respect of which the trustee, appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise, including any valid wakf deed, is liable as a representative assessee, consists or includes profits and gains of business, tax shall be charged on the whole of the income in respect of such a person at the "maximum marginal rate".

However, this provision will not apply in cases where such profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him.

If certain income is assessed in the hands of any person in the capacity of representative assessee, the same income shall not be assessed in his hands under any other provision of the Act [Section 161(2)].

(3) **Right of a representative assessee to recover tax paid [Section 162]:** Every representative assessee who pays any amount under the Act, is entitled to recover the sum so paid from the person on whose behalf he had paid it or to adjust it against any moneys in his possession, but belonging to the other persons. The representative assessee has the right to retain out of the moneys in his representative capacity, an amount equal to any sum paid or payable by him under the Act in addition to the right to recover the same from the beneficial owner of the income.

Any representative assessee or any person who apprehends that he may be assessed in respect of any other person (principal) as a representative assessee, has the right to retain out of the money payable by him to such other person, amount to the extent of his estimated liability.

In case of disagreement between the principal and representative assessee, such representative assessee, may secure from the Assessing Officer a certificate stating the amount to be so retained pending final settlement of the liability. The certificate so obtained shall be treated as warrant authorising retention of the amount.

The amount recoverable from such representative assessee at the time of final settlement shall not exceed the amount specified in such certificate. However, where representative assessee holds, in his hands, any additional assets of the principal at the time of final settlement, then the Assessing Officer may initiate the recovery of the balance tax liability of the principal from such representative to the extent of assets hold by him.

(4) **Statutory agent of non-residents [Section 163]:** An agent is considered a representative assessee but only if he is the agent of non-resident person. According to section 163, an agent, in relation to a non-resident person, includes any person in India:

(i) who is employed by or on behalf of the non-resident;

(ii) who is having any business connection with the non-resident;

(iii) from or through whom the non-resident is in receipt of any income, whether directly or indirectly;

(iv) who is trustee of the non-resident; and

any other person who (whether resident or non-resident) has acquired a capital asset in India by means of a transfer from the non-resident.

In the first four cases stated above, the person sought to be assessed as the agent of a non-resident must necessarily be in India whereas it need not be so in the fifth case. Thus, a non-resident may be treated as the agent of another non-resident. The appointment of the agent may be made any time before or after the expiry of the relevant previous year. An agent of a non- resident may be appointed under this section even if at the date of such appointment, the non-resident is not alive.

According to the proviso to this section, where transactions are carried on in the ordinary course of business through a broker in India and the broker does not deal directly with or on behalf of a non-resident principal but deals with or through a non-resident broker, the broker in India cannot be treated as statutory agent in respect of the income arising to the non-resident from such transactions. Thus, where bona fide hedging transactions take place through a broker in India and a foreign broker acting for an undisclosed principal, the Indian broker cannot be deemed to be agent of the foreign principal. But generally a broker is not deemed to be the agent of a non-resident person so long as he functions exclusively in his capacity as a broker.

For the purposes of section 163(1), the expression "business connection" shall have the meaning assigned to it in *Explanation 2* to clause (i) of section 9(1) of the Income-tax Act, 1961. [*Explanation* to section 163(1)]

Before a person can be treated as an agent of a non-resident he must be given a reasonable opportunity of being heard by the Assessing Officer as to his liability to be so treated.

22.3 TAXATION OF DISCRETIONARY TRUSTS [SECTION 164(1)]

Section 164 deals with taxation of trustees of discretionary trusts. This section applies in the case of a representative assessee referred to in clause (iii) or clause (iv) of sub-section (1) of section

160 in a case where any income or part thereof is not specifically receivable on behalf of or for the benefit of any one person or where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate or unknown.

The representative assessees referred to in clauses (iii) and (iv) of section 160(1) are the Court of Wards, the Administrator General, the Official Trustee or any receiver or manager including any person whatever his designation who in fact manages the property on behalf of another, appointed by or under any order of a Court and a trustee appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise (including any Wakf Validating Act, 1913).

Such a discretionary trust will be liable to tax at the maximum marginal rate of income-tax on their entire income.

With a view to obviating hardship in genuine cases where the circumstances are such that tax evasion could not be considered to be main purpose of creating a trust, certain exceptions have been specified where the trust would not be taxed at the maximum marginal rate. The exceptions are as under:

(1) Where none of the beneficiaries has any other income chargeable to tax exceeding the maximum amount not chargeable to income-tax in the case of an AOP and none of the beneficiaries is a beneficiary under any other trust; or

(2) Where the discretionary trust is created under a will and such trust is the only trust so created under the will.

(3) In case of a discretionary trust created prior to 1.3.1970 by a non-testamentary instrument if the Assessing Officer is satisfied that the trust was so created bona fide exclusively for benefit of the dependent relatives of settlor or where the settlor is a H.U.F. for the benefit of the members of such families in circumstances where such relatives or members are mainly dependent on the settlor for their support and maintenance.

(4) In cases where the income is receivable by the trustee on behalf of provident fund, superannuation fund, gratuity fund, pension fund or any other fund created bona fide by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or professions.

In the above four cases the income of the trustees will not be taxed at the marginal rate but at the rate applicable to the income of an association of persons.

Where any income in respect of which a trustee appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise, is liable as a representative assessee consists of or includes profits and gains of business, the above concessional treatment i.e. assessing the income at the rate applicable to an AOP will apply only if such profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him.

For the purposes of these provisions, a trust under which a discretionary power is given to the trustees, to decide the allocation of the income every year or a right is given to the beneficiary to exercise the option to receive the income or not each year will all be regarded as discretionary trusts and assessed accordingly. This is made clear in *Explanation 1* to section 164 which provides as under.

(a) Any income in respect of which the Court of Wards, the Administrator General, the Official Trustee, receiver, manager, trustee or mutawalli appointed under a Wakf deed is liable as a representative assessee or any part thereof shall be regarded as not being specifically receivable on behalf or for the benefit of any person unless the person on whose behalf or for whose benefit such income or such part thereof is receivable during the previous year is expressly stated in the order of the Court or the instruments of trust or wakf deed, as the case may be, and is identifiable as such on the date of such order, instrument or deed. For this purpose, it is not necessary that the beneficiary in the relevant previous year should be actually named in the order of the Court or the instrument of trust or wakf deed, all that is necessary is that the beneficiary should be identifiable with reference to the order of the Court or the instrument of trust or wakf deed on the date of such order instrument or deed.

(b) The individual shares of the person on whose behalf or for whose benefit such income or part thereof is receivable will be regarded as indeterminate or unknown unless the individual shares of such persons are expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be, and are ascertainable as such on the date of such order, instrument or deed.

This explanation seeks to prevent trustees and beneficiaries from manipulating the arrangements in such a manager that a discretionary trust is converted into a specific trust whenever it suits them tax-wise.

(1) **Income from property held under trust wholly for charitable or religious purposes [Section 164(2)]:** In case the income, in respect of which the shares of the beneficiaries are indeterminate or unknown, is derived from property held under trust wholly for charitable or religious purpose or which is of the nature referred to in section 2(24)(iia) [voluntary contributions received by a trust] or which is of the nature referred to in sub-section (4A) of section 11 [business income received by a trust], the tax shall be charged on so much of the income as is not exempt under section 11 or section 12 as if the income not so exempt were the income of an association of persons.

However, where the whole or any part of the relevant income is not exempt under section 11 or section 12 because any income thereof is for the benefit of prohibited persons or the rules with regard to investments in specified channels have not been followed, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

(2) **Income from property held under trust partly for charitable or religious purposes and partly for other purposes [Section 164(3)]:** In case the income is derived from property held

under trust partly for charitable or religious purposes and partly for other purposes or which is of the nature referred to in section 2(24)(iia) (voluntary contributions received by a trust) or which is of the nature referred to in sub-section (4A) of section 11 (business income received by a trust) and the individual share of the beneficiaries in the income applicable to purposes other than charitable or religious purposes is not known, tax liability will be the aggregate of the following:

(a) the tax which would be chargeable on that part of the relevant income which is applicable to charitable or religious purposes (as reduced by the income, if any, which is exempt under section 11 as if such part (or such part so reduced) were the total income of the association of persons; and

(b) the tax on that part of income which is applicable to purposes other than charitable or religious and in respect of which shares of beneficiaries are indeterminate or unknown, at the maximum marginal rate.

However, in the following cases, income will be charged to tax as if it were income of an association of persons:

(a) where none of the beneficiaries has any other income chargeable to tax exceeding the maximum amount not chargeable to income-tax in the case of an AOP and none of the beneficiaries is a beneficiary under any other trust; or

(b) where the trust is created by will and such trust is the only trust so declared by him; and

(c) where the trust is a non-testamentary one created before March 1, 1970 for the exclusive benefit (to the extent it is not utilised for charitable or religious purposes) or relatives of the settler mainly dependent on the settler for their support or maintenance or where settler is a Hindu undivided family, for the exclusive benefit of its members so dependent upon it.

Where the relevant income consists of or includes profits and gains of business, the preceding concessional method of taxation shall apply only if the income is receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him.

Where the whole or any part of the relevant income is not exempt under section 11 or section 12 because any income thereof enures to the benefit of prohibited persons or the rules with regard to investment in specified channels have not been followed, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

(3) **Taxation of Oral Trusts [Section 164A]:** Oral Trust is a trust which is not declared by a duly executed instrument in writing. As per section 164A, any income which a trustee receives or is entitled to receive on behalf of or for the benefit of any person under an oral trust will be chargeable to income tax at the maximum marginal rate.

However, such trust shall be deemed to be a trust declared by a duly executed instrument in writing if a statement in writing, signed by the trustee or trustees, setting out the purpose or purposes of the trust, particulars as to the trustee or trustees, the beneficiary or beneficiaries and the trust property, is forwarded to the Assessing Officer within three months from the date of declaration of the trust. In such a case, the income would be assessable at the rates applicable to the total income of beneficiaries.

(4) **Case where part of trust income is chargeable [Section 165]:** In cases where only same portion of the trust income to which the beneficiary or beneficiaries is/are entitled is taxable and the other portion is not taxable, the taxable portion of the income received by him from the trust as a beneficiary shall be only such portion thereof as bears to the whole income of the trust. In other words, where a part only of the trust income is chargeable to tax under this Act, the beneficiaries' share of the income should be taken to be that derived proportionately from the chargeable and non-chargeable portions of the trust income and should be assessed accordingly in the hands of trustee/s.

22.4 DIRECT ASSESSMENT OR RECOVERY NOT BARRED [SECTION 166]

In case of a beneficiary or the person on whose behalf or for whose income is receivable is received by any other person, then such beneficiary or the person on whose behalf or for whose benefit, it is so received shall be liable to be assessed directly and tax can also be recovered from him.

22.5 REMEDIES AGAINST PROPERTY IN CASES OF REPRESENTATIVE ASSESSEES [SECTION 167]

The Assessing Officer shall have the same remedies against all property of any kind vested in or under the control or management of any representative assessee as he would have against the property of any person liable to pay any tax irrespective of the fact whether the demand is raised against the representative assessee or against the beneficiary direct.

22.6 EXECUTORS AND ADMINISTRATORS [SECTIONS 168 AND 169]

(1) **Who is an executor or administrator?:** Executor is a person appointed to carry out to carry out the instructions and wishes of the deceased and to administrate the estate of a deceased person. The executor is appointed by the testator of the will (the individual who makes the will). An administrator is a person appointed by competent authority to administer the estate of a deceased person when there is no executor

Executor includes an administrator or other person administering the estate of a deceased person. [*Explanation* to section 168]

(2) **Chargeability of income in the hands of executor:** Where executors and administrators or other persons have been appointed to administer the estate of a deceased, the income arising from such an estate shall be chargeable to tax in the hands of the executor or executors, as the case may be.

In case there is one executor - If there is one executor the assessment shall be made on him in the status of an individual.

In case of more than one executor - If on the other hand, there are more executors than one, then the assessment will be made on them in the status of an association of persons.

The residential status of the executor shall be determined on the basis of the residential status of the deceased person during the previous year in which his death took place.

(3) **Separate assessments on executor:** The assessment of an executor shall be made separately from any assessment that may be made on him in respect of his own income.

Separate assessment shall be made on the executor or executors on the total income of each completed previous year or part thereof as is included in the period from the date of death of the deceased to the complete distribution to the beneficiaries of the estate according to their several interests.

The income chargeable in the hands of the executor or administrator is the income of the period commencing from the date of the death of the deceased. Any income in respect of any period prior to the date of death i.e., from the first day of the accounting year and ending with the date of death should be assessed in the hands of the legal representative under section 159.

(4) **Income applied for the benefit of specific legatee to be excluded from total income of executor:** In computing total income of any previous year, any income of the estate of that previous year which is distributed or applied to the benefit of any specific (but not residuary) legatee of the estate during that previous year shall be excluded from the computation of the total income of that previous year assessed in the hands of the executors. The income so excluded shall, however, be included in the total income of the previous year of the 'specific legatee' himself.

However, where the executors apply a portion of the income received by them from the estate in a particular way pursuant to the directions of the testator or other legal obligations, it is merely an application of income and would not entitle the executors to claim any deduction in respect of the income so applied. Thus, payment of the cost of the probate, death duties and other debts due to the State or periodic payments to the beneficiaries (other than the specific legatees) property of the testator or to a Court cannot be excluded in computing the executor's chargeable income from the estate

Under the general law when an executor gives his assent to a specific legatee, the title of the legatee relates back to the date of death and consequently the income arising after the death and before the asset belong to the legatee is taxable in his hands but not as the income of the executor. However, it is only the income distributed to or applied for the benefit of any specific legatee during the previous year which should be excluded from the executors' total income. In other words, if the income is not so distributed or applied in the previous year, it would be taxable as part of the income of the executor. If the executor is also the sole beneficiary it does not necessarily follow that he receives the income in the latter capacity.

If the legatee is a residuary legatee, the income from the residue is the income of the executor taxable in his hands so long as the estate has not been completely administered; it is only after the estate is fully administered and the net residue is ascertained that the residuary legatee gets a title and the income, therefore, can be said to accrue to him and can be taxed in his hands. This principle would apply irrespective of the fact whether the residue is settled in trust for a life tenant or is bequeathed absolutely and it would apply even if a part of the income of the estate had been actually paid on account to the residuary legatee pending the administration of the estate. However, the administration may be regarded as completed, the executor's assent to the residuary legacy as valid and the legatee's title as established, although some liabilities due by the estate may remain undischarged.

(5) **Right of executor to recover tax paid:** According to section 169, the rights of the executors for retention and reimbursement or for the recovery of the tax paid by them are the same as those of representative assessees under section 162 i.e., the executor will be able to recover such tax from the estate or from the persons on whose behalf it is paid.

22.7 LIABILITY OF SUCCESSOR TO BUSINESS IN RESPECT OF TAX CHARGEABLE FROM THE PREDECESSOR [SECTION 170]

(1) **Assessment of successor and predecessor:** Where a person carrying on any business, profession, or vocation is succeeded by another person who continues to carry on that business or profession, both the successor and the person who is succeeded to (hereinafter called the predecessor) shall be assessed in respect of the actual share to which he is separately entitled in his income, profits and gains of the previous year. Thus, the predecessor in business would be assessable in respect of the income of the year of succession upto the date of succession while the successor would be assessable in respect of the income of that year after the date of succession. Accordingly, the income of the year in which the succession takes place is to be apportioned between the predecessor and the successor with the share of each. The income must be computed separately and each must

be granted the deductions and allowance applicable to him. The assessment on each of these persons must be separate and distinct.

(2) **Assessment when predecessor cannot be found:** Where the predecessor cannot be found, the assessment of

- the income of the year in which the succession took place up to the date of succession and
- of the one year preceding the year of succession

should be made on the successor in like manner and to the same extent as it would have been made on the predecessor, and all the provisions of the Act shall apply accordingly.

(3) **Recovery of sum payable by predecessor from the successor:** If the assessment has already been made on the predecessor for either or both of the years aforesaid, but the sum payable in pursuance of each assessment cannot be recovered from the predecessor or any person, the sum payable by the predecessor shall be payable and recoverable by the successor. Successor shall be entitled to recover the full amount of sum paid by him from the predecessor.

Under this section, the Assessing Officer is required to record a finding that the sum in respect of the income of the year of succession or the preceding year cannot be recovered from the predecessor, before seeking to recover such sum from the successor.

(4) **Predecessor income includes capital gain by virtue of succession:** The successor's liability to tax arises also in respect of any gain (e.g., capital gains) accruing to the predecessor from the transfer of the business or profession as a result of the succession. [*Explanation* to section 170]

22.8 INCOME EARNED IN A FINANCIAL YEAR ASSESSED IN THE SAME FINANCIAL YEAR - EXCEPTIONS TO THE GENERAL RULE [SECTIONS 174 TO 176]

Generally, the assessment year is always ahead of the previous year. In other words, income which is earned during one financial year is not charged to tax in that very same year but in the next following financial year. To this general rule, there are certain exceptions which are as under:

(1) **Persons leaving India [Section 174]**

Where it appears to the Assessing Officer that any individual may leave India during the current financial year or shortly after its expiry and that there is no present intention of his returning to India, the Assessing Officer may proceed to assess his total income for the period comprised in the current financial year i.e. the total income of the period from the expiry of the last previous year and if a previous year has already been determined in his case upto the probable date of his departure.

The total income of each completed previous year or part thereof including such period shall be chargeable to tax at the rates in force in that assessment year and separate assessment must be made in respect of each such completed previous year or part thereof. The Assessing Officer is entitled to estimate the income of the individual leaving India for such period or part thereof in cases where his income cannot be readily determined in the manner provided in the Act for the computation of income under each head.

For the purposes of making this assessment, the Assessing Officer may serve a notice upon the assessee requiring him to furnish within such time (not being less than seven days), as may be specified in the notice, a return under section 142(1)(i) setting forth his total income for each completed previous year comprised in the period of assessment, and his estimated total income for any part of the period. If an assessee does not furnish the return as required by the notice of the Assessing Officer, a best judgment assessment must be made on him under section 144; non-compliance with the requirements of the notice may also attract liability to penalty under section 271.

The tax chargeable on any, individual under the section shall be over and above the tax, if any, chargeable under any other provision of the Act.

Assessment under this section may be made even on the income of the period beyond the expiry of the assessment year if the probable date of the assessee's departure is after the expiry of the assessment year. In addition to the issue of notice for making an assessment under this section, the Assessing Officer may as well issue notice under sections 142(1)(i) and 148(1) requiring him to furnish a return and other relevant information within such period being not less than seven days, as he may think fit. Thus, the Assessing Officer is empowered to make more assessment than one on a person leaving India before his departure from India.

(2) AOP or BOI or Artificial Juridical Person formed for a particular event or purpose [Section 174A]

Section 174A provides for accelerated assessments in cases of certain AOP, BOI etc. If such AOP, BOI etc. is formed or established for a particular event or purpose and the Assessing Officer apprehends that the AOP/BOI is likely to be dissolved in the same year or in the next year, the Assessing Officer can make assessment of the income upto the date of dissolution as income of the relevant assessment year. The proceedings in this case shall be on the same basis as contained in section 174 which deals with accelerated assessment of persons leaving India.

(3) Persons trying to alienate their assets [Section 175]

If it appears to the Assessing Officer during any current assessment year that any person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets with a view to avoiding payment of the whole or any part of his liability under the Income-tax Act, the total income of such person, for the period from the expiry of the previous year for that assessment year to the date when the Assessing Officer commences proceedings under this section shall be chargeable to tax in that assessment year itself. The proceedings in this case also shall be on the same basis as contained in section 174 which deals with accelerated assessment of persons leaving India.

(4) **Discontinuance of business or profession [Section 176]**

Where any business or profession is discontinued in any assessment year, an assessment may be made in that very year of the income from business for the period between the expiry of the previous year relevant to that assessment year and the date of discontinuance, in addition to the assessment, if any, made on the income, profits or gains of the earlier previous year or years. Thus, the Assessing Officer has an option to make a premature assessment of the profits earned up to the date of discontinuance in the year of discontinuance instead of the usual financial year.

Discontinuance and dissolution of business or profession by an association or a firm do not fall within the provisions of section 176 as they are dealt with under sections 177 and 189 respectively.

(i) **Meaning of discontinuance of business:** The term 'discontinuance' used in this context, refers to complete cessation of the business instead of a mere change of ownership or change in the constitution of firm. A change of ownership may involve succession and, for purpose of this section, a business must be regarded as being continued despite successive changes in its ownership. Since succession and discontinuance are two mutually exclusive concepts there cannot be a discontinuance in cases where there is succession. If a part of the business of an assessee is dropped owing to its non-profitable nature, either permanently or temporarily, it would not imply that the business has been discontinued. In other words, inactivity in trade does not lead to the conclusion that the trade has been discontinued. There may be cases where the trade may be carried on even after the dissolution of the firm or the liquidation of the company. The amalgamation of two separate and independent business belonging to two distinct owners may result in the discontinuance of those business and the change of ownership. Where the business of a joint family or a firm is split up on partition of the family or the dissolution of the firm and the business is divided into branches or portions amongst the members, it would be a case of discontinuance of the old business even if some or all the members carry on their business in the same premises and take advantages of the old business connections. This is because of the fact that in such a case of the assessee i.e., the family or the firm, has ceased to carry on the business and their is no succession insofar as the integrity of the business is not preserved as was held in *Sait Nagjee Purshotam and Co. Vs. C.I.T. (1964) 51 I.T.R. 489 (S.C.).*

(ii) **Meaning of discontinuance of profession:** In the case of a profession a firm may discontinue its profession though its patterns may remain in the profession and *vice versa*. Where a professional man joins a firm, he does not cease to carry on his profession and only when he retires from the firm and ceases to practice once and for all he would be said to have discontinued his profession even though the firm in which he was a partner might continue to function after his retirement with or without new partners. In order to constitute proper discontinuance of the profession for purposes of this section it is not essential that there should be a complete cessation of the professional practice for the rest of man's life. For instance, an advocate would be said to have discontinued his professional practice when he takes up a full-time assignment as a judge or a legal adviser; but after retirement or resignation from the service he is entitled to return to his professional practice again.

(iii) **Separate assessment of each year:** The total income of each completed previous year or part thereof included in the period for which assessment is to be made shall be computed separately and shall be chargeable to tax at the rate or rates in force in respect of each of the relevant assessment years.

(iv) **Notice to Assessing Officer:** Any person discontinuing his business or profession must necessarily give notice to the Assessing Officer of the fact of discontinuance within fifteen days from the date thereof. Failure to give this notice would entail the levy of penalty under section 272.

(v) **Income received after discontinuance:** In the case of discontinuing any business or profession on account of the cessation of the profession by, or on the retirement or death of the person carrying on profession, any sum received in any year after the date of discontinuance is deemed to be the income of the recipient and charged to tax accordingly in the year of receipt in his hands as if the amount would have been included in his total income if it had been received before the discontinuance.

The other procedural provisions in regard to service of notice, mode of assessment, collection of tax etc. are the same as those applicable to a person leaving India, as discussed earlier.

22.9 LIABILITIES ARISING WHEN AN ASSOCIATION CARRYING ON BUSINESS IS DISSOLVED OR BUSINESS IS DISCONTINUED [SECTION 177]

(1) Where any business or profession carried on by an association of persons had been discontinued or where an association of persons is dissolved, the Assessing Officer is bound to make an assessment of the total income of the association of persons as if no such discontinuance has taken place. Consequently, all the provisions of the Act, including those relating to the levy of penalty or any other sum chargeable under the Act, apply to such an assessment.

(2) If the Assessing Officer or the Commissioner (Appeals) in the course of any proceeding under the Act, in respect of any association of persons is satisfied that the association of persons is guilty of any of the acts attracting the provisions of sections 270 to 275, he may impose or direct the imposition of a penalty in accordance with those sections.

(3) Every person who was at the time of discontinuance or dissolution a member of the association of persons, and the legal representative of any such member who is deceased, shall be jointly and severally liable for the amount of tax penalty or other sum payable and all the provisions of the Act, so far as may be, shall apply to any such assessment, imposition of penalty etc.

(4) Where the dissolution or discontinuance had taken place after the commencement of any proceeding under the Act, the proceeding may be continued against the member of the association immediately prior to the discontinuance or dissolution and the legal representative of any deceased member from the stage at which they stood at the time of discontinuance or dissolution. The liability of the legal representative of any deceased member shall, however, be limited to the extent to which the estate is capable of meeting the liability. But if the legal representative, while his tax liability remains undischarged, creates a charge on or disposes off or parts with any of the assets of the estate of the deceased which are, or may, come into his possession, this personal liability shall, however, be limited to the value of the assets so charged, disposed of or parted with.

22.10 COMPANIES UNDER LIQUIDATION [SECTIONS 178 AND 179]

(1) In the case of all companies [Section 178]

(i) **Notice to Assessing Officer:** Every person

(a) who is the liquidator of any company which is being wound up, whether under the orders of a Court or otherwise, or

(b) who has been appointed as the receiver of any assets of a company

is bound under a statutory obligation to give notice of his appointment as liquidator or receiver, as the case may be. This notice may be given within thirty days of his appointment to the Assessing Officer having jurisdiction to assess the income of the company.

(ii) **Information of tax due by the Assessing Officer:** The Assessing Officer, in his turn is bound after making such enquiries or calling for such information as he may deem fit, to notify to the liquidator, within three months from the date of receipt of the notice of appointment, of the amount which in his opinion would be sufficient to provide for any tax which is then or likely thereafter to become payable by the company.

(iii) **Restriction on liquidator to part with assets:** The liquidator is debarred from parting with the assets of company and its properties in his hands until he is notified by the Assessing Officer of the amount which will be sufficient to provide for any tax which is then, or is likely thereafter, to become payable by the company except with the prior approval of

- the Principal Chief Commissioner or
- Chief Commissioner or
- Principal Commissioner or
- Commissioner

and on being so notified, shall asides an amount equal to the amount notified.

However, the above restriction of debarring the liquidator from parting with assest or properties shall not be applicable on

- payment of the tax payable by the company,
- payment to secured creditors whose debts are entitled under law to priority of payments over the debts due to the Government on the date of liquidation and
- meeting such costs and expenses of the winding up of the company

as are, in the opinion of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or the Commissioner, reasonable.

(iv) **Consequences of failure to give notice or set aside the tax due by the liquidator:** If the liquidator fails to notify the Assessing Officer of his appointment within the time specified or fails to set aside the amount intimated by the Assessing Officer as being sufficient to provide for the tax liability of the company or parts with any of the assets or property of the company in his hands in contravention of the above provisions, he shall be personally liable for payment of the tax which the company would be liable to pay.

However, if the amount of any tax payable by the company is notified by the Assessing Officer, the personal liability of the liquidator under this sub-section shall be to the extent of such amount.

Failure to comply with the above requirement would be an offence punishable under section 276A.

Where there are more liquidators than one, their obligations and liabilities under this section are joint and several.

(v) **Overrides other laws except IBC, 2016:** The provisions of this section have the effect of over-riding anything to the contrary contained under the Companies Act or any other law for the time being in force and apply to all companies, public or private except the provisions of Insolvency and Bankruptcy Code, 2016.

(2) **In the case of private companies [Section 179]**

(i) **Liability of directors:** Where any tax due from a private company in respect of any income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was director of a private company at any time during the relevant previous year shall be jointly and severally liable for the payment of the tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

The personal liability imposed by this section on the directors of a private company shall have the effect of over-riding any provision under the Companies Act, 2013 by which the liability of the directors is reduced or curtailed. Thus, personal liability can be imposed by the Assessing Officer on a direction even without any adjudication by a Court.

(ii) **Meaning of Tax Due:** For the purposes of this section, “tax due” includes penalty, interest or any other sum payable under the Income-tax Act, 1961.

EXERCISE

Question 1

"NEPTUNE" is a shipliner, used in carrying passengers and cargo, owned by M/s Thomas & Thomas of U.K. The ship carried the passengers and cargo in June, 2019 from Singapore to Chennai and vice versa and collected charges thereof amounting to ₹ 200 lacs. It left Chennai port on 15.6.2019 for its journey to Korea. No other journey to India was undertaken by any of the vessels of the company during the year ended on 31.3.2020. The non-resident company had authorized its Indian agent to comply with the income tax provisions.

You are consulted by the company to explain about the procedure as to return of income to be filed and the period within which the assessment thereof will be completed by the Assessing Officer.

Answer

M/s. Thomas & Thomas of U.K shall be required to file the return of income in India for the journey of its ship before it leaves for onward journey to Korea.

However, as per the proviso to section 172(3), where the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return before the departure of the ship from the port, and if satisfactory arrangements have been made for filing of return and payment of tax by the authorised agent in India, he may permit filing of return within 30 days of departure of the ship.

Section 172(4A) provides a time limit of 9 months for completion of assessment in such cases. The period of 9 months is reckoned from the end of the financial year in which the return under section 172(3) is furnished.

Question 2

The directors of a private company are personally liable to pay the income tax due from the company but their liability does not extend towards interest and penalty payable by the company. Discuss.

Answer

Section 179 contains the provisions relating to the liability of directors of a private company in liquidation in respect of tax due from the company. Where any tax due from a private company in respect of income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of such company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax. However, the director shall not be so liable if he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Explanation to section 179 clarifies that the expression **"tax due" includes penalty, interest or any other sum payable under the Act.** Therefore, the directors liability is not confined to tax alone but extends to penalty, interest or any other sum payable by the company.

Question 3

In respect of the taxes due from a private limited company, which could not be recovered from it, the Tax Recovery Officer attached the properties of an erstwhile director for recovery thereof. It was contended by the director that a notice under section 156 had not been served on him and therefore, the proceedings for recovery were not valid. What is the correct legal position?

Answer

The liability of a director of a private limited company for arrears due from the company is provided in section 179. There is no necessity to issue a notice to a director, because the position of a person on whom liability is fastened is equated to that of an 'assessee' in default. For the purpose of section 220(4), the person held liable under section 179 would be deemed to be an assessee-in-default. This may be contrasted with the arrears of a partnership firm which may be recovered from the erstwhile partners only after issue of a notice under section 156 and a default is committed by them.

Under section 179, every person who was a director of a private limited company at any time during the relevant previous year shall be jointly and severally liable for the payment of taxes which cannot be recovered from the company, unless he proves that the non-recovery cannot be attributed to any gross negligence, misfeasance or breach of duty on his part in relation to the affairs of the company.

CHAPTER 23

MISCELLANEOUS PROVISIONS

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **identify** the permissible mode of taking or accepting certain loans, deposits and money receivable in relation to transfer of immovable property and **examine** the penal consequences for non-compliance;

- **recognize** the permissible mode of receipt of amounts exceeding a certain threshold and **examine** the penal consequences for receipt of such amount by any other mode;

- **identify** the permissible mode of repayment of certain loans or deposit or advance money repayable in relation to transfer of immovable property and **examine** the penal consequences for non-compliance;

- **appreciate** the provisions relating to provisional attachment of property to protect the interest of the revenue;

- **list out** the permissible modes of service of notice and the persons on whom notice should be served;

- **comprehend** the meaning of "specified financial transaction" and **identify** the specified persons responsible for furnishing statement of financial transaction or reportable account;

- **list out** the persons who can act as "authorised representatives" on behalf of the assessee.

23.1 MODE OF TAKING OR ACCEPTING CERTAIN LOANS, DEPOSITS AND SPECIFIED SUM [SECTION 269SS]

Section 269SS provides that no person shall take or accept any loan or deposit or specified sum from any other person (depositor) except by account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account ***or through such other prescribed electronic mode (w.e.f. 1.9.2019)***, if –

(1) The amount of such loan or deposit or specified sum or the aggregate amount of such loan, deposit of specified sum; or

(2) 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

(3) The amount or the aggregate amount referred to in (1) together with the amount or the aggregate amount referred to in (2), is ₹ 20,000 or more.

Non-applicability of the above requirement in certain cases

(1) Loan or deposit or specified sum taken or accepted from, or any loan or deposit taken from or accepted by the Government, any banking company, post office saving bank or any co-operative bank, any corporation established by a Central, State or Provincial Act: or any Government company as defined in 2(45) of the Companies Act, 2013.

(2) Loan or deposit or specified sum taken, or accepted by, any institution, association or body or class of institutions, associations, bodies which the Central Government may, for reasons to be recorded in writing notify in this behalf in the Official Gazette.

(3) Cases where the persons involved in the transaction derive income only from agriculture or where neither of them has any income chargeable to tax under the Act.

Meaning of certain terms

	Term	Meaning
(i)	Loan or deposit	Any loan or deposit of money
(ii)	Specified sum	any sum of money receivable, whether as advance or otherwise, in relation to transfer of immovable property, whether or not the transfer takes place.

Penalty for failure to comply with the provisions of section 269SS

If a person takes or accepts any loan or deposit or specified sum in contravention of the provisions of section 269SS, he shall be liable to pay, by way of penalty under section 271D, a sum of equal to the amount of the loan or deposit or specified sum taken or accepted.

23.2 MODE OF UNDERTAKING TRANSACTIONS [SECTION 269ST]

Section 269ST provides that no person receive an amount of is **₹ 2,00,000** or more except by account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account ***or through such other prescribed electronic mode (w.e.f. 1.9.2019)***, –

(a) in aggregate from a person in a day; or

(b) in respect of a single transaction; or

(c) in respect of transactions relating to one event or occasion from a person.

Note - The CBDT has, vide Circular No. 22/2017 dated 3.7.2017, clarified that in respect of receipt in the nature of repayment of loan by Non-banking Finance Companies(NBFCs) or Housing Finance Companies (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 and all the instalments paid for a loan shall not be aggregated for the purposes of determining applicability of the provisions section 269ST.

Non-applicability of the above requirement in certain cases

(1) any receipt by Government, any banking company, post office savings bank or co-operative bank

(2) transactions of the nature referred to in section 269SS.

(3) such other persons or class of persons or receipts, notified by the Central Government.

Accordingly, vide Notification No. 28/2017, dated 5-4-2017 and Notification No. 57/2017, dated 3-7-2017, the Central Government has specified that the provision of section 269ST shall not apply to the following, namely:-

(a) receipt (cash withdrawals) by any person from a bank, co-operative bank or a post office savings bank

(b) receipt by a business correspondent on behalf of a banking company or co-operative bank, in accordance with the guidelines issued by the Reserve Bank of India;

(c) receipt by a white label automated teller machine operator from retail outlet sources on behalf of a banking company or co-operative bank, in accordance with the authorisation issued by the Reserve Bank of India under the Payment and Settlement Systems Act, 2007;

(d) receipt from an agent by an issuer of pre-paid payment instruments, in accordance with the authorisation issued by the Reserve Bank of India under the Payment and Settlement Systems Act, 2007;

(e) receipt by a company or institution issuing credit cards against bills raised in respect of one or more credit cards;

(f) receipt which is not includible in the total income under section 10(17A).

Penalty for failure to comply with the provisions of section 269ST

If a person receives any sum in contravention of the provisions of section 269ST, he shall be liable to pay, by way of penalty under section 271DA, a sum of equal to the amount of such receipt. However, no penalty shall be imposed if such person proves that there were good and sufficient reasons for the contravention.

Applicability of income-tax provisions under section 40A(3), section 269ST and Rule 114B to cash sale of agricultural produce by cultivators/agriculturists to traders [Circular No. 27/2017, dated 3-11-2017]

The provisions of section 40A(3) provide for the disallowance of expenditure exceeding ₹ 10,000 made otherwise than by an account payee cheque/draft or use of electronic clearing system through a bank account. However, Rule 6DD carves out certain exceptions from application of the provisions of section 40A(3) in some specific cases and circumstances, which *inter alia*, include payments made for purchase of agricultural produce to the cultivators of such produce. Therefore, no disallowance under section 40A(3) can be made if the trader makes cash purchases of agricultural produce from the cultivator.

Further, section 269ST, subject to certain exceptions, prohibits receipt of ₹ 2 lakh or more, otherwise than by an account payee cheque/draft or by use of electronic clearing system through a bank account from a person in a day or in respect of a single transaction or in respect of transactions relating to an event or occasion from a person. Therefore, any cash sale of an amount of ₹ 2 lakh or more by a cultivator of agricultural produce is prohibited under section 269ST.

Furthermore, the provisions relating to quoting of PAN or furnishing of Form No. 60 under Rule 114B do not apply to the sale transaction of ₹ 2 lakh or less.

In view of the above, it is clarified by the CBDT that cash sale of the agricultural produce by its cultivator to the trader for an amount less than ₹ 2 lakh will **not** -

(a) result in any disallowance of expenditure under section 40A(3) in the case of trader.

(b) attract prohibition under section 269ST in the case of the cultivator; and

(c) require the cultivator to quote his PAN/ or furnish Form No. 60.

Clarifications in respect of section 269ST [Circular No. 22/2017, Dated 03.07.2017]

With a view to promote digital economy and create a disincentive against cash economy, new section 269ST has been inserted in the Income-tax Act, 1961 vide Finance Act, 2017. 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. Penal provisions have also been introduced by way of a new section 271DA, which provides that if a person receives any amount in contravention to the provisions of section 269ST, it shall be liable to pay penalty of a sum equal to the amount of such receipt.

Subsequently, representations were received from non-banking financial companies (NBFCs) and housing finance companies (HFCs) as to whether the provisions of section 269ST shall apply to one instalment of loan repayment or the whole amount of such repayment.

Accordingly, the CBDT has, vide this circular, 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 section 269ST(b) and all the instalments paid for a loan shall not be aggregated for the purposes of determining applicability of the provisions section 269ST.

23.3 ACCEPTANCE OF PAYMENT THROUGH PRESCRIBED ELECTRONIC MODES [SECTION 269SU]

(i) ***Legislative intent*** - *In order to achieve the mission of the Government to move towards a less cash economy to reduce generation and circulation of black money and to promote digital economy, new section 269SU has been inserted w.e.f. 1st November, 2019.*

(ii) ***Applicability*** - *This section requires every person, carrying on business to provide facility for accepting payment through the prescribed electronic modes, in addition to the facility for other electronic modes of payment, if any, being provided by such person, if his* ***total sales, turnover or gross receipts in business exceeds Rs.50 crore during the immediately preceding previous year****.*

(iii) ***Penalty for non-compliance*** - *In order to ensure compliance of the provisions of section 269SU, new section 271DB has been inserted with effect from 1st November, 2019 to provide that the failure to provide facility for electronic modes of payment prescribed under section 269SU would attract penalty of a sum of ₹ 5,000, for every day during which such failure continues. However, the penalty shall not be imposed if the person proves that there were good and sufficient reasons for such failure. Further, any such penalty shall be imposed by the Joint Commissioner.*

(iv) ***Consequential amendment in the Payment and Settlement Systems Act, 2007*** – *This has been effected to ensure that no bank or system provider imposes any charge upon anyone, either directly or indirectly, for using the modes of electronic payment prescribed under section 269SU of the Income-tax Act, 1961.*

23.4 MODE OF REPAYMENT OF CERTAIN LOANS OR DEPOSITS [SECTION 269T]

Section 269T provides that no branch of the banking company or a co-operative bank or any other company or co-operative society or a firm or other person, shall repay any loan or deposit made with it or any specified advance received by it otherwise than by account payee cheque or account payee bank draft, drawn in the name of the person who has made the loan or depositor paid the specified advance, or by use of electronic clearing system through a bank account ***or through such other prescribed electronic mode (w.e.f. 1.9.2019)***, if –

(1) the amount of loan or depositor specified advance together with interest, if any, payable thereon; or

(2) the aggregate amount of such 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 eitherin his own name or jointly with any other person on the date of such repayment, together with the interest, if any, payable on such loan or deposit; or

(3) the 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 interest, if any, payable on such specified advances is ₹ 20,000 or more.

Non-applicability of the above requirement in certain cases

(1) Where the repayment is made by a branch of bank or a cooperative bank, such repayment could be made by crediting the amount of such loan or deposit to the saving bank account or the current account, if any, with such branch of the person to whom such loan or deposit has to be repaid.

(2) Further, the provisions of this section shall not apply in case of repayment of any loan or deposit or specified advance taken or accepted from -

(i) Government;

(ii) any banking company, post office savings bank or co-operative bank;

(iii) any corporation established by a Central, State or Provincial Act;

(iv) any Government company as defined in section 617 of the Companies Act, 1956[1];

(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.

[1] Section 2(45) of the Companies Act, 2013

Meaning of certain terms

	Term	Meaning
(1)	Banking company	A company to which the Banking Regulation Act, 1949 applies and includes any bank or banking institution referred to in section 51 of that Act.
(2)	Co-operative bank	The meaning assigned to it in Part V of the Banking Regulation Act, 1949 i.e., a state co-operative bank, a central co-operative bank and a primary co-operative bank.
(3)	Loan or Deposit	Any loan or deposit of money which is repayable after notice or repayable after a period. In the case of any person other than a company, loan or deposit of any nature will be covered by this section.
(4)	Specified Advance	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.

Penalty for failure to comply with the provisions of section 269T

If a person repays any loan or deposit or specified advance referred to in section 269T otherwise than in accordance with the provisions of that section, he shall be liable to pay, by way of penalty under section 271E, a sum equal to the amount of the loan or deposit or specified advance so repaid.

23.5 TRANSFERS TO DEFRAUD REVENUE VOID [SECTION 281]

(1) As a safeguard against non-realisation of revenue due to fraudulent transferring of assets by a defaulting assessee it is provided under this section that, certain transfers specified therein are deemed to be void for purpose of income-tax.

(2) Accordingly, in cases where, during the pendency of any proceeding under the Income-tax Act, 1961 or after the completion thereof, but before the service of notice by the Tax Recovery Officer any assessee creates a charge on, or parts with, the property by way of sale, mortgage, gift, exchange, or any other mode of transfer whatsoever of any of his assets in favour of any other person such a charge or transfer must be deemed to be void as against any claim in respect of any tax, penalty, interest or fine payable by the assessee as a result of the completion of the proceedings or otherwise.

(3) The charge or transfer made by the assessee, however, would not be void in case where it is made:

(a) for adequate consideration and without any notice of the pendency of such proceeding or, as the case may be, without any notice of such tax or other monies remaining payable by the assessee; or

(b) with the previous permission of the Assessing Officer.

(4) This provision applies to all cases where the amount of tax or other sum of money which is payable or likely to be payable exceeds ₹ 5,000 and the assets which are charged or transferred by the assessee exceeds ₹ 10,000 in value, in the aggregate.

(5) For this purpose, the term 'assets' should be taken to mean land, buildings, machinery, plant, shares, securities and fixed deposits in bank to the extent to which any of these assets do not form part of the stock-in-trade of the business carried on by the assessee. In other words, if these items of properties represent the stock-in-trade of the assessee's business, their transfer would not be treated as void.

23.6 PROVISIONAL ATTACHMENT TO PROTECT THE INTEREST OF THE REVENUE [SECTION 281B]

(1) **Assessing Officer's power to provisionally attach property for protecting interests of the revenue:** Under section 281B, the Assessing Officer is empowered to provisionally attach any property of the assessee, by an order in writing, during the pendency of assessment or reassessment proceedings, with the prior approval of the income-tax authorities specified therein, if he is of the opinion that it is necessary to do so for the purpose of protecting the interests of the revenue. Such provisional attachment has to be made in the manner provided in the Second Schedule.

(2) **Validity of provisional attachment:** The provisional attachment shall be valid for a period of 6 months from the date of the order. However, the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director may extend the period of provisional attachment, for reasons to be recorded in writing, by a further period as he thinks fit. However, the total period of extension should not exceed two years or sixty days after the date of assessment or reassessment, whichever is later.

(3) **Recommendation of Income Tax Simplification Committee:** The Income Tax Simplification Committee under the chairmanship of Justice R.V. Easwar (Retd.) has recommended that provisional attachment of property could be substituted by a bank guarantee subject to fulfilment of certain conditions.

(4) **Furnishing bank guarantee in lieu of provisional attachment of property - Enabling provisions inserted**: Accordingly, sub-sections (3) to (9) have been inserted in section 281B providing for furnishing of bank guarantee in lieu of provisional attachment of property. Further *Explanation* to section 281B(1), providing that proceedings under section

132(5) would be deemed to be proceedings for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment, has been consequently omitted.

(5) **Furnishing of bank guarantee in lieu of provisional attachment [Section 281B(3)]:** The Assessing Officer shall, by an order in writing, revoke provisional attachment of property made under section 281B(1) in a case where the assessee furnishes a guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.

(6) **Reference to Valuation Officer [Section 281B(4)]:** For enabling determination of the fair market value of the property provisionally attached, the Assessing Officer may, make a reference to the Valuation Officer, who is required to estimate of the fair market value of the property and submit the report of such estimation to the Assessing Officer within a period of 30 days from the date of receipt of such reference.

(7) **Time limit for passing order revoking the attachment of property [Section 281B(5)]:** For ensuring revocation of attachment of property in lieu of bank guarantee in a time bound manner, an order revoking the attachment has to be made by the Assessing Officer within the following time period:

	Case	Time period for revoking attachment
(i)	in a case where a reference is made to the Valuation Officer	within 45 days from the date of receipt of such guarantee
(ii)	in any other case	within 15 days from the date of receipt of such guarantee

(8) **Assessing Officer empowered to invoke bank guarantee for failure to pay sum specified in notice of demand [Section 281B(6)]:** Where a notice of demand specifying a sum payable is served upon the assessee and the assessee fails to pay such sum within the time specified in the notice of demand, the Assessing Officer may invoke the bank guarantee, wholly or partly, to recover the said amount.

(9) **Power to invoke bank guarantee on assessee's failure to renew or furnish new guarantee [Section 281B(7)]:** In a case where the assessee fails to renew the bank guarantee or fails to furnish a new guarantee from a scheduled bank for an equal amount fifteen days before the expiry of such guarantee, the Assessing Officer shall, in the interests of the revenue, invoke the bank guarantee.

(10) **Manner of adjustment of amount realized by invoking bank guarantee [Section 281B(8)]:**

(i) The amount realised by invoking the bank guarantee shall be adjusted against the existing demand which is payable by the assessee;

(ii) The balance amount, if any, has to be deposited in the Personal Deposit Account of the Principal Commissioner or Commissioner in the branch of Reserve Bank of India or the State Bank of India or of its subsidiaries or any bank as may be appointed by the Reserve Bank of India as its agent at the place where the office of the Principal Commissioner or Commissioner is situated.

(11) **Release of bank guarantee [Section 281B(9)]:**In a case where the Assessing Officer is satisfied that the bank guarantee is not required anymore to protect the interests of the revenue, he shall release that guarantee forthwith.

23.7 SERVICE OF NOTICE [SECTIONS 282, 283 & 284]

(1) **Permissible modes of service of notice [Section 282]** - The service of a notice or summon or requisition or order or any other communication under the Act may be made by delivering or transmitting a copy thereof to the person named therein -

(i) by post or such courier services as approved by the CBDT; or

(ii) in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or

(iii) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or

(iv) by any other means of transmission as may be provided by rules made by the CBDT in this behalf.

(2) **Rules to provide for the addresses for communication** - The CBDT is empowered to make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which such communication may be delivered or transmitted to the person named therein.

(3) **Addressee in case of different assessees** – The following is a list of persons on whom notice should be served and such a notice will be notice to the corresponding assessee mentioned.

	Assessee	Addressee
(i)	An existing firm	Any member of the firm
(ii)	An existing H.U.F.	The Manager or any adult member of the family.
(iii)	A Company	The Principal Officer thereof
(iv)	Local authority	The Principal Officer thereof
(v)	An existing association or body of individuals	The Principal Officer or any member thereof
(vi)	An individual	The individual himself

(vii)	Any other person	The person incharge of the management and control of his affairs.
(viii)	A dissolved firm	Any adult person who was a partner immediately before dissolution.
(ix)	A partitioned H.U.F.	The last manager of the family; if he is dead, all adults who were members immediately before the partition.
(x)	A dissolved association of persons	Any person who was a member immediately before dissolution
(xi)	A discontinued business	The assessee; In the case of a firm or an association of persons, any person who was a member at the time of discontinuance; In the case of a company, its Principal Officer.

23.8 AUTHENTICATION OF NOTICES AND OTHER DOCUMENTS [SECTION 282A]

(1) Section 282A provides that where any notice or other document is required to be issued by any income-tax authority, such notice or other document should be signed and issued in paper form or communicated in electronic form by that authority in accordance with the prescribed procedure. This is in order to provide adequate legal framework for paperless assessment for improving efficiency and reducing the compliance burden.

(2) Every notice or other document required to be issued, served or given for the purposes of this Act by any income-tax authority, shall be deemed to be authenticated if the name and office of a designated income-tax authority is printed, stamped or otherwise written thereon.

(3) A designated income-tax authority means any income-tax authority authorised by the CBDT to issue, serve or give such notice or other document after authentication in the manner as provided in (2) above.

23.9 OBLIGATION TO FURNISH STATEMENT OF FINANCIAL TRANSACTION OR REPORTABLE ACCOUNT [SECTION 285BA]

(1) Section 285BA imposes an obligation on specified persons to furnish statement of financial transaction or reportable account. Thus, the section also provides for furnishing of statement by a prescribed reporting financial institution in respect of a specified financial transaction or reportable account to the prescribed income-tax authority.

(2) As per section 285BA(1), the following persons, who are responsible for registering or maintaining books of account or other document containing a record of any specified financial transaction or any reportable account as may be prescribed under any law for the time being in force, are required to furnish a statement in respect of such specified financial transaction or reportable account which is registered or recorded or maintained by him and information relating to which is relevant and required for the purposes of the Income-tax Act, 1961 to the income-tax authority or such other authority or agency as may be prescribed -

(a) an assessee;

(b) a prescribed person in the case of an office of Government;

(c) a local authority or other public body or association; or

(d) the Registrar or Sub-Registrar appointed under the Registration Act, 1908; or

(e) the registering authority empowered to register motor vehicles under the Motor Vehicles Act, 1988; or

(f) the Post Master General referred to in the Indian Post Office Act, 1898; or

(g) the Collector referred to in the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013; or

(h) the recognised stock exchange referred to in the Securities Contracts (Regulation) Act, 1956; or

(i) an officer of the Reserve Bank of India; or

(j) a depository referred to in the Depositories Act, 1996; or

(k) a prescribed reporting financial institution; or

(l) ***a person, other than those referred to in clauses (a) to (k), as may be prescribed*. *[w.e.f. 1.9.2019]***

(3) "Specified financial transactions" means any of the following transactions which may be prescribed -

(a) transaction of purchase, sale or exchange of goods or property or right or interest in a property; or

(b) transaction for rendering any service; or

(c) transaction under a works contract; or

(d) transaction by way of an investment made or an expenditure incurred; or

(e) transaction for taking or accepting any loan or deposit,

(4) The CBDT may prescribe different values for different transactions in respect of different persons having regard to the nature of such transaction.

(5) As per Rule 114E, the statement of financial transaction or reportable account shall be furnished in Form No. 61A and shall be verified in the manner indicated therein.

Accordingly, the statement of financial transactions has to be furnished on or before 31st May, immediately following the financial year in which the transaction is registered or recorded.

(6) Where the prescribed income-tax authority considers that the statement furnished under section 285BA(1) is defective, he may intimate the defect to the person who has furnished such statement and give him an opportunity of rectifying the defect within a period of 30 days from the date of such intimation. The prescribed income-tax authority may allow, on an application made in this behalf, a further period of time, at his discretion.

(7) If the defect is not rectified within the said period of 30 days or, as the case may be, the further period so allowed, then, notwithstanding anything contained in any other provision of this Act, ***the provisions of this Act shall apply as if such person had furnished inaccurate information in the statement***.[2]

Consequently, the prescribed income-tax authority may direct such person to pay penalty of ₹ 50,000 under section 271FAA.

(8) Where a person who is required to furnish a statement under section 285BA(1), has not furnished the same within the specified time, the prescribed income-tax authority may serve upon such person a notice requiring him to furnish such statement within a period not exceeding thirty days from the date of service of such notice and he shall furnish the statement within the time specified in the notice [Section 285BA(5)].

(9) If any person, having furnished a statement under section 285BA(1), or in pursuance of a notice issued under section 285BA(5), comes to know or discovers any inaccuracy in the information provided in the statement, he shall, within a period of ten days inform the income-tax authority or other authority or agency referred to in section 285BA(1), the inaccuracy in such statement and furnish the correct information in the prescribed manner [Section 285BA(6)]

(10) Under section 285BA(7), the Central Government may, by way of rules, specify —

(i) the persons referred to in section 285BA(1) to be registered with the prescribed income-tax authority;

(ii) the nature of information and the manner in which such information shall be

[2] Prior to 1.9.2019, such statement would have been treated as an invalid statement and the provisions of the Act would have applied as if such person had failed to furnish the statement.

maintained by the persons referred to in point (i); and

(iii) the due diligence to be carried out by the persons for the purpose of identification of any reportable account referred to in section 285BA(1).

(11) **Furnishing of statement of financial transaction [Rule 114E**: The statement of financial transaction required to be furnished under section 285BA(1) of the Income-tax Act, 1961 shall be furnished by every person mentioned in column (3) of the Table below in respect of all the transactions of the nature and value specified in the corresponding entry in column (2) of the said Table, which are registered and recorded by him on or after 1st April, 2016.

S. No.	Nature and value of transaction	Class of person (reporting person)
(1)	(2)	(3)
1.	(a) Payment made in cash for purchase of bank drafts or pay orders or banker's cheque of an amount aggregating to ₹ 10 lakh or more in a financial year. (b) Payments made in cash aggregating to ₹ 10 lakh or more during the financial year for purchase of pre-paid instruments issued by Reserve Bank of India under the Payment and Settlement Systems Act, 2007. (c) Cash deposits or cash withdrawals (including through bearer's cheque) aggregating to ₹ 50 lakhs or more in a financial year, in or from one or more current account of a person.	A banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act)
2.	Cash deposits aggregating to ₹ 10 lakhs or more in a financial year, in one or more accounts (other than a current account and time deposit) of a person.	(i) A banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act); (ii) Post Master General as referred to in the Indian Post Office Act, 1898.
3.	One or more time deposits (other than a time deposit made through renewal of another time deposit) of a person	(i) A banking company or a co-operative bank to which the Banking Regulation Act, 1949

	aggregating to ₹ 10 lakhs or more in a financial year of a person.	applies (including any bank or banking institution referred to in section 51 of that Act); (ii) Post Master General as referred to in the Indian Post Office Act, 1898; (iii) Nidhi referred to in section 406 of the Companies Act, 2013; (iv) NBFC which holds a certificate of registration under section 45-IA of the Reserve Bank of India Act, 1934, to hold or accept deposit from public.
4.	Payments made by any person of an amount aggregating to- (i) ₹ 1 lakh or more in cash; or (ii) ₹ 10 lakh or more by any other mode, against bills raised in respect of one or more credit cards issued to that person, in a financial year.	A banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act) or any other company or institution issuing credit card.
5.	Receipt from any person of an amount aggregating to ₹ 10 lakh or more in a financial year for acquiring bonds or debentures issued by the company or institution (other than the amount received on account of renewal of the bond or debenture issued by that company).	A company or institution issuing bonds or debentures.
6.	Receipt from any person of an amount aggregating to ₹ 10 lakh or more in a financial year for acquiring shares (including share application money) issued by the company.	A company issuing shares
7.	Buy back of shares from any person (other than the shares bought in the open market) for an amount or value aggregating to ₹ 10 lakh or more in a financial year.	A company listed on a recognised stock exchange purchasing its own securities under section 68 of the Companies Act, 2013.
8.	Receipt from any person of an amount aggregating to ₹ 10 lakh or more in a	A trustee of a Mutual Fund or such other person managing the affairs of

	financial year for acquiring units of one or more schemes of a Mutual Fund (other than the amount received on account of transfer from one scheme to another scheme of that Mutual Fund).	the Mutual Fund as may be duly authorised by the trustee in this behalf.
9.	Receipt from any person for sale of foreign currency including any credit of such currency to foreign exchange card or expense in such currency through a debit or credit card or through issue of travelers cheque or draft or any other instrument of an amount aggregating to ₹ 10 lakh or more during a financial year	Authorised person as referred to in section 2(c) of the Foreign Exchange Management Act, 1999.
10.	Purchase or sale by any person of immovable property for an amount of ₹ 30 lakhs or more or valued by the stamp valuation authority referred to in section 50C at ₹ 30 lakhs or more	Inspector-General appointed under the Registration Act, 1908 or Registrar or Sub-Registrar appointed under that Act
11.	Receipt of cash payment exceeding ₹ 2 lakh for sale, by any person, of goods or services of any nature (other than those specified at Sl. Nos.1 to 10 above, if any).	Any person who is liable for audit under section 44AB.

Manner of application of threshold limit: The reporting person mentioned in column (3) of the Table [other than the person at Sl.No.10 and 11] shall, while aggregating the amounts for determining the threshold amount for reporting in respect of any person as specified in column (2) of the said Table,-

(a) take into account all the accounts of the same nature as specified in column (2) of the said Table maintained in respect of that person during the financial year;

(b) aggregate all the transactions of the same nature as specified in column (2) of the said Table recorded in respect of that person during the financial year;

(c) attribute the entire value of the transaction or the aggregated value of all the transactions to all the persons, in a case where the account is maintained or transaction is recorded in the name of more than one person;

(d) apply the threshold limit separately to deposits and withdrawals in respect of transaction specified in item (c) under column (2), against Sl. No.1 of the said Table.

23.10 PUBLICATION OF INFORMATION [SECTION 287]

The Central Government is empowered to publish the name and address of any assessee and other particulars relating to any proceedings or prosecutions in respect of such assessees, if it considers it necessary or expedient in the public interest to do so. However, no such publication relating to any penalty or prosecution shall be made until the time for presenting appeal to the Commissioner (Appeals) has expired without an appeal having been presented or until the appeal, if presented, has been disposed of. In the case of a firm, company or other association of persons, the names of the partners of the firm, directors, managing agents, secretaries and treasurers, or managers of the company or members of the associations, as the case may be, may also be published if, in the opinion of the Central Government, the circumstances of the case justify the same.

23.11 APPEARANCE BY REGISTERED VALUERS [SECTION 287A]

Any tax payer who is entitled to or required to attend before any income tax authority or the Appellate Tribunal in connection with any matter relating to the valuation of any asset, otherwise than he is required under section 131 to attend personally for examination on oath or affirmation, may attend by a registered valuer. For this purpose, a registered valuer means a person who is registered as a valuer for the purpose of section 34AB of the Wealth-tax Act, 1957.

23.12 APPEARANCE BY AUTHORISED REPRESENTATIVE [SECTION 288]

1. Section 288 deals with appearance by authorised representative. Accordingly, any assessee who is entitled or required to attend before any income-tax authority of the Appellate Tribunal in connection with any proceeding under this Act otherwise than when required under section 131 to attend personally for examination on oath or affirmation, may attend by an authorised representative.

2. For the purpose of this section, “authorised representative” means, a person authorised by the assessee in writing to appear on his behalf. The following persons can be authorised representatives:

   (a) A person related to the assessee in any manner by a person regularly employed by the assessee

   (b) any officer of a Scheduled Bank with which the assessee maintains a current account or has other regular dealings

   (c) any legal practitioner who is entitled to practice in any Civil Court in India

   (d) an Accountant i.e., a chartered accountant as defined in section 2(1)(b) of the

Chartered Accountants Act, 1949 who holds a valid certificate of practice under section 6(1) of that Act. However, the following persons are not included in the definition of accountant -

	Assessee	Person
(i)	Company	A person who is not eligible for appointment as an auditor of the said company under section 141(3) of the Companies Act, 2013, namely, (a) A body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008; (b) an officer or employee of the company (c) a person who is a partner, or who is in the employment, of an officer or employee of the company (d) a person who, or his relative or partner – (i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company[3] (ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 5 lakh. (iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 1 lakh. (e) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed. (f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel.

[3] However, the relative may hold security or interest in the company of face value not exceeding ₹ 1,000 or such sum as may be prescribed.

		(g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies (h) a person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction (i) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialised services as provided in section 144 of the Companies Act, 2013.
(ii)	Individual	The assessee himself or his relative
(iii)	Firm	Partner of the firm or his relative
(iv)	AOP	Member of the AOP or his relative
(v)	HUF	Member of the HUF or his relative
(vi)	Trust or Institution	(1) The author of the trust or founder of the institution or his relative (2) Any person who has made a substantial contribution to the trust or institution, i.e., any person whose total contribution upto the end of the relevant previous year exceeds ₹ 50,000, or his relative (3) Where such author, founder or person is a HUF, a member of the HUF or relative of such member (4) Any trustee of the trust or manager of the institution, or relative of the trustee or manager
(vii)	Any other person	The person who is competent to verify the return under section 139 in accordance with the provisions of section 140 or his relative.
(viii)	Any assessee referred to in (ii) to (vii)	(1) An officer or employee of the assessee (2) An individual who is a partner, or who is in the employment, of an officer or employee of the assessee. (3) An individual who, or his relative or partner - (I) is holding any security of, or interest in, the assessee[4].

[4] However, the relative may hold security or interest in the assessee of the face value not exceeding ₹ 1 lakh

		(II) is indebted to the assessee[5]. (III) has given a guarantee or provided any security in connection with the indebtedness of any third person to the assessee[6]. (4) a person who, whether directly or indirectly, has business relationship with the assessee of such nature as may be prescribed. (5) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.

However, the ineligibility for carrying out any audit or furnishing of any report/certificate in respect of an assessee shall not make an accountant ineligible for attending income-tax proceeding referred to in section 288(1) as authorised representative on behalf of that assessee.

(e) any person who has passed any accountancy examination recognised in this behalf by the Board. Rule 50 prescribes the accountancy examination recognised for this purpose. They are as follows:

(i) The National Diploma in Commerce awarded by the All India Council for Technical Education under the Ministry of Education, New Delhi, provided the diploma-holder has taken Advanced Accountancy and Auditing as an elective subject for the Diploma Examination

(ii) Government Diploma in Company Secretaryship awarded by the Department of Company Affairs under the Ministry of Industrial Development and Company Affairs, New Delhi

(iii) Final Examination of the Institute of Company Secretaries of India, New Delhi

(iv) The Final Examination of the Institute of Cost and Work Accountants of India constituted under the Cost and Works Accountants Act, 1959

(v) The Departmental Examination conducted by or on behalf of the Central Board of Direct Taxes for promotion

(vi) The Revenue Audit Examination for Section Officers conducted by the Office of the Comptroller and Auditor General of India

(f) any person who has acquired such education qualifications as the Board may, prescribe for this purpose. Rule 51 prescribes the concerned educational qualifications as follows:

[5] However, the relative may be indebted to the assessee for an amount not exceeding ₹ 1 lakh

[6] However, the relative may give guarantee or provide any security in connection with the indebtedness of any third person to the assessee for an amount not exceeding ₹ 1 lakh

A degree in Commerce or Law conferred by any of the following Universities:

(i) Indian Universities: Any Indian University incorporated by any law for the time being in force.

(ii) Rangoon University

(iii) English and Welsh Universities: The Universities of Birmingham, Bristol, Cambridge, Durham, Leeds, Liverpool, London, Manchester, Oxford, Reading, Sheffield and Wales

(iv) Scottish Universities: The Universities of Aberdeen, Edinburgh, Glasgow and St. Andrews

(v) Irish Universities: The Universities of Dublin (Trinity College), the Queen's University, Belfast and the National University of Dublin

(vi) Pakistan Universities: Any Pakistan University incorporated by any law for the time being in force.

3. The following persons shall not be qualified to represent an assessee:

(i) A person who has been dismissed or removed from government service.

(ii) A person who has been convicted of an offence connected with any income-tax proceeding or on whom a penalty has been imposed under this Act other than a penalty imposed on him under section 272A(1)(d) - In this case, the person will be disqualified for such time as the Principal Chief Commissioner or Chief Commissioner or the Principal Commissioner or Commissioner may, by order, determine.

(iii) A person has become insolvent - In this case, he will be disqualified for a period during which the insolvency continues.

(iv) A person convicted by a court of an offence involving fraud - He shall not be eligible to act as authorised representative for a period of 10 years from the date of such conviction.

4. If any person is a legal practitioner or an accountant and is found guilty of misconduct in his professional capacity by any authority entitled to institute disciplinary proceedings against him, an order passed by that authority shall have effect in relation to his right to attend before an income-tax authority as it has in relation to his right to practice as a legal practitioner or accountant.

5. If a person is not a legal practitioner or an accountant and is found guilty of misconduct in connection with any income-tax proceedings by the prescribed authority, the prescribed authority, may direct that he shall henceforth be disqualified to represent anassessee.

6. Before any order or direction of disqualification under point 3(ii) or 5 above is made, the following conditions must be satisfied :

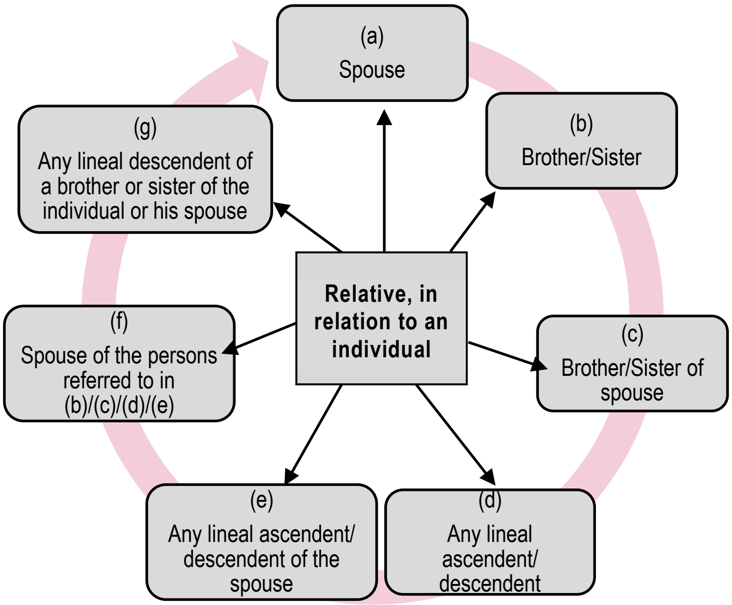
   (a) No such order or direction shall be made in respect of any person unless he has been given a reasonable opportunity of being heard

   (b) any person against whom any such order or direction is made, may within one month of the making of the order or direction, may appeal to the Board to have the order or direction cancelled

   (c) No such order or direction shall take effect until the expiration of one month from the making thereof or, where an appeal has been preferred, until the disposal of the appeal.

7. A person disqualified to represent an assessee under Indian Income-tax Act, 1922 shall stand disqualified under this Act also

8. Meaning of the term “relative” for the purpose of section 288:


(a)
Spouse
(b)
Brother/Sister
(g)
Any lineal descendent of a brother or sister of the individual or his spouse
Relative, in relation to an individual
(f)
Spouse of the persons referred to in (b)/(c)/(d)/(e)
(c)
Brother/Sister of spouse
(e)
Any lineal ascendent/ descendent of the spouse
(d)
Any lineal ascendent/ descendent

23.13 ROUNDING OFF OF INCOME, TAX ETC. [SECTIONS 288A & 288B]

(1) The total income of any assessee shall be rounded off to the nearest multiple of ten rupees.

(2) Further, any amount payable, and the amount of refund due, under the provisions of the Income-tax Act, 1961, shall be rounded off to the nearest multiple of ten rupees.

(3) For the above purposes, any part of a rupee consisting of paise shall be ignored. Thereafter, if such amount is not a multiple of ten, then, if the last figure in that amount is five or more, the amount shall be increased to the next higher amount which is a multiple of ten and if the last figure is less than five, the amount shall be reduced to the next lower amount which is a multiple of ten.

23.14 RECEIPT [SECTION 289]

The Department or the person or authority receiving any money paid by or recovered from the assessee or any other person shall issue a receipt for the same.

23.15 INDEMNITY [SECTION 290]

Every person deducting, retaining or paying any tax in pursuance of this Act in respect of income belonging to another person is entitled to be indemnified for the deduction, retention or payment thereof.

23.16 POWER TO TENDER IMMUNITY FROM PROSECUTION [SECTION 291]

The Central Government is empowered by section 291 to tender any person immunity from prosecution for any offence under this Act if it is of the opinion that it is necessary or expedient in the public interest to do so for the purpose of obtaining the evidence directly or indirectly concerned in or privy to the concealment of the income or to the evasion of payment to tax on any income taxable under the Act. A tender of immunity made to or accepted by the person concerned shall, to that extent, render him immune from prosecution for any offence in respect of which tender was made or from the imposition of any penalty under the Act.

23.17 COGNIZANCE OF OFFENCES AND BAR OF SUITS IN CIVIL COURTS [SECTIONS 292 AND 293]

(1) No Court inferior to that of a Presidency Magistrate or a Magistrate of the first class shall try any offence under this Act.

(2) No suit can be brought in any Civil Court to set aside or modify any order and no prosecution, suit or other proceedings shall lie against any Government Officer for any thing done or intended to be done by him in good faith under the Act.

23.18 CERTAIN LAWS NOT TO APPLY [SECTION 292A]

This section provides that the provisions of section 360 of the Code of Criminal Procedure, 1973 or the Probation of Offenders Act, 1958 shall not be applicable to any person who is convicted of an offence under the Income tax Act,1961 unless that person is under 18 years of age.

23.19 RETURN OF INCOME ETC. NOT TO BECOME INVALID [SECTION 292B]

Section 292B provides that no return of income, order of assessment, notice, summons or other proceedings furnished or made or taken or purported to have been furnished or made in pursuance of any of the provisions of the Income-tax Act, 1961 shall be invalid or shall be deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment, notice, summons or other proceeding, if they are in substance and effect in conformity with or according to the intent and purposes of the Income-tax Act, 1961. The provision, thus, enables tax authorities to accept returns and other documents and tax payers to accept orders, notice, etc., received from tax authorities even in cases where there are a few typographical, arithmetical or other mistakes which do not materially affect the objects with which the document was submitted by the assessee or order was issued by the department [Refer also to section 139(9)].

23.20 NOTICE DEEMED TO BE VALID IN CERTAIN CIRCUMSTANCES [SECTION 292BB]

(1) This section provides that the assessee would be precluded from raising any objection in any proceeding or inquiry that the notice was not served upon him or was not served in time or was served in an improper manner if he had appeared in any proceedings or co-operated in any enquiry relating to assessment or re-assessment.

(2) In short, if the assessee had appeared in any proceedings or co-operated in any enquiry, it shall be deemed that any notice required to be served on him has been duly served upon him in time in accordance with the provisions of the Act. However, such deeming provision would not apply where the assessee has raised an objection (regarding non-service of notice or non-service of notice in time or improper service of notice) before the completion of such assessment or reassessment.

23.21 PRESUMPTION AS TO ASSETS, BOOKS OF ACCOUNT, ETC. [SECTION 292C]

(1) Under section 132(4A), it is provided that the books of account, money, bullion, jewellery or other valuable article or thing found in the possession or control of any person in the course

of a search under section 132 will be presumed to belong to the said person.

(2) It is further provided that it will be presumed that -

(i) the contents of such books of account and other documents are true; and

(ii) the signature and every other part of such books of account and other documents which purport to be in handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting, and

(iii) in the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.

(3) The Supreme Court, in *P.R. Metrani v. CIT (2006) 287 ITR 209*, held that the aforesaid presumption is not available for framing regular assessment and such presumption is available only in regard to the proceedings for search and seizure under section 132. However, this decision did not reflect the correct intent of law.

(4) Therefore, section 292C was inserted to clarify that presumptions provided in section 132(4A) can be made in any proceeding under this Act.

(5) This section provides that where any books of account, other documents, money, bullion, jewellery or other valuable article or thing are or is found in the possession or control of any person in the course of a search under section 132 or survey under section 133A, it may, in any proceeding under this Act, be presumed that -

(i) such books of account, other documents, money, bullion, jewellery or other valuable article or thing belong or belongs to such person;

(ii) the contents of such books of account and other documents are true; and

(iii) the signature and every other part of such books of account and other documents which purport to be in the handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting;

(iv) In the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.

(6) Further, this presumption has also been extended to books of account, other documents or assets which have been delivered to the requisitioning officer in accordance with the provisions of section 132A. For this purpose, sub-section (2) provides that where any books of accounts, other documents or assets have been delivered to the requisitioning officer in accordance with the provision of section 132A then, the presumption would apply as if such books of accounts, other documents or assets which had been taken into custody from the

person referred to in clause (a) or clause (b) or clause(c), as the case may be, of sub-section (1) of section 132A, had been found in the possession or control of that person in the course of a search under section 132.

23.22 AUTHORITY EMPOWERED TO GRANT AN APPROVAL UNDER THE INCOME TAX ACT, 1961 DEEMED TO HAVE POWER TO WITHDRAW THE APPROVAL GRANTED [SECTION 293C]

(1) The Central Government, CBDT and income-tax Authorities are empowered under the various provisions of the Income-tax Act to grant approval to the assessees for availing the benefit of incentives available under the Act.

(2) However, only some provisions of the Income-tax Act, 1961 specifically contain provisions for withdrawal of approval. In all other cases, there is no specific power to withdraw the approval granted.

(3) Therefore, section 293C provides explicitly, such power to withdraw an approval granted. This section provides that an approval granting authority (i.e. the Central Government, CBDT or income-tax authority, as the case may be) shall also have the powers to withdraw the approval at any time.

(4) However, such withdrawal can be made only after giving a reasonable opportunity to the concerned assessee of showing cause against the proposed withdrawal. Further, the reasons for withdrawal of the approval should be recorded by the concerned authority.

23.23 ACT TO HAVE EFFECT PENDING LEGISLATIVE PROVISION FOR CHARGE OF TAX [SECTION 294]

If on the 1st April in any assessment year, provision has not yet been made by a Central Act for the charging of income-tax for that assessment year, this Act shall nevertheless have effect until such provision is so made as if the provision in force in the preceding assessment year or the provision proposed in the Bill then before Parliament, whichever is more favourable to the assessee, were actually in force.

23.24 RULES [SECTIONS 295 AND 296]

Section 295 authorises the CBDT to make rules for the whole or any part of India for carrying out the purposes and to implement the provisions of the Act. The powers of the Board in this regard are subject to the supervision and control of the Central Government. The Rules framed by the Board and approved by the Central Government are required to be placed before each House of the Parliament before enforcing the same. In exercise of the powers conferred on it by this section, the Board, with the approval and sanction of the Central Government and the Parliament, has framed the Income-tax Rules, 1962 which have been amended from time to time. This section also enumerates the important matters on which rules may be framed by the Board: the rules framed under this Act have the same force of the section of the Act. The rules must be interpreted in the light of the sections under which they have been made. But the rules should be so framed as not to adversely affect or derogate from the full operative effect of the provisions of the sections. The rules must be within the term of the mandate given to the Board and must be framed in such a way as to be consistent with and supplementary to the provisions of the Act.

23.25 SCHEDULES TO THE INCOME TAX ACT, 1961

There are fourteen Schedules to the Income-tax Act, 1961. The matters dealt with in certain schedules are highlighted below:

Schedule I	Method of computing profits and gains of Insurance business Section 44
Schedule II	Procedure for Recovery of Tax
Schedule III	Procedure for distraint by Assessing Officer or Tax Recovery Officer
Schedule IV	Recognised Provident Funds, approved superannuation funds and approved gratuity funds
Schedule VII	Containing a list of minerals and group of associated minerals in the context of section 35E.

EXERCISE

Question 1

How does the income of a person who is trying to alienate his assets with a view to avoid tax be dealt with under the Act?

Answer

The income of a person who is trying to alienate his assets with a view to avoid tax will be dealt with as per the provisions of section 175.

Accordingly, if it appears to the Assessing Officer during any current assessment year that any person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets with a view to avoiding payment of any liability under the Income-tax Act, 1961, the total income of such person for the period from the expiry of the previous year to the date when the Assessing Officer commences proceedings under this section is chargeable to tax in that assessment year.

The total income of each completed year or part of any previous year included in such period shall be chargeable to tax at the rates in force in that assessment year and separate assessments will be made for each completed previous year or part of any previous year.

The Assessing Officer may estimate the income of such individual for such period or any part thereof, where it cannot be readily determined in the manner provided in the Act.

The tax chargeable under this section shall be in addition to tax, if any, chargeable under any other provision of the Act.

Question 2

Fearless General Finance & Investment Limited, a residuary non-banking company, accepts public deposits, issues deposit certificate and repays the same after some period of time along with interest, under different schemes run by it. Following transactions were noted from their books of account:

(i) Mr. A, an individual, has deposited ₹ 15,000 on 1st May, 2016 for 48 months by bearer cheque and another ₹ 15,000 on 30th June, 2019 in cash to purchase a new certificate of 48 months tenure.

(ii) Mr. A has applied for premature withdrawal against both the certificates and the company has paid him ₹ 16,500, by a bearer cheque, against principal and interest on 23rd March, 2020, due against his first certificate (purchased in 2016) and ₹ 15,500 in cash on 25th March, 2020, against the second certificate.

Discuss the violation of income tax provision, if any, and consequential penalty for each transaction. Will it make any difference if the certificates were held by Mr. A with his wife Mrs. A, jointly, while repaying back in cash or bearer cheque?

Answer

(i) There is no violation of section 269SS at the time of acceptance of the first deposit of ₹ 15,000 by bearer cheque on 1.5.2016, since it is not in excess of the threshold limit of ₹ 20,000. However, violation under section 269SS is attracted at the time of acceptance of the second deposit in cash on 30th June, 2019, since as on that date, there is already an outstanding deposit of ₹ 15,000 and another cash deposit of ₹ 15,000 would take the aggregate to ₹ 30,000, which exceeds the threshold limit of ₹ 20,000. Therefore, penalty under section 271D of a sum equal to the amount of deposit taken from Mr. A is attracted for failure to comply with the provisions of section 269SS.

(ii) In this case, there is a violation of the provisions of section 269T at the time of first repayment by bearer cheque on 23rd March, 2020, since on that date, the aggregate amount of deposits held by Mr. A with the non-banking company (together with interest payable on such deposits) is more than ₹ 20,000. Therefore, penalty under section 271E equal to the amount of deposit so repaid will be attracted for failure to comply with the provisions of section 269T.

However, the second repayment of ₹ 15,500 on 25th March, 2020 in cash cannot be considered as a violation of section 269T, since neither the amount of deposit with interest thereon nor the aggregate amount of deposits held by Mr. A on that date together with interest exceeds the threshold limit of ₹ 20,000.

The provisions of section 269T will be attracted at the time of first repayment of bearer cheque even if the certificate is being held by Mr. A in joint name with his wife.

Question 3

The proceedings before the Income-tax Authorities either can be attended by the assessee in person or through an authorized representative. Who can be treated as an authorized representative of the assessee?

Answer

As per section 288, the proceedings before the income-tax authorities can be attended by an assessee in person or through an authorised representative, i.e., a person authorized by the assessee in writing to appear on his behalf, being -

(i) a person who is a relative or a regular employee of the assessee; or

(ii) any officer of a Scheduled Bank in which the assessee maintains a current account or has other regular dealings; or

(iii) a legal practitioner who is entitled to practise in any civil court in India; or

(iv) a chartered accountant within the meaning of the Chartered Accountants Act, 1949 who hold a valid certificate of practice

(v) any person who has passed any accountancy examination recognized in this behalf by the CBDT for this purpose; or

(vi) any person who has acquired such educational qualifications as prescribed by the CBDT; or

(vii) any person who, before the coming into force of this Act in the Union territory of Dadra and Nagar Haveli, Goa, Daman and Diu, or Pondicherry, attended any proceedings before an income-tax authority in the said territory on behalf of any assessee otherwise than in the capacity of an employee or relative of that assessee

(viii) any person who was actually practising as an income-tax practitioner, immediately before commencement of the Income-tax Act, 1961.

Question 4

An order for A.Y. 2018-19 was passed by the Assessing Officer as per section 143(3), but the typist wrongly typed in the order, the assessment year as A.Y.2017-18 and the relevant previous year as ending on 31.3.2017. The assessee claimed in appeal that the same is an invalid order which was not accepted by the CIT (Appeals) on the ground of the error being of clerical nature. Discuss the correctness of the order of the CIT(Appeals).

Answer

Section 292B provides that no return of income, assessment, notice or summons furnished or made or issued or taken in pursuance of any of the provisions of the Income-tax Act, 1961 shall be invalid or deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment or notice etc., if such return of income, assessment, notice, summons etc. is in substance and effect in conformity with or according to the intent and purpose of the Act. **Therefore, a clerical mistake cannot invalidate an otherwise valid assessment.** Thus, the typographical error in the assessment order as to assessment year and previous year does not make the same invalid unless established otherwise. Accordingly, the action of the CIT(Appeals) in not accepting the claim of the assessee is valid.

Question 5

"Proceedings cannot be initiated under the Act, unless a proper notice to this effect has been served upon." In this context answer:

(i) What are the prescribed modes of service of such notice?

(ii) On whom should the notice be addressed and served upon in the cases where the assessee is a dissolved firm, a deceased person and a partitioned HUF.

Answer

(i) As per section 282(1), the service of notice or summon or requisition or order or any other communication under this Act may be made by delivering or transmitting a copy thereof to the person named therein -

(1) by post or such courier services as approved by the CBDT; or

(2) in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or

(3) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or

(4) by any other means of transmission of documents as may be provided by rules made by the CBDT in this behalf.

The CBDT is empowered to make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which such communication may be delivered or transmitted to the person named therein.

(ii) The service of notice in the given cases should be on the persons mentioned hereunder:-

Person	Notice to be addressed and served on
A dissolved firm	Any person who was a partner (not being a minor) immediately before dissolution.
A deceased person	The legal heirs of the deceased.
A partitioned HUF	Last Manager of the HUF, or, if he is dead, then, all adult members of the erstwhile HUF.

Question 6

"Tax Recovery Officer, can recover the arrear demands from the assessee in default out of sale proceeds of the property attached after making a proclamation". How can such proclamation be made under the Act? Is there any time limit for sale of attached immovable property? Discuss.

Answer

Manner of making a proclamation

Movable Property [Rules 38 & 39 of Schedule II to the Income-tax Act, 1961]

Where the Tax Recovery Officer orders sale of movable property, he should issue a proclamation in the language of the district, of the intended sale, specifying the time and place of sale and whether the sale is subject to confirmation or not.

The proclamation should be made by beat of drum or other customary mode, -

(a) in the case of property attached by actual seizure –

(i) in the village in which the property was seized, or, if the property was seized in a town or city, then, in the locality in which it was seized; and

(ii) at such other places as the Tax Recovery Officer may direct;

(b) in the case of property attached otherwise than by actual seizure, in such places, if any, as the Tax Recovery Officer may direct.

A copy of the proclamation should also be affixed in a conspicuous part of the office of the Tax Recovery Officer.

Immovable Property [Rule 54 of Schedule II to the Income-tax Act, 1961]

The Tax Recovery Officer shall make a proclamation for sale of immovable property at some place on or near such property by beat of drum or other customary mode. A copy of the proclamation shall be affixed on a conspicuous part of the property and also upon a conspicuous part of the office of the Tax Recovery Officer.

Where the Tax Recovery Officer directs, such proclamation shall also be published in the Official Gazette or in a local newspaper or in both, and the cost of such publication shall be deemed to be cost of the sale.

Where the property to be sold is divided into lots for the purpose of being sold separately, then it is not necessary to make a separate proclamation for each lot of property, unless in the opinion of the Tax Recovery Officer, proper notice of sale cannot otherwise be given.

Time limit for sale of attached immovable property [Rule 68B of Schedule II to the Income-tax Act, 1961]

The sale of immovable property attached has to be made on or before the expiry of 7 years from the end of the financial year in which the order giving rise to a demand of any tax, interest, fine, penalty or any other sum, for the recovery of which the immovable property has been attached,

- has become conclusive under the provisions of section 245-I (where order of settlement under section 245D(4) is deemed to be conclusive as to the matters stated therein) or
- has become final in terms of the provisions of Chapter XX (Appeals and Revision).

However, the CBDT may, for reasons to be recorded in writing, extend the aforesaid period for a further period not exceeding 3 years.

Question 7

Explain the circumstances under which the Assessing Officer can resort to provisional attachment of the property of the assessee. Also, state the period of time for which such attachment can take place.

When can the Assessing Officer revoke provisional assessment of property? Discuss.

Answer

As per the provisions of section 281B, there can be provisional attachment to protect the interest of Revenue in certain cases i.e.-

(i) The proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment should be pending.

(ii) Such attachment should be necessary for the purpose of protecting the interest of Revenue in the opinion of the Assessing Officer.

(iii) The previous approval of the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director has been obtained by the Assessing Officer.

(iv) The Assessing Officer, may, by an order in writing attach provisionally any property belonging to the assessee in the manner provided in the Second Schedule.

(v) Such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of order made under section 281B(1). However, the period can be extended by the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director**,** as the case may be, for the reasons to be recorded in writing for a further period or periods as he thinks fit. The total period of extension in any case cannot exceed 2 years or 60 days after the date of order of assessment or reassessment, whichever is later.

The Assessing Officer shall, by order in writing, revoke provisional attachment of a property made under section 281B(1) in a case where the assesse furnishes a guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.

Question 8

Mr. Biswas, a stock broker, has defaulted with regard to his income-tax payments and the Assessing Officer has attached his membership card of Stock Exchange under section 281B of the Income-tax Act, 1961. Mr. Biswas contends that the membership card is not transferable and is not his personal asset. Discuss the validity of attachment of the card by the Assessing Officer in the context of Section 281B.

Answer

The right of membership is not a private asset and it is merely a personal privilege granted to the member. It is non-transferable and incapable of alienation by the member or his legal representative except to the limited extent provided in the rules and regulations of the stock exchange and subject to the fulfillment of conditions prescribed by the stock exchange. The nomination, even if permitted, is subject to the rules and is not automatic. The right of nomination is vested in the stock exchange absolutely in the case of death of or default of a member. Thus, the membership card is not the property of the assessee and therefore cannot be attached under section 281B. It has been so held by the Apex Court in the case of *Stock Exchange Ahmedabad vs. ACIT (2001) 248 ITR 209*.

SIGNIFICANT SELECT CASES

1. **Whether omission to issue notice under section 143(2) is a defect not curable in spite of section 292BB?**

Travancore Diagnostics (P) Ltd v. Asstt. CIT (2017) 390 ITR 167 (Ker)

Facts of the case: The assessee had a diagnostic laboratory in Kollam and a branch at Kottarakara. A survey under Section 133A was conducted, consequent to which the assessee filed its return of income. On the basis of certain incriminating documents and materials unearthed during the survey, a notice under section 148 was issued. Subsequently, the incomes were assessed for assessment years 2009-10 and 2010-11 under section 143(3) read with section 147.

The assessee raised additional jurisdictional grounds before the Appellate Tribunal. The assessee contended that for the assessment year 2009-10, the assessment was completed under section 143(3) read with section 147. However, a notice under section 143(2) was not issued. The Tribunal held that in view of section 292BB, the assessee's participation in the reassessment proceedings would condone the omission to issue a notice.

Issue: Whether failure to issue notice under section 143(2) would vitiate the assessment notwithstanding the assessee's participation in the proceedings? Would section 292BB come to the rescue of the Revenue authority if they omit to issue notice under section 143(2)?

High Court's Decision: The Apex Court had, in *Asstt. CIT v. Hotel Blue Moon (2010) 321 ITR 362,* held that without the statutory notice under section 143(2), the Assessing Officer could not assume jurisdiction. Here, Assessing Officer recorded his inability to generate a notice as the return was not filed electronically. Such defect cannot be cured subsequently, since it is not procedural but one that goes to the root of the jurisdiction. Even though the assessee had participated in the proceedings, in the absence of mandatory notice, section 292BB cannot help the Revenue officers who have no jurisdiction, to begin with. Section 292BB helps Revenue in countering claims of assessees who have participated in proceedings once a due notice has been issued.

2. **Can the Assessing Officer *suo moto* assume jurisdiction to declare sale of property as void under section 281?**

Dr. ManojKabra v. ITO (2014) 364 ITR 541 (All)

Facts of the case: The assessee acquired a property for ₹ 7 lakhs though the stamp duty was paid in accordance with the circle rate which was ₹ 12 lakhs. Pursuant to the sale deed, the assessee took possession of the property. Prior to the sale, the income tax assessment of vendor had been completed and a certain demand was raised against him in respect of the assessment year when the sale of the property was effected. The Assessing Officer issued a notice under section 281 to show cause as to why the sale deed executed in his favour (assessee-buyer) should not be treated as a void document. The assessee-buyer contended that he was a *bona fide* purchaser for adequate consideration and no notice of pendency of proceedings was to known him nor was it brought to his knowledge by the seller.

The assessee placed reliance on the decision of Supreme Court in the case of *TRO v. Gangadhar Vishwanath Ranade (Decd.) (1998) 234 ITR 188,* where it was held that section 281 of the Income-tax Act, 1961 is only a declaratory provision and not an adjudicatory provision entitling the income-tax authority to declare a document as a void document.

High Court's Observation: The High Court observed that the issue in this case was squarely covered by above Apex Court decision which held that the legislature had no intention to confer any exclusive power or jurisdiction upon the income-tax authority to decide any question arising under section 281. The Income-tax Act, 1961, does not prescribe any adjudicatory machinery for deciding any question which may arise under section 281. In order to declare a transfer as fraudulent under section 281, an appropriate proceeding in accordance with law was required to be taken under section 53 of the Transfer of Property Act, 1882. The Assessing Officer is required to file a suit for declaration to the effect that the transaction of transfer was void under section 281 of the Income-tax Act; but he himself cannot assume jurisdiction to declare the sale deed as void.

High Court's Decision: Applying the rationale of the Apex Court ruling, the High Court held that the Assessing Officer has no jurisdiction under section 281 to *suo moto* declare the sale as void.

Final Course

(Revised Scheme of Education and Training)

Study Material

(Modules 1 to 4)

Paper 7

Direct Tax Laws and International Taxation

Part – II: International Taxation

Module – 4

(Relevant for May, 2020 and
November, 2020 examinations)

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This study material has been prepared by the faculty of the Board of Studies. The objective of the study material is to provide teaching material to the students to enable them to obtain knowledge in the subject. In case students need any clarifications or have any suggestions for further improvement of the material contained herein, they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the study material has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

Permission of the Institute is essential for reproduction of any portion of this material.

© *The Institute of Chartered Accountants of India*

All rights reserved. No part of this book may be reproduced, stored in a retrieval system, or transmitted, in any form, or by any means, electronic, mechanical, photocopying, recording, or otherwise, without prior permission, in writing, from the publisher.

Edition	:	October, 2019
Website	:	www.icai.org
E-mail	:	bosnoida@icai.in
Committee/ Department	:	Board of Studies
ISBN No.	:	
Price (All Modules)	:	₹
Published by	:	The Publication Department on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi 110 002, India.
Printed by	:	

CONTENTS

PART I : DIRECT TAX LAWS

MODULE – 1

Chapter 1 : Basic Concepts

Chapter 2 : Residence and Scope of Total Income

Chapter 3 : Incomes which do not form part of Total Income

Chapter 4 : Salaries

Chapter 5 : Income from House Property

Chapter 6 : Profits and Gains of Business or Profession

Chapter 7 : Capital Gains

Chapter 8 : Income from Other Sources

Chapter 9 : Income of Other Persons included in assessee's Total Income

Chapter 10 : Aggregation of income; set-off, or carry forward and set-off, of Losses

MODULE – 2

Chapter 11 : Deductions from Gross Total Income

Chapter 12 : Assessment of Various Entities

Chapter 13: Assessment of Charitable or Religious Trusts or Institutions, Political Parties and Electoral Trusts

Chapter 14 : Tax Planning, Tax Avoidance & Tax Evasion

MODULE – 3

Chapter 15 : Deduction, Collection and Recovery of tax

Chapter 16 : Income-tax Authorities

Chapter 17 : Assessment Procedure

Chapter 18 : Appeals and Revision

Chapter 19 : Settlement of Tax Cases

Chapter 20 : Penalties

Chapter 21 : Offences and Prosecution

Chapter 22 : Liability in Special Cases

Chapter 23 : Miscellaneous Provisions

PART II: INTERNATIONAL TAXATION

MODULE - 4

Chapter 1 : Transfer Pricing & Other Anti-Avoidance Measures

Chapter 2: Non-resident Taxation

Chapter 3 : Double Taxation Relief

Chapter 4 : Advance Rulings

Chapter 5 : Equalisation levy

Chapter 6 : Application and Interpretation of Tax Treaties

Chapter 7 : Fundamentals of Base Erosion and Profit Shifting

Chapter 8 : Overview of Model Tax Conventions

DETAILED CONTENTS : MODULE - 4

CHAPTER 1 - TRANSFER PRICING AND OTHER PROVISIONS TO CHECK AVOIDANCE OF TAX

Learning Outcomes 1.1

Contents:

1.1 Introduction.. 1.3

1.2 Meaning of the term “Arm’s Length Principle” 1.3

1.3 Significance of Arm’s Length Principle 1.4

1.4 Practical difficulties in application of ALP.. 1.5

1.5 The Indian Scenario 1.6

1.6 Transfer of income to Non-residents [Section 93] 1.72

1.7 Transactions in securities [Section 94] 1.74

1.8 Introduction of specific anti-avoidance measures in respect of transactions with persons located in notified jurisdictional area [Section 94A]........................ 1.76

1.9 Limitation of interest deduction in certain cases [Section 94B].......................... 1.79

Exercise 1.82

CHAPTER 2 – NON RESIDENT TAXATION

Learning Outcomes 2.1

Contents:

2.1 Introduction.. 2.2

2.2 Residential status and scope of total income.. 2.2

2.3 Exempt income of Non-residents.. 2.43

2.4 Presumptive taxation for Non-residents.. 2.51

2.5 Capital gain taxation for Non-residents.. 2.63

2.6 Special provisions prescribed under Chapter XII-A 2.66

2.7 Determination of tax in certain special cases [Chapter XII]............................... 2.72

2.8 Special Provisions Relating to Conversion of Indian Branch of a Foreign Bank into a subsidiary Company [Chapter XII-BB] 2.82

2.9 Withholding Tax provisions for Non-Residents 2.86

2.10 Miscellaneous provisions.. 2.89

Exercise 2.92

CHAPTER 3 – DOUBLE TAXATION RELIEF

Learning Outcomes 3.1

Contents:

3.1 Concept of Double Taxation Relief 3.2

3.2 Types of Relief 3.2

3.3 Double Taxation Relief provisions under the Income-tax Act, 1961 .... 3.3

3.4 Concept of Permanent Establishment.. 3.11

3.5 Taxing Foreign Income 3.14

3.6 Taxation of Business Process Outsourcing Units in India 3.15

Exercise 3.17

CHAPTER 4 – ADVANCE RULINGS

Learning Outcomes 4.1

Contents:

4.1 Introduction 4.2

4.2 Definitions... 4.2

4.3 Authority for Advance Rulings [Section 245-O].. 4.4

4.4 Qualifications, terms and conditions of service of Chairman, Vice Chairman and Members [Section 245-OA] 4.5

4.5 Vacancies, etc., not to invalidate proceedings [Section 245P]............................ 4.7

4.6 Application for advance ruling [Section 245Q] 4.7

4.7 Procedure on receipt of application [Section 245R] 4.8
4.8 Applicability of Advance Ruling [Section 245S] 4.9
4.9 Advance Ruling to be void in certain circumstances [Section 245T]................. 4.10
4.10 Powers of the Authority [Section 245U] 4.10
4.11 Procedure of Authority [Section 245V] 4.10
Exercise 4.12

CHAPTER 5 – EQUALISATION LEVY

Learning Outcomes 5.1

Contents:

5.1 Growth of e-commerce and concerns emerging therefrom 5.2
5.2 Taxation issues relating to e-commerce 5.2
5.3 OECD Recommendations under Action Plan 1 of the BEPS project 5.2
5.4 Equalisation Levy - Chapter VIII in the Finance Act, 2016.................................. 5.3
Exercise 5.15

CHAPTER 6 – APPLICATION AND INTERPRETATION OF TAX TREATIES

Learning Outcomes..6.1

Contents:

6.1 Introduction... 6.2
6.2 Double Taxation and Connecting Factors... 6.3
6.3 Overview of Tax Treaties.. 6.4
6.4 Application and Interpretation of Tax Treaties 6.7
6.5 Role of Vienna Convention in Application and Interpretation of Tax Treaties 6.16
Exercise 6.21

CHAPTER 7- FUNDAMENTALS OF BASE EROSION AND PROFIT SHIFTING

Learning Outcomes 7.1

Contents:

7.1 Background 7.2

7.2 Overview of BEPS 7.3

Action Plan 1 – Addressing the challenges of the digital economy 7.7

Action Plan 2 – Neutralise the effects of Hybrid Mismatch arrangements 7.10

Action Plan 3 – Strengthen Controlled Foreign Company (CFC) Rules 7.13

Action Plan 4 – Interest deductions and other financial payments 7.14

Action Plan 5 – Counter harmful tax practices 7.15

Action Plan 6 – Preventing treaty abuse 7.16

Action Plan 7– Prevent the artificial avoidance of Permanent Establishment (PE) status 7.17

Action Plan 8-10-Transfer Pricing Outcomes in line with Value Creation/ Intangibles/Risk and Capital and other high-risk transactions 7.19

Action Plan 11 – Measuring and monitoring BEPS 7.20

Action Plan 12 – Disclosure of aggressive tax planning arrangements 7.21

Action Plan 13 – Re-examine transfer pricing documentation 7.21

Action Plan 14 – Making dispute resolution more effective 7.24

Action Plan 15 – Developing a multilateral instrument 7.24

Exercise 7.28

CHAPTER 8 – OVERVIEW OF MODEL TAX CONVENTIONS

Learning Outcomes 8.1

Contents:

8.1 Introduction 8.2

8.2 Comparative Analysis of some of the Significant Articles of OECD and UN Model Conventions 8.5

Exercise 8.25

CHAPTER 1

TRANSFER PRICING AND OTHER PROVISIONS TO CHECK AVOIDANCE OF TAX

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **appreciate** the need for incorporation of transfer pricing provisions in the Income-tax Act, 1961;
- **comprehend** the meaning and significance of arm's length principle and the practical difficulties in application of arm's length principle;
- **appreciate** the meaning and significance of the terms "associated enterprise", "international transaction" and "specified domestic transaction";
- **determine** the arm's length price using different methods prescribed under the income-tax law;
- **appreciate** the meaning of safe harbour and rules for safe harbor incorporated in the income-tax law;

- ❑ **appreciate** the benefits of entering into advance pricing agreements;
- ❑ **identify** the cases where secondary adjustments have to be made;
- ❑ **pinpoint** the responsibilities of a person entering into an international transaction to keep and maintain prescribed information and documents;
- ❑ **identify** the circumstances when the Assessing Officer can invoke the power to determine the arm's length price;
- ❑ **comprehend and appreciate** the country-by-country reporting requirements and related matters incorporated in the income-tax law in compliance with BEPS Action Plan 13;
- ❑ **appreciate** the specific anti-avoidance measures incorporated in the Income-tax Act, 1961 in respect of transactions with persons located in notified jurisdictional areas;
- ❑ **appreciate** the provisions incorporated in the Income-tax Act, 1961 restricting interest deduction claimed by an entity in respect of borrowings from an associated enterprise in line with BEPS Action Plan 4.

1.1 INTRODUCTION

In the present age of commercial globalisation, it is a universal phenomena that Multinational Companies (MNCs) have branches/ subsidiaries/ divisions operating in more than one country. In such a situation, it is a common event for MNCs to transfer goods produced by a branch in one tax jurisdiction to an associate branch operating in another tax jurisdiction. While doing so, the MNC concerned has in mind the goal of minimizing tax burden and maximizing profits but the two tax jurisdictions/countries have also the consideration of maximizing their revenue while making laws that govern such transactions. It is an internationally accepted practice that such 'transfer pricing' should be governed by the Arm's Length Principle (ALP) and the transfer price should be the price applicable in case of a transaction of arm's length. In other words, the transaction between associates should be priced in the same way as a transaction between independent enterprises.

The principles governing the taxation of MNCs are embodied in the OECD Model Tax Convention on Income and Capital (OECD Model Convention), which serves as the basis for the bilateral income-tax treaties between OECD member countries and between OECD member and non-OECD member countries. According to these guidelines, "Transfer prices" are the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises. Two enterprises are "associated enterprises" if one of the enterprises participates directly or indirectly in the management, control or capital of the other or if both enterprises are under common control. Since international transfer pricing involves more than one tax jurisdiction, any adjustment to the transfer price in one jurisdiction requires a corresponding adjustment in the other jurisdiction. If a corresponding adjustment is not made, double taxation will result.

1.2 MEANING OF THE TERM "ARM'S LENGTH PRINCIPLE"

The Arm's Length Price (ALP) of a transaction between two associated enterprises is the price that would be paid if the transaction had taken place between two comparable independent and unrelated parties, where the consideration is only commercial.

The Arm's Length Principle, in the context of taxation, is explained in the OECD Model Tax Convention as under:

"Where conditions are made or imposed between two associated enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

The OECD transfer pricing guidelines provides guidance on the application of the arm's length principle in order to arrive at the proper transfer pricing range between associated enterprises. Market forces determine business relations between independent parties. The arm's length principle seeks to adjust the profits between two associated enterprises by comparing the same as if the transaction is carried out between two independent enterprises. It treats each enterprise as a separate independent entity rather than as inseparable parts of a single unified business.

1.3 SIGNIFICANCE OF ARM'S LENGTH PRINCIPLE

There are several reasons as to why the OECD member countries and other countries have adopted the arm's length principle.

Parity between MNCs and independent enterprises – A major reason is that the ALP provides broad parity of tax treatment for MNCs and independent enterprises. Since the ALP puts associated and independent enterprises on a more equal footing for tax purposes, it avoids the creation of tax advantages and disadvantages that would otherwise distort the relative competitive positions of these entities. The ALP, thus promotes the growth of international trade and investment by removing these tax considerations from economic decisions.

Determines real taxable profits - The transfer price adopted by a multinational has a direct bearing on the proportional profit it derives in each country in which it operates. If inadequate or excessive consideration is paid for the transfer of goods, services or intangible property between the members of an MNC group, the income calculated for each of those members will be inconsistent with their relative economic contributions. An 'arm's length' price – a price two independent firms operating at arm's length would agree on – is needed to determine taxable profits earned in each country. The arm's length doctrine permits the taxing authorities to rectify the accounts of the enterprise so as to reflect correctly the income that the establishment would have earned if it were an independent enterprise.

Reduction of artificial price distortion - If the ALP is not followed, an MNC will sell goods/ provide services to a controlled entity in a high tax regime at a high price (which exceeds the market price) and to an entity in a low-tax regime or a tax haven at a low price (which is lower than the market price). This would result in extreme price distortion of goods and services in the international market.

Minimization of double taxation – The ALP is an international concept and it represents the international norm. The potential for double taxation is minimized, since in international transfer pricing, adjustment to the transfer price in one tax jurisdiction requires a corresponding adjustment in the other tax jurisdiction.

Accurate measurement of economic contribution – The ALP provides accurate measurement of the fair market value of the economic contribution units of an MNC. The focus of the ALP is to ensure that the proper amount of income is attributed to where it is earned. This result in each unit of the MNC earning a return commensurate with its economic contribution and risk assumed.

1.4 PRACTICAL DIFFICULTIES IN APPLICATION OF ALP

There are, however, certain practical difficulties in applying the ALP, which are described hereunder:

True comparison difficult in certain cases – The commercial and financial conditions governing a transaction between independent enterprises are, by and large, never similar to those existing between associated enterprises. As a result, there cannot be a true comparison. The economies of scale and integration of various business activities of the associated enterprise may not be truly appreciated by arm's length principle. Further, associated enterprises may enter into transactions which independent enterprises may not enter into, like say, licensing of valuable intangible or sharing the benefits of research. The owner of an intangible may be hesitant to enter into licensing arrangements with independent enterprises for fear of the value of the intangible being degraded. In contrast, he may be prepared to offer terms that are less restrictive to associated enterprises because the use of the intangible can be closely monitored. Further, there is no risk to the overall group's profit from a transaction of this kind between members of an MNC group. In such situations, where independent enterprises seldom undertake transactions of the type entered into by associated enterprises, the ALP is difficult to apply because there is little or no direct evidence of what conditions would have been established by independent enterprises.

Availability of data and reliability of available data – There may be difficulty in getting adequate and reliable information and data in order to apply arm's length principle. The comparison of controlled and uncontrolled transactions between associated and independent enterprises usually requires a large quantum of data. Easily accessible information may be incomplete and difficult to interpret while the relevant and required information may be difficult to obtain due to geographical constraints or secrecy and confidentiality aspects. In other cases, information about an independent enterprise which could be relevant may not exist at all. Due to these difficulties, the tax administration and tax payers may have to exercise reason and judgment when applying the ALP.

Absence of market price - There must be a reasonably reliable and comparable uncontrolled market price. The ALP does not meet this condition because of the nature of the market place. A market price is an outcome of unique negotiations. It may be possible to know the price range, but it is very difficult to know the actual market price unless a market transaction actually takes place.

Absence of comparable market price for "intangible" transactions - The ALP reaches a comparable uncontrolled market price that is reasonably reliable for standard transactions where the price range is narrow and market price is certain. However, the ALP generally fails to achieve a comparable market price for transactions involving intangibles because they are unique. The unique nature of these transactions creates a very wide price range.

Administrative burden - In certain cases, the arm's length principle may result in an administrative burden for both the taxpayer and the tax administrations of evaluating significant numbers and types of cross-border transactions.

Time lag - Although an associated enterprise normally establishes the conditions for a transaction at the time it is undertaken, at some point the enterprise may be required to demonstrate that these are consistent with the arm's length principle. The tax administration may also have to engage in the verification process perhaps some years after the transactions have taken place. It may result in substantial cost being incurred by the tax payer and the tax administration. It is also difficult to appreciate the business realities which prevailed at the time when the transactions were entered into. This may lead to bias against the tax payer.

In spite of the practical difficulties listed above, OECD member countries are of the view that the ALP does provide a sound basis to appreciate the transfer pricing between associated enterprises. It has so far provided acceptable solutions to both taxpayers and the tax administrations. The experience gained so far should be effectively used to remove the practical difficulties and improve the administration.

1.5 THE INDIAN SCENARIO

(1) Transfer pricing in relation to International Transactions

In order to provide a statutory framework empowering the tax authorities to determine reasonable, fair and equitable profits and tax in respect of cross-border transactions, sections 92 to 92F had been included in Chapter X of the Income-tax Act, 1961, through the Finance Act, 2001, providing for a transfer pricing mechanism based on computation of income from cross-border transactions. The following conditions must be satisfied in order to attract the special provisions of Chapter X relating to avoidance of tax:

(i) There must be an international transaction;

(ii) Such international transaction should be between two or more associated enterprises either or both of whom are non-residents;

(iii) Such international transaction should be in the nature of:

  (a) purchase, sale or lease of tangible or intangible property; or

  (b) provision of service; or

  (c) lending or borrowing money; or

  (d) any other transaction having a bearing on the profits, income, losses or assets of such enterprise.

(iv) Further, such transaction may also involve allocation or apportionment of, or any contribution to any cost or expenses incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of the associated enterprises on the basis of mutual agreement or arrangement between such associated enterprises.

(v) Such international transaction must be done at arm's length price and if such international transaction has been done at less than the arm's length price, it shall require determination of income or apportionment of cost or expense on the basis of arm's length price.

(vi) The above adjustment should either result in an increase of income or decrease of loss returned by the assessee. In other words, the adjustment should not have the effect of reducing the income chargeable to tax or increasing the loss.

The Finance Act, 2001, has introduced provisions relating to pricing of international transaction between the assessee and associated enterprises. These provisions are contained in sections 92 to 92F of the Income-tax Act, 1961. These provisions apply to international transactions entered into with effect from 1st April, 2001. Rules 10A to 10E have been inserted in the Income-tax Rules, 1962 by a notification dated 21st August, 2001. These sections and rules of the Income-tax Act, 1961 and the Income-tax Rules, 1962, respectively, will affect all non-corporate and corporate assessees who have dealings with non-residents for import or export of goods, properties or services. In other words, price paid for import of goods, properties or services and price received for export of goods, properties or services will be subject to scrutiny by the Assessing Officer. Therefore, it is necessary to make a detailed study of these provisions. All assessees who have such dealings with non-residents will have to keep detailed records as prescribed under the Rules and will have to furnish audit report every year with the return of income about their international transactions.

The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing. There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue. Therefore, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

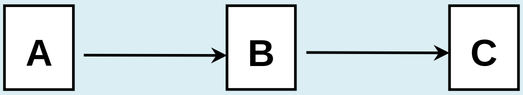
I. Computation of income from transaction with non-resident [Section 92]: Section 92 provides that any income arising from an "international transaction" shall be computed having regard to "the arm's length price". For this purpose, the allowance for any expense or interest shall be determined on the basis of arm's length price. The section further provides that in an international transaction between two or more 'associated enterprises" when there is a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expenses in connection with a benefit, service or facility provided to any one or more of such enterprises, the allocation of cost, expenses etc. shall be determined having regard to arm's length price of such benefit, service or facility. Similarly, the price received for exports and amounts received for services rendered to associated enterprise will be determined on the basis of arm's length price. It will be noticed that in the international transaction, the income or expense will have to be at arm's length price, if the transaction is between associated enterprises.

The objective of transfer pricing provisions is to protect the tax base of India and to ensure that due to inter-company transactions, there is no reduction in the taxable profits or the taxes paid by the Indian taxpayer. The reverse, however, does not hold true.

While determining arm's length price under the provisions of transfer pricing regulations, if the income works out to a figure lower than the income shown in the books of accounts, the provision of transfer pricing regulations will not apply.

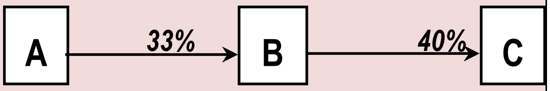
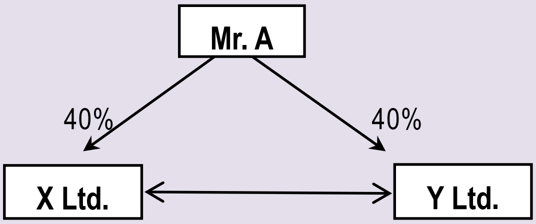
The Assessing Officer will have wide powers to determine what is an arm's length price for such transactions and make adjustments for computation of income. The keywords in section 92 are (i) associated enterprises, (ii) international transactions and (iii) arm's length price. These terms are defined in sections 92A, 92B and 92C.

II. Associated Enterprises [Section 92A]: The term "associated enterprise" in relation to another enterprise is defined in section 92A(1).

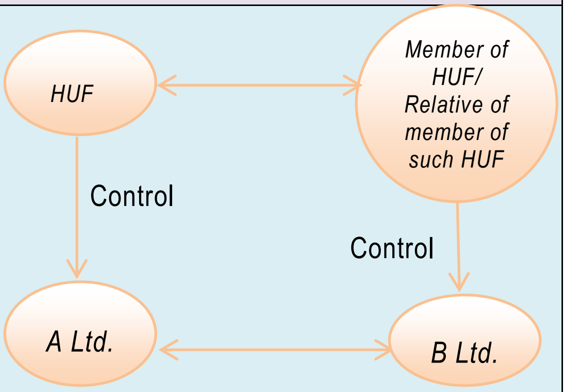
Associated Enterprises [Section 92A(1)]		
	Condition	**Example**
(1)	An enterprise which participates, directly or indirectly, or through one or more intermediaries, in: • Management of the other enterprise, or • control of other enterprise, or • capital of other enterprise	*Where A Ltd. directly participate in management of B Ltd. and B Ltd. directly participate in management of C Ltd. In such situation, A Ltd. has direct participation in management of B Ltd. but has an indirect participation in management of C Ltd.*  *In such scenario, both B Ltd. and C Ltd. would be Associated Enterprises of A Ltd.*
(2)	If one or more persons participates, directly or indirectly, or through one or more intermediaries in: • *management* of the two different enterprises • control of two different enterprises	*Mr. A directly has control in A Ltd. and B Ltd. In such a scenario, both A Ltd. & B Ltd. are Associated Enterprises since they have a common person i.e. Mr. A, who controls both entities A Ltd. & B Ltd.*

	• capital of two different enterprises Then, those two enterprises are AEs.	

Section 92A(2) provides that two enterprises shall be deemed to be associated enterprises for the purposes of sub-section (1) if, at any time during the previous year –

Deemed Associated Enterprises [Section 92A(2)]		
Condition	**Situation**	**Example**
Substantial Voting Power	**One enterprise holds 26% or more of the Voting Power,** directly or indirectly, in the **other enterprise.**	*A Ltd. holds 33% of Voting Power in B Ltd. and B Ltd. holds 40% Voting Power in C Ltd.*  *In above situation, A Ltd. holds 33% of Voting Power in B Ltd. directly and 40% of Voting Power in C Ltd. indirectly (i.e. through B Ltd.). Therefore, both B Ltd. & C Ltd. are deemed Associated Enterprises of A Ltd.*
Substantial Voting Power in two entities by common person	Any person or enterprise **holds 26% or more of the Voting Power power,** directly or indirectly, in each of **two different enterprises.**	*Mr. A holds 40% of shareholding in both X Ltd. and Y Ltd. where neither X Ltd. has any holding in Y Ltd. nor Y Ltd. has any holding in X Ltd.*  *In this situation, since Mr. A directly holds 40% of shareholding in both X Ltd. and Y Ltd., X Ltd. & Y Ltd. will be deemed Associated Enterprises.*
Advancing of substantial sum of money	One enterprise advances loan to the other enterprise of an amount of **51% or more** of the book value of **the total assets of other enterprise**	*Book Value of total assets of Y Ltd. is ₹ 100 crores. X Ltd. advances loan of ₹ 60 crores to Y Ltd.* *Since, in this case, X Ltd. advances loan which is 60% of the Book Value of total assets of Y Ltd., X Ltd. & Y Ltd. are deemed Associated Enterprises.*
Guaranteeing borrowings	One enterprise guarantees **10% or more** of the **total**	*P Inc. has total loan of 1 million dollars from XYZ Bank of America. Out of that, A Ltd., an*

	borrowings of the **other enterprise**.	*Indian company, guarantees 20% of total borrowings in case of any default made by P Inc. In such case, P Inc. and A Ltd. would be deemed Associated Enterprises.*
Appointment of majority directors of other enterprise	One enterprise appoints **more than half of the board of directors** or members of the governing board, or one or more executive directors or executive members of the governing board of **other enterprise**.	*X Ltd. has 15 directors on its Board. Out of that, Y Ltd. has appointed 8 directors. In such case, X Ltd. and Y Ltd. would be deemed Associated Enterprises.*
Appointment of majority directors of two different enterprises by same person(s)	**More than half of the directors** or members of the governing board, or one or more of the executive directors or members of the governing board of each of the **two** enterprises are appointed **by the same person(s).**	*Mr. A appointed 9 directors out of 15 directors of X Ltd. and appointed 2 executive directors on the board of Y Ltd. In such case, since a common person i.e. Mr. A appointed more than half of the directors in X Ltd. and appointed 2 executive directors in Y Ltd., both X Ltd. and Y Ltd. are deemed Associated Enterprises.*
Dependence on intangibles w.r.t which other enterprise has exclusive rights	The **manufacture or processing of goods** or articles or business carried out by one enterprise is **wholly dependent (i.e. 100%) on the know-how**, patents, copyrights etc., or any data, documentation, drawing or specification relating to any patent, invention, model etc. of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights.	
Dependence on raw material supplied by other enterprise	**90% or more of raw materials and consumables** required for the manufacture or processing of goods or articles or business carried out by one enterprise, **are supplied by the other enterprise**, or by persons specified by the other enterprise, where the prices and other conditions relating to the supply are influenced by such other enterprise.	
Dependence on sale	The **goods or articles manufactured** or processed by one enterprise, **are sold to the other enterprise** or to persons specified by the other enterprise, and the **prices and other conditions** relating thereto are **influenced by such other enterprise.**	

Control by common individual	Where **one enterprise is controlled by an individual**, the **other enterprise** is also **controlled by such individual** or his relative or jointly by such individual and his relatives.	*Mr. A and Mr. B are relatives. Mr. A has control over X Ltd. and Mr. B has control over Y Ltd. In such a case, both X Ltd. and Y Ltd. would be deemed Associated Enterprises.*
Control by HUF or member thereof	Where one enterprise is **controlled by an HUF** and the **other enterprise is controlled** by a **member** of such HUF or by **relative of a member** of such HUF or jointly by such member and his relative.	 HUF Member of HUF/ Relative of member of such HUF Control Control A Ltd. B Ltd. *A Ltd & B Ltd are deemed Associated Enterprises*
Interest in a firm, AOPs or BOIs	Where one enterprise is a firm, AOPs or BOIs, the **other enterprise** holds **10% or more interest** in **firm/HUF/BOI**.	
Mutual interest relationship	There exists **b/w the two enterprises**, any **relationship of mutual interest**, as may be **prescribed**.	

Section 92A(1) lays down the circumstances when two enterprises can be considered as associated enterprises. The mere fact of participation by one enterprise in the management, control or capital of the other enterprise, or participation by one or more persons in the management, control or capital of both the enterprises is not sufficient unless the tests laid down in section 92A(2) are fulfilled. In other words, the deeming tests contained in section 92A(2) are exhaustive and should be applied to determine the association between two or more enterprises.

Meaning of Enterprise: The term "enterprise" is defined in section 92F to mean a person (including its certain specified Permanent Establishment) who is, or has been, or is proposed to be, engaged in any activity,

- relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copy rights, trade-marks, licences, franchises or any other business or commercial rights of similar nature or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or

- the provision of services of any kind, or in carrying out any work in pursuance of a contract, or in investment, or providing loan or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate,

whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places.

Meaning of Permanent establishment: "Permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

III. Definition of International Transaction [Section 92B]

❑ **International Transaction [Section 92B(1)]**: As per section 92B of the Act, an international transaction means:

(i) a transaction between two or more associated enterprises, either or both of whom are non-residents; and

(ii) transaction in the nature of:

(a) sale/ purchase/ lease of tangible property; or

(b) sale/ purchase/ lease of intangible property; or

(c) provision of services; or

(d) lending/ borrowing money; or

(e) any other transaction having a bearing on profits, income, losses or assets of such enterprises; or

(f) mutual agreement or arrangement between two or more associated enterprise for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

❑ **Deemed International Transaction [Section 92B(2)]:** Where, in respect of a transaction entered into by an enterprise with a person other than an associated enterprise (hereinafter referred to as "other person"),

♦ there exists a prior agreement in relation to the relevant transaction between the other person and the associated enterprise **or**,

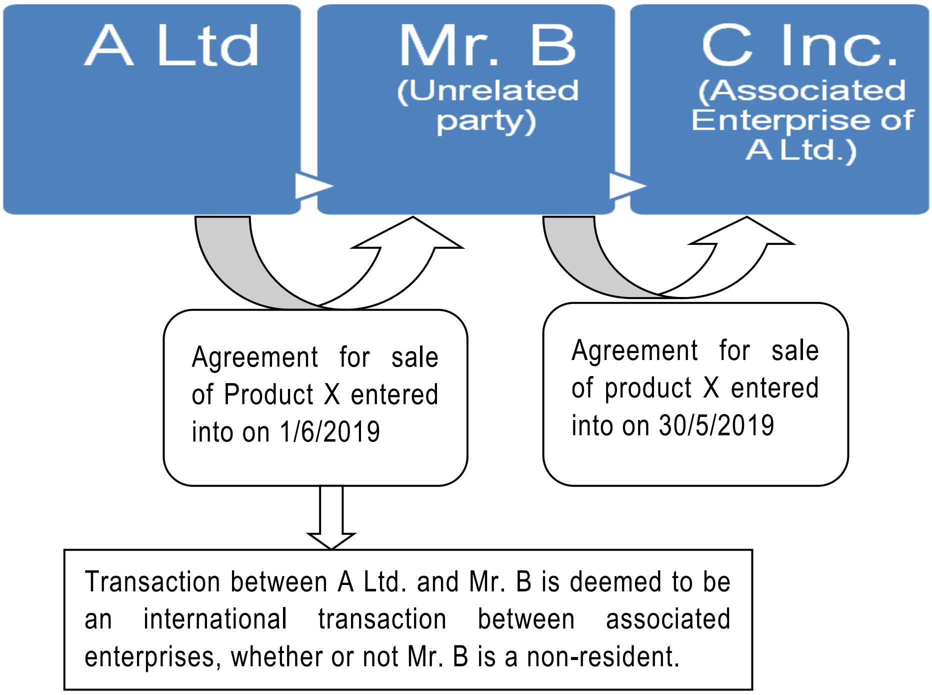
♦ where the terms of the relevant transaction are determined in substance between such other person and the associated enterprise; **and**

♦ either the enterprise or the associated enterprise or both of them are non-residents,

then such transaction entered into between the enterprise and the other person shall be deemed to be an **international transaction** entered into between two associated enterprises, **whether or not such other person is a non-resident.**

Example:

If A Ltd., an Indian company, has entered into an agreement for sale of product X to Mr. B, an unrelated party, on 1/6/2019 and Mr. B has entered into an agreement for sale of product X with C Inc., a non-resident entity, which is a specified foreign company in relation to A Ltd., on 30/5/2019, then, the transaction between A Ltd. and Mr. B shall be deemed to be an international transaction entered into between two associated enterprises, irrespective of whether or not Mr. B is a non-resident.



Agreement for sale of Product X entered into on 1/6/2019

Agreement for sale of product X entered into on 30/5/2019

Transaction between A Ltd. and Mr. B is deemed to be an international transaction between associated enterprises, whether or not Mr. B is a non-resident.

Note – *C Inc. is deemed to be an associated enterprise of A Ltd. since it is a specified foreign company in relation to A Ltd., which means that A Ltd. holds 26% or more in the nominal value of the equity share capital of C Inc.*

❑ The scope of **"international transaction"** shall include:

	Transactions	Amplification of scope of terms used
(1)	Purchase, sale, transfer, lease or use of tangible property	Tangible property includes - • building, • transportation vehicle, • machinery, equipment, tools, plant, • furniture, • commodity or

		• any other article, product or thing;
(2)	Purchase, sale, transfer, lease or use of intangible property, including transfer of ownership or the provision of use of certain rights	"Use of certain rights" refer to – • land use, • copyrights, patents, trademarks, licences, franchises, • customer list, marketing channel, brand, commercial secret, • know-how, • industrial property right, • exterior design or practical and new design or • any other business or commercial rights of similar nature.
(3)	Capital financing	• any type of long-term or short-term borrowing, • lending or guarantee, • purchase or sale of marketable securities or • any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business.
(4)	Provision of services	• provision of market research, • market development, • marketing management, • administration, • technical service, • repairs, • design, • consultation, • agency, • scientific research, • legal or accounting service.
(5)	Business restructuring or reorganization entered into by an enterprise with an associated enterprise	All such transactions are included in the definition of "international transaction", whether or not it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date.

- ❑ The expression “**intangible property**” shall include:

	Type of intangible asset in relation to	**Examples of each type of intangible asset**
(1)	Marketing	• Trademarks • trade names • brand names • logos
(2)	Technology	• Process patents • patent applications • technical documentation such as laboratory notebooks • technical know-how
(3)	Artistic	• literary works and copyrights • musical compositions • copyrights • maps • engravings
(4)	Data processing	• proprietary computer software • software copyrights • automated databases • integrated circuit masks and masters
(5)	Engineering	• industrial design • product patents • trade secrets • engineering drawing and schematics • blueprints • proprietary documentation
(6)	Customer	• customer lists • customer contracts • customer relationship • open purchase orders
(7)	Contract	• favourable supplier • contracts,

		• licence agreements • franchise agreements • non-compete agreements
(8)	Human	• trained and organised work force • employment agreements • union contracts
(9)	Location	• leasehold interest • mineral exploitation rights • easements • air rights • water rights
(10)	Goodwill	• institutional goodwill • professional practice goodwill • personal goodwill of professional • celebrity goodwill • general business going concern value
(11)	methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, or technical data;	
(12)	any other similar item that derives its value from its intellectual content rather than its physical attributes.	

❑ **Transaction:** The word "transaction" has been defined in section 92F to include an arrangement, understanding or action in concert

(i) whether or not such arrangement, understanding or action is formal or in writing; or

(ii) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings."

Section 92F(v) provides an inclusive definition of the term "transaction". Based on the reading of the section, it is evident that it is not necessary that for a transaction undertaken between two enterprises there needs to be a formal written agreement between them. It is only relevant whether a transaction has been entered into in substance. The section also negates the requirement as to the legal enforceability of agreement or understanding.

It may be noted that one of the parties to the international transaction should be a non-resident. Therefore, transactions between a resident assessee ("A" Ltd.) and its foreign branches or between its two or more foreign branches will not be considered as international transactions. This is for the reason that when "A" Ltd. is a resident in India, all its foreign branches will be deemed to be resident in India and transactions between Head Office and branches or between branches *inter se* will be considered as transactions between residents. Even otherwise there can be no avoidance of income in the transactions between Indian Head Office and foreign branches.

On the other hand, if an Indian branch of a foreign company ("B" Ltd.) is having a transaction with the head office the same will be covered by the definition of international transaction between associated enterprises. This is because the Indian branch (permanent establishment of "B" Ltd.) will be liable to tax in India in respect of its Indian operations and, therefore, any transaction between the Indian branches of "B" Ltd. with its head office in foreign country or with any of the branches of "B" Ltd. outside India will be considered as an international transaction and it will have to establish that the transaction is at an arm's length price. This will be the position even in respect of transactions between a parent company ("A" Ltd.) and its foreign subsidiary and, therefore, such transactions will have to comply with the provisions of transfer pricing regulations.

IV. Arm's Length Price [Section 92C]: "Arm's length price" is defined in section 92F(ii) to mean price which is applied or proposed to be applied in a transaction between persons other than associated enterprises in uncontrolled conditions. Section 92C deals with the method for determining arm's length price and the factors which are to be considered for applicability or non-applicability of a particular method to a given situation. The factors as well as methods incorporated in this section are not exhaustive and the CBDT may prescribe further factors and methods. It provides that the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely -

(a) comparable uncontrolled price method;

(b) resale price method;

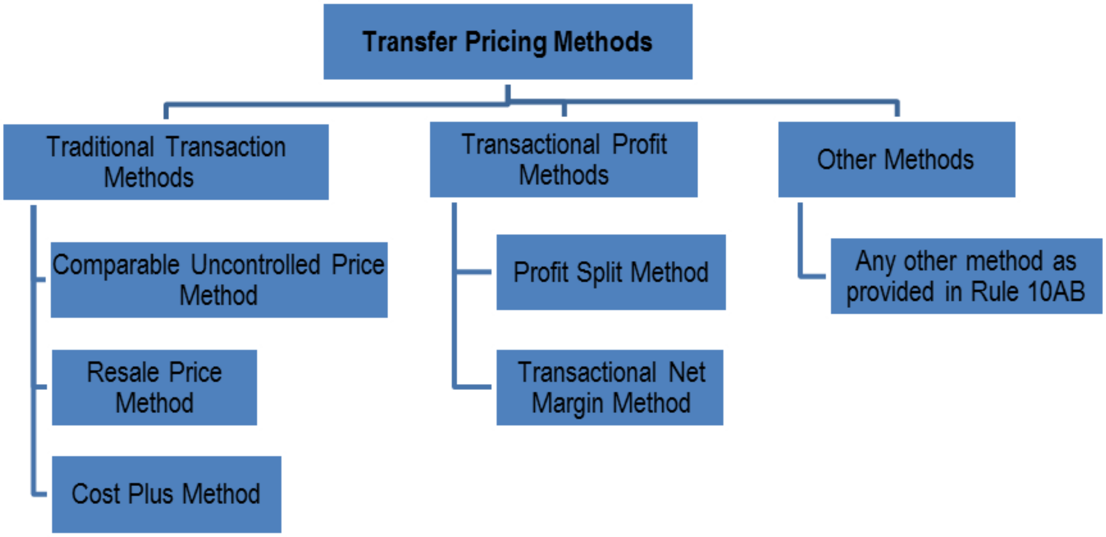
(c) cost plus method;

(d) profit split method;

(e) transactional net margin method;

(f) such other method as may be prescribed by the Board.

Accordingly, the Board has prescribed that the other method for determination of arm's length price in relation to an international transaction shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts. [Rule 10AB].


Transfer Pricing Methods
Traditional Transaction Methods
Transactional Profit Methods
Other Methods
Comparable Uncontrolled Price Method
Resale Price Method
Cost Plus Method
Profit Split Method
Transactional Net Margin Method
Any other method as provided in Rule 10AB

Section 92C(2) provides that the most appropriate method out of the above methods has to be applied for determination of arm's length price, in the prescribed manner.

Rule 10B(1) prescribed the manner to determine the arm's length price under the five methods as stated in above diagram in respect of any goods, property or services purchased or sold under any international transaction.

(i) Comparable Uncontrolled Price Method

(a) Under this method the price charged or paid for property transferred or services provided under any comparable uncontrolled transaction or transactions should be identifiable.

(b) Adjustment to account for differences between the international transaction and comparable uncontrolled transactions or between the enterprises entering into such transactions which could materially affect the price in the open market can be made.

(c) The adjusted price as worked out under (b) will be considered as an arm's length price in respect of the property transferred or services provided in the international transaction.

(ii) Resale Price Method

(a) Under this method, the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise should be identifiable.

(b) The following adjustments can be made to such resale price.

- For normal gross profit margin

- For expenses incurred in connection with the purchase of property or obtaining of services.
- For functional and other differences, including differences in accounting practices which could materially affect the gross profit margin in the open market.

(c) The adjusted price as stated in (b) above will be considered as the arm's length price.

(iii) Cost Plus Method

(a) Under this method, the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise should be determined.

(b) The amount of a normal gross profit mark-up to such costs arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise in comparable uncontrolled transaction or transactions should be determined.

(c) The above normal gross profit mark-up can be adjusted to take into account the functional and other differences which could materially affect such profit mark-up in the open market.

(d) Costs referred to in (a) above should be increased by the adjusted profit mark-up as stated in (c) above and the price so arrived at will be considered as the arm's length price.

(iv) Profit Split Method

(a) This is a method which may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction.

(b) Under this method, combined net profit of the associated enterprises arising from the international transactions in which they are engaged is first determined.

(c) The relative contribution of each associated enterprise to the earning of such combined net profit is then evaluated on the basis of the functions performed, assets employed and risks assumed by each enterprise. This evaluation is to be made on the basis of reliable external market data which can indicate how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances.

(d) The combined net profit is then split amongst the enterprises in proportion to their relative contributions. The profit thus apportioned to the assessee is taken into consideration to arrive at an arm's length price in relation to the international transaction.

(e) In certain cases the combined net profit referred to in (b) above may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction in which it is engaged. This has to be determined with reference to market returns achieved for similar types of transactions by independent enterprises. Thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises as stated in (c) and (d) above. In such a case the aggregate of net profit allocated in the first instance together with the residual profit apportioned should be considered for arriving at the arm's length price of the international transaction.

(v) Transactional Net Margin Method

(a) In this method, the net profit margin realised by the enterprise from an international transaction with an associated enterprise is computed having regard to costs incurred or sales effected or assets employed or having regard to any other relevant base.

(b) The net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction by applying the same base as in (a) above is computed. This profit margin is adjusted to take into account the differences which could materially affect the net profit margin in the open market having regard to international transaction and comparable uncontrolled transactions or having regard to the enterprise entering into such transactions.

(c) If the net profit margin realised by the enterprise as in (a) above is established to be the same as the net profit margin as in (b) above, then the same is taken into consideration to arrive at an arm's length price in relation to the international transaction.

(v) Other Method as may be prescribed by the CBDT

The Other method allows the use of 'any method' which takes into account

(i) the price which has been charged or paid or

(ii) would have been charged or paid for the same or similar uncontrolled transactions with or between non-associated enterprises, under similar circumstances.

The various data which may possibly be used for comparability purposes under this method could be third party quotations, valuation reports, tender/Bid documents, documents relating to the negotiations, standard rate cards, commercial & economic business models; etc.

For applying the above methods, the comparability of the international transaction with an uncontrolled transaction is to be judged with reference to the following factors:

(i) The specific characteristics of the property transferred or services provided in either transaction;

(ii) The functions performed, taking into account assets employer or to be employer and the risks assumed, by the respective parties to the transactions;

(iii) The contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(iv) Conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

Rule 10B(3) provides that an uncontrolled transaction shall be comparable to an international transaction

- if none of the differences between the transactions being comparable or between the enterprises entering into such transactions is likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market or
- reasonably accurate adjustments can be made to eliminate the material effects of such differences.

Data to be used for analyzing the comparability of an uncontrolled transaction with an international transaction

The data to be used for analyzing the comparability of an uncontrolled transaction and an international transaction should relate to the financial year (current year) in which the international transaction has been entered into.

In case the most appropriate method for determination of ALP of a transaction entered into on or after 1.4.2014 is the **resale price method** or **cost plus method** or **the transactional net margin method**, then, the data to be used for analyzing the comparability of an uncontrolled transaction with an international transaction shall be –

(a) the data relating to the current year; or

(b) the data relating to the financial year immediately preceding the current year, if the data relating to the current year is not available at the time of furnishing the return of income by the assessee, for the assessment year relevant to the current year.

However, where the data relating to the **current year is subsequently available** at the time of determination of arm’s length price of an international transaction **during the course of any assessment proceeding** for the assessment year relevant to the current year, then, **such data shall be used** for such determination **irrespective of the fact that the data was not available** at the time of furnishing the return of income of the relevant assessment year.

Methods for computing ALP [Section 92C]

CUP Method	Resale Price Method(RPM)	Cost Plus Method (CPM)	Profit Split Method (PSM)	Transactional Net Margin Method (TNMM)
This method is applied where there are similar transaction(s) b/w unconnected parties	This method is applied where item obtained from AE is resold to unrelated party	This method is generally applied where semi-finished goods are sold to AEs	This method is applied where there is transfer of unique intangibles or in multiple International Transaction	Compute NP margin of the enterprise from International Transaction with AE having regard to cost incurred/sales effected/assets employed
Identify price in a comparable uncontrolled transaction (CUCT)	Identify the RP at which the item is resold to unrelated party	Identify direct & indirect COP incurred for property transferred or services provided to AE	Determine combined NP of the AEs arising out of International Transaction	Compute the NP margin realised by the enterprise or unrelated enterprise in a CUCT by applying the same base
	Reduce the RP by the normal GP margin on CUCT & expenditure incurred (customs duty) w.r.t. purchase	Determine normal GP mark up to such costs by an unrelated enter in CUCT	Evaluate the relative contribution of each enterprise to the earning of combined NP on the basis of FAR	Adjust NP margin realised from CUCT to a/c for differences affecting NP margin in the OM
Adjust the price for material differences in terms of contract, credit, transport etc.	Adjust the price for functional & other differences materially affecting GP margin in open market (OM)	Adjust the normal GP mark-up for functional and other differences materially affecting GP mark-up in OM	Split the combined NP amongst the enterprise in proportion to market returns; & residual profits in proportion to their relative contribution	Compare NP margin relative to costs/sales/assets of the AE with NP margin of uncontrolled party in comparable transactions
Adjusted price is ALP	Adjusted price is ALP	Total Costs ↑d by adjusted mark up = ALP	ALP to be determined on the basis of profit apportioned.	Adjusted NP margin taken into A/c to arrive at ALP

Determination of the most appropriate method: Rule 10C deals with the determination of most appropriate method. Under this Rule, the method which is best suited to the facts and circumstances and which provides the most reliable measure of an arm's length price in relation to the international transaction will be considered to be the most appropriate method.

For the purpose of selecting the most appropriate method, the following factors should be taken into account.

(i) The nature and class of the international transaction;

(ii) The class, or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

(iii) The availability, coverage and reliability of data necessary for application of the method;

(iv) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;

(v) The extent to which reliable and accurate adjustments can be made to account for difference, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;

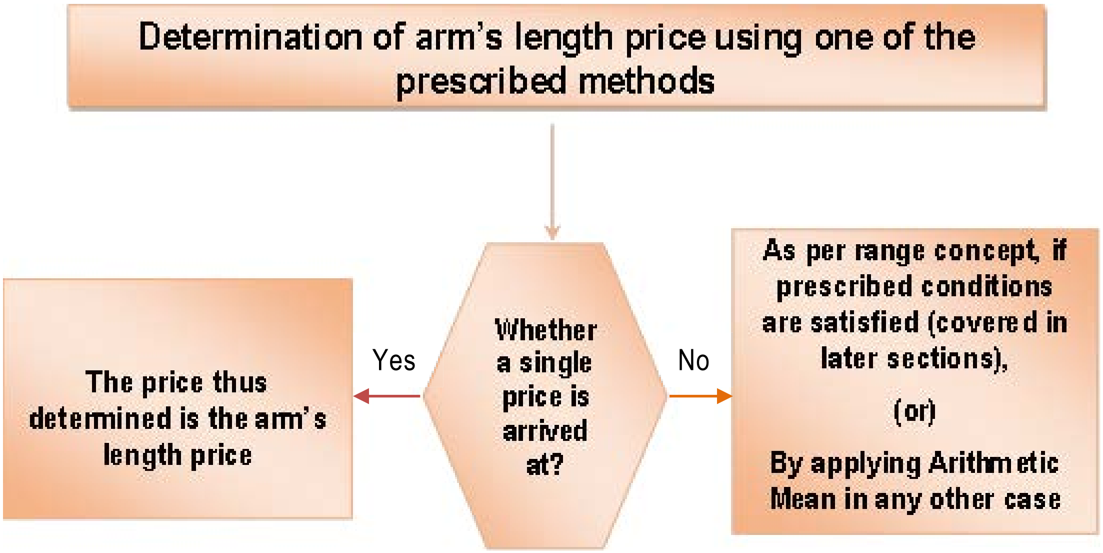
(vi) The nature, extent and reliability of assumptions required to be made in application of a method.

Manner of computation of Arm's length price (Applicable for international transactions and specified domestic transactions undertaken on or after 1.4.2014) [Third proviso to section 92C(2)]

In case of an international transaction or specified domestic transaction[1] undertaken on or after 1.4.2014, where more than one price is determined by the most appropriate method, the ALP shall be computed in the prescribed manner specified in Rule 10CA.

[1] discussed later in this Chapter

Computation of arm's length price in certain cases [Rule 10CA]


Determination of arm's length price using one of the prescribed methods
Whether a single price is arrived at?
Yes
The price thus determined is the arm's length price
No
As per range concept, if prescribed conditions are satisfied (covered in later sections),
(or)
By applying Arithmetic Mean in any other case

Rule 10CA(1) provides that where in respect of an international transaction or a specified domestic transaction, the application of the most appropriate method referred to in section 92C(1) results in determination of more than one price, then, the arm's length price in respect of such international transaction or specified domestic transaction has to be computed on the basis of the dataset constructed by placing such prices in an ascending order as provided in Rule 10CA(2).

Application of multiple year data for construction of dataset

Multiple year data allowed only in cases where determination of ALP is done using TNMM, RPM or CPM

Where the most appropriate method is the resale price method or cost plus method or transactional net margin method and the comparable uncontrolled transaction has been identified on the basis of data relating to the current year and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction or the specified domestic transaction referred to in sub-rule (1)], has in either or both of the two financial years immediately preceding the current year undertaken the same or similar comparable uncontrolled transaction then,-

(i) the most appropriate method used to determine the price of the comparable uncontrolled transaction undertaken in the current year shall be applied in similar manner to the comparable uncontrolled transaction or transactions undertaken in the aforesaid period and the price in respect of such uncontrolled transactions shall be determined; and

(ii) the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the current year and in the aforesaid period preceding it shall be included in the dataset instead of the price referred to in sub-rule (1).

Further, where the most appropriate method is the resale price method or cost plus method or transactional net margin method where the comparable uncontrolled transaction has been identified **on the basis of the data relating to the financial year immediately preceding the current year** and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction or the specified domestic transaction referred to in sub-rule (1)], has in the financial year immediately preceding the said financial year undertaken the same or similar comparable uncontrolled transaction then, -

(i) the price in respect of such uncontrolled transaction shall be determined by applying the most appropriate method in a similar manner as it was applied to determine the price of the comparable uncontrolled transaction undertaken in the financial year immediately preceding the current year; and

(ii) the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the aforesaid period of two years shall be included in the dataset instead of the price referred to in sub-rule (1).

Also, in such cases, where the use of data relating to the current year for determination of ALP subsequently at the time of assessment establishes that,-

(i) the enterprise has not undertaken same or similar uncontrolled transaction during the current year; or

(ii) the uncontrolled transaction undertaken by an enterprise in the current year is not a comparable uncontrolled transaction,

then, irrespective of the fact that such an enterprise had undertaken comparable uncontrolled transaction in the financial year immediately preceding the current year or the financial year immediately preceding such financial year, the price of comparable uncontrolled transaction or the weighted average of the prices of the uncontrolled transactions, as the case may be, undertaken by such enterprise shall **not** be included in the dataset.

Rule 10CA(3) provides that where an enterprise has undertaken comparable uncontrolled transactions in more than one financial year, then for the purposes of sub-rule (2) the weighted average of the prices of such transactions shall be computed in the following manner, namely:-

	Method used to determine the prices	Manner of computation of weighted average of the prices
(i)	The resale price method	By assigning weights to the quantum of sales which has been considered for arriving at the respective prices
(ii)	The cost plus method	By assigning weights to the quantum of costs which has been considered for arriving at the respective prices
(iii)	The transactional net margin method	By assigning weights to the quantum of costs incurred or sales effected or assets employed or to be employed, or as the case may be, any other base which has been considered for arriving at the respective prices.

Range Concept: Rule 10CA(4) provides that where the most appropriate method applied is –

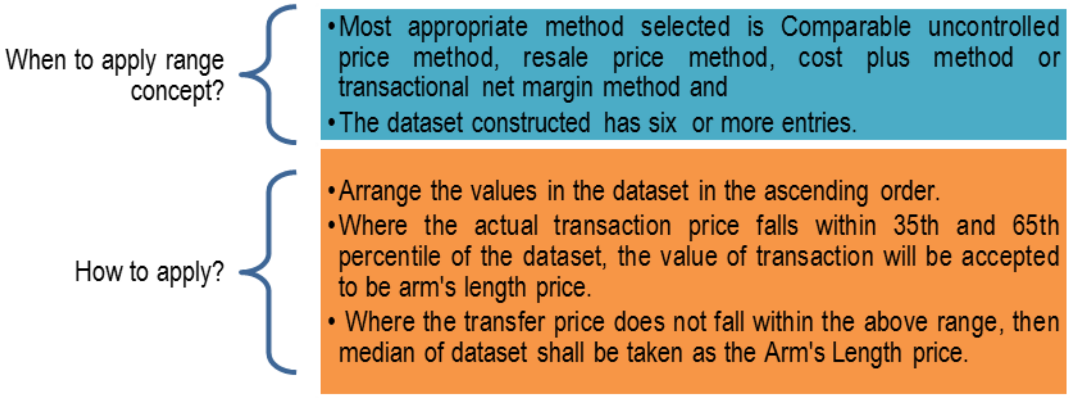
(i) a method other than the profit split method or a method prescribed by the CBDT under section 92C(1)(f); and

(ii) the dataset constructed in accordance with sub-rule (2) consists of six or more entries,

an arm's length range beginning from the thirty-fifth percentile of the dataset and ending on the sixty-fifth percentile of the dataset shall be constructed.

If the price at which the international transaction or the specified domestic transaction has actually been undertaken is within the said range, then, the price at which such international transaction or the specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price [Rule 10CA(5)].

If the price at which the international transaction or the specified domestic transaction has actually been undertaken is outside the said arm's length range, the arm's length price shall be taken to be the median of the dataset [Rule 10CA(6)].



When to apply range concept?

- Most appropriate method selected is Comparable uncontrolled price method, resale price method, cost plus method or transactional net margin method and
- The dataset constructed has six or more entries.

How to apply?

- Arrange the values in the dataset in the ascending order.
- Where the actual transaction price falls within 35th and 65th percentile of the dataset, the value of transaction will be accepted to be arm's length price.
- Where the transfer price does not fall within the above range, then median of dataset shall be taken as the Arm's Length price.

Range concept not applicable:

In a case where the provisions of Rule 10CA(4) are not applicable, the arm's length price shall be the arithmetical mean of all the values included in the dataset. However, if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage not exceeding 3% of the latter, as may be notified by the Central Government in the Official Gazette in this behalf, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price [Rule 10CA(7)].

Meaning of certain terms [Rule 10CA(8)]

	Term	Meaning
(a)	the thirty-fifth percentile of a dataset (having values arranged in an ascending order)	The lowest value in the dataset such that at least 35% of the values included in the dataset are equal to or less than such value. However, if the number of values that are equal to or less than the aforesaid value is a whole number, then, the thirty-fifth percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.
(b)	the sixth-fifth percentile of a dataset (having values arranged in an ascending order)	The lowest value in the dataset such that at least 65% of the values included in the dataset are equal to or less than such value. However, if the number of values that are equal to or less than the aforesaid value is a whole number, then, the sixty-fifth percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.
(c)	the median of the dataset (having values arranged in an ascending order)	The lowest value in the dataset such that at least 50% of the values included in the dataset are equal to or less than such value. However, if the number of values that are equal to or less than the aforesaid value is a whole number, then, the median shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.

V. Reference to Transfer Pricing Officer [Section 92CA]: This section provides for a procedure for reference to a Transfer Pricing Officer (TPO) of any issue relating to computation of arm's length price in an international transaction. The procedure is as under -

(1) The option to make reference to TPO is given to the Assessing Officer. Where the assessee has entered into an international transaction in any previous year and if Assessing Officer considers it necessary or expedient to do so he may refer the computation of the arm's

length price in relation to the said international transaction to the TPO. This option is not, however, available to the assessee.

(2) The Assessing Officer has to take the approval of the PCIT/ CIT before making such a reference.

(3) Any Joint /Deputy/Assistant Commissioner of Income-tax, authorised by CBDT, can be appointed as TPO.

(4) When such reference is made, TPO would serve a notice to the assessee requiring him to produce on a date specified in the notice, any evidence on which the assessee relied in support of the computation of arm's length price made by him in relation to the international transaction.

(5) The TPO can also determine the ALP of other international transactions identified subsequently in the course of proceedings before him as if such transaction is referred to the TPO by the Assessing Officer under section 92CA(1) [Sub-section (2A)].

(6) Where in respect of an international transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the TPO during the course of proceeding before him, the transfer pricing provisions shall apply as if such transaction is referred to the TPO by the Assessing Officer under section 92CA(1) [Sub-section (2B)].

(7) The TPO has to pass an order determining the arm's length price after considering the evidence, documents, etc. produced by the assessee and after considering the material gathered by him. He has to send a copy of his order to Assessing Officer as well as the assessee.

(8) The order of the Transfer Pricing Officer determining the arm's length price of an international transaction is binding on the Assessing Officer and the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer [Sub-section (4)].

(9) In order to provide sufficient time to the Assessing Officer to complete the assessment in a case where reference is made to the Transfer Pricing Officer, section 92CA(3A) provides for determination of arm's length price of international transactions by the Transfer Pricing Officer at least 60 days before the expiry of the time limit under section 153 or section 153B for making an order of assessment by the Assessing Officer. This provision would apply in a case where reference is made on or after 1.6.2007 or in a case where reference is made before that date but the order of the Transfer Pricing Officer is pending on that date [Sub-section (3A)].

(10) In many cases, it becomes necessary to seek information from foreign jurisdictions for the purpose of determining the arm's length price by the TPO. At times, proceedings before the TPO may also be stayed by a court order.

Taking into consideration such cases, it has been provided that where assessment proceedings are stayed by any court or where a reference for exchange of information has been made by the competent authority under an agreement referred to in section 90 or 90A, the time available to the Transfer Pricing Officer for making an order after excluding the time for which assessment proceedings were stayed or the time taken for receipt of information, as the case may be, is less than 60 days, then, such remaining period shall be extended to 60 days.

(11) The TPO has power to rectify his order under section 154 if any mistake apparent from the record is noticed. If such rectification is made, the Assessing Officer has to rectify the assessment order to bring it in conformity with the same.

(12) The TPO can exercise all or any of the powers specified in clause (a) to (d) of section 131(1) or section 133(6) or section 133A for determination of arm's length price once the above reference is made to him.

VI. Safe Harbour Rules for determination of arm's length price in case of international transactions [Section 92CB]

(i) Section 92C provides for adjustment in the transfer price of an international transaction with an associated enterprise if the transfer price is not equal to the arm's length price. This has resulted in a large number of such transactions being subjected to adjustment giving rise to considerable dispute.

(ii) Therefore, section 92CB has been introduced to empower the CBDT to formulate safe harbour rules to determine the arm's length price under section 92C and 92CA. Section 92CB(2) empowers the CBDT to prescribe safe harbour rules[2].

'Safe harbour' means circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee.

VII. Introduction of Advance Pricing Agreements [Sections 92CC & 92CD]

(1) An Advance Pricing Agreement (APA) is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future. They offer better assurance on transfer pricing methods and provide certainty and unanimity of approach.

[2] *The Safe Harbour Rules relevant for A.Y. 2020-21 are yet to be notified by the CBDT as on the date of release of the Study Material. These rules, when notified, will form part of the webhosted Statutory Update.*

(2) Keeping in mind the benefits offered by the APAs, sections 92CC and section 92CD have been introduced in the transfer pricing regime to provide a framework for formulation of APAs between the tax payer and the income-tax authorities.

(3) Section 92CC enables the Board (with the approval of the Central Government), to enter into an APA with any person undertaking an international transaction.

(i) **Purpose of APA:** The APA shall relate to an international transaction to be entered into by such person. The APA shall be entered into for the purpose of determination of the arm's length price or specifying the manner in which arm's length price shall be determined, in relation to such international transaction.

(ii) **Manner of determination of Arm's Length Price in APA:** The manner for determination of arm's length price referred above may include methods referred to in section 92C(1) or any other method with necessary adjustments or variations.

(iii) **Non-applicability of section 92C or section 92CA:** In case an APA has been entered into in respect of any international transaction, the arm's length price in relation to that transaction shall be determined in accordance with that APA notwithstanding any contrary provisions contained in section 92C or section 92CA i.e., the provisions of the APA shall apply overriding the provisions of section 92C or section 92CA, which are normally applicable for determination of arm's length price.

(iv) **Validity of APA:** The APA shall be valid for such period as specified in the agreement, which shall in no case exceed five consecutive previous years.

(v) **Binding nature of APA:** The APA so entered into shall be binding on:

(a) the person in whose case, and in respect of the transaction in relation to which, the APA has been entered into; and

(b) the Principal Commissioner or Commissioner and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.

(vi) **Not binding of APA:** The APA shall not be binding if there is any change in law or facts having bearing on such APA.

(vii) **Conditions to declare APA as *void ab initio*:** In case the Board finds that the APA so entered into has been obtained by the person by way of fraud or misrepresentation of facts, the Board is empowered to pass an order declaring any such APA to be void ab initio, with the approval of Central Government.

(viii) **Consequences of declaration of an APA as *void ab initio*:** As a result of declaration of an APA as *void ab initio*:

(a) all the provisions of the Act shall apply to such person as if such APA had never been entered into.

(b) The period beginning with the date of such APA and ending on the date of order declaring the APA as *void ab initio*, shall be excluded for the purpose of computation of any period of limitation under this Act (for example period of limitation specified in the section 153, 153B etc). This is irrespective of anything contained in any other provision of the Act.

(c) In case the period of limitation after exclusion of the above mentioned period is less than 60 days, such remaining period of limitation shall be extended to 60 days.

(ix) If an application is made by a person for entering into an APA, then, the proceeding, in respect of such person for the purpose of the Act, shall be deemed to be pending.

(x) **Prescribed scheme for APA:** The Board is empowered to prescribe a scheme specifying the manner, form, procedure and any other matter generally in respect of the APA.

Prescribed Advance Pricing Agreement Scheme for the purpose of section 92CC [Rule 10F to 10T]:]: In exercise of the powers conferred in section 92CC(9) read with section 295 of the Income-tax Act, 1961, the CBDT has prescribed rules specifying an Advance Pricing Agreement (APA) Scheme. Some of the important provisions of the scheme are briefed hereunder –

(1) Persons eligible to apply [Rule 10G]: Any person who has undertaken an international transaction or is contemplating to undertake an international transaction, shall be eligible to enter into an agreement under these rules.

(2) Pre-filing Consultation [Rule 10H]:

(a) Any person proposing to enter into an agreement under these rules may, by an application in writing, make a request for a pre-filing consultation in the prescribed form to the Director General of Income-tax (International Taxation).

(b) The pre-filing consultation shall, among other things,-

(i) determine the scope of the agreement;

(ii) identify transfer pricing issues;

(iii) determine the suitability of international transaction for the agreement;

(iv) discuss broad terms of the agreement.

(c) The pre-filing consultation shall –

(i) not bind the Board or the person to enter into an agreement or initiate the agreement process;

(ii) not be deemed to mean that the person has applied for entering into an agreement.

(3) Application for advance pricing agreement [Rule 10-I]

(a) Any person who is eligible to apply may enter into agreement may, if such person desires to enter into an agreement furnish an application in the prescribed form along with proof of payment of requisite fee as specified, to the Director General of Income-tax (International Taxation) in case of unilateral agreement and to the competent authority in India in case of bilateral or multilateral agreement.

(b) The application may be filed at any time -

(i) before the first day of the previous year relevant to the first assessment year for which the application is made, in respect of transactions which are of a continuing nature from dealings that are already occurring; or

(ii) before undertaking the transaction in respect of remaining transactions.

Note - The applicant may withdraw the application for agreement at any time before the finalisation of the terms of the agreement. However, application fees paid shall not be refunded on withdrawal of application by the applicant.

(4) Approval of Central Government: The agreement shall be entered into by the Board with the applicant after its approval by the Central Government.

(5) Terms of the agreement [Rule 10M]

(a) An agreement may among other things, include –

(i) the international transactions covered by the agreement;

(ii) the agreed transfer pricing methodology, if any;

(iii) determination of arm's length price, if any;

(iv) definition of any relevant term to be used in item (ii) or (iii);

(v) critical assumptions i.e., the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement, if any of the factors or assumptions is changed;

(vi) rollback provision referred to in Rule 10MA;

(vii) the conditions, if any, other than provided in the Act or these rules.

(b) The agreement shall not be binding on the Board or the assessee if there is a change in any of critical assumptions or failure to meet conditions subject to which the agreement has been entered into.

(c) The binding effect of agreement shall cease only if any party has given due notice of the concerned other party or parties.

(d) In case there is a change in any of the critical assumptions or failure to meet the conditions subject to which the agreement has been entered into, the agreement can be revised or cancelled, as the case may be.

(6) Furnishing of Annual Compliance Report [Rule 10-O]: The assessee shall furnish an annual compliance report in quadruplicate in the prescribed form to Director General of Income-tax (International Taxation) for each year covered in the agreement, within 30 days of the due date of filing income-tax return for that year, or within 90 days of entering into an agreement, whichever is later.

(7) Compliance Audit of the agreement [Rule 10P]:

(a) The Transfer Pricing Officer having the jurisdiction over the assessee shall carry out the compliance audit of the agreement for each of the year covered in the agreement. For this purpose, the Transfer Pricing Officer may require –

(i) the assessee to substantiate compliance with the terms of the agreement, including satisfaction of the critical assumptions, correctness of the supporting data or information and consistency of the application of the transfer pricing method;

(ii) the assessee to submit any information, or document, to establish that the terms of the agreement has been complied with.

(b) The compliance audit report shall be furnished by the Transfer Pricing Officer within six months from the end of the month in which the Annual Compliance Report is received by the Transfer Pricing Officer.

(8) Revision of an agreement [Rule 10Q]:

(a) An agreement, after being entered, may be revised by the Board either *suo moto* or on request of the assessee or the competent authority in India or the Director General of Income-tax (International Taxation), if –

(i) there is a change in critical assumptions or failure to meet a condition subject to which the agreement has been entered into;

(ii) there is a change in law that modifies any matter covered by the agreement but is not of the nature which renders the agreement to be non-binding ; or

(iii) there is a request from competent authority in the other country requesting revision of agreement, in case of bilateral or multilateral agreement.

(b) Except when the agreement is proposed to be revised on the request of the assessee, the agreement shall not be revised unless an opportunity of being heard has been provided to the assessee and the assessee is in agreement with the proposed revision.

(c) The revised agreement shall include the date till which the original agreement is to apply and the date from which the revised agreement is to apply.

(9) Cancellation of an agreement [Rule 10R]:

(a) An agreement shall be cancelled by the Board for any of the following reasons:

(i) the compliance audit has resulted in the finding of failure on the part of the assessee to comply with the terms of the agreement;

(ii) the assessee has failed to file the annual compliance report in time;

(iii) the annual compliance report furnished by the assessee contains material errors; or

(iv) the assessee is not in agreement with the revision proposed in the agreement or the agreement is to be cancelled under rule 10RA(7);.

(b) The Board shall give an opportunity of being heard to the assessee, before proceeding to cancel an application.

(c) The order of cancellation of the agreement shall be in writing and shall provide reasons for cancellation and for non-acceptance of assessee's submission, if any.

(d) The order of cancellation shall also specify the effective date of cancellation of the agreement, where applicable.

(e) The order under the Act, declaring the agreement as void ab initio, on account of fraud or misrepresentation of facts, shall be in writing and shall provide reason for such declaration and for non-acceptance of assessee's submission, if any.

(10) Mere filing of an application for an agreement under these rules shall not prevent the operation of Chapter X of the Act for determination of arms' length price under that Chapter till the agreement is entered into. [Rule 10T(1)]

(11) The negotiation between the competent authority in India and the competent authority in the other country or countries, in case of bilateral or multilateral agreement, shall be carried out in accordance with the provisions of the tax treaty between India and the other country or countries. [Rule 10T(2)]

(xi) **Provision for Roll back in APA Scheme [Section 92CC]**

(a) In order to reduce current pending as well as future litigation in respect of the transfer pricing matters, section 92CC(9A) provides roll back mechanism in the APA scheme.

(b) Accordingly, the APA may, subject to such prescribed conditions, procedure and manner, provide for determining the ALP or for specifying the manner in which ALP is to be determined in relation to an international transaction entered into by a person during any period not exceeding four previous years preceding the first of the previous years for which the APA applies in respect of the international transaction to be undertaken.

The CBDT has, vide *Notification No.23/2015 dated 14.3.2015*, in exercise of the powers conferred by 92CC(9A) read with section 295, following conditions, procedure and manner for determining the arm's length price or for specifying the manner in which arm's length price is to be determined in relation to an international transaction:

Rule	Particulars	Conditions, Procedure & Manner of determination of ALP
10F(ba)	Definition of Applicant	A person who has made an application.
10F(ha)	Definition of Rollback year	Any previous year, falling within the period **not exceeding four previous years,** preceding the first of the five consecutive previous years referred to in section 92CC(4).
10MA	Roll back of the agreement	The said rule provides the following: 1. The agreement may provide for determining the arm's length price or specify the manner in which arm's length price shall be determined in relation to the international transaction entered into by the person during the rollback year (hereinafter referred as "rollback provision"). **2. Conditions for applying for rollback provisions:** The agreement shall contain rollback provision in respect of an international transaction subject to the following, namely:- (i) the international transaction is same as the international transaction to which the agreement (other than the rollback provision) applies;

		(ii) the return of income for the relevant rollback year has been or is furnished by the applicant before the due date as specified in *Explanation 2* of section 139(1). (iii) the report in respect of the international transaction had been furnished in accordance with section 92E; (iv) the applicability of rollback provision, in respect of an international transaction, has been requested by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant; and (v) the applicant has made an application seeking rollback in Form 3CEDA in accordance with sub-rule (5); 3. **Non-applicability of Rollback provision**: Rollback provision shall not be provided in respect of an international transaction for a rollback year, if,- (i) the determination of arm's length price of the said international transaction for the said year has been subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement; or (ii) the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year. 4. **Manner for determining arm length price to be the same for rollback years and other previous years:** Where the rollback provision specifies the manner in which arm's length price shall be determined in relation to an international transaction undertaken in any rollback year then such manner shall be the same as the manner which has been agreed to be provided for determination of arm's length price of the same international transaction to be undertaken in any previous year to which the agreement applies, not being a rollback year. 5. **Time limit for filling application for rollback provision:** The applicant may furnish along with the

		application for advance pricing agreement, the request for rollback provision in Form No. 3CEDA with proof of payment of an additional fee of ₹ 5 lakh.
10RA	Procedure for giving effect to rollback provision of an Agreement	Rule 10RA has been inserted to provide the "Procedure for giving effect to rollback provision of an Agreement" as follows: (i) The applicant shall furnish modified return of income referred to in section 92CD in respect of a rollback year to which the agreement applies along with the proof of payment of any additional tax arising as a consequence of and computed in accordance with the rollback provision. (ii) The modified return in respect of rollback year shall be furnished along with the modified return to be furnished in respect of first of the previous years for which the agreement has been requested for in the application. (iii) If any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is the subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant before furnishing the modified return for the said year. (iv) If any appeal filed by the Assessing Officer or the Principal Commissioner or Commissioner is pending before the Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement, shall be withdrawn by the Assessing Officer or the Principal Commissioner or the Commissioner, as the case may be, within three months of filing of modified return by the applicant. (v) The applicant, the Assessing Officer or the Principal Commissioner or the Commissioner, shall inform the Dispute Resolution Panel or the Commissioner (Appeals) or the Appellate Tribunal or the High Court, as the case may be, the fact of an agreement containing rollback provision having been entered into along with a copy of the same as soon as it is practicable to do so.

		(vi) In case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled.

Subsequent to the notification of the rules, the CBDT has issued *Circular No. 10/2015 dated 10.6.2015* adopting a Question and Answer format to clarify certain issues arising out of the said Rules. The questions raised and answers to such questions as per the said Circular are given hereunder:

Question 1

Under rule 10MA(2)(ii) there is a condition that the return of income for the relevant roll back year has been or is furnished by the applicant before the due date specified in Explanation 2 to section 139(1). It is not clear as to whether applicants who have filed returns under section 139(4) or 139(5) of the Act would be eligible for roll back.

Answer

The return of income under section 139(5) can be filed only when a return under section 139(1) has already been filed. Therefore, the return of income filed under section 139(5) of the Act, replaces the original return of income filed under section 139(1). Hence, if there is a return which is filed under section 139(5) to revise the original return filed before the due date specified in *Explanation 2* to sub-section (1) of section 139, the applicant would be entitled for rollback on this revised return of income.

However, rollback provisions will not be available in case of a return of income filed under section 139(4) because it is a return which is not filed before the due date.

Note – *A belated return filed under section 139(4) can also be revised under section 139(5). In such a case, the revised return would replace the belated return. Therefore, an applicant would not be entitled for roll back provisions on a revised return which replaces a belated return.*

Question 2

Rule 10MA(2)(i) mandates that the rollback provision shall apply in respect of an international transaction that is same as the international transaction to which the agreement (other than the rollback provision) applies. It is not clear what is the meaning of the word "same". Further, it is not clear whether this restriction also applies to the Functions, Assets, Risks (FAR) analysis.

Answer

The international transaction for which a rollback provision is to be allowed should be the same as the one proposed to be undertaken in the future years and in respect of which the agreement has been reached. There cannot be a situation where rollback is finalised for a transaction which is not covered in the agreement for future years. The term same international transaction implies that the transaction in the rollback year has to be of same nature and undertaken with the same associated enterprise(s), as proposed to be undertaken in the future years and in respect of which agreement has been reached. In the context of FAR analysis, the restriction would operate to ensure that rollback provisions would apply only if the FAR analysis of the rollback year does not differ materially from the FAR validated for the purpose of reaching an agreement in respect of international transactions to be undertaken in the future years for which the agreement applies.

The word “materially” is generally being defined in the Advance Pricing Agreements being entered into by CBDT. According to this definition, the word “materially” will be interpreted consistently with its ordinary definition and in a manner that a material change of facts and circumstances would be understood as a change which could reasonably have resulted in an agreement with significantly different terms and conditions.

Question 3

Rule 10MA(2)(iv) requires that the application for rollback provision, in respect of an international transaction, has to be made by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant. Clarification is required as to whether rollback has to be requested for all four years or applicant can choose the years out of the block of four years.

Answer

The applicant does not have the option to choose the years for which it wants to apply for rollback. The applicant has to either apply for all the four years or not apply at all. However, if the covered international transaction(s) did not exist in a rollback year or there is some disqualification in a rollback year, then the applicant can apply for rollback for less than four years. Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years. Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then it would be denied the benefit of rollback for that rollback year. However, for other rollback years, it can still apply for rollback.

Question 4

Rule 10MA(3) states that the rollback provision shall not be provided in respect of an international transaction for a rollback year if the determination of arm’s length price of the *said international transaction for the said year has been the subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement. Further, Rule 10 RA(4) provides that if any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant.*

There is a need to clarify the phrase "Tribunal has passed an order disposing of such appeal" and on the mismatch, if any, between Rule 10MA(3) and Rule 10RA(4).

Answer

The reason for not allowing rollback for the international transaction for which Appellate Tribunal has passed an order disposing of an appeal is that the ITAT is the final fact finding authority and hence, on factual issues, the matter has already reached finality in that year. However, if the ITAT has not decided the matter and has only set aside the order for fresh consideration of the matter by the lower authorities with full discretion at their disposal, the matter shall not be treated as one having reached finality and hence, benefit of rollback can still be given.

There is no mismatch between Rule 10MA(3) and Rule 10RA(4).

Question 5

Rule 10MA(3)(ii) provides that rollback provision shall not be provided in respect of an international transaction for a rollback year if the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year. It may be clarified whether the rollback provisions in such situations can be applied in a manner so as to ensure that the returned income or loss is accepted as the final income or loss after applying the rollback provisions.

Answer

It is clarified that in case the terms of rollback provisions contain specific agreement between the Board and the applicant that the agreed determination of ALP or the agreed manner of determination of ALP is subject to the condition that the ALP would get modified to the extent that it does not result in reducing the total income or increasing the total loss, as the case may be, of the applicant as declared in the return of income of the said year, the rollback provisions could be applied. For example, if the declared income is ₹ 100, the income as adjusted by the TPO is ₹ 120, and the application of the rollback provisions results in reducing the income to ₹ 90, then the rollback for that year would be determined in a manner that the declared income ₹ 100 would be treated as the final income for that year.

Question 6

Rule 10RA(7) states that in case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled. It is to be clarified as to whether the entire agreement is to be cancelled or only that year for which roll back fails.

Answer

The procedure for giving effect to a rollback provision is laid down in Rule 10RA. Sub-rules (2), (3), (4) and (6) of the Rule specify the actions to be taken by the applicant in order that effect may be given to the rollback provision. If the applicant does not carry out such actions for any of the rollback years, the entire agreement shall be cancelled.

This is because the rollback provision has been introduced for the benefit of the applicant and is applicable at its option. Accordingly, if the rollback provision cannot be given effect to for any of the rollback years on account of the applicant not taking the actions specified in sub-rules (2), (3), (4) or (6), the entire agreement gets vitiated and will have to be cancelled.

Question 7

If there is a Mutual Agreement Procedure (MAP) application already pending for a rollback year, what would be the stand of the APA authorities? Further, what would be the view of the APA Authorities, if MAP has already been concluded for a rollback year?

Answer

If MAP has been already concluded for any of the international transactions in any of the rollback year under APA, rollback provisions would not be allowed for those international transactions for that year but could be allowed for other years or for other international transactions for that year, subject to fulfilment of specified conditions in Rules 10MA and 10RA. However, if MAP request is pending for any of the rollback year under APA, upon the option exercised by the applicant, either MAP or application for roll back shall be proceeded with for such year.

Question 8

Rule 10MA(1) provides that the agreement may provide for determining ALP or manner of determination of ALP. However, Rule 10MA(4) only specifies that the manner of determination of ALP should be the same as in the APA term. Does that mean the ALP could be different?

Answer

Yes, the ALP could be different for different years. However, the manner of determination of ALP (including choice of Method, comparability analysis and Tested Party) would be same.

Question 9

Will there be compliance audit for roll back? Would critical assumptions have to be validated during compliance audit?

Answer

Since rollback provisions are for past years, ALP for the rollback years would be agreed after full examination of all the facts, including validation of critical assumptions. Hence, compliance audit for the rollback years would primarily be to check if the agreed price or methodology has been applied in the modified return.

Question 10

Whether applicant has an option to withdraw its rollback application? Can the applicant accept the rollback results without accepting the APA for the future years?

Answer

The applicant has an option to withdraw its roll back application even while maintaining the APA application for the future years. However, it is not possible to accept the rollback results without accepting the APA for the future years. It may also be noted that the fee specified in Rule 10MA(5) shall not be refunded even where a rollback application is withdrawn.

Question 11

For already concluded APAs, will new APAs be signed for rollback or earlier APAs could be revised?

Answer

The second proviso to Rule 10MA(5) provides for revision of APAs already concluded to include rollback provisions.

Question 12

For already concluded APAs, where the modified return has already been filed for the first year of the APA term, how will the time-limit for filing modified return for rollback years be determined?

Answer

The time to file modified return for rollback years will start from the date of signing the revised APA incorporating the rollback provisions.

Question 13

In case of merger of companies, where one or more of those companies are APA applicants, how would the rollback provisions be allowed and to which company or companies would it be allowed?

Answer

The agreement is between the Board and a person. The principle to be followed in case of merger is that the person (company) who makes the APA application would only be entitled to enter into the agreement and be entitled for the rollback provisions in respect of international transactions undertaken by it in rollback years. Other persons (companies) who have merged with this person (company) would not be eligible for the rollback provisions.

To illustrate, if A, B and C merge to form C and C is the APA applicant, then the agreement can only be entered into with C and only C would be eligible for the rollback provisions. A and B would not be eligible for the rollback provisions. To illustrate further, if A and B merge to form a new company C and C is the APA applicant, then nobody would be eligible for rollback provisions.

Question 14

In case of a demerger of an APA applicant or signatory into two or more companies (persons), who would be eligible for the rollback provisions?

Answer

The same principle as mentioned in the previous answer, i.e., the person (company) who makes an APA application or enters into an APA would only be entitled for the rollback provisions, would continue to apply. To illustrate, if A has applied for or entered into an APA and, subsequently, demerges into A and B, then only A will be eligible for rollback for international transactions covered under the APA. As B was not in existence in rollback years, availing or grant of rollback to B does not arise.

(4) Section 92CD provides for the following procedure for giving effect to an APA -

(i) In case a person has entered into an APA and prior to the date of entering into such APA, he has furnished the return of income under the provisions of section 139 in respect of any assessment year relevant to a previous year to which the APA applies, then, such person shall, within a period of three months from the end of the month in which the said agreement was entered into, furnish a modified return, notwithstanding any contrary provision contained in section 139.

(ii) Such modified return shall be in accordance with and limited to the provisions of such APA i.e., modifications can only be made on account of such APA in the return to be filed.

(iii) All other provisions of this Act shall apply as if the modified return is a return furnished under section 139, unless anything to the contrary is provided in this section.

(iv) If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the APA applies have been completed before the expiry of period allowed for furnishing of modified return, the Assessing Officer shall, in a case where modified return is filed in accordance with the provisions of this section, proceed to assess or reassess or re-compute the total income of the relevant assessment year having regard to and in accordance with the APA.

However, with effect from 1.9.2019, Assessing Officer shall pass an order modifying the total income of the relevant assessment year determined in such assessment or reassessment, as the case may be, having regard to and in accordance with the APA, instead of proceeding to assess or reassess the total income.

Such order for assessment or reassessment or re-computation of total income shall be passed within a period of 1 year from the end of the financial year in which the modified return was furnished. This shall apply notwithstanding the period of limitation contained under section 153 or 153B or 144C.

The appeal against such order shall lie to Commissioner (Appeals) [Section 246A]

(v) Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the APA applies, are pending on the date of filing of modified return, the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the APA taking into consideration the modified return so furnished.

In this case, the time period of completion of pending assessment or reassessment mentioned under section 153 or 153B or 144C shall be extended by 12 months. This shall apply notwithstanding the period of limitation contained under section 153 or 153B or 144C.

(vi) The assessment or reassessment proceedings for an assessment year shall be deemed to have been completed where -

(a) an assessment or reassessment order has been passed; or

(b) no notice has been issued under section 143(2) till the expiry of the limitation period provided under the said section.

VIII. Secondary Adjustment [Section 92CE]

(1) Meaning of Primary Adjustment and Secondary Adjustment

"Primary adjustment" to a transfer price means the determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee.

"Secondary adjustment" means an adjustment in the books of accounts of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.

(2) **Forms of Secondary Adjustment** - As per the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD transfer pricing guidelines), secondary adjustment may take the form of constructive dividends, constructive equity contributions, or constructive loans.

(3) **Alignment of economic benefit of the transaction with the arm's length position -** The provisions of secondary adjustment are internationally recognised and are already part of the transfer pricing rules of many leading economies in the world. Whilst the approaches to secondary adjustments by individual countries vary, they represent an internationally recognised method to align the economic benefit of the transaction with the arm's length position.

(4) **Cases where secondary adjustment has to be made -** In order to align the transfer pricing provisions in line with OECD transfer pricing guidelines and international best practices, section 92CE provides that the assessee shall be required to carry out secondary adjustment where the primary adjustment to transfer price:

(i) has been made *suo motu* by the assessee in his return of income; or

(ii) made by the Assessing Officer has been accepted by the assessee; or

(iii) is determined by an advance pricing agreement entered into by the assessee under section 92CC ***on or after 1.4.2017***; or

(iv) is made as per the safe harbour rules framed under section 92CB; or

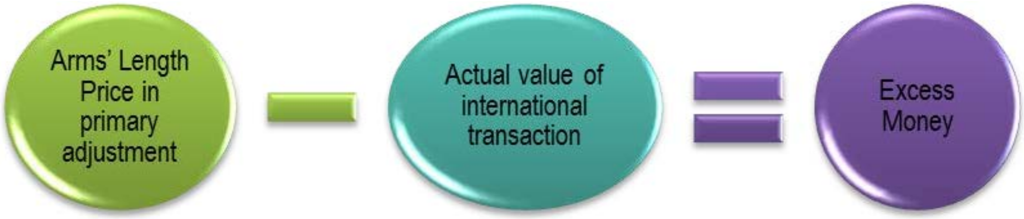
(v) is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or 90A for avoidance of double taxation.

(5) **No requirement of secondary adjustment in certain cases -** Such secondary adjustment, however, shall not be carried out if, the amount of primary adjustment made in the case of an assessee in any previous year does not exceed ₹ 1 crore **or** the primary adjustment is made in respect of A.Y.2016-17 or an earlier assessment year.

(6) **Non-repatriation of excess money by the associated enterprise deemed to be an advance -** Where, as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the assessee, the excess money ***or part thereof, as the case may be***, which is available with its associated enterprise, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed as the income of the assessee, in the prescribed manner.

Such excess money or part thereof may be repatriated from any of the associated enterprises of the assessee which is not resident in India.

*"**Excess money**" means the difference between the arm's length price determined in primary adjustment and the price at which the international transaction has actually taken place.*


Arms' Length Price in primary adjustment
Actual value of international transaction
Excess Money

(7) **Time limit for repatriation of excess money or part thereof**

Rule 10CB(1) prescribes the time limit for repatriation of excess money i.e., on or before **90 days** from the date given in column (3) in the cases mentioned in column (2) of the table below:

	Case	**Date**
(1)	**(2)**	**(3)**
(i)	Where primary adjustments to transfer price has been made *suo-moto* by the assessee in his return of income	the due date of filing of return u/s 139(1)
(ii)	If primary adjustments to transfer price as determined in the order of the Assessing Officer or the appellate authority has been accepted by the assessee	the date of the said order
(iii)	Where agreement for advance pricing has been entered into by the assessee under section 92CD	the due date of filing of return u/s 139(1)
(iv)	Where option has been exercised by the assessee as per the safe harbour rules under section 92CB	the due date of filing of return u/s 139(1)

(v)	Where agreement under the Mutual agreement procedure under a DTAA has been entered into u/s 90 or 90A	the due date of filing of return u/s 139(1)

(8) **Rate of interest for the purpose of computation on interest on excess money or part thereof, if not repatriated within the prescribed time**

Rule 10CB(2) prescribes the rate at which the per annum interest income shall be computed in case of failure to repatriate the excess money within the above time limit. The interest would be computed at the rates mentioned in column (3) in respect of the cases mentioned in column (2) of the table below:

	Case	**Rate**
(1)	**(2)**	**(3)**
(i)	Where the international transaction is denominated in Indian rupee	At the one year marginal cost of fund lending rate of SBI as on 1st April of the relevant previous year + 3.25%
(ii)	Where the international transaction is denominated in foreign currency	At six month London Interbank Offered Rate (LIBOR) as on 30th September of the relevant previous year + 3.00%

(9) ***Option to pay additional income-tax, if the excess money not repatriated:*** *In a case where the excess money or part thereof has not been repatriated within the prescribed time as mentioned above, the assessee has the option to pay additional income-tax @* ***20.9664%*** *(i.e., tax@18%* ***plus*** *surcharge@12%* ***plus*** *cess@4%) on such excess money or part thereof, as the case may be.*

Where additional income-tax is so paid by the assessee, he will ***not*** *be required to make secondary adjustment and compute interest from the date of payment of such tax. This implies that he would, in any case, be required to compute interest upto the date of payment of such additional tax.*

The additional income-tax so paid by the assessee shall be treated as the final payment of tax in respect of excess money or part thereof not repatriated and no further credit would be allowed to the assessee or to any other person in respect of the amount of additional income-tax so paid.

Further, no deduction in respect of the amount on which such additional income-tax has been paid, would be allowed under any other provision of the Act.

IX. **Records to be maintained [Section 92D]:** Transfer pricing documentation is the documentation maintained to review Transfer Pricing arrangements for transactions taking place between different entities of the same group (also known as intra-group transactions). The primary objective of the transfer pricing documentation is to review the arm's length (fair price) nature of the transactions taking place between different entities of an Multi National Company

(1) Persons responsible for keeping and maintaining prescribed information and document - *Section 92D imposes responsibility on every person*

(i) who ***enters into an international transaction*** *to keep and maintain such information and documents in respect thereof as may be prescribed by CBDT*

(ii) being a ***constituent entity of an international group****, to keep and maintain the prescribed information and document* ***in respect of an international group****.*

The constituent entity is required to keep and maintain the information and document irrespective of the fact ***whether or not any international transaction is undertaken*** *by such constituent entity.*

The constituent entity has to furnish the information and document to the authority prescribed under section 286(1), i.e., Director General of Income-tax (Risk Assessment) in the prescribed manner, on or before prescribed date

(2) Information and documents to be kept and maintained for prescribed period *- The CBDT is empowered to prescribe the period for which the information and documents shall be kept and maintained.*

(3) Assessing Officer & Commissioner (Appeals) empowered to require persons entering into international transaction to furnish prescribed information and documents *- The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceedings under the Income-tax Act, require any person who has entered into an international transaction to furnish any such prescribed information or documents within a period of* ***30 days*** *from the date of receipt of a notice issued in this regard. The requisition period may, on request, be extended further for a period not exceeding thirty days by the Assessing Officer or the Commissioner (Appeals).*

Information to be kept and maintained under section 92D[Rule 10D(1)]

Rule 10D(1) provides for the information and documents to be kept and maintained by the assessee under section 92D(1)(i). Under this Rule, the following information and documents have to be maintained:

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

(ii) 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 have been entered into by the assessee, and ownership linkages among them;

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

(iv) The nature and terms (including prices) of international 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;

(v) 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 transactions;

(vi) 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 entered into by the assessee;

(vii) A record of uncontrolled transactions taken into account for analysing their comparability with the international 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;

(viii) A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;

(ix) A description of the methods considered for determining the arm's length price in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with explanation as to why such method was so selected, and how such method was applied in each case;

(x) 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 to apply the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;

(xi) The assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;

(xii) Details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under the Income-tax Rules and consequent adjustment made to the total income for tax purposes;

(xiii) Any other information, data or documents, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

Threshold limit for maintenance of prescribed information and documents [Rule 10D(2)]

Rule 10D(2) provides that in a case where the aggregate value of international transactions does not exceed ₹ 1 crore, it will not be obligatory for the assessee to maintain the above information and documents.

However, it is provided that in the above cases also the assessee will have to substantiate that the income arising from the international transactions with associated enterprises, as disclosed by the accounts, is in accordance with section 92. This will mean that, even if the aggregate value of the international transactions is less than ₹ 1 crore, the assessee will have to maintain adequate records and evidence to show that the international transactions with associated enterprises are on the basis of arm's length principle.

Information to be supported by authentic documents [Rule 10D(3)]

The information to be maintained by the assessee, is to be supported by authentic documents. These documents may include the following:

(i) Official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country;

(ii) Reports of market research studies carried out and technical publications brought out by institutions of national or international repute;

(iii) Price publications including stock exchange and commodity market quotations;

(iv) Published accounts and financial statements relating to the business affairs of the associated enterprises;

(v) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions;

(vi) Letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;

(vii) Documents normally issued in connection with various transactions under the accounting practices followed.

It is also provided that the information and documents to be maintained should be contemporaneous and should exist latest by the date specified for getting the audit report. In the case of international transactions which continue to have effect over more than one financial year, fresh documents will not be required to be maintained for each year if there are no significant change which may affect the determination of arm's length price.

The above information and documents are required **to be maintained for a period of eight years** from the end of the relevant assessment year.

X. Power of Assessing Officer: Section 92C(3) and (4) gives power to the Assessing Officer to determine the arm's length price under the following circumstances and also empowers the Assessing Officer to re-compute total income of the assessee having regard to arm's length price determined by him. It also provides that deduction under section 10AA and Chapter VI-A shall not be allowed from the additional income computed by him.

For example, if the total income declared by the assessee in his return of income is, say ₹ 7 lakhs and the total income computed by the Assessing Officer applying the arm's length principle is, say ₹ 9 lakhs, the difference of ₹ 2 lakhs will not qualify for deduction under section 10AA or Chapter VI-A.

The Assessing Officer may invoke the power to determine arm's length price if during the course of any proceeding, he is of the opinion that, on the basis of material or information or documents in his possession:

(a) The price charged or paid in an international transaction has not been determined in accordance with section 92C(1) and (2); or

(b) Any information and documents relating to an international transaction has not been kept and maintained by the assessee in accordance with the provisions contained in section 92D(1) and the rules made in this behalf (Rule 10D); or

(c) The information or data used in computation of the arm's length price is not reliable or correct; or

(d) The assessee has failed to furnish within the specified time, any information or documents which he was required to furnish by a notice issued under section 92D(3).

Before invoking the power to determine arm's length price, an opportunity of being heard is to be given to the assessee.

Second proviso to section 92C(4) provides that if the total income of an associated enterprise is computed under this section on the determination of arm's length price paid to another associated enterprise, from which tax is deducted or deductible at source, the income of the other associated enterprise shall not be recomputed on this count.

For example, if "A" Ltd. has paid royalty to "B" Ltd. (Non-Resident) @10% of sales and tax is deducted at source, "B" Ltd. cannot claim refund if the Assessing Officer has determined 8% as arm's length price in the case of "A" Ltd. and disallowed 2% of the royalty amount.

XI. Audit Report [Section 92E]: Under section 92E, every person who enters into an international transaction during a previous year is required to obtain a report from a chartered accountant and furnish such report on or before the specified date on the prescribed form.

Rule 10E provides that the auditor's report shall be in Form No.3CEB. It requires the auditor to state that he has examined the accounts and records of the assessee relating to the international transactions entered into by the assessee during the relevant year. He has also to give his opinion whether the prescribed information and documents relating to the above transactions have been kept by the assessee. Further, he has to state that the particulars stated in the Annexure to his report are true and correct. The Annexure is in two parts.

In the first part of the Annexure, general information of the assessee is required to be reported. In the second part of the Annexure, the particulars about the international transactions are required to be stated. Broadly stated these particulars include list of associated enterprises, particulars and description of transactions relating to purchase, sales, provisions of service, loans, advances, etc

"Specified date" shall have the same meaning as assigned to due date in *Explanation 2* below sub-section (1) of section 139. The due date for filing of transfer pricing report under section 92E in Form 3CEB is 30th November of the assessment year.

XII. Penalties: Stringent penalties are provided in various sections for non-compliance with the above provisions. These are as under:

Penalty for failure to report any international transaction or any transaction deemed to be an international transaction: Under section 270A, penalty@50% of tax payable on under-reported income is leviable. However, the amount of under-reported income represented by any addition made in conformity with the arm's length price determined by the Transfer Pricing Officer would not be included within the scope of under-reported income under section 270A, where the assessee had maintained information and documents, as prescribed under section 92D, declared the international transactions under Chapter X and disclosed all material facts relating to the transaction.

Failure to report any international transaction or any transaction deemed to be an international transaction or specified domestic transaction to which the provisions of Chapter X applies would constitute **'misreporting of income'** under section 270A(9), in respect of which penalty@200% would be attracted.

Penalty for failure to keep and maintain information and documentation [Section 271AA]: The penalty provisions in respect of international transaction are broadly covered under section 271BA providing for levy of penalty of ₹ 1 lakh in cases where any person fails to furnish a report from an accountant as required by section 92E. Section 271G which provides for penalty @2% of the value of the international transaction for each failure in case of failure to furnish information or document under section 92D(3).

Further, in order to ensure compliance with the transfer pricing regulations, section 271AA provides that, the Assessing Officer or Commissioner (Appeals) may direct the person entering into an international transaction to pay a penalty@2% of the value of each international transaction entered into by him, if the person:

(1) fails to keep and maintain any such document and information as required by section 92D(1) and section 92D(2);

(2) fails to report such international transaction which is required to be reported; or

(3) maintains or furnishes any incorrect information or document.

The penalty under section 271AA shall be in addition and not in substitution of penalty under section 271BA.

Penalty for failure to comply with TP provisions : A Summary

Section	Nature of default	Penalty
270A(9)	Failure to report any International transaction or deemed International transaction to which the provision of Chapter X applies would constitute 'misreporting of income'	200% of the tax payable on under-reported income
271BA	Failure to furnish a report from an accountant as required under section 92E	₹ 1 lakh
271G	Failure to furnish info or doc as required by Assessing Officer or CIT(A) u/s 92D(3) within 30 days from the date of receipt of notice or extended period not exceeding 30 days, as the case may be.	2% of the value of the International transaction for each failure
271AA	(1) Failure to keep and maintain any such document and information as required by section 92D(1)/(2); (2) Failure to report such International transaction which is required to be reported; or (3) Maintaining or furnishing any incorrect information or document.	2% of the value of each such International transaction

Notes:

- ***The penalty u/s 271AA shall be in addition and not in substitution of penalty u/s 271BA.***
- ***If the assessee proves that there was reasonable cause for the failure, no penalty would be leviable under section 271BA, 271G and 271AA.***

(2) Furnishing of report in respect of international group in line with BEPS Action Plan – Country by Country Report and Master File

(i) Transfer Pricing provisions under the Income-tax Act, 1961

Chapter X of the Income-tax Act, 1961 comprising sections 92 to 92F contain provisions relating to transfer pricing regime.

Section 92D requires maintenance of prescribed information and document relating to the international transaction and specified domestic transaction.

(ii) Requirements as per OECD report on Action 13 of BEPS Action Plan

The report provides for:

(a) revised standards for transfer pricing documentation; and

(b) a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity.

(iii) Three-tier structure mandated by BEPS

The BEPS report recommends that countries adopt a standardised approach to transfer pricing documentation; it mandates the following three-tier structure:-

	Document	Information
(1)	Master File	Standardised information relevant for all multinational enterprises (MNE) group members
(2)	Local file	Specific reference to material transactions of the local taxpayer
(3)	Country-by-country report	Information relating to the global allocation of the MNE's income and taxes paid; and Indicators of the location of economic activity within the MNE group.

(iv) Advantages of the three tier structure [as per BEPS Report]:

(a) Taxpayers will be required to articulate consistent transfer pricing positions;

(b) Tax administrations would get useful information to assess transfer pricing risks;

(c) Tax administrations would be able to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.

(v) Country-by-country Report: Reporting Requirements of MNEs

The Country-by-Country (CbC) report has to be submitted by parent entity of an international group to the prescribed authority in its country of residence. This report is to be based on consolidated financial statement of the group.

(a) MNEs have to report annually and for each tax jurisdiction in which they do business:

(1) the amount of revenue;

(2) profit before income tax; and

(3) income tax paid and accrued.

(b) MNEs have to report their total employment, capital, accumulated earnings and tangible assets in each tax jurisdiction.

(c) MNEs have to identify each entity within the group doing business in a particular tax jurisdiction and provide an indication of the business activities each entity engages in.

(vi) Master File: Objective & Features

(a) The master file would provide an overview of the MNE groups business, including:

(1) the nature of its global business operations,

(2) its overall transfer pricing policies, and

(3) its global allocation of income and economic activity

in order to assist tax administrations in evaluating the presence of significant transfer pricing risk.

(b) The master file is intended to provide a high-level overview in order to place the MNE group's transfer pricing practices in their global economic, legal, financial and tax context.

(c) The master file shall contain information which may not be restricted to transaction undertaken by a particular entity situated in particular country.

(d) Thus, information in master file would be more comprehensive than the existing regular transfer pricing documentation.

(e) The master file shall be furnished by each entity to the tax authority of the country in which it operates.

(vii) Implementation of international consensus in India

India is one of the active members of BEPS initiative and part of international consensus. For the purpose of implementing the international consensus, a specific reporting regime in respect of CbC reporting and also the master file has been incorporated in the Income-tax Act, 1961. The essential elements have been incorporated in the Income-tax Act, 1961 while remaining aspects would be dealt with in detail in the Income-tax Rules, 1962.

(viii) Elements relating to CbC reporting requirement and related matters which have been incorporated in the Income-tax Act, 1961 [Section 286]

(a) **Threshold limit for applicability of CbC reporting [Sub-section (7)]:** The reporting provision shall apply in respect of an international group for an accounting year, if the total consolidated group revenue as reflected in the consolidated financial statement (CFS) for the accounting year preceding such accounting year is above a threshold to be prescribed i.e., ₹ 5,500 crore.

Where the total consolidated group revenue of the international group, as reflected in the consolidated financial statement, is in foreign currency, the rate of exchange for the calculation of the value in rupees of such total consolidated group revue shall be the telegraphic transfer buying rate (TTBR) of such currency on the last day of the accounting year preceding the accounting year [Rule 10DB(7)].

(b) **Time limit for furnishing CbC report [Sub-section (2)]:** The parent entity of an international group or the alternate reporting entity, if it is resident in India shall be required to furnish the report in respect of the group to the Director General of Income-tax (Risk Assessment) for every reporting accounting year, within a period of twelve months from the end of the said reporting accounting year for which the report is being furnished, in Form No. 3CEAD.

(c) **Details to be furnished by constituent entity resident in India [Sub-section (1):** Every constituent entity resident in India, of an international group having parent entity that is not resident in India, shall notify the Director General of Income-tax (Risk Assessment) at least two months prior to the due date for furnishing Cbc report –

(1) whether it is the alternate reporting entity of the international group; or

(2) the details of the parent entity or the alternate reporting entity, if any of the international group, and the country of territory of which the said entities are resident.

The report shall be furnished in prescribed manner and in the prescribed form i.e., 3CED.

(d) **Details/ information to be included in CbC report [Sub-section (3)]:** It should contain aggregate information in respect of:

(1) the amount of revenue,

(2) profit and loss before income-tax,

(3) amount of income-tax paid and accrued,

(4) details of stated capital, accumulated earnings, number of employees, tangible assets other than cash or cash equivalent in respect of each country or territory along with details of each constituent's incorporation country and residential status, nature and details of main business activity or activities of each constituent entity and any other information as may be prescribed.

This shall be based on the template provided in the OECD BEPS report on Action Plan 13.

(e) **Furnishing of CbC report by resident constituent entity [Sub-section (4):** A constituent entity of an international group resident in India, other than the parent entity or the alternate reporting entity, shall be required to furnish CbC report in Form No. 3CEAE within the **twelve months from the end of the reporting accounting year** to the Director General of Income-tax (Risk Assessment), if the parent entity of the group is resident of a country or territory,-

(1) in which it is not obligated to file report of the nature of CbC report;

(2) with which India does not have an arrangement for exchange of the CbC report; or

(3) there has been a systemic failure of the country or territory i.e., such country is not exchanging information with India even though there is an agreement and this fact has been intimated to the entity by the prescribed authority.

However, in case the parent entity of the constituent entity is resident of a country or territory, where, there has been a systemic failure of the country or territory and the said *failure has been intimated to such constituent entity, the period for submission of the report would be* ***six months from the end of the month in which said systemic failure has been intimated.***

(f) **Nomination of one constituent entity for furnishing CbC report [Proviso to sub-section (4)]:** If there are more than one such constituent entity of the group, resident in India, other than the parent entity or the alternate reporting entity, then the group can nominate (under intimation in writing on behalf of the group to the prescribed authority), then, one constituent entity that shall furnish the report on behalf of the group. This entity would then furnish the report.

(g) **No obligation to furnish CbC report in certain cases [Sub-section (5)]:** If an international group, having parent entity which is not resident in India, had designated an alternate entity for filing its report with the tax jurisdiction in which the alternate entity is resident and such alternate entity has furnished such report on or before the date specified by that country or territory, then, the entities of such group operating in India would not be obliged to furnish report if

- the report is required to be furnished under the law for the time being in force in the said country or territory
- the report can be obtained under the agreement of exchange of such reports by Indian tax authorities
- No systemic failure in respect of the said country or territory has been conveyed to any constituent entity of the group that is resident in India
- the said country or territory has been informed in writing by the constituent entity that it is the alternative reporting entity on behalf of the international group
- the same has been informed to the prescribed authority by the entity in accordance with section 286(1).

(h) **Entity to furnish documents and information called for [Sub-section (6)]:** The DGIT (Risk Assessment) may call for such document and information from the entity furnishing the report as it may specify in notice in writing for the purpose of verifying the accuracy. The entity shall be required to make submission within thirty days of receipt of notice or further period if extended by the prescribed authority, but extension shall not be beyond a further period of 30 days.

(ix) Penalty for non-furnishing of the report by any reporting entity which is obligated to furnish such report [Section 271GB(1) & (3)]

	Period of delay/ b default	Penalty
(a)	Not more than a month	₹ 5,000 per day
(b)	beyond one month	₹ 15,000 per day for the period exceeding one month

(c)	Continuing default even after service of order levying penalty either under (a) or under (b)	₹ 50,000 per day of continuing failure beginning from the date of service of order

(x) Penalty for failure to produce information and documents within prescribed time [Section 271GB(2) & (3)]

	Default	Penalty
(a)	Failure to produce information before prescribed authority within the period allowed u/s 286(6)	₹ 5,000 per day of continuing failure, from the day immediately following the day on which the period for furnishing the information and document expires.
(b)	Continuing default even after service of penalty order	₹ 50,000 per day for the period of default beyond the date of service of penalty order.

(xi) Penalty for submission of inaccurate information in the CBC report [Section 271GB(4)]

If the reporting entity has provided any inaccurate information in the report, the penalty would be ₹ 5,00,000 if,-

(a) the entity has knowledge of the inaccuracy at the time of furnishing the report but does not 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 notice of the prescribed authority under section 286(6).

(xii) Non-levy of penalty if reasonable cause for failure is proved [Section 273B]

Section 273B provides for non-levy of penalty under various sections if the assessee proves that there was reasonable cause for such failure. Section 271GB has been included within the scope of section 273B. Therefore, the entity can offer reasonable cause defence for non-levy of penalties mentioned above.

(xiii) Maintenance and furnishing of Master file: Consequent amendments in the Income-tax Act, 1961

	Section	Provision
(1)	92D(1)(ii)	***Every person, being constituent entity of an international group, has to keep and maintain the prescribed information and document in respect of the international group. Constituent entity has to keep and maintain such prescribed information and document irrespective of the fact whether or not any international transaction is undertaken by such constituent entity***.

		The rules shall, thereafter, prescribe the information and document as mandated for master file under OECD BEPS Action 13 report;
(2)	92D(4)	The information and document shall also be furnished to the prescribed authority u/s 286(1) within such period as may be prescribed and the manner of furnishing may also be provided for in the rules
(3)	271AA(2)	For non-furnishing of the information and document to the prescribed authority, a penalty of ₹ 5 lakh shall be leviable.
(4)	273B	Reasonable cause defence against levy of penalty shall be available to the entity.

(xiv) Meaning of certain terms [Section 286(9)]

<table>
<tr><th></th><th>Term</th><th>Meaning</th></tr>
<tr><td>(a)</td><td>Accounting year</td><td><table><tr><th>Case</th><th>Accounting year</th></tr><tr><td>In a case where the parent entity is resident in India; or</td><td>A previous year</td></tr><tr><td>In any other case</td><td>An annual accounting period, with respect to which the parent entity of the international group prepares its financial statements under any law for the time being in force or the applicable accounting standards of the country or territory of which such entity is resident</td></tr></table></td></tr>
<tr><td>(b)</td><td>Agreement</td><td>A combination of all of the following agreements, namely –
(i) an agreement referred to in section 90(1) or section 90A(1); or
(ii) an agreement for exchange of the CbC report referred to in section 286(2) as may be notified by the Central Government.</td></tr>
<tr><td>(c)</td><td>Alternate reporting entity</td><td>Any constituent entity of the international group that has been designated by such group, in the place of the parent entity, to furnish the CbC report in the country or territory in which the said constituent entity is resident on behalf of such group.</td></tr>
<tr><td>(d)</td><td>Constituent entity</td><td>(i) any separate entity of an international group that is included in the consolidated financial statement of the said group for financial reporting purposes, or may be so included for the said purpose, if the equity share of any entity of the international group were to be listed on a stock exchange;
(ii) any such entity that is excluded from the consolidated financial statement of the international group solely on the basis of size or</td></tr>
</table>

		materiality; or (iii) any permanent establishment of any separate business entity of the international group included in sub clause (i) or sub clause (ii), if such business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting or internal management control purposes
(e)	Group	This includes a parent entity and all the entities in respect of which, for the reason of ownership or control, a consolidated financial statement for financial reporting purposes,— (i) is required to be prepared under any law for the time being in force or the accounting standards of the country or territory of which the parent entity is resident; or (ii) would have been required to be prepared had the equity shares of any of the enterprises were listed on a stock exchange in the country or territory of which the parent entity is resident.
(f)	Consolidated financial statement	The financial statement of an international group in which the assets, liabilities, income, expenses and cash flows of the parent entity and the constituent entities are presented as those of a single economic entity
(g)	International group	Any group that includes,— (i) two or more enterprises which are resident of different countries or territories; or (ii) an enterprise, being a resident of one country or territory, which carries on any business through a permanent establishment in other countries or territories;
(h)	Parent entity	A constituent entity, of an international group holding, directly or indirectly, an interest in one or more of the other constituent entities of the international group, such that,— (i) it is required to prepare a consolidated financial statement under any law for the time being in force or the accounting standards of the country or territory of which the entity is resident; or (ii) it would have been required to prepare a consolidated financial statement had the equity shares of any of the enterprises were listed on a stock exchange, and, there is no other constituent entity of such group which, due to ownership of any interest, directly or indirectly, in the first mentioned constituent entity, is required to prepare a consolidated financial statement, under the circumstances referred to in sub clause (i) or sub clause (ii), that includes the separate financial statement of the first mentioned constituent entity.

(i)	Permanent establishment	Meaning assigned to it in clause (iiia) of section 92F i.e., includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.
(j)	Reporting accounting year	The accounting year in respect of which the financial and operational results are required to be reflected in the report to be furnished every year by the parent entity or the alternate reporting entity, resident in India, in respect of the international group of which it is a constituent under section 286(2) or by a constituent entity of an international group referred to in section 286(4).
(k)	Reporting entity	The constituent entity including the parent entity or the alternate reporting entity, that is required to furnish a report referred to in section 286(2) and 286(4).
(l)	Systemic failure	Systemic failure, with respect to a country or territory, means that the country or territory has an agreement with India providing for exchange of report of the nature referred to in section 286(2), but— (i) in violation of the said agreement, it has suspended automatic exchange; or (ii) has persistently failed to automatically provide to India the report in its possession in respect of any international group having a constituent entity resident in India

(3) Transfer pricing for Specified Domestic Transactions

(i) **Income from domestic related party transactions to be subject to transfer pricing [Section 92(2A)]:** Section 92 provides that any income arising from an international transaction shall be computed having regard to the arm's length price. In order to provide objectivity in determination of income from domestic related party transactions and determination of reasonableness of expenditure between related domestic parties, the provisions of section 92 have been extended to include within its ambit the specified domestic transactions. Section 92(2A) provides that, any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the specified domestic transaction shall be computed having regard to the arm's length price. However, as per section 92(3), the provisions of this section would not apply if such allowance for expense or interest under section 92(2A) has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be.

(ii) **Meaning of "specified domestic transaction" [Section 92BA]:** Section 92BA provides the meaning of "specified domestic transaction". As per section 92BA, for the purpose of sections 92, 92C (Computation of arm's length price), 92D (Maintenance and keeping of information and documents) and 92E (Furnishing of report from an accountant), in case of an assessee the specified domestic transaction shall mean any of the following transactions, not being an international transaction, namely,-

(1) any transaction referred to in section 80A i.e., inter-unit transfer of goods and services by an undertaking or unit or enterprise or eligible business to other business carried on by the assessee or *vice versa*, for consideration not corresponding to the market value on the date of transfer;

(2) any transfer of goods or services referred to in section 80-IA(8) i.e., inter-unit transfer of goods or services between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods and services;

(3) any business transacted between the assessee carrying on eligible business and other person as referred to section 80-IA(10);

(4) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of section 80-IA(8) or section 80-IA(10) are applicable; or

(5) any other transaction as may be prescribed,

(iii) However, the above mentioned transactions shall not be treated as specified domestic transaction in case the aggregate of such transactions entered into by the assessee in the previous year does not exceed a sum of ₹ 20 crore.

(iv) **Arm's length price and income of a specified domestic transaction to be computed in the same manner as applicable to an international transaction [Sections 92 & 92C]:** In order to determine the arm's length price in respect of the specified domestic transaction, the provisions of section 92 and 92C shall apply to the specified domestic transaction as they apply to the international transaction. Accordingly, the methods of computation of arm's length price for an international transaction would be applicable to a specified domestic transaction also.

(v) **Persons entering into a specified domestic transaction to maintain information and documents and furnish report of an accountant [Section 92D & 92E]:** With a view to create a legally enforceable obligation on assessees entering into a specified domestic transaction to maintain proper documentation and obtain and furnish report of a Chartered Accountant on or before the specified date, the provisions of section 92D and 92E have been made applicable to a specified domestic transaction as they apply to an international transaction.

(vi) **Reference to Transfer Pricing Officer for computation of arm's length price of specified domestic transaction [Section 92CA]:** According to section 92CA, where any person has entered into an international or a specified domestic transaction in any previous year, the Assessing Officer can with the previous approval of the Principal Commissioner or Commissioner, if he considers necessary or expedient to do so, refer the computation of the arm's length price of such transaction to the Transfer Pricing Officer (TPO).

When such reference is made, TPO can call upon the assessee to produce evidence in support of the computation of arm's length price made by him in respect of such transaction.

The TPO has to pass an order determining the arm's length price in respect of the specified domestic transaction after considering the evidence, documents, etc. produced by the assessee and after considering the material gathered by him. He has to send a copy of his order to the Assessing Officer as well as the assessee.

However, the powers available to the TPO to determine the ALP of other international transactions identified subsequently in the course of proceedings before him, is not available in respect of other specified domestic transaction i.e., the TPO can determine the ALP in respect of other international transaction that came to his notice subsequently during the course of proceedings but such power is not available in respect of specified domestic transaction subsequently identified.

(vii) **Penalty provisions to apply to specified domestic transactions as they apply to an international transaction [Sections 271AA, 271BA & 271G]:** The penalty provisions under sections 271AA, 271BA and 271G shall apply to the specified domestic transaction as they apply to an international transaction defined under section 92B.

Failure to furnish the report under section 92E from an accountant would attract penalty of ₹ 1,00,000 under section 271BA.

In addition,

(i) in case of failure to keep and maintain information, document as required under section 92D(1) or 92D(2); or

(ii) failure to report such specified domestic transaction which is required to be reported; or

(iii) maintain or furnishes incorrect information or document

penalty under section 271AA at 2% of the value of each transaction would be attracted.

Penalty@2% of value of specified domestic transaction would be attracted under section 271G for failure to furnish the prescribed information or document as required under section 92D(3) within the period of 30 days from the date of receipt of notice or the extended period not exceeding another 30 days, as the case may be.

(viii) **Market value to be the arm's length price of goods or services in a specified domestic transaction [Section 80A & 80-IA(8)]:** As per the provisions of section 80A(6), in a case where the goods or services held for the purpose of the undertaking or unit or enterprise or eligible business are transferred to any other business carried on by the assessee or where any goods or services held for the purposes of any other business carried on by the assessee are transferred to the undertaking or unit or enterprise or eligible business, the transfer price of such goods and services shall be determined at the market value of such goods or services as on the date of transfer.

Clause (iii) of *Explanation* to section 80A(6) clarifies that "market value" in relation to any goods or services sold, supplied or acquired, means the arm's length price as defined under section 92F of such goods or services, if it is a specified domestic transaction referred to in section 92BA i.e., the aggregate value of all such transaction specified in section 92BA exceeds ***₹ 20 crore***.

Therefore, in case the transfer of goods and services between undertaking or unit or enterprise or eligible business and any other business of the assessee takes place at the arm's length price, such arm's length price shall be the market value for the purpose of section 80A(6), and no further adjustment would be required in respect of the same, if the transaction is a specified domestic transaction.

(ix) Similarly, for the purpose of section 80-IA(8), the market value, in relation to any goods or services transferred between the eligible business and any other business carried on by the assessee, shall mean -

(1) the price that such goods or services would ordinarily fetch in the open market; or

(2) the arm's length price as defined under section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA.

(x) **Profit from transactions between an assessee carrying on "eligible business" and other assessees to be determined as per arm's length price [Section 80-IA(10)]:** Under section 80-IA(10), the Assessing Officer is empowered to make an adjustment while computing the profit and gains of the eligible business on the basis of the reasonable profit that can be derived from the transaction, in case the transaction between the assessee carrying on the eligible business under section 80-IA and any other person is so arranged that the transaction produces excessive profits to the eligible business.

It has been provided that if the aforesaid arrangement between the assessee carrying on the eligible business and any other person is a specified domestic transaction referred to in section 92BA, then, the amount of profit of such transaction shall be determined having regard to arm's length price as defined under section 92F and not as per the reasonable profit from such transaction.

(xi) **Transfer Pricing Rules made applicable to Specified Domestic Transactions as well [*Notification No. 41/2013 dated 10.06.2013*]**

With effect from A.Y 2013-14, the transfer pricing provisions have been extended to Specified Domestic Transactions. Accordingly, the transfer pricing rules prescribed for international transactions have been suitably amended to make the same applicable for specified domestic transactions, as well.

Rule No.	Particulars	Amendment
10A	Meaning of expressions used in computation of Arm's length price	**Definition of "associated enterprise" and "enterprise" included** **"Associated Enterprise"** shall - (i) have the same meaning as assigned to it in section 92A; and (ii) in relation to a specified domestic transaction entered into by an assessee, include - (A) other units or undertakings or businesses of such assessee in respect of a transaction referred to in section 80A or section 80-IA(8); (B) any other person referred to in section 80-IA(10) in respect of a transaction referred to therein; (C) other units, undertakings, enterprises or business of such assessee, or other person referred to in section 80-IA(10) or in respect of a transaction referred to in section 10AA or the transactions referred to in Chapter VI-A to which the provisions of section 80-IA(8) or section 80-IA(10) are applicable; **"Enterprise"** shall have the same meaning as assigned to it in clause (iii) of section 92F and shall, for the purposes of a specified domestic transaction, include a unit, or an enterprise, or an undertaking or a business of a person who undertakes such transaction.
10AB	Other methods of determination of ALP	This Rule provides that for the purpose of section 92C(1)(f), the other method for determination of the arm's length price in relation to an international transaction shall be any method which takes into account the price which has been charged or paid or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts. This Rule has now been made applicable to specified domestic transactions as well.
10B	Determination of ALP under section 92C	The methods for determination of arm's length price specified in this Rule for the purpose of section 92C(2) in relation to an international transaction shall also be made applicable in respect of specified domestic transactions.
10C	Most appropriate	Sub-rule (1) provides that, for the purposes of section 92C(1), the most appropriate method shall be the method which is best

	method	suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length price in relation to an international transaction. Sub-rule (2) specifies the factors to be taken into account in selecting the most appropriate method. This Rule is made applicable in respect of a specified domestic transaction as well.
10D	Information and documents to be kept and maintained under section 92D	Sub-rule (1) requires every person who has entered into an international transaction or specified domestic transaction to maintain the requisite information and documents as detailed thereunder. As per sub-rule (2), maintenance of information and documents shall not apply where the aggregate value of international transactions does not exceed ₹ 1 crore. However, sub-rule (1) shall be applicable for every specified domestic transaction irrespective of its value.
10E	Report from an accountant to be furnished under section 92E	This rule provides for submission of audit report from a chartered accountant by every person who has entered into an international transaction. This provision would also apply to a person entered into a specified domestic transaction as well.

(xii) **Safe Harbour Rules notified for Specified Domestic Transactions [Rule 10TH to Rule 10THD]**

Section 92CB(1) provides that the determination of arm's length price under section 92C or section 92CA shall be subject to safe harbour rules. Section 92CB(2) empowers the CBDT to prescribe safe harbour rules.

Safe harbour means circumstances in which the income tax authorities shall accept the transfer price declared by the assessee.

Accordingly, the CBDT has, in exercise of the powers conferred by section 92CB and 92D, read with section 295, inserted Rules 10TH, 10THA, 10THB, 10THC & 10THD providing the safe harbour rules for specified domestic transactions.

Rule	Rule heading	Particulars
10THA	Definitions: Appropriate Commission →	Meaning assigned to it in section 2(4) of the Electricity Act, 2003. Appropriate Commission means the Central Regulatory Commission referred to in sub-section (1) of section 76 or the State Regulatory Commission referred to in section 82 or the

	Government Company →	Joint Commission referred to in section 83, as the case may be, of the Electricity Act, 2003. Meaning assigned to it in section 2(45) of the Companies Act, 2013. Government company means any company in which not less than 51% of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.
10THA	Eligible assessee	• A person who has exercised a valid option for application of safe harbour Rules in accordance with the provisions of Rule 10THC, **AND** • is a Government company engaged in the business of generation, supply, transmission or distribution of electricity; or • is a co-operative society engaged in the business of procuring and marketing milk and milk products.
10THB	Eligible Specified Domestic Transaction	A specified domestic transaction undertaken by an eligible assessee and which comprises of: (i) supply of electricity; or (ii) transmission of electricity; or (iii) wheeling of electricity; or (iv) purchase of milk or milk products by a co-operative society from its members.
10THC	Safe harbour	(1) Where an eligible assessee has entered into an eligible specified domestic transaction in any previous year relevant to an assessment year and the option exercised by the said assessee is treated to be validly exercised under Rule 10THD, the transfer price declared by the assessee in respect of such transaction for that assessment year shall be accepted by the income-tax authorities, if it is in accordance with the circumstances specified in Rule 10THC(2). (2) The following are the circumstances in respect of the eligible specified domestic transaction.

S. No.	Eligible specified domestic Transaction	Circumstances
1	Supply of electricity, transmission of electricity, wheeling of electricity	The tariff in respect of supply of electricity, transmission of electricity, wheeling of electricity, as the case may be, is determined or the methodology for determination of the tariff is approved by the Appropriate Commission in accordance with the provisions of the Electricity Act, 2003.
2	Purchase of milk or milk products by a co-operative society from its members	The price of milk or milk products is determined at a rate which is fixed on the basis of the quality of milk, namely, fat content and Solid Not Fat (SNF) content of milk; and – (a) the said rate is irrespective of,- (i) the quantity of milk procured; (ii) the percentage of shares held by the members in the co-operative society; (iii) the voting power held by the members in the society; and (b) such prices are routinely declared by the co-operative society in a transparent manner and are available in public domain.

(3) No comparability adjustment and allowance under the second proviso to section 92C(2) shall be made to the transfer price declared by the eligible assessee and accepted by the income-tax authority.

(4) The provisions of sections 92D relating to maintenance and keeping of information and document and section

		92E for submission of report from an accountant in respect of a specified domestic transaction shall apply irrespective of the fact that the assessee exercises his option for safe harbour in respect of such transaction.
10THD	Procedure	**Furnishing of Form 3CEFB** The assessee has to furnish Form 3CEFB, complete in all respects, to the Assessing Officer on or before the due date for furnishing the return of income for the relevant assessment year specified in *Explanation 2* to section 139(1), for exercising the option of safe harbour. The return of income should be furnished on or before the date of submitting the Form 3CEFB. **Verification by the Assessing Officer** Before treating the option for safe harbor by the assessee as validly exercised, the Assessing Officer has to verify whether the assessee exercising the option is an eligible assessee and the transaction in respect of which the option is exercised is an eligible specified domestic transaction. **Furnishing of documents or information required by the Assessing Officer** Assessing Officer may issue a notice to the assessee to furnish such information or documents or other evidence as he may consider necessary. The assessee has to furnish the same within the specified time in such notice. **Circumstances when option exercised can be declared Invalid** The Assessing Officer shall, by order in writing, declare the option exercised by the assessee as invalid and cause a copy of the order to be served on the assessee if – (i) the assessee does not furnish the information or documents or other evidence required by the Assessing Officer (ii) the Assessing Officer finds that the assessee is not an eligible assessee (iii) the Assessing Officer finds that the specified domestic transaction in respect of which option has been exercised is not an eligible specified domestic transaction (iv) the tariff is not in accordance with the circumstances specified in Rule 10THC.

		Order by Assessing Officer The Assessing Officer shall pass the order declaring the option exercised by the assessee as invalid within a period of 3 months from the end of the month in which Form 3CEFB is received by him. No order can be passed declaring the option exercised by the assessee invalid unless an opportunity of being heard is given to him. **Filling of objections against the order of Assessing Officer by the assessee** If the assessee objects to the order of the Assessing Officer declaring the option to be invalid, he may file his objections with the Principal Commissioner or the Commissioner or the Principal Director or the Director, as the case may be, to whom the Assessing Officer is subordinate, **within 15 days of receipt of the order of the Assessing Officer**. On receipt of objection, the Principal Commissioner or Commissioner or Principal Director or Director, as the case may be, shall, after providing an opportunity of being heard to the assessee, pass appropriate order, **within a period of 2 months from the end of the month** in which the objection filed by the assessee is received by him, in respect of the validity or otherwise of the option exercised by the assessee. A copy of the said order has to be served on the assessee and the Assessing Officer. If the Assessing Officer or the Principal Commissioner or the Commissioner or the Principal Director or the Director, as the case may be, does not pass an order within the specified time, then the option for safe harbour exercised by the assessee shall be treated as valid.

(xiii) **Information and documents to be kept and maintained under section 92D in case of an eligible assessee referred to in Rule 10THA in respect of eligible specified domestic transaction [Rule 10D(2A)]:**

Section 92D(1)(i) provides that every person who has entered into an international transaction or specified domestic transaction shall keep and maintain prescribed information and document.

Rule 10D(1) provides for information and documents to be maintained under section 92D. Sub-rule (2A) in Rule 10D provides that nothing contained in Rule 10D(1) in so far as it relates to specified domestic transaction referred to in Rule 10THB, shall apply in the case of an eligible assessee referred to in Rule 10THA.

The information and documents to be maintained by an eligible assessee referred to in Rule 10THA relating to an eligible specified domestic transaction referred to in Rule 10THB are given in Rule 10D(2A) as follows:

Rule	Eligible Assessee	Information and documents to be kept and maintained
10THA(i)	A government company engaged in the business of generation, supply, transmission or distribution of electricity	(i) a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises; (ii) 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; (iii) the nature and terms (including prices) of specified domestic transactions entered into with each associated enterprise and the quantum and value of each such transaction or class of such transaction; (iv) a record of proceedings, if any, before the regulatory commission and orders of such commission relating to the specified domestic transaction; (v) a record of the actual working carried out for determining the transfer price of the specified domestic transaction; (vi) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the transfer price; and (vii) any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the transfer price.
10THA(ii)	A co-operative society engaged in the business of procuring and marketing milk and milk products	(i) a description of the ownership structure of the assessee co-operative society with details of shares or other ownership interest held therein by the members; (ii) description of members including their addresses and period of membership; (iii) the nature and terms (including prices) of specified domestic transactions entered into with each member and the quantum and value of each such

		transaction or class of such transaction; (iv) a record of the actual working carried out for determining the transfer price of the specified domestic transaction; (v) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the transfer price; (vi) the documentation regarding price being routinely declared in transparent manner and being available in public domain; and (vii) any other information, data or document which may be relevant for determination of the transfer price.
The above information should be supported by authentic documents. Both the information and documents must be contemporaneous and should exist latest by the due date of filing return under section 139(1) i.e., 30th November of the assessment year. Such information and documents have to be kept ad maintained for a period of eight years from the end of the relevant assessment year.		

1.6 TRANSFER OF INCOME TO NON RESIDENTS [SECTION 93]

Section 93 hits at transactions which are effected with a view to avoiding liability to taxation. For the purpose, the word “non-resident” also includes a person who is not-ordinarily resident. In order to attract the provisions of this section, all the following conditions must be satisfied:

(a) There is a transfer of assets - whether movable or immovable and whether tangible or intangible.

(b) The transfer is made by any person in India or outside irrespective of his residential status or citizenship.

(c) The transfer is made either alone or in connection with associated operations.

(d) The assets transferred directly yield income chargeable to tax under this Act.

(e) The transfer of assets is effected in such a manner that the income becomes payable to a person outside India who is either a non-resident or a not ordinarily resident in India.

(f) The transferor acquires any right by virtue of which he gets the power to enjoy the income whether immediately or in future.

(g) The Assessing Officer is satisfied that avoidance of liability to tax in India is the purpose of the transfers.

In particular, this section deems any income of a non-resident person which, if it were the income of a resident person, would be chargeable to tax in India (in the absence of this Section), as the income of the resident person in India for all purposes of the Act provided that all the conditions stated above are satisfied. This section also covers a variety of transactions constituting a transfer including cases where assets are transferred to a non-resident person and the transferor indirectly derives income under the guise of obtaining loans or repayment of loans. If the aforesaid conditions are fulfilled, the income from the assets transferred should be treated as the income of the transferor and would accordingly be taxable in his hands. Therefore, where assets are transferred to a body corporate outside India, in consideration of shares allotted by it to the transferor, he (the transferor), will become assessable under this section in respect of the income of the company derived by it from those assets. This section will not, however, apply to cases where it is shown to the satisfaction of the Assessing Officer that (i) neither the transfer nor any associated operation had for its purpose or for one of its purposes the avoidance of liability to taxation or (ii) it is provided to the satisfaction of the Assessing Officer that the transfer was effected for *bonafide* commercial purpose and with no intent to avoid tax.

The income which is deemed to be that of the transferor under this section may also arise as a result of the transfer in connection with associated operations. However, in this case also, the treatment of the income would be the same.

Meaning of "associated operation": The expression 'associated operation," in relation to a transfer, means an operation of any kind effected by any person in relation to:

(i) any of the assets transferred;

(ii) any assets representing, whether directly or indirectly, any of the assets transferred;

(iii) any income arising from such assets;

(iv) any assets representing, whether directly or indirectly, the accumulation of income arising from such assets.

Meaning of "Assets": It includes property or rights of any kind.

Meaning of "transfer": In relation to rights, transfer includes the creation of those rights.

Meaning of "benefit": It includes a payment of any kind.

In order to determine the liability of the assessee in respect of the deemed income it is immaterial if the income or benefits from the transfer (i) are actually received or not or (ii) are received or are receivable in cash or kind or (iii) are receivable directly or indirectly. For purposes of this section, a person is deemed to have the power to enjoy the income of a non-resident if:

(i) the income, in fact, so dealt with by any person as to be calculated at some point of time to enure for the benefit of the transferor, whether in the same form of the income or otherwise;

(ii) the receipt or accrual of the income operates to increase value of any assets held by the transferor or for his direct or indirect benefit;

(iii) the transferor receives or is entitled to receive at any time any benefit out of the income or out of any money available for the purpose by reason of the effect or successive effects of the associated operations on that income and the assets which represent that income;

(iv) the transferor is in a position to obtain for himself the beneficial enjoyment of the income by exercising any power of appointment or power of revocation or otherwise, whether with or without the consent of any other person, or

(v) the transferor is able to control directly or indirectly the application of the income in any manner whatsoever.

However, in determining whether a person has the power to enjoy the income due regard shall be had to the substantial result and effect of the transfer and any associated operations must be taken into consideration irrespective of the nature or form of the benefits.

It may be noted that where an assessee has been charged to tax in respect of a sum deemed to be his income under this section, the subsequent receipt of that sum by the assessee, whether as income or in any other form, shall not be liable to tax in his hands at the time of receipt.

1.7 TRANSACTIONS IN SECURITIES [SECTION 94]

Section 94 aims at preventing avoidance of tax by an assessee by sale or purchase of securities in devices and under different circumstances. In all cases where there is a transfer of shares or securities before the due date of payment of interest whereby the transferor avoids tax or shifts the burden of tax to some other person, the income from the securities transferred shall be deemed to be that of the transferor and shall be assessable in his hands accordingly.

Bond washing transactions: Bond washing transactions, i.e. cases of sale of securities and shares cum-interest or cum-dividend would fall within the provisions of the section. Income by way of interest on securities or dividends does not accrue day by day but on a certain fixed date or on the date of declaration, as the case may be. Accordingly, the seller of securities cum-interest or shares cum-dividends, on accrual of the interest, is not assessable on the interest or dividend income on the securities or shares sold by him since that part of the consideration received would be part of the capital price realised on sale. As a result, if a person, on the eve of payment of interest, sells or otherwise transfers his securities to another and buys back or re-acquires the same after the interest income had been received by the transfer would escape tax thereon. This would amount to either total avoidance of tax or shifting the burden of tax by the transferor indirectly and transactions of this type are commonly known as bond washing transaction. In order to prevent this type of avoidance of tax by the assessee, it has been specifically provided that where the owner of any shares or securities sells or otherwise transfers them and then buys them back or otherwise re-acquires them, the interest received by the transferee shall be the income of the transferor.

Similarly, in cases where shares or securities are sold by the owner of such shares or securities or by a person having beneficial interest therein and, as a result of the sale, the transferor receives either no income or less income from the securities or shares than that which would have been received by him, had the sale not been made, then the income from such securities or shares of such year shall be deemed to be the income of the transferor. Thus, this provision applies only to cases where

(i) the income accrues or falls due periodically and

(ii) the income in question is of a recurring nature, though the interval of time between the two dates of accrual may not equal (e.g., dividends).

However, the notional dividends specified in section 2(22) would not be covered by this section and the assessment of such fictional dividends should be made only in the hands of the person who is entitled to the same and not in the hands of the transferor.

There is however, one exception to both the above provisions given in sub-section (3). According to the exception, the above provisions would not apply (i) if there has been no avoidance of tax, (ii) if the avoidance was exceptional and not systematic and there was no avoidance of income-tax by the assessee during the three years immediately preceding the previous year. It is for the assessee to prove to the satisfaction of the Assessing Officer that there had been no avoidance of tax or that the avoidance of tax is exceptional and not systematic.

Where any person carrying on business, wholly or in part, as a dealer in shares and securities, buys or acquires any security and sells back or re-transfers the same, then, the interest, received or receivable by him in respect of such securities, which is deemed to be the income of the transferor, shall not be taken into account for computing his business income.

The Assessing Officer is empowered to issue a notice in writing requiring any person to furnish to him within a specified time (not being less than 28 days) in respect of all securities of which such person was the owner or in which he had a beneficial interest at any time during the period specified by him in the notice, such particulars at he may consider necessary for purposes of this Section and for the purpose of ascertaining whether tax has been borne in respect of interest or dividends on all those securities or shares.

(a) If any person buys or acquires any securities or unit within a period of three months prior to the record date and

(b) such person sells or transfers –

  (i) such securities within a period of three months after such date, or

  (ii) such unit within a period of nine months after such date and

(c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then, the loss, if any, arising therefrom shall be ignored for the purposes of computing his income chargeable to tax. Such loss should not exceed the amount of dividend or income received or receivable on such securities or unit [Sub-section (7)].

Where

(a) any person buys or acquires any units within a period of three months prior to the record date;

(b) such person is allotted additional units without any payment on the basis of holding such units on such date;

(c) such person sells or transfers all or any of the units referred to in (a) above within a period of nine months after such date, while continuing to hold all or any of the additional units referred to in (b), then –

   (i) the loss on sale of original units sold within a period of 9 months after the record date will be ignored and

   (ii) the amount of such loss will be considered as the cost of purchase or acquisition of the bonus units held by him on the date of such sale or transfer.

For the purposes of this section,-

	Term	Meaning
(i)	Interest	Interest includes dividend
(ii)	Record date	Such date as may be fixed by - (i) A company for the purposes of entitlement of the holder of the securities to receive dividend; or (ii) A mutual fund or the Administrator of the specified undertaking or the specified company as referred to in the *Explanation* to section 10(35), for the purposes of entitlement of the holder of the units to receive income, or additional unit without any consideration, as the case may be.
(iii)	Securities	The term includes stocks and shares.
(iv)	Unit	Unit of a mutual fund specified in section 10(23D) or unit of the Unit Trust of India.

1.8 INTRODUCTION OF SPECIFIC ANTI AVOIDANCE MEASURES IN RESPECT OF TRANSACTIONS WITH PERSONS LOCATED IN NOTIFIED JURISDICTIONAL AREA [SECTION 94A]

The objective of anti-avoidance measures is to discourage assessees from entering into transactions with persons located in countries or territories which do not have effective information exchange mechanism with India. The following are the anti-avoidance measures introduced -

(i) The Central Government empowered to notify any such country or territory outside India as a NJA (Notified Jurisdictional Area), having regard to the lack of effective exchange of information with such country or territory.

> ***Clarification on removal of Cyprus from the list of notified jurisdictional area under section 94A of the Income-tax Act, 1961 – [Circular No. 15/2017, dated 21-04-2017]***
>
> *Cyprus was specified as a "notified jurisdictional area" (NJA) under section 94A of the Income-tax Act, 1961 vide Notification No. 86/2013 dated 01.11.2013. The said Notification No. 86/2013 was subsequently rescinded vide Notification No. 114 dated 14.12.2016 and Notification No. 119 dated 16.12.2016 with effect from the date of issue of the notification.*
>
> *The CBDT has, vide this Circular, clarified that Notification No. 86/2013 has been rescinded with effect from the date of issue of the said notification, thereby, removing Cyprus as a notified jurisdictional area with retrospective effect from 01.11.2013.*

(ii) A transaction where one of the parties thereto is a person located in a NJA would be deemed to be an international transaction then all parties to the transaction to be deemed as associated enterprises, and accordingly, all the provisions of transfer pricing to be attracted in case of such a transaction. However, the benefit of permissible variation between the ALP and the transfer price [provided for in the second proviso to section 92C(2)] based on the rate notified by the Central Government would not be available in respect of such transaction.

(iii) Such transaction may be in the nature of –

(1) purchase, sale or lease of tangible or intangible property or

(2) provision of service or

(3) lending or borrowing money or

(4) any other transaction having a bearing on the profits, income, losses or assets of the assessee. It may include a mutual agreement or arrangement for allocation or apportionment of, or contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided by or to the assessee.

(iv) Person located in a NJA shall include a person who is a resident of the NJA and a person, not being an individual, which is established in the NJA. It would also include a permanent establishment of any other person in the NJA.

(v) Payments made to any financial institution located in a NJA would not be allowed as deduction unless the assessee authorizes the CBDT or any other income-tax authority acting on its behalf to seek relevant information from the financial institution on behalf of the assessee.

(vi) No deduction in respect of any other expenditure or allowance, including depreciation, arising from the transaction with a person located in a NJA would be allowed unless the assessee maintains the relevant documents and furnishes the prescribed information.

(vii) Any sum credited or received from a person located in a NJA to be deemed to be the income of the recipient-assessee if he does not explain satisfactorily the source of such money in the hands of such person or in the hands of the beneficial owner, if such person is not the beneficial owner.

(viii) The rate of TDS in respect of any payment made to a person located in the NJA, on which tax is deductible at source, will be the higher of the following rates –

(1) rates specified in the relevant provision of the Income-tax Act, 1961; or

(2) rate or rates in force; or

(3) 30%.

ILLUSTRATION 1

A Ltd., an Indian company, provides technical services to a company, XYZ Inc., located in a NJA for a consideration of ₹ 40 lakhs in October, 2019. It charges ₹ 42 lakhs for similar services rendered to PQR Inc., which is not located in a NJA. PQR Inc. is not an associated enterprise of A Ltd.

Discuss the tax implications under section 94A read with section 92C in respect of the above transaction of provision of technical services by A Ltd. to XYZ Inc.

SOLUTION

Since XYZ Inc. is located in a NJA, the transaction of provision of technical services by the Indian company, A Ltd., would be deemed to be an international transaction and XYZ Inc. and A Ltd. would be deemed to be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

The price of ₹ 42 lakhs charged for similar services from PQR Inc, being an independent entity located in a non-NJA country, can be taken into consideration for determining the arm's length price (ALP) under Comparable Uncontrolled Price (CUP) Method.

Since the ALP is more than the transfer price, the ALP of ₹ 42 lakhs would be considered as the income arising from the international transaction between A Ltd. and XYZ Inc.

It may be noted that the benefit of permissible variation between the ALP and transfer price is not available in respect of a transaction entered into with an entity in NJA.

ILLUSTRATION 2

Mr. X, a non-resident individual, is due to receive interest of ₹ 5 lakhs during March 2020 from a notified infrastructure debt fund eligible for exemption under section 10(47). He incurred expenditure amounting to ₹ 10,000 for earning such income. Assuming that Mr. X is a resident of a NJA, discuss the tax implications under section 94A, read with sections 115A and 194LB.

SOLUTION

The interest income received by Mr. X, a non-resident, from a notified infrastructure debt fund would be subject to a concessional tax rate of 5% under section 115A on the gross amount of such interest income. Therefore, the tax liability of Mr. X in respect of such income would be ₹ 26,000 (being 5% of ₹ 5 lakhs *plus* health and education cess@4%).

Under section 194LB, tax is deductible @5% (*plus* health and education cess@4%) on interest paid by such fund to a non-resident. However, since X is a resident of a NJA, tax would be deductible@30% (*plus* health and education cess@4%) as per section 94A, and not @5% specified under section 194LB. This is on account of the provisions of section 94A(5), which provides that "**Notwithstanding anything contained in any other provision of this Act,** where a person located in a NJA is entitled to receive any sum or income or amount on which **tax is deductible under Chapter XVII-B,** the **tax shall be deducted at the highest of the following rates**, namely–

(a) at the rate or rates in force;

(b) at the rate specified in the relevant provision of the Act;

(c) at the rate of thirty per cent."

Mr. X can, however, claim refund of excess tax deducted along with interest.

1.9 LIMITATION OF INTEREST DEDUCTION IN CERTAIN CASES [SECTION 94B]

(1) **Preference of debt over equity as a measure to finance businesses**: Debt and equity are the instruments through which a company is generally financed or capitalized. The manner in which a company is capitalized has a major impact on the amount of taxable profit as the tax laws of countries generally provide for a deduction in respect of interest paid or payable while arriving at the taxable profit. However, the dividend paid on equity contribution is not deductible. Therefore, the higher the level of debt in a company, and thus, the amount of interest it pays, the lower will be its taxable income. Due to this reason, debt is considered a more tax efficient method of finance than equity. Multinational groups are often able to structure their financing arrangements to maximize tax benefits.

(2) **Tax Rules to prevent shifting of profits through excessive interest payments**: In order to address this issue, tax rules are in place in each country to fix a ceiling limit on the amount of interest deductible in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, with the objective of protecting a country's tax base.

(3) **Relevant Action Plan of BEPS**: Under the initiative of the G-20 countries, the Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting

(BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in Action Plan 4 and recommended certain measures in its final report.

(4) **Insertion of provision in the Income-tax Act, 1961 in line with BEPS Action Plan 4**: Section 94B has, accordingly, been inserted in the Income-tax Act, 1961, in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest expenses claimed by an entity to its associated enterprises shall not be deductible in computation of income under the “Profits and gains of business or profession” to the extent that it arises from excess interest.

Excess interest shall mean an amount of

- total interest paid or payable* in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or
- interest paid or payable to associated enterprise for that previous year

whichever is less.

**Total interest paid or payable may be interpreted as interest paid or payable to non-resident associated enterprise as per the intent expressed in section 94B(1) and also the Explanatory Memorandum to the Finance Bill, 2017.*

(5) **Applicability**: The provision shall be applicable to an Indian company, or a permanent establishment of a foreign company in India, being the borrower who incurs expenditure by way of interest or similar nature in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower.

However, the provision of this section would be applicable only where the expenditure by way of interest or of similar nature exceeds **₹ 1 crore,** in respect of any form of debt issued by a non-resident, being an 'associated enterprise' of such borrower.

(6) **Meaning of debt**: Any loan, financial instrument, finance lease, financial derivative, or any arrangement that gives rise to interest, discounts or other finance charges that are deductible in the computation of income chargeable under the head “Profits and gains of business or profession”.

(7) **Provision of guarantee and deposit of matching amount deemed to be debt issued**: Where the debt is issued by a lender which is not associated but an associated enterprise either

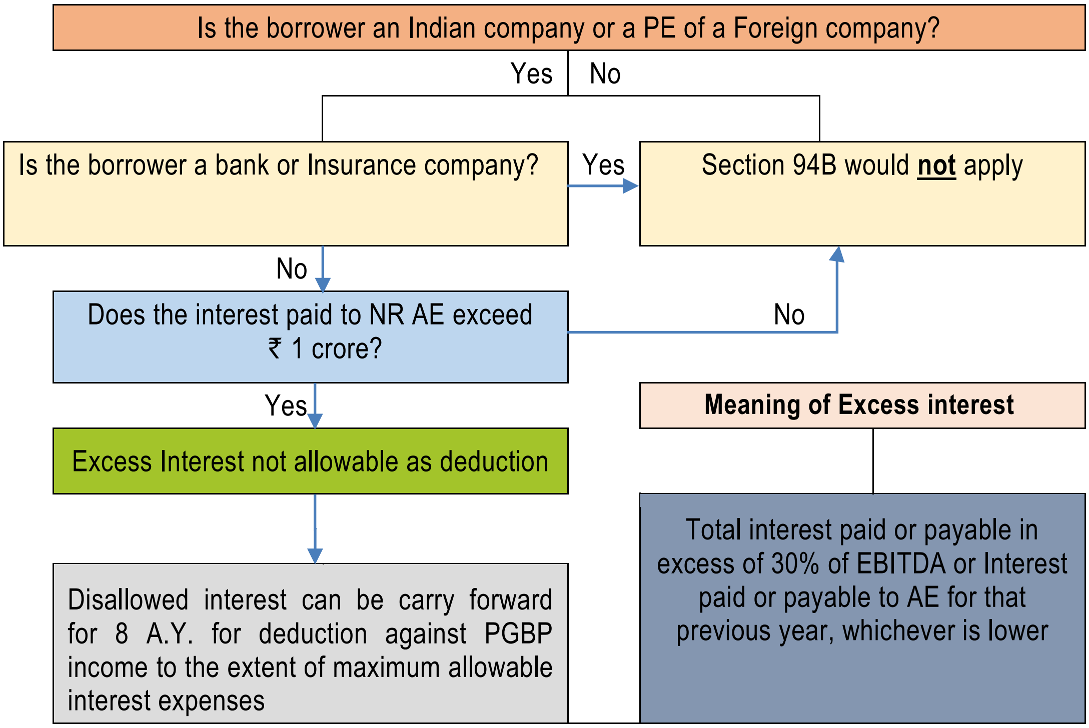
- provides an implicit or explicit guarantee to such lender or
- deposits a corresponding and matching amount of funds with the lender,

such debt shall be deemed to have been issued by an associated enterprise.

(8) **Carry forward of excess interest**: The disallowed interest expense can be carried forward upto eight assessment years immediately succeeding the assessment year for which the disallowance was first made and claimed as deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure.

(9) **Businesses excluded from applicability of the provisions of section 94B**: Taking into consideration the special nature of business of Banks and Insurance business, an Indian company or permanent establishment of a foreign company which is engaged in these business have been excluded from the applicability of the provisions of this section.

Limitation of interest deduction (Section 94B): A Summary


Is the borrower an Indian company or a PE of a Foreign company?
Yes
No
Is the borrower a bank or Insurance company?
Yes
Section 94B would not apply
No
Does the interest paid to NR AE exceed ₹ 1 crore?
No
Yes
Excess Interest not allowable as deduction
Meaning of Excess interest
Disallowed interest can be carry forward for 8 A.Y. for deduction against PGBP income to the extent of maximum allowable interest expenses
Total interest paid or payable in excess of 30% of EBITDA or Interest paid or payable to AE for that previous year, whichever is lower

EXERCISE

Question 1

Examine the consequences that would follow if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment?

Answer

In case the Assessing Officer makes adjustment to arm's length price in an international transaction which results in increase in taxable income of the assessee, the following consequences shall follow:-

(1) No deduction under section 10AA or Chapter VI-A shall be allowed from the income so increased.

(2) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:-

(1) In case the assessee is an eligible assessee under section 144C, he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Assessing Officer in pursuance of the directions of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.

(2) In any other case, he can file an appeal under section 246A to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.

(3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within one year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

Question 2

I. Limited, an Indian Company supplied billets to its holding company, U. Limited, UK during the previous year 2019-20. I. Limited also supplied the same product to another UK based company, V. Limited, an unrelated entity. The transactions with U. Limited are priced at Euro 500 per MT (FOB), whereas the transactions with V. Limited are priced at Euro 700 per MT (CIF). Insurance *and Freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with U. Limited.*

Answer

In this case, I. Limited, the Indian company, supplied billets to its foreign holding company, U. Limited. Since the foreign company, U. Limited, is the holding company of I. Limited, I. Limited and U. Limited are the associated enterprises within the meaning of section 92A.

As I. Limited supplies similar product to an unrelated entity, V. Limited, UK, the transactions between I. Limited and V. Limited can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between I. Limited and U. Limited Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

Transactions with U. Limited are on FOB basis, whereas transactions with V. Limited are on CIF basis. This difference has to be adjusted before comparing the prices.

	Amount (in Euro)
Price per MT of billets to V. Limited	700
Less: Cost of insurance and freight per M.T.	200
Adjusted Price per M.T.	500

Since the adjusted price for V. Limited, UK and the price fixed for U. Limited are the same, the arm's length price is Euro 500 per MT. Since the sale price to related party (i.e., U. Limited) and unrelated party (i.e., V. Limited) is the same, the transaction with related party U. Limited has also been carried out at arm's length price.

Question 3

X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% shares of X Ltd. and out of 7 directors of the company, 4 were appointed by them. The Assessing Officer, after verification of international transactions of ₹ 300 lacs of X Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accountants report, adjusted its income by making an addition of ₹ 30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd seeks your expert opinion.

Answer

The facts of the case indicate that X Ltd. and Yen Ltd. of Japan are associated enterprises since Yen Ltd. holds 55% shares of X Ltd. and has appointed more than half of the board of directors of X Ltd. Since Yen Ltd. is a non-resident, any transaction between X Ltd. and Yen Ltd. would fall within the meaning of "international transaction" under section 92B. Therefore, the income arising from such transactions have to be computed having regard to the arm's length price.

The action of the Assessing Officer in making addition to the declared income and issuing show cause notice for levy of various penalties is correct since X Ltd. had committed defaults, as listed hereunder, in respect of which penalty, as briefed hereunder, is imposable -

(i) Failure to report any international transaction or any transaction, deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X applies, would attract penalty @ 200% of the amount of tax payable since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).

(ii) Failure to maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which will be 2% of the value of each international transaction.

(iii) Failure to furnish report from an accountant as required under section 92E makes it liable for penalty under section 271BA i.e., a fixed penalty of ₹ 1 Lac.

The Assessing Officer shall give an opportunity of hearing to the assessee with a notice as to why the arm's length price should not be determined on the basis of material or information or document in the possession of the Assessing Officer.

Note: *It is assumed that X Ltd. has not entered into an APA and has also not opted to be subject to Safe Harbour Rules.*

Question 4

Anush Motors Ltd., an Indian company declared income of ₹ 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2020:

(i) 10,000 cars sold to Rida Ltd., US company, which holds 30% shares in Anush Motors Ltd. at a price which is less by $ 200 each car than the price charged from Shingto Ltd.

(ii) Royalty of $ 1,20,00,000 was paid to Kyoto Ltd., a US company, for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for $ 90,00,000.

(iii) Loan of Euro 1000 crores carrying interest @10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2020. The total book value of assets of Anush Motors Ltd. on the date was ₹ 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y.2020-21 keeping in mind that the value of 1$ and of 1 EURO was ₹ 63 and ₹ 84, respectively, throughout the year.

Answer

Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.

Section 92A defines an "associated enterprise" and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that "Anush Motors Ltd." is associated with :-

(i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;

(ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

(iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Anush Motors Ltd.

The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2020-21.

	Particulars	**₹ (in crores)**
Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X		300.00
Add:	Difference on account of adjustment in the value of international transactions:	
(i)	Difference in price of car @ $ 200 each for 10,000 cars ($ 200 x 10,000 x ₹ 63)	12.60
(ii)	Difference for excess payment of royalty of $ 30,00,000 ($ 30,00,000 x ₹ 63) [See Note below]	18.90
(iii)	Difference for excess interest paid on loan of EURO 1000 crores (₹ 84*1000*1/100)	840.00
Total Income		**1,171.50**

The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Anush Motors Ltd is wholly dependent on the use of know-how owned by Kyoto Ltd.

***Note**: It is presumed that Anush Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.*

Question 5

What is the legislative objective of bringing into existence the provisions relating to transfer pricing in relation to international transactions? Examine.

Answer

The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing.

There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue. Therefore, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

Question 6

R, an individual resident in India, bought 1,000 equity shares of ₹ 10 each of A Ltd. at ₹ 50 per share on 30.5.2019. He sold 700 equity shares at ₹ 35 per share on 30.9.2019 and the remaining 300 shares at ₹ 25 per share on 20.12.2019. A Ltd. declared a dividend of 50%, the record date being 10.8.2019. R sold on 1.2.2020, a house from which he derived a long-term capital gain of ₹ 75,000.

Compute the amount of capital gain arising to R for the assessment year 2020-21.

Answer

The amount of capital gains arising to R has to be computed applying the provisions of section 94(7), which provides that where:

(a) any person buys or acquires any securities or unit within a period of three months prior to the record date; and

(b) such person sells or transfers -

 (i) such securities within a period of three months after such date; or

 (ii) such unit within a period of nine months after such date; and

(c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then the loss, if any, arising to him on account of such purchase and sale of securities or unit, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or unit, shall be ignored for the purpose of computing his income chargeable to tax".

For this purpose, "record date" means such date as may be fixed by a company for the purpose of entitlement of the holder of the securities to receive dividend; "securities" includes stocks and shares.

Computation of capital gains of Mr. R for the assessment year 2020-21

Particulars	₹	₹
Long-term capital gain on sale of building		75,000
Less: Short-term capital loss on sale of shares		
700 shares	7,000	
300 shares	7,500	14,500
Taxable long-term capital gains		**60,500**

Computation of capital gain on sale of shares of A Ltd. by Mr. R

Date of purchase of shares		30.5.2019
Record date		10.8.2019
Date of sale of shares	30.9.2019	20.12.2019
Number of shares sold	700	300
Sale price per share	₹ 35	₹ 25

Particulars	₹	₹
Sale consideration	24,500	7,500
Less: Cost of acquisition	35,000	15,000
	10,500	7,500
Less: Dividend income as per section 94(7)[700×₹10×50%] [See Note below]	3,500	-
Short-term capital loss on sale of shares	**7,000**	**7,500**

Note:

(1) 700 shares are sold within 3 months after the record date. Hence, as per section 94(7), the related dividend income should be deducted from the loss.

(2) 300 shares having been sold after 3 months of record date, section 94(7) is not attracted. Therefore, the dividend income of ₹ 1,500 [300×₹10×50%] should not be deducted. Such dividend is exempt under section 10(34).

(3) Short-term capital loss can be set-off against long-term capital gains as per the provisions of section 74(1)(a). Therefore, short-term capital loss on sale of shares can be set-off against long-term capital gains on sale of building.

Question 7

XE Ltd. is an Indian Company in which Zilla Inc., a US company, has 28% shareholding and voting power. Following transactions were effected between these two companies during the financial year 2019-20.

(i) XE Ltd. sold 1,00,000 pieces of T-shirts at $ 2 per T-Shirt to Zilla Inc. The identical T-Shirts were sold to unrelated party namely Kennedy Inc., at $ 3 per T-Shirt.

(ii) XE Ltd. borrowed $ 2,00,000 from a foreign lender based on the guarantee of Zilla Inc. For this, XE Ltd. paid $ 10,000 as guarantee fee to Zilla Inc. To an unrelated party for the same amount of loan, Zilla Inc. collected $ 7000 as guarantee fee.

(iii) XE Ltd. paid $15,000 to Zilla Inc. for getting various potential customers details to improve its business. Zilla Inc. provided the same service to unrelated parties for $ 10,000.

Assume the rate of exchange as 1 $ = ₹ 64

XE Ltd. is located in a Special Economic (SEZ) and its income before transfer pricing adjustments for the year ended 31st March, 2020 was ₹ 1,200 lakhs.

Compute the adjustments to be made to the total income of XE Ltd. Assuming that such adjustments are made by the Assessing Officer, state whether it can claim deduction under section 10AA for the income enhanced by applying transfer pricing provisions.

Answer

XE Ltd, the Indian company and Zilla Inc., the US company are deemed to be associated enterprises as per section 92A(2)(a), since Zilla Inc. holds shares carrying not less than 26% of the voting power in XE Ltd.

As per *Explanation* to section 92B, the transactions entered into between these two companies for sale of product, lending or guarantee and provision of services relating to market research are included within the meaning of "international transaction".

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm's length price. In this case, from the information given, the arm's length price has to be determined taking the comparable uncontrolled price method to be the most appropriate method.

Particulars		₹ in lakhs
Amount by which total income of XE Ltd. is enhanced on account of adjustment in the value of international transactions:		
(i)	Difference in price of T-Shirt @ $ 1 each for 1,00,000 pieces sold to Zilla	64.00

	Inc. ($ 1 x 1,00,000 x ₹ 64)	
(ii)	Difference for excess payment of guarantee fee to Zilla Inc. for loan borrowed from foreign lender ($ 3,000 x ₹ 64)	1.92
(iii)	Difference for excess payment for services to Zilla Inc. ($ 5,000 x ₹ 64)	3.20
		69.12
XE Ltd. cannot claim deduction under section 10AA in respect of ₹ 69.12 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4)		

Question 8

Examine the correctness or otherwise of the following with reference to the provisions of the Income-tax Act, 1961

(i) *Transfer pricing rules shall have no implication where income is computed on the basis of book profits.*

(ii) *Assessing Officer can complete the assessment of income from international transaction in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of assessee.*

Answer

(i) The statement is correct.

For the purpose of computing book profit for levy of minimum alternate tax, the net profit shown in the statement of profit and loss prepared in accordance with the Companies Act can be increased/ decreased only by the additions and deductions specified in *Explanation 1* below section 115JB(2).

No other adjustments can be made to arrive at the book profit for levy of MAT, except where:

(a) it is discovered that the statement of profit and loss is not drawn up in accordance with the relevant Schedule of the Companies Act

(b) incorrect accounting policies and/or accounting standards have been adopted for preparing such accounts; and

(c) the method and rate of depreciation adopted is not correct.

Therefore, transfer pricing adjustments cannot be made while computing book profit for levy of MAT.

(ii) The statement is not correct.

Section 92CA(4) provides that on receipt of the order of the Transfer Pricing Officer determining the arm's length price of an international transaction, the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer.

The order of the Transfer Pricing Officer is binding on the Assessing Officer. Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer by accepting the contention raised by the assessee.

CHAPTER 2

NON RESIDENT TAXATION

LEARNING OUTCOMES

After studying this Chapter, you will be able to –

□ **determine** the residential status of foreign companies applying the Place of Effective Management (POEM) Guidelines;

□ **examine** the scope of income taxable in the hands of non-residents;

□ **examine** when income arising in the hands of non-resident from a transaction is deemed to accrue or arise in India;

□ **appreciate** the circumstances when the presence of eligible fund manager in India would not constitute business connection in India for an eligible investment fund;

□ **identify** whether a particular income is exempt in the hands of a non-resident based on the provisions of the Income-tax Act, 1961;

□ **compute** the profits and gains from shipping business, business of operation of aircraft, business of civil construction etc. in certain turnkey power projects in the case of non-corporate non-residents and foreign company applying the presumptive tax provisions under the Income-tax Act, 1961;

□ **determine** the quantum of head office expenditure allowable as deduction, in the case of non-residents;

□ **determine** the tax payable by the non-residents on dividend, royalty and fees for technical service applying the special provisions of Chapter XII;

□ **determine** the tax payable by non-residents applying the special provisions relating to certain incomes of non-residents prescribed under Chapter XII-A;

□ **examine** the withholding tax provisions to determine the tax, if any, required to be deducted at source on certain payments made to non-residents;

□ **compute** the total income of non-residents and tax payable thereon, applying the general provisions and special provisions applicable to non-residents under the Income-tax Act, 1961.

2.1 INTRODUCTION

Taxation of cross-border transactions are generally based on the two concepts:

1. Residence based taxation
2. Source based taxation

Residence based taxation: The concept of residence-based taxation asserts that natural persons or individuals are taxable in the country or tax jurisdiction in which they establish their residence or domicile, regardless of the source of income. In case of companies, the place of incorporation or the place of effective management is generally considered as its place of residence.

Source based taxation: According to this concept, a country considers certain income as taxable income, if such income arises within its jurisdiction. Such income is taxed in the country of source regardless of the residence of the taxpayer.

The overview of residence and source rules in India may largely be gathered from sections 5, 6 & 9 of the Income-tax Act, 1961. While residents are taxable on global income, non-residents are taxed on their India-source income or income that is received in India or has accrued or deemed to accrue in India.

The term "Non-resident" is defined under section 2(30) of the Income-tax Act, 1961 as a person who is not a "resident", and for the purposes of sections 92 ,93 and 168 includes a person who is not ordinarily resident within the meaning of clause (6) of section 6.

2.2 RESIDENTIAL STATUS AND SCOPE OF TOTAL INCOME

Section 6 contains the provisions for determining the residential status of a person, section 5 deals with scope of total income of resident, resident but not ordinarily resident and non-resident. The provisions of these sections except determination of residential status of foreign companies applying the Place of Effective Management (POEM) Guidelines are discussed in detail in Chapter 2: Residential Status and Scope of Total Income in Module 1 of Part I – Direct Tax Laws.

(1) Residential status of a Company

With effect from assessment year 2017-18, a company would be resident in India in any previous year, if-

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India.

> ***"Place of effective management"** means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made [Explanation to section 6(3)].*

Guiding Principles for determination of Place of Effective management ('POEM') of a Company, other than an Indian company – [Circular No. 6/2017, dated 24.01.2017 & Circular No. 8/2017, dated 23-02-2017]:

Place of effective management' (POEM) is an internationally recognised test for determination of residence of a company incorporated in a foreign jurisdiction. Most of the tax treaties entered into by India recognises the concept of 'place of effective management' for determination of residence of a company as a tie-breaker rule for avoidance of double taxation.

The CBDT has laid down the following guiding principles to be followed for determination of POEM.

Concept of Substance over form

Any determination of the POEM will depend upon the facts and circumstances of a given case. The POEM concept is one of substance over form. It may be noted that an entity may have more than one place of management, but it can have only one place of effective management at any point of time. Since "residence" is to be determined for each year, POEM will also be required to be determined on year to year basis.

Whether the company is engaged in active business outside India? - An important criterion for determination of POEM

The process of determination of POEM would be primarily based on the fact as to **whether or not the company is engaged in active business outside India.**

A company shall be said to be engaged in 'active business outside India'

- if passive income is not more than 50% of its total income, and
- less than 50% of its total asset are situated in India; and
- less than 50% of total number of employees are situated in India or are resident in India; and
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Meaning of certain terms:

Term	Meaning
Income	(a) As computed for tax purpose in accordance with the laws of the country of incorporation; or (b) As per books of account, where the laws of the country of incorporation does not require such a computation.

Value of assets	**(a) In case of an individually depreciable asset**	The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the previous year; and
	(b) In case of pool of fixed asset, being treated as a block for depreciation	The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year;
	(c) In case of any other asset	Value as per books of account
Number of employees	The average of the number of employees as at the beginning and at the end of the year and shall include persons, who though not employed directly by the company, perform tasks similar to those performed by the employees.	
Pay roll	This term includes the cost of salaries, wages, bonus and all other employee compensation including related pension and social costs borne by the employer.	
Passive income	It is the aggregate of, - (i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and (ii) income by way of royalty, dividend, capital gains, interest or rental income; However, any income by way of interest shall not be considered to be passive income in case of a company which is engaged in the business of banking or is a public financial institution, and its activities are regulated as such under the applicable laws of the country of incorporation.	

Place of Effective Management:

(i) In case of Companies engaged in Active Business outside India

POEM of a company engaged in active business shall be presumed to be outside India if the majority of the board meeting are held outside India.

However, in case the Board is not exercising its powers of management and such powers are being exercised by either the holding company or any other person, resident in India, then POEM shall be considered to be in India.

For this purpose, merely because the Board of Directors (BOD) follows general and objective principles of global policy of the group laid down by the parent entity which may be in the field of Pay roll functions, Accounting, Human resource (HR) functions, IT infrastructure and network platforms, Supply chain functions, Routine banking operational procedures, and not being specific to any entity or group of entities per se; would not constitute a case of BoD of companies standing aside.

CBDT Circular No. 25/2017, dated 23.10.2017 clarifies that so long as the Regional Headquarter operates for subsidiaries/ group companies in a region within the general and objective principles of global policy of the group laid down by the parent entity in the field of Pay roll functions, Accounting, HR functions, IT infrastructure and network platforms, Supply chain functions, Routine banking operational procedures, and not being specific to any entity or group of entities per se; it would, in itself, not constitute a case of BoD of companies standing aside and such activities of Regional Headquarter in India alone will not be a basis for establishment of PoEM for such subsidiaries/ group companies.

It is further mentioned in the said Circular that the provisions of General Anti-Avoidance Rule contained in Chapter X-A of the Income-tax Act, 1961 may get triggered in such cases where the above clarification is found to be used for abusive/ aggressive tax planning.

For the purpose of determining whether the company is engaged in active business outside India, the average of the data of the previous year and two years prior to that shall be taken into account. In case the company has been in existence for a shorter period, then data of such period shall be considered. Where the accounting year for tax purposes, in accordance with laws of country of incorporation of the company, is different from the previous year, then, data of the accounting year that ends during the relevant previous year and two accounting years preceding it shall be considered.

The final guidelines have clarified that mere following of global policies laid down by the Indian holding company would not constitute that Board is standing aside.

(ii) In case Companies not engaged in active business outside India

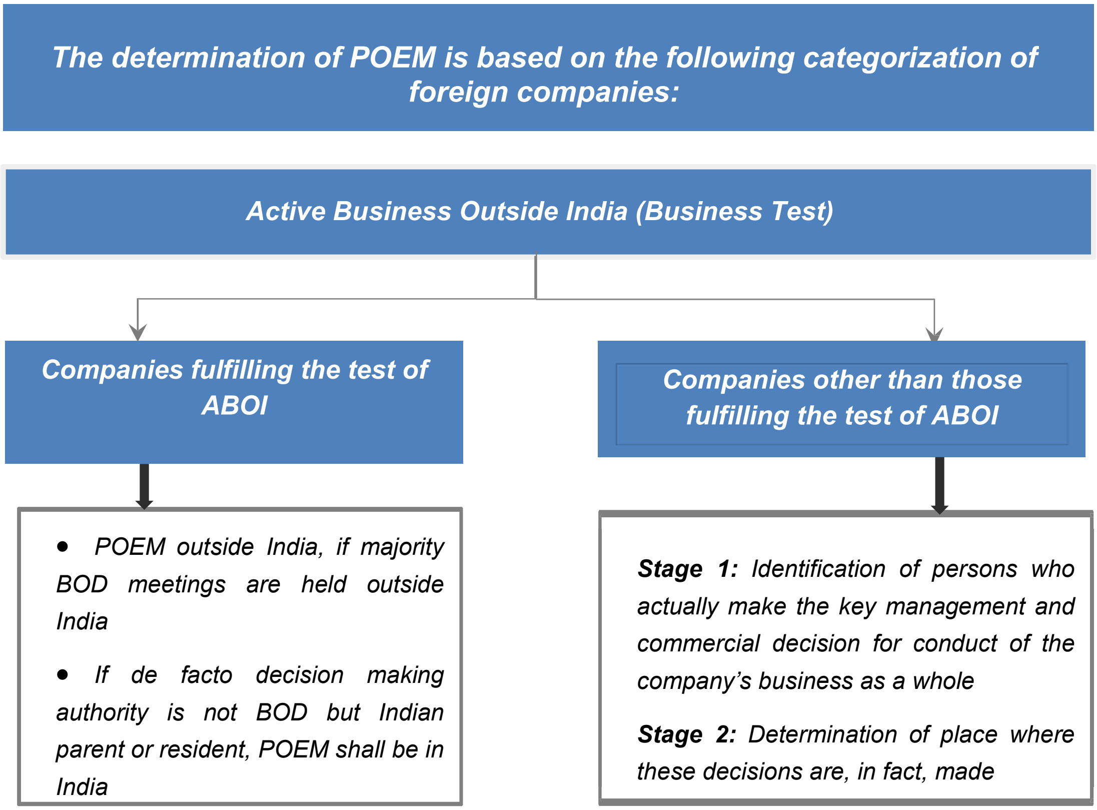
The guidelines provide a two stage process for determination of POEM in case of companies not engaged in active business.

(a) **First stage**: Identifying the person(s) who actually make the key management and commercial decisions for the conduct of the company as a whole.

(b) **Second stage**: Determine the place where these decisions are, in fact, being made.

> *The place where these management decisions are taken would be more important than the place where such decisions are implemented. For the purpose of determination of POEM, it is the substance which would be conclusive rather than the form.*

The conditions specified in the circular are depicted in the flow charts below:



The determination of POEM is based on the following categorization of foreign companies:

Active Business Outside India (Business Test)

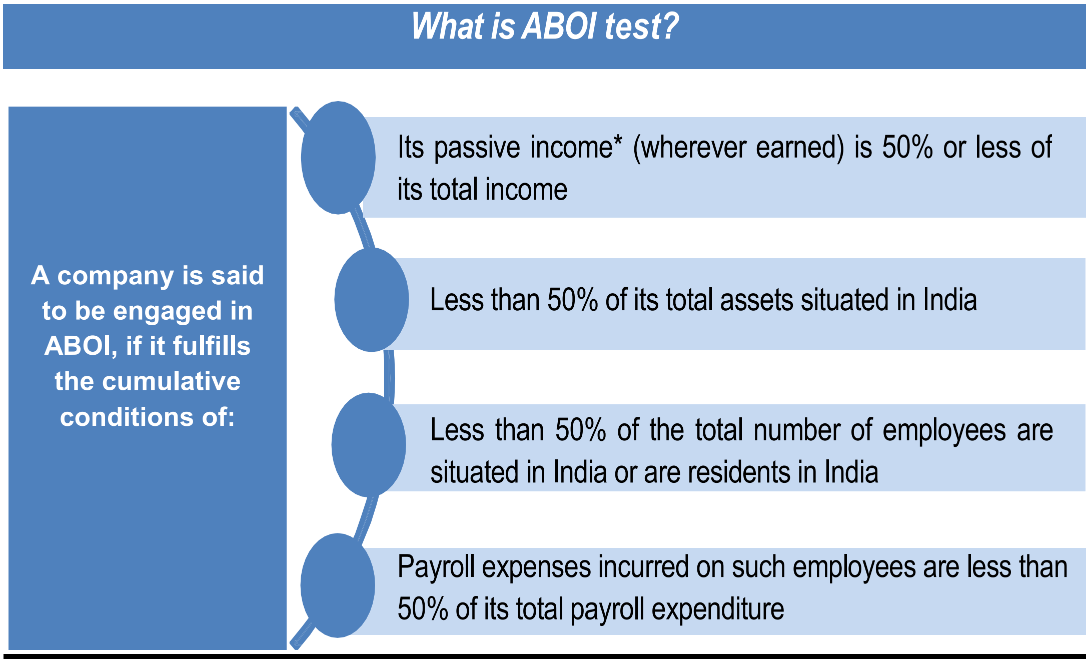
Companies fulfilling the test of ABOI

- *POEM outside India, if majority BOD meetings are held outside India*
- *If de facto decision making authority is not BOD but Indian parent or resident, POEM shall be in India*

Companies other than those fulfilling the test of ABOI

Stage 1: *Identification of persons who actually make the key management and commercial decision for conduct of the company's business as a whole*

Stage 2: *Determination of place where these decisions are, in fact, made*



What is ABOI test?

A company is said to be engaged in ABOI, if it fulfills the cumulative conditions of:

- Its passive income* (wherever earned) is 50% or less of its total income
- Less than 50% of its total assets situated in India
- Less than 50% of the total number of employees are situated in India or are residents in India
- Payroll expenses incurred on such employees are less than 50% of its total payroll expenditure

** Passive income of a company shall be aggregate of:*

(i) Income from the transactions where both the purchase and sale of goods is from/ to its associated enterprises; and

(ii) income by way of royalty, dividend, capital gains, interest (except for banking companies and public financial institutions) or rental income whether or not involving associated enterprises

Some of the guiding principles which may be taken into account for determining the POEM are as follows:

(a) **Location where the Board of Directors meet and makes decisions: This location may be** the place of effective management of a company provided, the Board –

(i) retains and exercises its authority to govern the company; and

(ii) does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.

It may be mentioned that mere formal holding of board meetings at a place would by itself not be conclusive for determination of POEM being located at that place. If the key decisions by the directors are in fact being taken in a place other than the place where the formal meetings are held then such other place would be relevant for POEM.

As an example this may be the case where the board meetings are held in a location distinct from the place where head office of the company is located or such location is unconnected with the place where the predominant activity of the company is being carried out.

If a Board has *de facto* delegated the authority to make the key management and commercial decisions for the company to the senior management or any other person including a shareholder, promoter, strategic or legal or financial advisor etc. and does nothing more than routinely ratifying the decisions that have been made, the company's place of effective management will ordinarily be the place where these senior managers or the other person make those decisions.

"Senior Management" in respect of a company means the person or persons who are generally responsible for developing and formulating key strategies and policies for the company and for ensuring or overseeing the execution and implementation of those strategies on a regular and on-going basis. While designation may vary, these persons may include:

(i) Managing Director or Chief Executive Officer;

(ii) Financial Director or Chief Financial Officer;

(iii) Chief Operating Officer; and

(iv) The heads of various divisions or departments (for example, Chief Information or Technology Officer, Director for Sales or Marketing).

(b) **Location of Executive Committee, in case powers are delegated by the Board:** A company's board may delegate some or all of its authority to one or more committees such as an executive committee consisting of key members of senior management. In these situations, the location where the members of the executive committee are based and where that committee develops and formulates the key strategies and policies for mere formal approval by the full board will often be considered to be the company's place of effective management.

The delegation of authority may be either *de jure* (by means of a formal resolution or Shareholder Agreement) or *de facto* (based upon the actual conduct of the board and the executive committee).

(c) **Location of Head Office**: The location of a company's head office will be a very important factor in the determination of the company's place of effective management because it often represents the place where key company decisions are made. The following points need to be considered for determining the location of the head office of the company:-

If the company's senior management and their support staff are based in a single location and that location is held out to the public as the company's principal place of business or headquarters then that location is the place where head office is located.

If the company is more decentralized (for example where various members of senior management may operate, from time to time, at offices located in the various countries) then the company's head office would be the location where these senior managers,-

(i) are primarily or predominantly based; or

(ii) normally return to following travel to other locations; or

(iii) meet when formulating or deciding key strategies and policies for the company as a whole.

Members of the senior management may operate from different locations on a more or less permanent basis and the members may participate in various meetings via telephone or video conferencing rather than by being physically present at meetings in a particular location. In such situation the head office would normally be the location, if any, where the highest level of management (for example, the Managing Director and Financial Director) and their direct support staff are located.

In situations where the senior management is so decentralised that it is not possible to determine the company's head office with a reasonable degree of certainty, the location of a company's head office would not be of much relevance in determining that company's place of effective management.

"Head Office" of a company would be the place where the company's senior management and their direct support staff are located or, if they are located at more than one location, the place where they are primarily or predominantly located. A company's head office is not necessarily the same as the place where the majority of its employees work or where its board typically meets.

(d) **Use of modern technology:** The use of modern technology impacts the place of effective management in many ways. It is no longer necessary for the persons taking decision to be physically present at a particular location. Therefore physical location of board meeting or executive committee meeting or meeting of senior management may not be where the key decisions are in substance being made. In such cases the place where the directors or the persons taking the decisions or majority of them usually reside may also be a relevant factor.

(e) **Decision *via* circular resolution or round robin voting:** In case of circular resolution or round robin voting the factors like, the frequency with which it is used, the type of decisions made in that manner and where the parties involved in those decisions are located etc. are to be considered. It cannot be said that proposer of decision alone would be relevant but based on past practices and general conduct; it would be required to determine the person who has the authority and who exercises the authority to take decisions. The place of location of such person would be more important.

(f) **Decisions made by Shareholders are not relevant factor in determination of POEM:** The decisions made by shareholder on matters which are reserved for shareholder decision under the company laws are not relevant for determination of a company's place of effective management. Such decisions may include sale of all or substantially all of the company's assets, the dissolution, liquidation or deregistration of the company, the modification of the rights attaching to various classes of shares or the issue of a new class of shares etc. These decisions typically affect the existence of the company itself or the rights of the shareholders as such, rather than the conduct of the company's business from a management or commercial perspective and are therefore, generally not relevant for the determination of a company's place of effective management.

However, the shareholder's involvement can, in certain situations, turn into that of effective management. This may happen through a formal arrangement by way of shareholder agreement etc. or may also happen by way of actual conduct. As an example if the shareholders limit the authority of board and senior managers of a company and thereby remove the company's real authority to make decision then the shareholder guidance transforms into usurpation and such undue influence may result in effective management being exercised by the shareholder.

Therefore, whether the shareholder involvement is crossing the line into that of effective management is one of fact and has to be determined on case-to-case basis only.

(g) **Day to day routine operational decisions are not relevant for determination of POEM:** It may be clarified that day to day routine operational decisions undertaken by junior and middle management shall not be relevant for the purpose of determination of POEM. The operational decisions relate to the oversight of the day-to-day business operations and activities of a company whereas the key management and commercial decision are concerned with broader strategic and policy decision. For example, a decision to open a major new manufacturing facility or to discontinue a major product line would be examples of key commercial decisions affecting the company's business as a whole. By contrast, decisions by the plant manager appointed by senior management to run that facility, concerning repairs and maintenance, the implementation of company-wide quality controls and human resources policies, would be examples of routine operational decisions. In certain situations it may happen that person responsible for operational decision is the same person who is responsible for the key management and commercial decision. In such cases it will be necessary to distinguish the two type of decisions and thereafter assess the location where the key management and commercial decisions are taken.

If the above factors do not lead to clear identification of POEM then the final guidelines provide that following secondary factors may be considered:

- Place where main and substantial activity of the company is carried out; or
- Place where the accounting records of the company are kept.

It needs to be emphasized that the determination of POEM is to be based on all relevant facts related to the management and control of the company, and is not to be determined on the basis of isolated facts that by itself do not establish effective management, as illustrated by the following examples:

(i) The fact that a foreign company is completely owned by an Indian company will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(ii) The fact that there exists a Permanent Establishment of a foreign entity in India would itself not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(iii) The fact that one or some of the Directors of a foreign company reside in India will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(iv) The fact of, local management being situated in India in respect of activities carried out by a foreign company in India will not, by itself, be conclusive evidence that the conditions for establishing POEM have been satisfied.

(v) The existence in India of support functions that are preparatory and auxiliary in character will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

It is reiterated that the above principles for determining the POEM are for guidance only. No single principle will be decisive in itself. The above principles are not to be seen with reference to any particular moment in time rather activities performed over a period of time, during the previous year, need to be considered.

In other words, a "snapshot" approach is not to be adopted. Further, based on the facts and circumstances if it is determined that during the previous year the POEM is in India and also outside India then POEM shall be presumed to be in India if it has been mainly /predominantly in India

The CBDT also clarified that the Assessing Officer (AO) shall, before initiating any proceedings for holding a company incorporated outside India, on the basis of its POEM, as being resident in India, seek prior approval of the Principal Commissioner or the Commissioner, as the case may be.

Further, in case the AO proposes to hold a company incorporated outside India, on the basis of its POEM, as being resident in India then any such finding shall be given by the AO after seeking prior approval of the collegium of three members consisting of the Principal Commissioners or the Commissioners, as the case may be, to be constituted by the Principal Chief Commissioner of the region concerned, in this regard. The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter.

Example 1: *Company A Co. is a sourcing entity, for an Indian multinational group, incorporated in country X and is 100% subsidiary of Indian company (B Co.). The warehouses and stock in them are the only assets of the company and are located in country X. All the employees of the company are also in country X. The average income wise breakup of the company's total income for three years is, -*

(i) 30% of income is from transaction where purchases are made from parties which are non-associated enterprises and sold to associated enterprises;

(ii) 30% of income is from transaction where purchases are made from associated enterprises and sold to associated enterprises;

(iii) 30% of income is from transaction where purchases are made from associated enterprises and sold to non-associated enterprises; and

(iv) 10% of the income is by way of interest.

Interpretation: In this case, passive income is 40% of the total income of the company. The passive income consists of, -

(i) 30% income from the transaction where both purchase and sale is from/to associated enterprises; and

(ii) 10% income from interest.

The A Co. satisfies the first requirement of the test of active business outside India. Since no assets or employees of A Co. are in India the other requirements of the test is also satisfied. Therefore, company is engaged in active business outside India.

Example 2: *The other facts remain same as that in Example 1 with the variation that A Co. has a total of 50 employees. 47 employees, managing the warehouse, storekeeping and accounts of the company, are located in country X. The Managing Director (MD), Chief Executive Officer (CEO) and sales head are resident in India. The total annual payroll expenditure on these 50 employees is of ₹ 5 crore. The annual payroll expenditure in respect of MD, CEO and sales head is of ₹ 3 crore.*

Interpretation: Although the first limb of active business test is satisfied by A Co. as only 40% of its total income is passive in nature. Further, more than 50% of the employees are also situated outside India. All the assets are situated outside India. However, the payroll expenditure in respect of the MD, the CEO and the sales head being employees resident in India exceeds 50% of the total payroll expenditure. Therefore, A Co. is not engaged in active business outside India.

Example 3: *The basic facts are same as in Example 1. Further facts are that all the directors of the A Co. are Indian residents. During the relevant previous year 5 meetings of the Board of Directors is held of which two were held in India and 3 outside India with two in country X and one in country Y.*

Interpretation: The A Co. is engaged in active business outside India as the facts indicated in Example 1 establish. The majority of board meetings have been held outside India. Therefore, the POEM of A Co. shall be presumed to be outside India.

Example 4: *The facts are same as in Example 3 but it is established by the Assessing Officer that although A Co.'s senior management team signs all the contracts, for all the contracts above ₹ 10 lakh the A Co. must submit its recommendation to B Co. and B Co. makes the decision whether or not the contract may be accepted. It is also seen that during the previous year more than 99% of the contracts are above ₹ 10 lakh and over past years also the same trend in respect of value contribution of contracts above ₹ 10 lakh is seen.*

Interpretation: These facts suggest that the effective management of the A Co. may have been usurped by the parent company B Co. Therefore, POEM of A Co. may in such cases be not presumed to be outside India even though A Co. is engaged in active business outside India and majority of board meeting are held outside India.

Example 5: *An Indian multinational group has a local holding company A Co. in country X. The A Co. also has 100% downstream subsidiaries B Co. and C Co. in country X and D Co. in country Y. The A Co. has income only by way of dividend and interest from investments made in its subsidiaries. The Place of Effective Management of A Co. is in India and is exercised by ultimate parent company of the group. The subsidiaries B, C and D are engaged in active business outside*

India. The meetings of Board of Director of B Co., C Co. and D Co. are held in country X and Y respectively.

Interpretation: Merely because the POEM of an intermediate holding company is in India, the POEM of its subsidiaries shall not be taken to be in India. Each subsidiary has to be examined separately. As indicated in the facts since B Co., C Co., and D Co. are independently engaged in active business outside India and majority of Board meetings of these companies are also held outside India. The POEM of B Co., C Co., and D Co. shall be presumed to be outside India.

Further, the CBDT vide Circular no. 8/2017 dated 23.02.2017 also clarified that POEM guidelines shall not apply to a company having turnover or gross receipts of ₹ 50 crores or less in a financial year.

ILLUSTRATION 1

ABC Inc., a Swedish company headquartered at Stockholm, not having a permanent establishment in India, has set up a liaison office in Mumbai in April, 2019 in compliance with RBI guidelines to look after its day to day business operations in India, spread awareness about the company's products and explore further opportunities. The liaison office takes decisions relating to day to day routine operations and performs support functions that are preparatory and auxiliary in nature. The significant management and commercial decisions are, however, in substance made by the Board of Directors at Sweden. Determine the residential status of ABC Inc. for A.Y. 2020-21.

SOLUTION

Section 6(3) provide that a company would be resident in India in any previous year, if-

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India .

In this case, ABC Inc. is a foreign company. Therefore, it would be resident in India for P.Y.2019-20 only if its place of effective management, in that year, is in India.

Explanation to section 6(3) defines "place of effective management" to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made. In the case of ABC Inc., its place of effective management for P.Y.2019-20 is not in India, since the significant management and commercial decisions are, in substance, made by the Board of Directors outside India in Sweden.

ABC Inc. has only a liaison office in India through which it looks after its routine day to day business operations in India. The place where decisions relating to day to day routine operations are taken and support functions that are preparatory or auxiliary in nature are performed are not relevant in determining the place of effective management.

Hence, ABC Inc., being a foreign company is a non-resident for A.Y.2020-21, since its place of effective management is outside India in the P.Y.2019-20.

Transition Mechanism for a company incorporated outside India and has not been assessed to tax earlier [Chapter XII-BC – Section 115JH]

A transition mechanism for a company which is incorporated outside India, which has not been assessed to tax in India earlier and has become resident in India for the first time due to application of POEM, has been provided in Chapter XII-BC comprising of section 115JH.

(a) Accordingly, the Central Government is empowered to notify exception, modification and adaptation subject to which, the provisions of the Act relating to computation of income, treatment of unabsorbed depreciation, set-off or carry forward and set off of losses, special provision relating to avoidance of tax and the collection and recovery of taxes shall apply in a case where a foreign company is said to be resident in India due to its POEM being in India for the first time and the said company has never been resident in India before.

(b) In a case where the determination regarding foreign company to be resident in India has been made in the assessment proceedings relevant to any previous year, then, these transition provisions would also cover any subsequent previous year, if the foreign company is resident in India in that previous year and the previous year ends on or before the date on which such assessment proceeding is completed. In effect, the transition provisions would also cover any subsequent amendment upto the date of determination of POEM in an assessment proceeding. However, once the transition is complete, then, normal provisions of the Act would apply.

(c) In the notification issued by the Central Government, certain conditions including procedural conditions subject to which these adaptations shall apply can be provided for and in case of failure to comply with the conditions, the benefit of such notification would not be available to the foreign company.

Accordingly, where in a previous year, any benefit, exemption or relief has been claimed and granted to the foreign company in accordance with the notification, and subsequently, there is failure to comply with any of the conditions specified therein, then –

(i) the benefit, exemption or relief shall be deemed to have been wrongly allowed;

(ii) the Assessing Officer may re-compute the total income of the assessee for the said previous year and make the necessary amendment as if the exceptions, modifications and adaptations as per the notification does not apply; and

(iii) the provisions of section 154 shall, so far as may be, apply thereto and the period of four years for rectification of mistake apparent from the record has to be reckoned from the end of the previous year in which the failure to comply with the condition stipulated in the notification takes place.

(d) Every notification issued in exercise of this power by the Central Government shall be laid before each house of the Parliament.

(e) Accordingly, in exercise of the power under section 115JH(1) of the Income-tax Act, 1961,the Central Government has, vide notification No. 29/2018, dated 22nd June, 2018, specified the exceptions, modifications and adaptions subject to which, the provisions of the Act relating to computation of income, treatment of unabsorbed depreciation, set-off or carry forward and set off of losses, special provision relating to avoidance of tax and the collection and recovery of taxes shall apply in a case where a foreign company is said to be resident in India in any previous year on account of its POEM being in India and the such foreign company has not been resident in India before the said previous year.

Particulars	Provisions
Determination of opening WDV	**If the foreign company is assessed to tax in the foreign jurisdiction** **Where depreciation is required to be taken into account for the purpose of computation of its taxable income**, the WDV of the depreciable asset as per the tax record in the foreign country on the 1st day of the previous year shall be adopted as the opening WDV for the said previous year. **Where WDV is not available as per tax records,** the WDV shall be calculated assuming that the asset was installed, utilised and the depreciation was actually allowed as per the provisions of the laws of that foreign jurisdiction. The WDV so arrived at as on the 1st day of the previous year shall be adopted to be the opening WDV for the said previous year. **If the foreign company is not assessed to tax in the foreign jurisdiction** WDV of the depreciable asset as appearing in the books of account as on the 1st day of the previous year maintained in accordance with the laws of that foreign jurisdiction shall be adopted as the opening WDV for the said previous year.
Brought forward loss and unabsorbed depreciation	**If the foreign company is assessed to tax in the foreign jurisdiction** Brought forward loss and unabsorbed depreciation as per the tax record shall be determined year wise on the 1st day of the said previous year. **If the foreign company is not assessed to tax in the foreign jurisdiction** Brought forward loss and unabsorbed depreciation as per the books

	of account prepared in accordance with the laws of that country shall be determined year wise on the 1st day of the said previous year. **Other provisions** Such brought forward loss and unabsorbed depreciation shall be deemed as loss and unabsorbed depreciation brought forward as on the 1st day of the said previous year and shall be allowed to be set off and carried forward in accordance with the provisions of the Act for the remaining period calculated from the year in which they occurred for the first time taking that year as the first year. However, the losses and unabsorbed depreciation of the foreign company shall be allowed to be set off only against such income of the foreign company which has become chargeable to tax in India on account of it becoming resident in India due to application of POEM. In cases where the brought forward loss and unabsorbed depreciation originally adopted in India are revised or modified in the foreign jurisdiction due to any action of the tax or legal authority, the amount of the loss and unabsorbed depreciation shall be revised or modified for the purposes of set off and carry forward in India.
Period of profit and loss account and balance sheet in cases where accounting year of foreign company does not end on 31st March	The foreign company is required to prepare profit and loss account and balance sheet for the period starting from the date on which the accounting year immediately following said accounting year begins, upto 31st March of the year immediately preceding the period beginning with 1st April and ending on 31st March during which the foreign company has become resident. The foreign company is also required to prepare profit and loss account and balance sheet for succeeding periods of twelve months, beginning from 1st April and ending on 31st March, till the year the foreign company remains resident in India on account of its POEM. **Examples:** **Example 1:** If the accounting year of the foreign company is a calendar year and the company becomes resident in India during P.Y. 2019-20 for the first time due to its POEM being in India, then, the company is required to prepare profit and loss account and balance sheet for the period 1st January, 2019 to 31st March, 2019. It is also required to prepare profit and loss account and balance sheet for the period 1st April, 2019 to 31st March, 2020. For the purpose of carry forward of loss and unabsorbed depreciation in this case, since the period 1st January, 2019 to 31st March, 2019 is less than 6 months, it is to be included in the accounting year immediately preceding the accounting year in which the foreign company is held to be resident in India for the first time. Accordingly, the profit and loss and balance sheet of the 15 month period from 1 January, 2018 to 31st March, 2019 is to be prepared.

	Example 2: If the accounting year of the foreign company is from 1st July to 30th June and the company becomes resident in India during P.Y. 2019-20 for the first time due to its POEM being in India, then, the company is required to prepare profit and loss account and balance sheet for the period 1st July, 2018 to 31st March, 2019. It is also required to prepare profit and loss account and balance sheet for the period 1st April, 2019 to 31st March, 2020. For the purpose of carry forward of loss and unabsorbed depreciation in this case, since the period is more than 6 months, it is to be treated as a separate accounting year. The loss and unabsorbed depreciation as per tax record or books of account, as the case may be, of the foreign company shall, be allocated on proportionate basis.
Applicability of provisions of Chapter XVII-B (TDS provisions)	Where more than one provision of Chapter XVII-B of the Act applies to the foreign company as resident as well as foreign company, the provision applicable to the foreign company alone shall apply. Compliance to those provisions of Chapter XVII-B of the Act as are applicable to the foreign company prior to its becoming Indian resident shall be considered sufficient compliance to the provisions of said Chapter. The provisions of section 195(2) relating to application to Assessing Officer to determine the appropriate proportion of sum chargeable to tax shall apply in such manner so as to include payment to the foreign company.
Availability of deduction under section 90 or 91 (Foreign tax credit)	The foreign company shall be entitled to relief or deduction of taxes paid in accordance with the provisions of section 90 or section 91 of the Act. Where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India in respect of the income to which it relates and shall be in accordance with the provisions of rule 128 of the Income-tax Rules, 1962 [Given as Annexure 1 at the end of this material].
Non applicability of the notification	The above exceptions, modifications and adaptations shall not apply in respect of such income of the foreign company which otherwise would have been chargeable to tax in India, even if the foreign company had not become Indian resident.
Applicability of the notification where foreign company becomes resident in the subsequent	In a case where the foreign company is said to be resident in India during a previous year, immediately succeeding a previous year during which it is said to be resident in India; the exceptions, modifications and adaptations shall apply to the said previous year subject to the condition that the WDV, the brought forward loss and the unabsorbed depreciation to be adopted on the 1st day of the previous year shall be those which

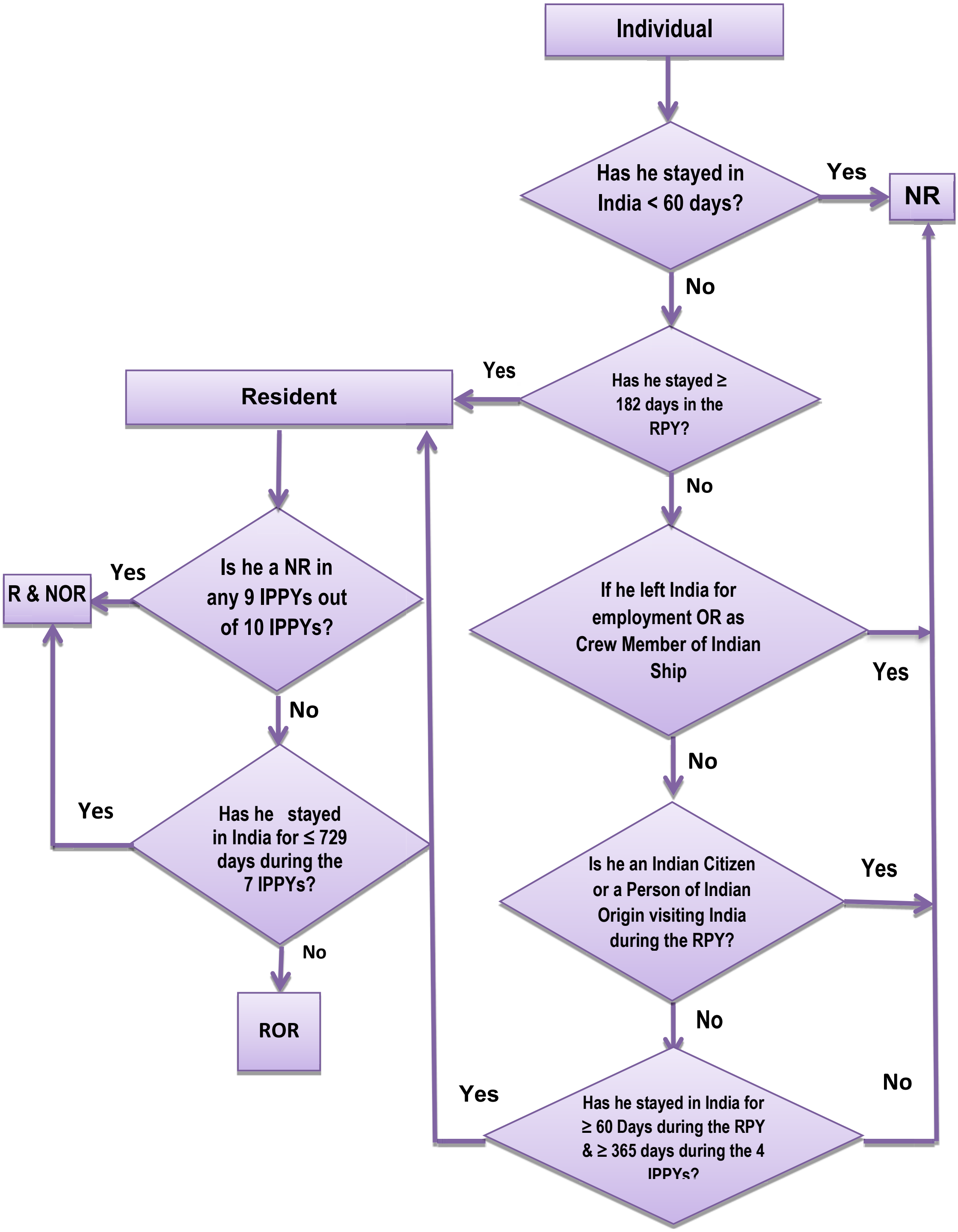
previous year also	have been arrived at on the last day of the preceding previous year in accordance with the provisions of this notification.
No effect on other transactions	Any transaction of the foreign company with any other person or entity under the Act shall not be altered only on the ground that the foreign company has become Indian resident.
Applicability of other provisions relating to foreign company	Subject to the above exceptions, modifications and adaptions specifically provided vide this notification, the foreign company shall continue to be treated as a foreign company even if it is said to be resident in India and all the provisions of the Act shall apply accordingly. Consequently, the provisions specifically applicable to,— (i) a foreign company, shall continue to apply to it; (ii) non-resident persons, shall not apply to it; and (iii) the provisions specifically applicable to resident, shall apply to it.
Applicability of tax rate on foreign company	In case of conflict between the provision applicable to the foreign company as resident and the provision applicable to it as foreign company, the later shall generally prevail. Therefore, the rate of tax in case of foreign company i.e., 40% shall remain the same, i.e., rate of income-tax applicable to the foreign company even though residency status of the foreign company changes from non-resident to resident on the basis of POEM.
Applicability of notification	This notification shall be deemed to have come into force from 1st April, 2017.
Meaning of foreign jurisdiction	The place of incorporation of the foreign company.
Applicability of rule 115 of the Income-tax Rules, 1962.	The rate of exchange for conversion into rupees of value expressed in foreign currency, wherever applicable, shall be in accordance with provision of rule 115 of the Income-tax Rules, 1962. [Given as Annexure 2 at the end of this material]

Determination of Residential Status: A summary

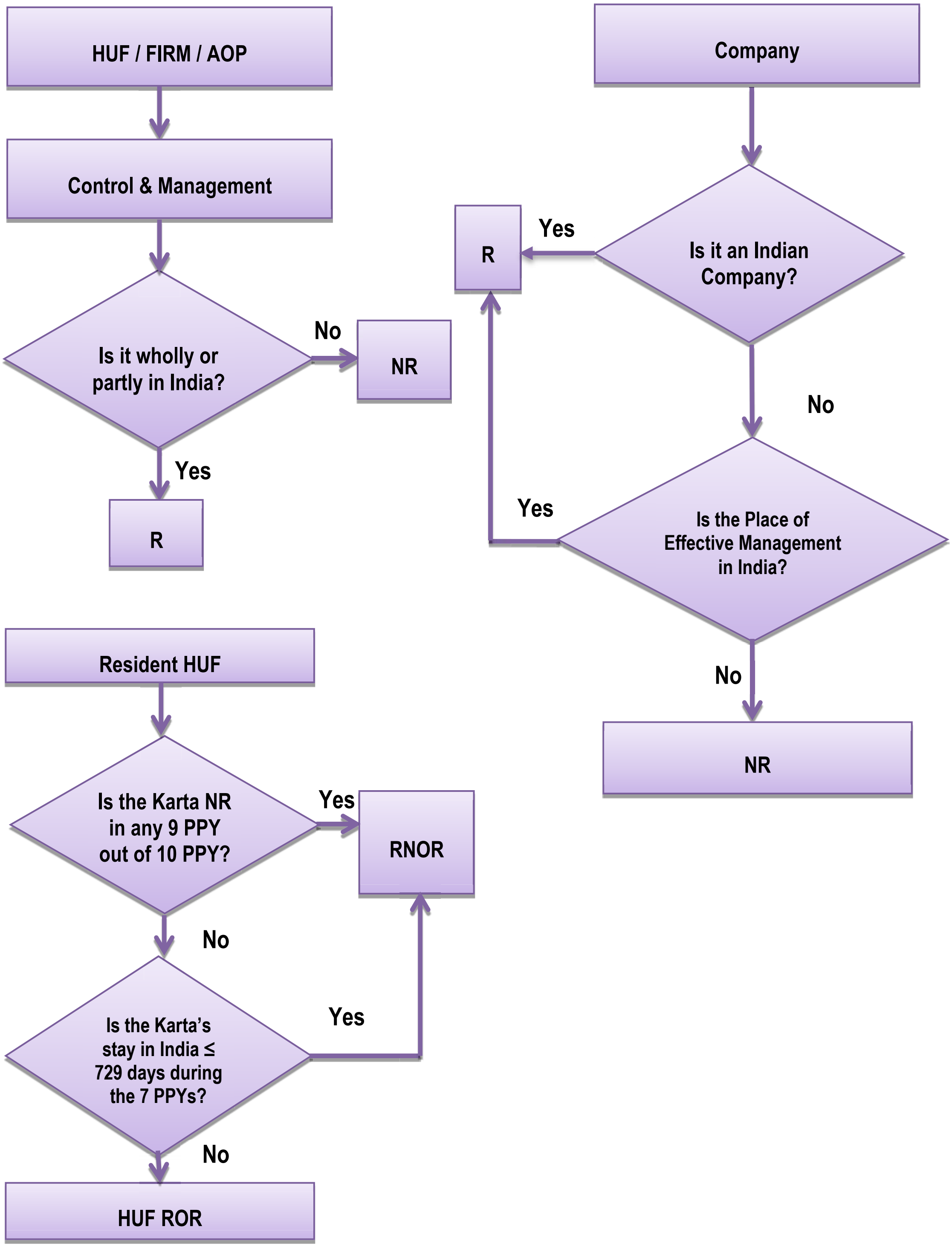
Abbreviations used in the Flow Charts in pages 2.19 & 2.20

IC	=	**Indian Citizen**	**RPY**	=	**Relevant Previous Year**
R	=	**Resident**	**NR**	=	**Non-resident**
IPPYs	=	**Immediately Preceding Previous Years**	**AOP**	=	**Association of Persons**
N & OR	=	**Resident but Not Ordinarily Resident**	**HUF**	=	**Hindu Undivided Family**
ROR	=	**Resident and Ordinarily Resident**			

Determination of Residential Status of Individual


Individual
Has he stayed in India < 60 days?
Yes
NR
No
Has he stayed ≥ 182 days in the RPY?
Yes
Resident
No
If he left India for employment OR as Crew Member of Indian Ship
Yes
No
Is he an Indian Citizen or a Person of Indian Origin visiting India during the RPY?
Yes
No
Has he stayed in India for ≥ 60 Days during the RPY & ≥ 365 days during the 4 IPPYs?
Yes
No
Is he a NR in any 9 IPPYs out of 10 IPPYs?
Yes
R & NOR
No
Has he stayed in India for ≤ 729 days during the 7 IPPYs?
Yes
No
ROR

Determination of Residential Status of HUF/ Firm/ AOP/ Company


HUF / FIRM / AOP
Control & Management
Is it wholly or partly in India?
No
NR
Yes
R
Company
Is it an Indian Company?
Yes
R
No
Is the Place of Effective Management in India?
Yes
No
NR
Resident HUF
Is the Karta NR in any 9 PPY out of 10 PPY?
Yes
RNOR
No
Is the Karta's stay in India ≤ 729 days during the 7 PPYs?
Yes
No
HUF ROR

(2) Scope of Total Income [Section 5]

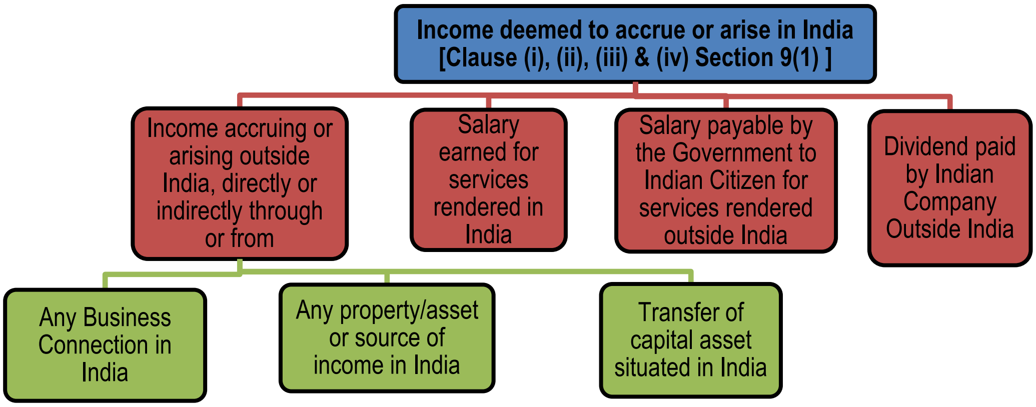
Section 5 provides the scope of total income in terms of the residential status of the assessee because the incidence of tax on any person depends upon his residential status.

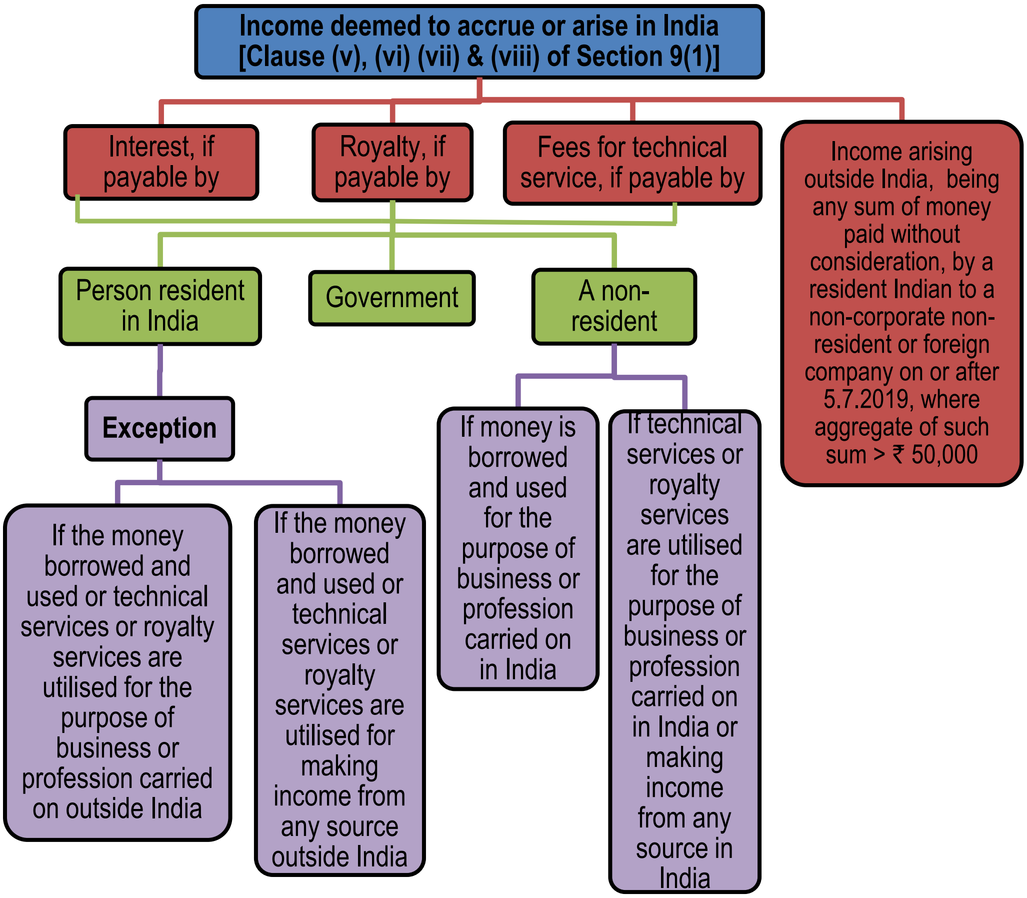
Summary of scope of Total Income

Particulars	Resident and Ordinary Resident	Not ordinary Resident	Non-Resident
Income received or deemed to be received in India whether earned in India or elsewhere	Yes	Yes	Yes
Income which accrue or arise or deemed to accrue or arise in India during the previous year whether received in India or elsewhere	Yes	Yes	Yes
Income which accrue or arise outside India and received outside India from a business controlled from India	Yes	Yes	No
Income which accrue or arise outside India and received outside India in the previous year from any other source	Yes	No	No
Income which accrues or arises outside India and received outside India during the year preceding the year and remitted to India during the previous year	No	No	No

(i) Income deemed to accrue or arise in India [Section 9]

Under section 9, certain types of income are deemed to accrue or arise in India even though they may actually accrue or arise outside India.


Income deemed to accrue or arise in India [Clause (i), (ii), (iii) & (iv) Section 9(1)]
Income accruing or arising outside India, directly or indirectly through or from
Salary earned for services rendered in India
Salary payable by the Government to Indian Citizen for services rendered outside India
Dividend paid by Indian Company Outside India
Any Business Connection in India
Any property/asset or source of income in India
Transfer of capital asset situated in India


Income deemed to accrue or arise in India [Clause (v), (vi) (vii) & (viii) of Section 9(1)]
Interest, if payable by
Royalty, if payable by
Fees for technical service, if payable by
Income arising outside India, being any sum of money paid without consideration, by a resident Indian to a non-corporate non-resident or foreign company on or after 5.7.2019, where aggregate of such sum > ₹ 50,000
Person resident in India
Government
A non-resident
Exception
If the money borrowed and used or technical services or royalty services are utilised for the purpose of business or profession carried on outside India
If the money borrowed and used or technical services or royalty services are utilised for making income from any source outside India
If money is borrowed and used for the purpose of business or profession carried on in India
If technical services or royalty services are utilised for the purpose of business or profession carried on in India or making income from any source in India

The categories of income which are deemed to accrue or arise in India are:

(1) Any income accruing or arising to an assessee in any place outside India whether directly or indirectly

(i) through or from any business connection in India,

(ii) through or from any property in India,

(iii) through or from any asset or source of income in India or

(iv) through the transfer of a capital asset situated in India

would be deemed to accrue or arise in India. **[Section 9(1)(i)]**

(i) What is Business Connection?

'Business connection' shall include any business activity carried out through a person acting on behalf of the non-resident [*Explanation 2* to section 9(1)(i)]

For a business connection to be established, the person acting on behalf of the non-resident –

(a) must have an authority, which is habitually exercised in India, to conclude contracts on behalf of the non-resident or

habitually concludes contracts or plays the principal role leading to conclusion of contracts by that non-resident and such contracts are

- in the name of the non-resident; or
- for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or
- for the provision of services by that non-resident.

Note - This amendment in the definition of "business connection" is for the purpose of alignment with the provisions of the Double Taxation Avoidance Agreement (DTAA) as modified by Multilateral Instrument (MLI) so as to make the provisions in the treaty effective.

(b) in a case, where he has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, or

(c) habitually secures orders in India, mainly or wholly for the non-resident.

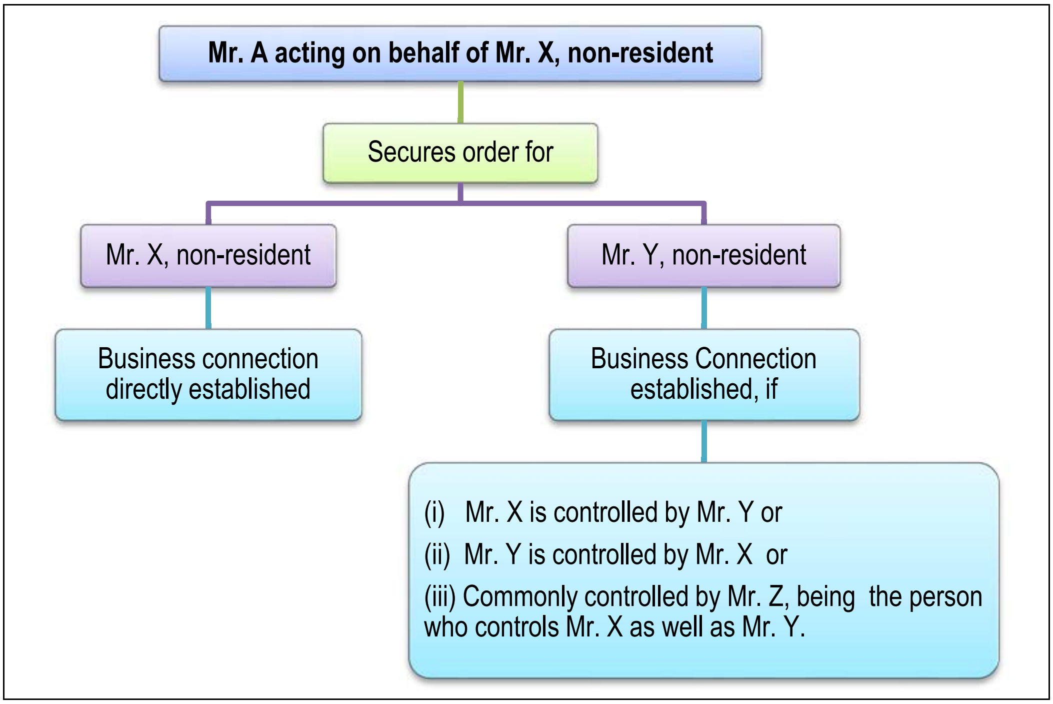
Further, there may be situations when the person acting on behalf of the non-resident secure order for other non-residents. In such situation, business connection for other non-residents is established if,

i. such other non-resident controls the non-resident or

ii. such other non-resident is controlled by the non-resident or

iii. such other non-resident is subject to same control as that of non-resident.

In all the three situations, business connection is established, where a person habitually secures orders in India, mainly or wholly for such non-residents.


Mr. A acting on behalf of Mr. X, non-resident
Secures order for
Mr. X, non-resident
Mr. Y, non-resident
Business connection directly established
Business Connection established, if
(i) Mr. X is controlled by Mr. Y or
(ii) Mr. Y is controlled by Mr. X or
(iii) Commonly controlled by Mr. Z, being the person who controls Mr. X as well as Mr. Y.

Agents having independent status are not included in Business Connection: Business connection, however, shall not be established, where the non-resident carries on business through a broker, general commission agent or any other agent having an independent status, if such a person is acting in the ordinary course of his business.

A broker, general commission agent or any other agent shall be deemed to have an independent status where he does not work mainly or wholly for the non-resident.

He will, however, not be considered to have an independent status in the three situations explained above, where he is employed by such a non-resident.

Where a business is carried on in India through a person referred to in (a), (b) or (c) of (i) above, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India *[Explanation 3* to section 9(1)(i)].

Significant economic presence [*Explanation 2A* to section 9(1)(i)]

Significant economic presence of a non-resident in India shall also constitute business connection in India.

Significant economic presence means-

	Nature of transaction	Condition
(a)	transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India,	Aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed
(b)	systematic and continuous soliciting of business activities or engaging in interaction with users in India through digital means	The users should be of such number as may be prescribed

The threshold of "aggregate of payments" in (a) and "users" in India in (b) would be prescribed by Rules. Further, the above transactions or activities shall constitute significant economic presence in India, whether or not,—

(i) the agreement for such transactions or activities is entered in India;

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

However, where a business connection is established by reason of significant economic presence in India, only so much of income as is attributable to the transactions or activities referred to in (a) or (b) above shall be deemed to accrue or arise in India.

In the case of a non-resident the following shall not, however, be treated as business connection in India *[Explanation 1* to section 9(1)(i)*]:*

(a) **In the case of a business, in respect of which all the operations are not carried out in India [*Explanation 1(a)* to section 9(1)(i)]:** In the case of a business of which all the operations are not carried out in India, the income of the business deemed to accrue or arise in India shall be only such part of income as is reasonably attributable to the operations carried out in India. Therefore, it follows that such part of income which cannot be reasonably attributed to the operations in India, is not deemed to accrue or arise in India.

(b) **Purchase of goods in India for export [*Explanation 1(b)* to section 9(1)(i)]:** In the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export.

(c) **Collection of news and views in India for transmission out of India [*Explanation 1(c)* to section 9(1)(i)]:** In the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India.

(d) **Shooting of cinematograph films in India [*Explanation 1(d)* to section 9(1)(i)]:** In the case of a non-resident, no income shall be deemed to accrue or arise in India through or from operations which are confined to the shooting of any cinematograph film in India, if such non-resident is :

- an individual, who is not a citizen of India or
- a firm which does not have any partner who is a citizen of India or who is resident in India; or
- a company which does not have any shareholder who is a citizen of India or who is resident in India.

(e) **Activities confined to display of rough diamonds in SNZs [*Explanation 1(e)* to section 9(1)(i)]**: In case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to display of uncut and unassorted diamonds in any special zone notified by the Central Government in the Official Gazette in this behalf.

(ii) & (iii) Income from property, asset or source of income in India

Any income which arises from any property in India (movable, immovable, tangible and intangible property) would be deemed to accrue or arise in India.

Examples:

- *Hire charges or rent paid outside India for the use of the machinery or buildings situated in India,*
- *deposits with an Indian company for which interest is received outside India etc.*

(iv) Income through transfer of a capital asset situated in India

Capital gains arising through or from the transfer of a capital asset situated in India would be deemed to accrue or arise in India in all cases irrespective of the fact whether

- The capital asset is movable or immovable, tangible or intangible;
- The place of registration of the document of transfer etc., is in India or outside; and
- The place of payment of the consideration for the transfer is within India or outside.

Accordingly, the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of". ***[Explanation 4* to section 9(1)(i)*]***

Further, an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India. ***[Explanation 5* to section 9(1)(i)*]***

However, an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I or Category-II foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, made under the Securities and Exchange Board of India Act, 1992, shall not deemed to be or deemed to have been situated in India [Proviso to *Explanation 5* to section 9(1)(i)]

The CBDT has, vide Circular No. 28/2017, dated 07.11.2017, clarified that the provisions of section 9(1)(i) read with Explanation 5, shall not apply in respect of income accruing or arising to a non-resident on account of redemption or buyback of its share or interest held indirectly (i.e. through upstream entities registered or incorporated outside India) in the specified funds (namely, investment funds, venture capital company and venture capital funds) if such income accrues or arises from or in consequence of transfer of shares or securities held in India by the specified funds and such income is chargeable to tax in India.

However, the above benefit shall be applicable only in those cases where the proceeds of redemption or buyback arising to the non-resident do not exceed the pro-rata share of the non-resident in the total consideration realized by the specified funds from the said transfer of shares or securities in India. It is further clarified that a non-resident investing directly in the specified funds shall continue to be taxed as per the extant provisions of the Act.

Declaration of dividend by a foreign company outside India does not have the effect of transfer of any underlying assets located in India. *Circular No. 4/2015, dated 26-03-2015*, therefore, clarifies that the dividends declared and paid by a foreign company outside India in respect of shares which derive their value substantially from assets situated in India would **NOT** be deemed to be income accruing or arising in India by virtue of the provisions of section 9(1)(i).

***Explanation 6* to section 9(1)(i)** provides that the share or interest in a company or entity registered or incorporated outside India, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if on the specified date, the value of Indian assets, -

- exceeds the amount of ₹ 10 crore; and
- represents at least 50% of the value of all the assets owned by the company or entity, as the case may be;

Meaning of certain terms:

Term	Meaning
Value of an asset	The **fair market value as on the specified date**, of such asset **without reduction of liabilities**, if any, in respect of the asset, determined in prescribed manner**.**

Specified date	The date on which the **accounting period** of the company or, as the case may be, the entity **ends** preceding the date of transfer of a share or an interest. However, the date of transfer shall be the specified date of valuation, in a case where the book value of the assets of the company or entity on the date of transfer exceeds by at least 15%, the book value of the assets as on the last balance sheet date preceding the date of transfer.
Accounting period	Each period of 12 months ending with 31st March. However, where a company or an entity, referred to in *Explanation 5*, regularly adopts a period of 12 months ending on a day other than 31st March for the purpose of— (a) complying with the provisions of the tax laws of the territory, of which it is a resident, for tax purposes; or (b) reporting to persons holding the share or interest, then, the period of twelve months ending with the other day shall be the accounting period of the company or, as the case may be, the entity:
First Accounting Period	First accounting period of the company or, as the case may be, the entity shall **begin from the date of its registration or incorporation** and **end with the 31st March** or such other day, as the case may be, following the date of such registration or incorporation.
Later accounting period	Later accounting period shall be the **successive periods of twelve months**
Accounting period of an entity which ceases to exist	If the company or the entity ceases to exist before the end of accounting period, as aforesaid, then, the accounting period shall end immediately before the company or, as the case may be, the entity, ceases to exist.

Note - The manner of determination of fair market value of the assets of the foreign company is given in Rule 11UB. Determination of income attributable to assets in India is given in Rule 11UC[1].

***Explanation 7* to section 9(1)(i)** provides that **no income shall be deemed** to accrue or arise to a non-resident from transfer, outside India, of any share of, or interest in, a company or an entity, registered or incorporated outside India, in the following cases;

(1)	Foreign company or entity **directly** owns the assets situated in India	**AND**	**the transferor** (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, **does not hold** • the right of management or control in relation to foreign company or entity; or • the voting power or share capital or interest

[1] For detailed reading of Rule 11UB and 11UC of the Income-tax Rules, 1962, students may visit https://www.incometaxindia.gov.in/Pages/default.aspx

			exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the foreign company or entity; or
(2)	Foreign company or entity **indirectly** owns the assets situated in India	**AND**	**the transferor** (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, **does not hold** • the right of management or control in relation to foreign company or entity; or • any right in, or in relation to, such foreign company or entity which would entitle him to the right of management or control in the company or entity that directly owns the assets situated in India; or • such percentage of voting power or share capital or interest in foreign company or entity which results in holding of (either individually or along with associated enterprises) a voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the company or entity that directly owns the assets situated in India;

In effect, the exemption shall be available to the transferor of a share of, or interest in, a foreign entity if he along with its associated enterprises, -

- neither holds the right of control or management,
- nor holds voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest,

in the foreign company or entity directly holding the Indian assets (direct holding company).

In case the transfer is of shares or interest in a foreign entity which does not hold the Indian assets directly then the exemption shall be available to the transferor if he along with its associated enterprises,-

- neither holds the right of management or control in relation to such company or the entity,
- nor holds any rights in such company which would entitle it to either exercise control or management of the direct holding company or entity or entitle it to voting power or share capital or total interest exceeding 5% in the direct holding company or entity.

Further, where all the assets owned, directly or indirectly, by a company or, as the case may be, an entity registered or incorporated outside India, are not located in India, the income of the non-resident transferor, from transfer outside India of a share of, or interest in the foreign company or entity, deemed to accrue or arise in India under this clause, shall be only such part of the income as is reasonably attributable to assets located in India and determined in the prescribed manner.

"Associated enterprise", in relation to another enterprise, means an enterprise—

- which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

(2) Income from salaries earned in India [Section 9(1)(ii)]

Income, which falls under the head "Salaries", deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India would be treated as earned in India.

Further, any income under the head "Salaries" payable for rest period or leave period which is preceded and succeeded by services rendered in India, and forms part of the service contract of employment, shall be regarded as income earned in India.

(3) Income from salaries payable by the Government for services rendered outside India [Section 9(1)(iii)].

Income from 'Salaries' which is payable by the Government to a citizen of India for services rendered outside India would be deemed to accrue or arise in India.

However, allowances and perquisites paid or allowed outside India by the Government to an Indian citizen for services rendered outside India is exempt, by virtue of section 10(7).

ILLUSTRATION 2

J, a citizen of India, employed in the Indian Embassy at Tokyo, Japan. He received salary and allowances at Tokyo from the Government of India for the year ended 31.3.2020 for services rendered by him in Tokyo. Besides, he was allowed perquisites by the Government. He is a non-resident for the assessment year 2020-21. Examine the taxability of salary, allowances and perquisites in the hands of J for the assessment year 2020-21.

SOLUTION

As per section 9(1)(iii), salaries payable by the Government to a citizen of India for services rendered outside India shall be deemed to accrue or arise in India. As such, salary received by J is chargeable to tax, even though he was a non-resident for A.Y. 2020-21.

As per section 10(7), all allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering services outside India is exempt from tax. Therefore, the allowances and perquisites received by J are exempt as per section 10(7).

(4) Dividend paid by a Indian company outside India [Section 9(1)(iv)]

All dividends paid by an Indian company would be deemed to accrue or arise in India. Under section 10(34), income from dividends referred to in section 115-O i.e., dividend distributed by a domestic company on which DDT is leviable in the hands of the company, is exempt from tax in the hands of the shareholder. However, it will not be exempt if such dividend is chargeable to tax under section 115BBDA. Section 115BBDA, which brings to tax dividend in excess of ₹ 10 lakh in the hands of the shareholder @10%, does not apply to the non-residents.

(5) Interest [Section 9(1)(v)]

Under section 9(1)(v), an interest is deemed to accrue or arise in India if it is payable by -

(i) the Government;

(ii) a person resident in India;

Exception: Where it is payable in respect of any debt incurred or money borrowed and used, for the purposes of a business or profession carried on by him outside India or for the purposes of making or earning any income from any source outside India, it will not be deemed to accrue or arise in India.

(iii) a non-resident, when it is payable in respect of any debt incurred or moneys borrowed and used, for the purpose of a business or profession carried on in India by him.

Exception: Interest on money borrowed by the non-resident for any purpose other than a business or profession, will not be deemed to accrue or arise in India.

> ***Example:*** *If a non-resident 'A' borrows money from a non-resident 'B' and invests the same in shares of an Indian company, interest payable by 'A' to 'B' will not be deemed to accrue or arise in India.*

Meaning of interest: Interest means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized.

Taxability of interest payable by the Permanent Establishment of a non-resident engaged in banking business to the head office

In order to provide clarity and certainty, on the issue of taxability of interest payable by the PE of a non-resident engaged in banking business to the head office, an Explanation has been inserted in section 9(1)(v). Accordingly, in the case of a **non-resident, being a person engaged in the business of banking,** any interest payable by the **PE in India of such non-resident to the head office** or any PE or any other part of such non-resident outside India, shall be deemed to accrue or arise in India.

Such interest shall be chargeable to tax in addition to any income attributable to the PE in India.

Further, the PE in India shall be deemed to be a person separate and independent of the non-resident person of which it is a PE and the provisions of the Act relating to computation of total income, determination of tax and collection and recovery would apply accordingly.

Also, the PE in India has to deduct tax at source on any interest payable to either the head office or any other branch or PE, etc. of the non-resident outside India. Non-deduction would result in disallowance of interest claimed as expenditure by the PE and may also attract levy of interest and penalty in accordance with relevant provisions of the Act.

Permanent establishment includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

(6) Royalty [Section 9(1)(vi)]

Royalty will be deemed to accrue or arise in India when it is payable by -

(i) the Government;

(ii) a person who is a resident in India

Exception: Where it is payable for the transfer of any right or the use of any property or information or for the utilization of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India, or

(iii) a non-resident only when the royalty is payable in respect of any right, property or information used or services utilised for purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.

Important points:

1. **Lumpsum royalty not deemed to accrue arise in India:** Lumpsum royalty payments made by a resident for the transfer of all or any rights (including the granting of a licence) in respect of **computer software** supplied by a non-resident manufacturer along with computer hardware under any scheme approved by the government under the policy on computer software export, software development and training, 1986 shall not be deemed to accrue or arise in India.

2. **Meaning of Computer software:** "Computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customised electronic data.

3. **Meaning of Royalty:** The term 'royalty' means consideration (including any lumpsum consideration but excluding any consideration which would be the income of the recipient chargeable under the head 'capital gains') for:

   (i) the transfer of all or any rights (including the granting of licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property;

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

(v) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

(vi) the transfer of all or any rights (including the granting of licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films;

(vii) the rendering of any service in connection with the activities listed above.

The definition of 'royalty' for this purpose is wide enough to cover both industrial royalties as well as copyright royalties. The deduction specially excludes income which should be chargeable to tax under the head 'capital gains'.

4. Consideration for use or right to use of computer software is royalty within the meaning of section 9(1)(vi)

The consideration for use or right to use of computer software is royalty by clarifying that, transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred *[Explanation 4]*

Consequently, the provisions of tax deduction at source under section 194J and section 195 would be attracted in respect of consideration for use or right to use computer software since the same falls within the definition of royalty.

Note - The Central Government has, vide *Notification No. 21/2012 dated 13.6.2012* to be effective from 1st July, 2012, exempted certain software payments from the applicability of tax deduction under section 194J. Accordingly, where payment is made by the transferee for acquisition of software from a resident-transferor, the provisions of section 194J would not be attracted if –

(1) the software is acquired in a subsequent transfer without any modification by the transferor;

(2) tax has been deducted either under section 194J or under section 195 on payment for any previous transfer of such software; and

(3) the transferee obtains a declaration from the transferor that tax has been so deducted along with the PAN of the transferor.

5. Consideration in respect of any right, property or information – Is it royalty?

Explanation 5 provides that Royalty includes and has always included consideration in respect of any right, property or information, whether or not,

(a) the possession or control of such right, property or information is with the payer;

(b) such right, property or information is used directly by the payer;

(c) the location of such right, property or information is in India *[Explanation 5]*

6. Meaning of Process

Explanation 6 provides that the term "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret *[Explanation 6]*

ILLUSTRATION 3

Mr. Soham, an Indian Citizen, left India on 20-04-2017 for the first time to setup a software firm in Singapore. On 10-04-2019, he entered into an agreement with LK Limited, an Indian Company, for the transfer of technical documents and designs to setup an automobile factory in Faridabad. He reached India along with his team to render the requisite services on 15-05-2019 and was able to complete his assignment on 20-08-2019. He left for Singapore on 21-08-2019. He charged ₹ 50 lakhs for his services from LK Limited.

Determine the residential status of Mr. Soham for the Assessment Year 2020-21 and examine whether the fees charged from LK Limited would be chargeable to tax as per the Income-tax Act, 1961.

SOLUTION

Determination of residential status of Mr. Soham

As per section 6(1), an individual is said to be resident in India in any previous year if he satisfies the conditions:-

(i) He has been in India during the previous year for a total period of 182 days or more, or

(ii) He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the previous year.

In the case of an Indian citizen leaving India for the purposes of employment outside India during the previous year or an Indian citizen, who being outside India, comes on a visit to India in any previous year, the period of stay during the previous year in condition (ii) above, to qualify as a resident, would be 182 days instead of 60 days.

In this case, Mr. Soham is an Indian citizen who left India to set up a software firm in Singapore on 20.04.2017. Therefore, he is an Indian citizen living in Singapore, who comes on a visit to India during the P.Y.2019-20. His stay in India during the period of his visit is only 99 days (i.e., 17+30+31+21 days). Since his stay in India during the previous year 2019-20 is only 99 days, he does not satisfy the minimum criterion of 182 days stay in India for being a resident. Hence, his residential status for A.Y.2020-21 is Non-Resident.

Taxability of income

As per section 5(2), in case of a non-resident, only income which accrues or arises or which is deemed to accrue or arise to him in India or which is received or deemed to be received in India in the relevant previous year is taxable in India.

In this case, Mr. Soham, a non-resident, charges fees from LK Ltd., an Indian company, for transfer of technical documents and designs to set up an automobile factory in Faridabad. He renders the requisite services in India for which he stays in India for 99 days during the P.Y.2019-20.

Section 9(1)(vi) defines "royalty" to mean consideration for transfer of all or any rights in respect of, *inter alia*, a design and also for the rendering of services in connection with such activity. Transfer of rights in the above definition includes transfer of right for use or right to use a computer software also. Therefore, the fees received by Mr. Soham for transfer of technical documents and designs and rendering of requisite services in relation thereto would fall within the meaning of "royalty".

As per section 9(1)(vi), income by way of royalty payable by a person who is a resident (in this case, LK Limited, an Indian company) would be deemed to accrue or arise in India in the hands of the non-resident (Mr. Soham, in this case), except where such royalty is payable in respect of any right or property or information used or for services utilized for the purpose of a business carried on by such person outside India or for the purposes of making or earning income from any source outside India.

In this case, since the royalty is payable by LK Limited, an Indian company, to Mr. Soham, a non-resident, in respect of services utilized for a business in India (namely, for setting up an automobile factory in Faridabad), the same is deemed to accrue or arise in India and is hence, taxable in India in the hands of Mr. Soham, a non-resident for the A.Y. 2020-21.

(7) Fees for technical services [Section 9(1)(vii)]

Any fees for technical services will be deemed to accrue or arise in India if they are payable by -

(i) the Government.

(ii) a person who is resident in India

Exception: Where the fees is payable in respect of technical services utilised in a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India.

(iii) a person who is a non-resident, only where the fees are payable in respect of services utilised in a business or profession carried on by the non-resident in India or where such services are utilised for the purpose of making or earning any income from any source in India.

Fees for technical services mean any consideration (including any lumpsum consideration) for the rendering of any managerial, technical or consultancy services (including providing the services of technical or other personnel). However, it does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'.

Income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fee for technical services to be taxed irrespective of territorial nexus [*Explanation* to section 9]

Income by way of interest, royalty or fee for technical services which is deemed to accrue or arise in India by virtue of clauses (v), (vi) and (vii) of section 9(1), shall be included in the total income of the non-resident, whether or not –

(i) the non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India.

In effect, the income by way of fee for technical services, interest or royalty, from services utilized in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

ILLUSTRATION 4

Miss Vivitha paid a sum of 5000 USD to Mr. Kulasekhara, a management consultant practising in Colombo, specializing in project financing. The payment was made in Colombo. Mr. Kulasekhara is a non-resident. The consultancy is related to a project in India with possible Ceylonese collaboration. Is this payment chargeable to tax in India in the hands of Mr. Kulasekhara?

SOLUTION

A non-resident is chargeable to tax in respect of income received outside India only if such income accrues or arises or is deemed to accrue or arise to him in India.

The income deemed to accrue or arise in India under section 9 comprises, *inter alia*, income by way of fees for technical services, which includes any consideration for rendering of any managerial, technical or consultancy services. Therefore, payment to a management consultant relating to project financing is covered within the scope of "fees for technical services".

The *Explanation* below section 9(2) clarifies that income by way of, *inter alia*, fees for technical services, from services utilized in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India or whether or not the non-resident has a residence or place of business or business connection in India.

In the instant case, since the services were utilized in India, the payment received by Mr. Kulasekhara, a non-resident, in Colombo is chargeable to tax in his hands in India, as it is deemed to accrue or arise in India.

(8) Any sum of money paid by a resident Indian to a non-corporate non-resident or foreign company [Section 9(1)(viii)]

Income arising outside India, being any sum of money paid without consideration, by a Indian resident person to a non-corporate non-resident or foreign company on or after 5.7.2019 would be deemed to accrue or arise in India if the same is chargeable to tax under section 56(2)(x) i.e., if the aggregate of such sum received by a non-corporate non-resident or foreign company exceeds ₹ 50,000.

ILLUSTRATION 5

Compute the total income in the hands of an individual, aged 55 years, being a resident and ordinarily resident, resident but not ordinarily resident, and non-resident for the A.Y. 2020-21:

Particulars	*Amount (₹)*
Interest on UK Development Bonds, 50% of interest received in India	*10,000*
Income from a business in Chennai (50% is received in India)	*20,000*
Short term capital gains on sale of shares of an Indian company received in London	*20,000*
Dividend from British company received in London	*5,000*
Long term capital gains on sale of plant at Germany, 50% of profits are received in India	*40,000*
Income earned from business in Germany which is controlled from Delhi (₹ 40,000 is received in India)	*70,000*
Profits from a business in Delhi but managed entirely from London	*15,000*
Income from house property in London deposited in an Indian Bank at London, brought to India (Computed)	*50,000*
Interest on debentures in an Indian company received in London	*12,000*

Fees for technical services rendered in India but received in London	*8,000*
Profits from a business in Bombay managed from London	*26,000*
Pension for services rendered in India but received in Burma	*4,000*
Income from property situated in Pakistan, received there	*16,000*
Past foreign untaxed income brought to India during the previous year	*5,000*
Income from agricultural land in Nepal received there and then brought to India	*18,000*
Income from profession in Kenya which was set up in India, received there but spent in India	*5,000*
Gift received on the occasion of his wedding	*20,000*
Interest on savings bank deposit in State Bank of India	*12,000*
Income from a business in Russia, controlled from Russia	*20,000*
Dividend from Reliance Petroleum Limited, an Indian Company	*5,000*
Agricultural income from a land in Rajasthan	*15,000*

SOLUTION

Computation of total income for the A.Y. 2020-21

Particulars	Resident and ordinarily resident ₹	Resident but not ordinarily resident ₹	Non-resident ₹
Interest on UK Development Bonds, 50% of interest received in India	10,000	5,000	5,000
Income from a business in Chennai (50% is received in India)	20,000	20,000	20,000
Short term capital gains on sale of shares of an Indian company received in London	20,000	20,000	20,000
Dividend from British company received in London	5,000	-	-
Long term capital gain on sale of plant at Germany, 50% of profits are received in India	40,000	20,000	20,000
Income earned from business in Germany which is controlled from Delhi, out of which ₹ 40,000 is received in India	70,000	70,000	40,000
Profits from a business in Delhi but managed entirely from London	15,000	15,000	15,000
Income from property in London deposited in a Bank at London, later on remitted to India	50,000	-	-

Interest on debentures in an Indian company received in London	12,000	12,000	12,000
Fees for technical services rendered in India but received in London	8,000	8,000	8,000
Profits from a business in Bombay managed from London	26,000	26,000	26,000
Pension for services rendered in India but received in Burma	4,000	4,000	4,000
Income from property situated in Pakistan, received there	16,000	-	-
Past foreign untaxed income brought to India during the previous year	-	-	-
Income from agricultural land in Nepal received there and then brought to India	18,000	-	-
Income from profession in Kenya which was set up in India, received there but spent in India	5,000	5,000	-
Gift received on the occasion of his wedding **[not taxable]**	-	-	-
Interest on savings bank deposit in State Bank of India	12,000	12,000	12,000
Income from a business in Russia, controlled from Russia	20,000	-	-
Dividend from Reliance Petroleum Limited, an Indian Company **[Exempt under section 10(34)]**	-	-	-
Agricultural income from a land in Rajasthan **[Exempt under section 10(1)]**	-	-	-
Gross Total Income	**3,51,000**	**2,17,000**	**1,82,000**
Less: Deduction under section 80TTA			
[Interest on savings bank account subject to a maximum of ₹10,000]	10,000	10,000	10,000
Total Income	**3,41,000**	**2,07,000**	**1,72,000**

(3) Presence of Eligible Fund Manager in India not to constitute Business Connection in India of such Eligible Investment Fund on behalf of which he undertakes Fund Management Activity [Section 9A]

(i) **Fund Management Activity through an eligible fund manager not to constitute business connection:** In the case of an eligible investment fund, the fund management activity carried out through an eligible fund manager acting on behalf of such fund shall not constitute business connection in India of the said fund, subject to fulfillment of certain conditions.

(ii) **Location of Fund Manager in India not to affect residential status of an eligible investment fund:** An eligible investment fund shall not be said to be resident in India merely because the eligible fund manager undertaking fund management activities on its behalf, is located in India.

(iii) **Conditions to be fulfilled by an Eligible Investment Fund:** The eligible investment fund means a fund established or incorporated or registered outside India, which collects funds from its members for investing it for their benefit. Further, it should fulfill the following conditions:

(a) the fund should not be a person resident in India;

(b) the fund should be a resident of a country or a specified territory with which an agreement referred to in section 90(1) or section 90A(1) has been entered into or should be established or incorporated or registered outside India in a country or a specified territory notified by the Central Government in this behalf;

(c) the aggregate participation or investment in the fund, directly or indirectly, by persons being resident in India should not exceed 5% of the corpus of the fund;

(d) the fund and its activities should be subject to applicable investor protection regulations in the country or specified territory where it is established or incorporated or is a resident;

(e) the fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;

(f) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;

(g) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%;

(h) the investment by the fund in any entity shall not exceed 20% of the corpus of the fund;

(i) no investment shall be made by the fund in its associate entity;

(j) the monthly average of the corpus of the fund shall not be less than ₹ 100 crore. If the fund has been established or incorporated in the previous year, the corpus of fund should not be less than ₹ 100 crore rupees ***at the end of a period of six months from the last day of the month of its establishment or incorporation, or the end of such previous year, whichever is later***;

However, this condition shall not be applicable to a fund which has been wound up in the previous year.

(k) the fund shall not carry on or control and manage, directly or indirectly, any business in India;

(l) the fund should neither be engaged in any activity which constitutes a business connection in India nor should have any person acting on its behalf whose activities constitute a business connection in India other than the activities undertaken by the eligible fund manager on its behalf.

(m) the remuneration paid by the fund to an eligible fund manager in respect of fund management activity undertaken on its behalf should not be less than ***the amount calculated in the prescribed manner***.

(iv) **Certain conditions not to apply to investment fund set up by the Government or the Central Bank of a foreign State or a Sovereign Fund or other notified fund [Proviso to Section 9A(3)]:** The following conditions would, however, not be applicable in case of an investment fund set up by the Government or the Central Bank of a foreign State or a sovereign fund or such other fund notified by the Central Government (i.e., an investment fund set up by a Category-I or Category-II Foreign Portfolio Investor registered under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, made under the Securities and Exchange Board of India Act, 1992:

(e) the fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;

(f) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;

(g) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%.

(v) **Eligible Fund Manager [Section 9A(4)]:** The eligible fund manager, in respect of an eligible investment fund, means any person who is engaged in the activity of fund management and fulfills the following conditions:

(a) the person should not be an employee of the eligible investment fund or a connected person of the fund;

(b) the person should be registered as a fund manager or investment advisor in accordance with the specified regulations;

The CBDT has, vide ***Circular No.8/2019 dated 10.5.2019****, clarified that a fund manager includes an Asset Management Company (AMC) approved by SEBI under the SEBI (Mutual Funds) Regulations, 1996. This is because AMCs are engaged in* *the activity of fund management of Mutual Funds and hence are, in substance, Fund Managers.*

(c) the person should be acting in the ordinary course of his business as a fund manager;

(d) the person along with his connected persons shall not be entitled, directly or indirectly, to more than 20% of the profits accruing or arising to the eligible investment fund from the transactions carried out by the fund through such fund manager.

(vi) **Furnishing of Statement in prescribed form [Section 9A(5)]:** Every eligible investment fund shall, in respect of its activities in a financial year, furnish within 90 days from the end of the financial year, a statement in the prescribed form to the prescribed income-tax authority. The statement should contain information relating to –

(a) the fulfillment of the above conditions; and

(b) such other relevant information or document which may be prescribed.

If any eligible investment fund fails to furnish such statement or information or document within 90 days from the end of the financial year, the income-tax authority prescribed under the said sub-section may direct that such fund shall pay, by way of penalty, a sum of ₹ 5,00,000. [Section 271FAB]

(vii) **Non-applicability of special taxation regime under section 9A [Section 9A(6)]:** This special taxation regime would not have any impact on taxability of any income of the eligible investment fund which would have been chargeable to tax irrespective of whether the activity of the eligible fund manager constituted business connection in India of such fund or not.

Further, the said regime shall not have any effect on the scope of total income or determination of total income in the case of the eligible fund manager.

(viii) CBDT to prescribe guidelines for the manner of application of the provisions of this section.

(ix) **Meaning of certain terms:**

Term	Meaning
Associate	An entity in which a director or a trustee or a partner or a member or a fund manager of the investment fund or a director or a trustee or a partner or a member of the fund manager of such fund, holds, either individually or collectively, share or interest, being more than 15% of its share capital or interest, as the case may be.
Corpus	The total amount of funds raised for the purpose of investment by the eligible investment fund as on a particular date.
Connected	Any person who is connected directly or indirectly to another person and

person	includes,— (a) any relative of the person, if such person is an individual; (b) any director of the company or any relative of such director, if the person is a company; (c) any partner or member of a firm or association of persons or body of individuals or any relative of such partner or member, if the person is a firm or association of persons or body of individuals; (d) any member of the Hindu undivided family or any relative of such member, if the person is a Hindu undivided family; (e) any individual who has a substantial interest in the business of the person or any relative of such individual; (f) a company, firm or an association of persons or a body of individuals, whether incorporated or not, or a Hindu undivided family having a substantial interest in the business of the person or any director, partner, or member of the company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member; (g) a company, firm or association of persons or body of individuals, whether incorporated or not, or a Hindu undivided family, whose director, partner, or member has a substantial interest in the business of the person, or family or any relative of such director, partner or member; (h) any other person who carries on a business, if - (i) the person being an individual, or any relative of such person, has a substantial interest in the business of that other person; or (ii) the person being a company, firm, association of persons, body of individuals, whether incorporated or not, or a Hindu undivided family, or any director, partner or member of such company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member, has a substantial interest in the business of that other person;

2.3 EXEMPT INCOME OF NON RESIDENTS

Section 10 of the Income-tax Act, 1961 exempts from tax various incomes including the following in the hands of a non-resident:

(1) Interest on moneys standing to the credit of individual in his NRE A/c [Section 10(4)(ii)]

As per section 10(4)(ii), in the case of an individual, any income by way of interest on moneys standing to his credit in a **Non-resident (External) Account (NRE A/c)** in any bank in India in accordance with the Foreign Exchange Management Act, 1999 (FEMA, 1999), and the rules made thereunder, would be exempt, provided such individual;

- is a person resident outside India, as defined in FEMA, 1999, or
- is a person who has been permitted by the Reserve Bank of India to maintain such account.

In this context, it may be noted that the joint holders of the NRE Accounts do not constitute an AOP by merely having these accounts in joint names. The benefit of exemption under section 10(4)(ii) will be available to such joint account holders, subject to fulfillment of other conditions contained in that section by each of the individual joint account holders.

Example: *Mrs. Neena Kansal, is resident of Singapore since year 2000. She holds an NRE account with Bank of Baroda, New Delhi Branch. Interest of ₹ 10,000 was credited to such account during financial year 2019-20. Such interest income earned by her shall be exempt from income-tax while she files her tax return for A.Y 2020-21.*

(2) Interest income of a non-corporate non-resident or foreign company on specified off-shore Rupee Denominated Bonds issued by an Indian company or business trust [Section 10(4C)]

Interest payable by an Indian company or business trust to a non-corporate non-resident or a foreign company in respect of money borrowed from a source outside India by way of issue of rupee denominated bond during the period from 17.9.2018 to 31.3.2019 would be exempt.

(3) Income of a specified fund on transfer of certain specified asset on recognized stock exchange, to the extent such income accrues or arises to, or is received in respect of units held by a non-resident [Section 10(4D)]

Income accrued or arising to or received by specified fund on transfer of a capital asset, being a bond of an Indian Company or a public sector company (sold by the Government and purchased by the specified fund in foreign currency), GDR or rupee denominated bond or derivative or any other notified security, on a recognized stock exchange located in any IFSC would be exempt –

(i) where the consideration is paid or payable in convertible foreign exchange,

(j) to the extent such income accrues or arises to, or is received in respect of units held by a non-resident.

Meaning of certain terms:

S. No.	*Term*	*Meaning*
1	*Specified fund*	*A fund established or incorporated in India in the form of a trust or a company or a LLP or a body corporate, –* *(i) which has been granted a certificate of registration as a Category III Alternative Investment Fund and is regulated under the SEBI*

		(Alternative Investment Fund) Regulation, 2012, made under the SEBI Act, 1992 *(ii) which is located in any IFSC* *(iii) of which all the units are held by non-residents other than units held by a sponsor or manager*
2	*Trust*	*A trust established under the Indian Trust Act, 1882 or under any other law for the time being in force.*
3	*Unit*	*Unit means beneficial interest of an investor in the fund and shall include shares or partnership interests.*
4	*Manager*	*Any person or entity who is appointed by the Alternative Investment Fund to manage its investment by whatever name called. Manager may also be same as the sponsor of the Fund.*
5	*Sponsor*	*Any person or persons who set up the Alternative Investment Fund and includes promoter in case of a company and designated partner in case of LLP.*

(4) Remuneration received by individuals, who are not citizens of India [Section 10(6)]

(i) Remuneration received by officials of Embassies etc. of Foreign States [Section 10(6)(ii)]: The remuneration received by an individual, who is not a citizen of India, for services as an official by whatever name called of an embassy, high commission, legation, commission, consulate or trade representation of foreign state, or a member of staff of any of these official is exempt.

Conditions

(a) The remuneration received by our corresponding Government officials resident in such foreign countries should be exempt.

(b) The above-mentioned member of the staff of such officials should be the subjects of the respective countries and should not be engaged in any other business or profession or employment in India.

Examples:

1. *Mr. A, a citizen of India but resident of USA since year 2012, was appointed as a senior official of the US embassy in India. He earned a remuneration of ₹ 10 lakhs during F.Y. 2019-20.* ***Being an Individual who is a citizen of India, though fulfilling other conditions of the section, such remuneration shall not be exempt in his hands for A.Y. 2020-21.***

2. *Mr. Vikram Kohli, an Indian born person but currently the resident and Citizen of USA, was appointed as a senior official of the US embassy in India. He earned a remuneration of ₹ 10 lakhs during F.Y. 2019-20.* ***Being an Individual who is not***

a citizen of India and also fulfilling other conditions of the section, such remuneration shall be exempt in his hands for A.Y. 2020-21.

3. *Mr. Frank D'Souza, an Irish Citizen but currently the resident of USA, was appointed as a senior official of the US embassy in India. He earned a remuneration of ₹ 10 lakhs during F.Y. 2019-20.* ***Being an Individual who is not a citizen of India, such remuneration shall be exempt in his hands for A.Y. 2020-21, subject to fulfilment of the conditions.***

(ii) **Remuneration received for services rendered in India by a Foreign National employed by foreign enterprise [Section 10(6)(vi)]:** The remuneration received by a foreign national as an employee of a foreign enterprises, for services rendered by him during his stay in India is exempt from tax.

Conditions

(a) The foreign enterprise is not engaged in any business or trade in India:

(b) The employee's stay in India does not exceed in the aggregate a period of 90 days in such previous year and

(c) The remuneration is not liable to be deducted from the income of the employer chargeable under the Income-tax Act, 1961.

Examples:

1. *Mr. A, citizen of India but resident of USA since year 2012, was appointed in India in October, 2018 as an employee of a US enterprise. Such US enterprise is not engaged in any business in India. A's job requires him to visit his US office every twenty five (25) days for reporting purposes.*

   During F.Y. 2019-20, Mr. A earned a remuneration of ₹ 10 lakhs for his India related assignment and his stay in India in aggregate was 85 days. Further, such US enterprise has not claimed any deduction of such remuneration under the Income-tax Act, 1961.

   Being an Individual who is a citizen of India, such remuneration shall not be exempt in his hands for A.Y. 2020-21 under this section i.e., section 10(6)(vi), though he may get exemption under any other provision of the Income-tax Act, 1961, subject to fulfilment of conditions stipulated thereunder.

2. *In the above case, let's consider that Mr. A is a citizen of USA. All other facts remaining same, his* ***remuneration shall be exempt from tax in his hands for A.Y. 2020-21 under this section.***

3. *Let's take another variation, Mr. A is a citizen of USA but the remuneration paid to him is borne by the permanent establishment of such US enterprise in India. ₹ 10*

lakhs paid to A is cross charged by the US enterprise to its Indian permanent establishment (PE).

In this case, the remuneration shall not be exempt from taxation in the hands of Mr. A as the same is getting deducted from the income of the Indian PE of such foreign enterprise.

(iii) **Salary received by a non-citizen for services rendered in connection with employment on foreign ship [Section 10(6)(viii)]:** Any income chargeable under the head "Salaries" received by or due to, non-citizen of India who is also a non-resident as remuneration for services rendered in connection with his employment on a foreign ship is exempt provided his total stay in India does not exceed 90 days during the previous year.

(iv) **Remuneration received by Foreign Government employees during their stay in India for specified training [Section 10(6)(xi)]:** Any remuneration received by employee of the Government of a foreign state from their respective Government during his stay in India, is exempt from tax, if remuneration is received in connection with training in any establishment or office of or in any undertaking owned by,-

(a) the Government, or

(b) any company owned by the Central Government or any State Government or partly by the Central Government and partly by one or more State Government

(c) any company which is subsidiary of a company referred to in (b) above, or

(d) any statutory corporation; or

(e) any society registered under Societies Registration Act, 1860 or under any law and wholly financed by the Central Government or any State Government(s) or partly by the Central Government and partly by one or more State Governments.

It may be carefully noted that exemption is available under section 10(6) only to an individual who is not a citizen of India.

Exempt Income of Non-Residents

Section	Income	Available to
10(4)(ii)	Interest on money standing to the credit in a Non-resident (External) account of an Individual in any bank in India as per the FEMA Act, 1999.	Individual resident outside India (under FEMA Act) or an individual who has been permitted to maintain said account by RBI
10(4C)	***Interest payable by an Indian company or business trust in respect of moneys borrowed from a source outside India by way of issue of***	***A non-corporate non-resident or foreign company***

	rupee denominated bond during the period from 17.9.2018 to 31.3.2019	
10(4D)	***Income on transfer of a capital asset, being a bond of an Indian Company or a public sector company (sold by the Government and purchased by the specified fund in foreign currency), GDR or rupee denominated bond or derivative or any other notified security, on a recognized stock exchange located in any IFSC is exempt –*** ***(i) where the consideration is paid or payable in convertible foreign exchange;*** ***(ii) to the extent such income accrues or arises to, or is received in respect of units held by a non-resident***	***A specified fund***
10(6)(ii)	Remuneration received by Foreign Diplomats/ Consulate and their staff (Subject to conditions)	Individual (not being a citizen of India)
10(6)(vi)	Remuneration received as an employee of a foreign enterprise for services rendered by him during his stay in India, if: a) Foreign enterprise is not engaged in any trade or business in India; b) His stay in India does not exceed the aggregate a period of 90 days in such previous year; and c) Such remuneration is not liable to deducted from the income of employer chargeable under this Act	Individual - Salaried Employee (not being a citizen of India) of a foreign enterprise
10(6)(viii)	Salary received by or due for services rendered in connection with his employment on a foreign ship if his total stay in India does not exceed 90 days in the previous year.	Individual Salaried Employee (Non-resident who is not a citizen of India) of a foreign enterprise
10(6)(xi)	Remuneration received as an employee of the Government of a foreign state during his stay in India in connection with his training in any Government Office/ Statutory Undertaking/ corporation/ registered society etc.	Individual - Salaried Employee (not being a citizen of India) of Government of foreign state
10(6A)	Tax paid by Government or Indian concern (under terms of agreement entered into after 31-3-1976 but before 1-6-2002 by the Government or Indian concern with the foreign company) on income	Foreign Company

	derived by way of royalty or fees for technical services by the foreign company from Government or Indian concern.	
10(6B)	Tax paid by Government or Indian concern under terms of agreement entered into before 1-6-2002 by Central Government with Government of foreign State or international organization on income derived by a non-corporate non-resident or foreign company from the Government or Indian concern, other than income by way of salary, royalty or fees for technical services	Non-corporate non-resident or foreign company
10(6BB)	Tax paid by Indian company, engaged in the business of operation of aircraft, which has acquired an aircraft or an aircraft engine on lease, under an approved (by Central Government) agreement entered into between 1-4-1997 and 31-3-1999, or after 31-3-2007, on lease rental/income derived (other than payment for providing spares or services in connection with the operation of leased aircraft) by the Government of a Foreign State or foreign enterprise.	Government of foreign State or foreign enterprise (i.e., a person who is a non-resident)
10(6C)	Royalty income or fees for technical services under an agreement with the Central Government for providing services in or outside India in projects connected with security of India	Foreign company (notified by the Central Government)
10(6D)	Royalty income from or fees from technical services rendered in or outside India to, the National Technical Research Organisation (NTRO)	Non-corporate non-resident or foreign company
10(8)	Foreign income; and Remuneration received by an individual from the Government of a foreign State, in connection with any co-operative technical assistance programme and project under agreement between Central Government and the Government of a foreign State.	Individual who is assigned to duties in India
10(8A)	Foreign income; and Any remuneration or fee received by such person (agreement relating to his engagement must be approved) out of funds made available to an international organization (agency like World Bank or any other multi-lateral agency) under a technical assistance grant agreement between that agency and the Government of a foreign State (such	Consultant, being (i) An individual: a) not being an Indian citizen; or b) being an Indian citizen who is not ordinarily resident in India, or

	technical assistant should be in accordance with an agreement between the Central Government and the agency).	(ii) any other person, being a non- resident engaged by the agency for rendering technical services in India in connection with any technical assistance programme or project in accordance with the approved agreement.
10(8B)	Foreign income; and Remuneration received, directly or indirectly, by an individual who is assigned to duties in India in connection with any technical assistance programme and project in accordance with an agreement entered into by the Central Government and the agency from a consultant referred to in section 10(8A)	Employee of a consultant, being an individual: a) not being an Indian citizen; or b) being an Indian citizen who is not ordinarily resident in India Contract of service must be approved by the prescribed authority before commencement of service.
10(9)	Foreign income	Any family member of individual as referred to in section 10(8)/(8A)/(8B), accompanying him to India.
Foreign income referred in section 10(8)/(8A)/(8B)/(9) above refers to the other income accruing or arising outside India. Such income would be exempt provided: (i) it is not deemed to accrue or arise in India; and (ii) the individual is required to pay any income tax or social security tax of such income to the Government of that Foreign State or Country of origin of such member.		
10(15)(iiia)	Interest on deposits made by a foreign bank with scheduled bank with approval of RBI.	Bank incorporated outside India and authorised to perform Central Banking functions in that country.
10(15)(iv)(fa)	Interest payable by scheduled bank on deposits in foreign currency where acceptance of such deposits is duly approved by RBI. [Scheduled bank does not include co-operative bank]	a) Non-resident b) Individual or HUF being a resident but not ordinary resident
10(15)(viii)	Interest on deposit on or after 01.04.2005 in an Offshore Banking Unit	

10(15)(ix)	***Interest payable by a unit located in an IFSC in respect of monies borrowed by it on or after 1.9.2019***	***Non-resident***
10(15A)	Lease rental paid by Indian company, engaged in the business of operation of aircraft, to acquire an aircraft or an aircraft engine on lease (other than payment for providing spares or services in connection with the operation of leased aircraft) under an approved (by Central Government) agreement not entered into between 1-4-1997 and 31-3-1999, or after 31-3-2007.	Government of foreign State or foreign enterprise (i.e., a person who is a non-resident)
10(23BBB)	Income of European Economic Community derived in India from interest, dividends or capital gains from investment out of its funds under notified scheme of Central Government.	European Economic Community
10(23BBC)	Income of SAARC Fund for Regional Projects set up by Colombo Declaration.	SAARC Fund for Regional Projects.
10(48)	Income received in India in Indian currency on account of sale of Crude oil or any other goods or rendering of services as may be notified by the Central Government in this behalf. Foreign company and agreement should be notified by the Central Government in national interest.	Foreign company on account of sale of crude oil, any other goods or rendering of services. It should not be engaged in any other activity in India.
10(48A)	Income accruing or arsing on account of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India. Foreign company and agreement should be notified by the Central Government in national interest.	Foreign company on account of storage of crude oil in a facility in India and sale of crude oil therefrom.
10(48B)	Income from sale of leftover stock of crude oil from facility in India after the expiry of agreement or arrangement referred to in section 10(48A) or on termination of the said agreement or arrangement, in accordance with the terms mentioned therein, as the case may be, subject to such conditions, as may be notified by the Central Government.	Foreign company from sale of leftover stock of crude oil from the facility in India.

2.4 PRESUMPTIVE TAXATION FOR NON RESIDENTS

Section 28 details the income chargeable to tax under the head “Profits and Gains of Business or Profession”. Certain provisions have been incorporated in the Income-tax Act, 1961, whereby the

"Profits and gains of business or profession" of certain non-resident assessee is computed on the basis of certain percentage of the amount accrued or arisen and received in India.

(1) Special provision for computing the profits and gains of shipping business in the case of non-residents [Section 44B]

Section 44B is a non-obstante clause. Accordingly, sections 28 to 43A are not applicable in the case of a non-resident engaged in the business of operation of ships.

Section 44B provides that profits and gains of a non-resident engaged in the business of operation of ships are to be taken @ 7.5% of the aggregate of the following amounts:

(i) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of carriage of passengers, livestock, mail or goods shipped at any port in India; and

(ii) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock mail or goods shipped at any port outside India.

The amounts referred to in (i) and (ii) shall include demurrage charges or handling charges or any other amount of similar nature.

The amounts paid or payable or the amounts received or deemed to be received will also include the amount paid or payable or received or deemed to be received by way of demurrage charges or handling charges or any other amount of similar nature [*CIT v. Japan Lines Ltd. 260 ITR 656 (Mad)*]. Thus 7.5% of the gross amounts mentioned above would be liable to tax and no deduction would be allowed for any expenditure, (i.e. the provisions of section 28 to 43A are not to be taken into account) however carried forward losses would be allowed to be set off from such income.

Analysis of section 44B and section 172:

Section 44B	Section 172
Presumptive tax provisions for non-residents engaged in shipping business. It does not, however, contain any procedure for assessment and collection of tax.	Complete code for taxation of occasional shipping business of non-residents, including assessment and collection of tax.
Manner of computation of presumptive Income:	
Notwithstanding anything to the contrary contained in sections 28 to 43A, in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7.5% of the aggregate of the - - amount paid or payable (whether in or outside	Where a ship carries passengers, livestock, mail or goods shipped at a port in India, a sum equal to **7.5%** of - the amount paid or payable on account of such carriage to the owner or the charterer or to any person on his behalf,

India) to the non-resident or to any other person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any Indian port and - the amount received or deemed to be received in India on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India. **shall be deemed to be the profits and gains of such business** chargeable to tax under the head "Profits and gains of business or profession".	whether that amount is paid or payable in or out of India, **shall be deemed to be income accruing in India** to the owner or charterer on account of such carriage.

Other provisions of section 172

(i) Furnish a return of the amount paid to the owner: Section 172(3) imposes an obligation on the master of the ship to prepare and furnish to the Assessing Officer a return of the full amount paid or payable to the owner or charterer or any person on this behalf, on account of the carriage of all passengers, livestock, mail or goods shipped at any port in India since the last arrival of the ship thereat. Such return is, ordinarily, to be furnished by the master of the ship before the departure, from that port in India, of the ship.

A return may, however, be filed by the person authorized by the master of the ship within 30 days of the departure of the ship from the port, if:

(a) the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return required by section 172(3) before the departure of the ship from the port and

(b) the master of the ship has made satisfactory arrangement for the filing of the return and payment of tax by any other person on this behalf.

(ii) Assessment [Section 172(4)]: This section provides for a summary procedure of assessment. On receipt of the return filed by the master of the ship or by any person on this behalf, the Assessing Officer has to determine the tax payable on the taxable income. By virtue of the provisions of section 172(2), the taxable income is a sum equal to 7.5% of the amount paid or payable on account of carriage of passengers etc. to the owner or charterer or to any person on his behalf, whether that amount is paid or payable in or out of India. The tax payable on such taxable income is to be calculated at the **rate or rates in force applicable to the total income of a foreign company**. The master of the ship is liable for payment of such tax.

(iii) **Time limit for passing the assessment order [Section 172(4A)/(5)]:** It is incumbent on the Assessing Officer to pass the order of assessment within 9 months from the end of the financial year in which the return of income under section 172(3) is filed.

For the purpose of determining the tax payable, Assessing Officer is empowered to call for such accounts and documents as he may require.

(iv) **Grant of port of clearance to the ship [Section 172(6)]:** A port clearance shall not be granted to the ship until the Collector of customs or other authorized officer, is satisfied that the tax assessable under section 172 has been duly paid or that satisfactory arrangements have been made for the payment thereof.

(v) **Option to pay tax as per normal provisions of the Income-tax Act, 1961 on the income chargeable to tax under section 172 [Section 172(7)]:** The owner or charterer has the option to claim before the expiry of the assessment year relevant to the previous year in which the date of departure of the ship from the Indian port falls, that an assessment in respect of his total income for the previous year and the tax payable on the basis thereof be determined in accordance with the other provisions of this Act. In such a case, any payment made under section 172 is to be treated as a payment in advance of the tax leviable for that assessment year and the difference between the sum so paid and the amount of tax found payable by him on such assessment is to be paid by him or refunded to him, as the case may be.

The sum chargeable to tax under this section shall include amounts payable by way of **demurrage charge or handling charge** or any other amount of similar nature [Section 172(8)].

Section 172 *vis-à-vis* section 44B

In case the assessee is covered under section 172, 7.5 per cent of the amount paid or payable on account of the carriage of the passengers, livestock, mail or goods to the owner or the chartered or to any person on his behalf is deemed as his income and tax is levied on such income at a rate applicable to a foreign company i.e., 40% *plus* surcharge, if any, and *plus* health and education cess @4%.

Under the provisions of section 172(7), the non-resident owner or charterer is allowed an option to be assessed on his total income of the previous year in accordance with other provisions of the Act i.e., as per section 44B.

When such option is exercised, a regular assessment is made. In such a case, the tax already paid under the provisions of section 172(4) by the non-resident owner or charterer would be treated as tax paid in advance for that assessment year before determining the amount of tax finally due**.** The difference between the sum so paid and the amount of tax payable by him on such assessment shall be paid by the assessee or refunded to him (See Note below).

In that case, the non-resident assessee is liable to pay interest under sections 234B and 234C and also entitled to receive interest under section 244A of the Income-tax Act, 1961 as the case may be. [**Circular No. 9/2001, dated 9-7-2001]**

Note *–Refund may arise in case of non-corporate non-residents, since they are liable to pay tax at a rate lower than the rate of 40% (plus surcharge, if any, and cess@4%) applicable to a foreign company.*

The Supreme Court, in *A.S. Glittre v CIT (1997) 225 ITR 739 (SC)*, held that the assessment made under section 172(4) shall be an 'adhoc' assessment and it will be superceded if a regular assessment is opted as per the provisions of the Act.

ILLUSTRATION 6

Sea Port Shipping Line, a non-resident foreign company ships is engaged in the business of carriage of goods shipped at Mumbai port. During the previous year ended on 31.3.2020, it had collected freight of 100 lakhs, demurrages of ₹ 20 lakhs and handling charges of ₹ 10 lakhs. The expenses of operating its fleet during the year for the Indian Ports were ₹ 110 lakhs. Compute its income applying the presumptive provisions under section 44B.

SOLUTION

Section 44B provides that in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7.5% of the aggregate of the following amounts would be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

(i) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and

(ii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The above amounts will include demurrage charges and handling charges.

These provisions for computation of income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act, 1961.

Therefore, in this case, M/s. Sea Port Shipping Line is required to pay tax in India on the basis of presumptive scheme as per the provisions of section 44B. The assessee shall not be entitled to set off any of the expenses incurred for earning of such income. Therefore, the Shipping Line is required to pay tax on deemed profit of ₹ 9.75 lacs (7.50% on the total receipts of ₹ 130 lacs). The tax payable would be reduced by the amount of tax paid under section 172(4).

(2) Special provision for computing profits and gains in connection with the business of exploration etc. of mineral oils [Section 44BB]

Section 44BB is a non-obstante clause. Accordingly, sections 28 to 41 and section 43 and 43A are not applicable in the case of a non-resident engaged in the business of providing services of facilities in connection with, or supplying plant and machinery on hire used, or to be used in the prospecting for, or extraction or production of, mineral oils.

(i) **Eligible assessee:** Section 44BB provides for determination of income of taxpayer being a non-resident engaged in the business of providing services and facilities in connection with, or supplying plant and machinery on hire used or to be used in the prospecting for, or extraction or production of mineral oils.

(ii) **Presumptive rate:** In such case, the profits and gains shall be deemed to be equal to 10% of the following amounts:

- paid or payable to the taxpayer or to any person on his behalf whether in or out of India, on account of the provision of such services or facilities or supply of plant & machinery for the aforesaid purposes in India; and
- received or deemed to be received in India by or on behalf of the assesse on account of such service or facilities or supply of plant and machinery used or to be used in prospecting for, or extraction or production of mineral oils outside India.

(iii) **Non-applicability of presumptive taxation under section 44BB:** The provisions of section 44BB shall not apply to any income to which the provisions of section 42 or section 44DA, 115A or 293A apply for the purpose of computing profit or gains or any other income referred to in these sections.

Section	Provision
42	Special provision for deductions in the case of business for prospecting, etc., for mineral oil
44DA	Special provisions for computing income by way of royalties, etc., in case of non-residents.
115A	Tax on dividends, royalty and fees for technical services in the case of foreign companies
293A	Power to make exemption, etc., in relation to participation in the business of prospecting for, extraction, etc., of mineral oils.

(iv) **Option to claim lower profits:** An assessee may claim lower income than the presumptive rate of 10%, if he keeps and maintains books of account under section 44AA(2) and get them audited and furnish a report of such audit under section 44AB. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

(v) Meaning of certain terms: For the purposes of this section,-

(a) "Plant" includes ships, aircraft, vehicles, drilling units, scientific apparatus and equipment, used for the purposes of the said business;

(b) "Mineral oil" includes petroleum and natural gas.

Note *- If the income of a non-resident is in the nature of fees for technical services, it shall be taxable under the provisions of either section 44DA or section 115A irrespective of the business to which it relates. Section 44BB would apply only in a case where consideration is for services and other facilities relating to exploration activity which are not in the nature of technical services.*

(3) Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents [Section 44BBA]

Section 44BBA is a non-obstante clause. Accordingly, sections 28 to 43A are not applicable in the case of a non-resident engaged in the business of operation of aircraft.

(i) Eligible assessee: Section 44BBA provides presumptive rate in case of a non-resident engaged in the business of operation of aircraft.

(ii) Presumptive rate: Income from such business is calculated at a flat rate of **5%** of the following:

(a) amount paid or payable, in or out of India, to the tax payer or to any person on his behalf on account or carriage of passenger, livestock, mail or goods from any place in India and

(b) amount received or deemed to be received in India by or on behalf of the taxpayer on account of carriage of passenger, livestock, mail or goods from any place outside India.

ILLUSTRATION 7

Mr. Q, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts while carrying on the business of operation of aircrafts for the year ended 31.3.2020:

(i) ₹ 2 crores in India on account of carriage of passengers from Chennai.

(ii) ₹ 1 crore in India on account of carriage of goods from Chennai.

(iii) ₹ 3 crores in India on account of carriage of passengers from Singapore.

(iv) ₹ 1 crore in Singapore on account of carriage of passengers from Chennai.

The total expenditure incurred by Mr. Q for the purposes of the business during the year ending 31.3.2020 was ₹ 6.75 crores.

Compute the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the assessment year 2020-21.

What would be your answer in case the business was carried on by a foreign company, Q Airlines (P) Ltd?

SOLUTION

Section 44BBA says for computing profits and gains of the business of operation of aircraft in the case of non-residents a sum equal to 5% of the aggregate of the following amounts -

(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

Keeping in view the provisions of section 44BBA, the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder-

Particulars	₹
Amount received in India on account of carriage of passengers from Chennai	2,00,00,000
Amount received in India on account of carriage of goods from Chennai	1,00,00,000
Amount received in India on account of carriage of passengers from Singapore	3,00,00,000
Amount received in Singapore on account of carriage of passengers from Chennai	1,00,00,000
	7,00,00,000

Income from business under section 44BBA at 5% of ₹ 7,00,00,000 is ₹ 35,00,000, which is the income of Mr. Q chargeable to tax in India under the head “Profits and gains of business or profession” for the A.Y. 2020-21.

In case the assessee is a foreign company, say, Q Airlines (P) Ltd, the answer would be the same since section 44BBA does not distinguish corporate and non-corporate taxpayers who operate aircraft provided their residential status is that of non-resident.

(4) Special provision for computing profits and gains of foreign companies engaged in the business of civil construction etc. in certain turnkey power projects [Section 44BBB]

(i) **Eligible assessee:** A foreign company engaged in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof in connection with a turnkey power project approved by the Central Government in this behalf.

(ii) **Presumptive rate:** A sum equal to 10% of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account of such civil construction, erection, testing or commissioning shall be deemed to be the profits and gains of such business chargeable to tax under the head 'profits and gains of business or profession'.

(iii) **Option to claim lower profits:** An assessee may claim lower income than the presumptive rate of 10%, if he keeps and maintains books of account under section 44AA(2) and get them audited and furnish a report of such audit under section 44AB. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

SUMMARY OF PRESUMPTIVE PROVISIONS APPLICABLE TO NON RESIDENTS

Particulars	44B	44BBA	44BB	44BBB
Nature of business	Shipping business	Operation of aircraft	Business of providing services or facilities in connection with, or supplying P & M on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils	Business of civil construction or the business of erection of P&M or testing or commissioning thereof, in connection with turnkey power projects approved by the Central Government.
Eligible assessee	Non-resident	Non-resident	Non-resident	Only Foreign Co.
Presumptive income	7.5% of specified sum	5% of specified sum	10% of specified sum	10% of specified sum
Specified sum	(i) Amount paid or payable on account of carriage of passengers, livestock, mail or goods shipped at/ from any port/place in India; and (ii) Amount received or deemed to be received in India on account of the carriage of passengers, livestock mail or goods shipped at/ from any port/place outside India		(i) Amount paid or payable on account of the provision of such services or facilities for the aforesaid purposes in India; and (ii) Amount received or deemed to be received in India on account of the provisions of services or facilities for the aforesaid purpose outside India.	Amount paid or payable on a/c of such civil construction, erection, testing or commissioning
Option to declare lower profits	Not available		Lower profits may be claimed u/s 44BB and u/s 44BBB provided the assessee maintains Books of account u/s 44AA and gets them audited u/s 44AB.	

(5) Deduction in respect of head office expenses in case of non-residents [Section 44C]

In case of a non-resident, head office expenditure is allowed in accordance with the provision of section 44C. This section is a non-obstante provision and anything contrary contained in sections 28 to 43A is not applicable.

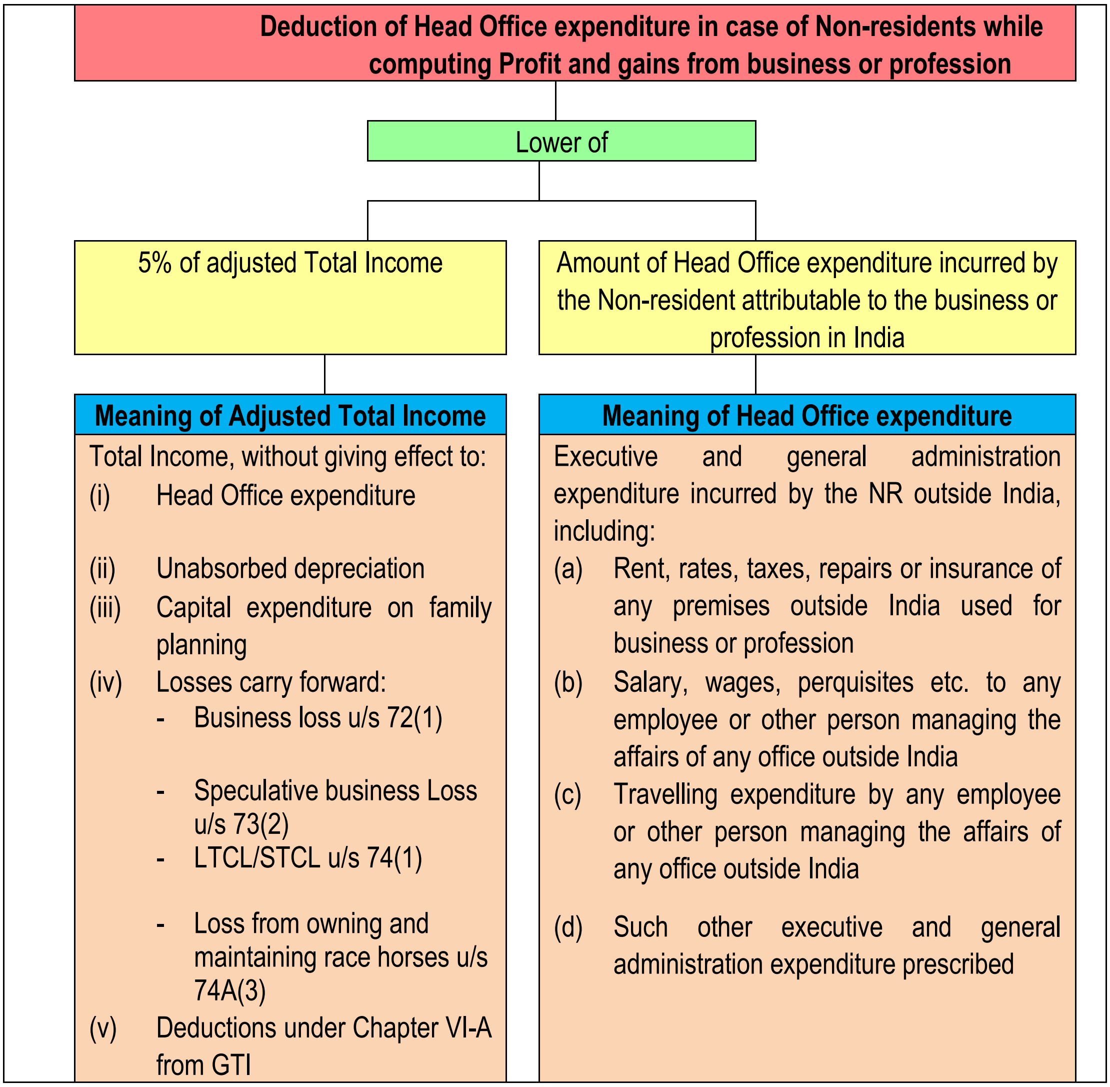
Deduction in respect of head office expenditure is restricted to the least of the following:

(a) an amount equal to 5% of **"adjusted total income"** or in the case of loss, 5% of the **"average" adjusted total income**; or

(b) the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India.

Meaning of certain terms:

Term	Meaning
Adjusted total income	Total income computed in accordance with the provisions of the Act without giving effect to the following :- ▪ Allowance under this section ▪ Unabsorbed depreciation allowance under section 32(2). ▪ Expenditure incurred by a company for the purpose of promoting family planning amongst its employees under first proviso to section 36(1)(ix). ▪ Business loss brought forward under section 72(1). ▪ Speculation loss brought forward under section 73(2). ▪ Loss under the head Capital Gain under section 74(1). ▪ Loss from certain specified source brought forward under Section 74A(3). ▪ Deduction under Chapter VI-A.
Average adjusted total income	(a) The total income of the assessee, assessable for each of the **three assessment years** immediately preceding the relevant assessment year, one third of the aggregate amount of the adjusted total income in respect of previous years relevant to the aforesaid three assessment years is average adjusted total income. (b) When the total income of the assessee is assessable only for **two of the aforesaid three assessment years**, one half of the aggregate amount of the adjusted total income in respect of the previous year's relevant to the aforesaid two assessment years is taken on average adjusted total income. (c) Where the total income of the assessee is assessable only for **one of the aforesaid three assessment years,** the amount of the adjusted total income in respect of the previous year relevant to that assessment year is average adjusted total income.
Head office expenditure	Executive and general administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of: a. rent, rates, taxes, repairs or insurance of any premises outside India used for the purpose of the business or profession. b. salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profit in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India; c. traveling by any employee or other person employed in, or managing the affairs, of any office outside India; and d. such other matters connected with executive and general administrative as may be prescribed.



Deduction of Head Office expenditure in case of Non-residents while computing Profit and gains from business or profession

Lower of

5% of adjusted Total Income

Amount of Head Office expenditure incurred by the Non-resident attributable to the business or profession in India

Meaning of Adjusted Total Income

Total Income, without giving effect to:

(i) Head Office expenditure

(ii) Unabsorbed depreciation

(iii) Capital expenditure on family planning

(iv) Losses carry forward:

- Business loss u/s 72(1)
- Speculative business Loss u/s 73(2)
- LTCL/STCL u/s 74(1)
- Loss from owning and maintaining race horses u/s 74A(3)

(v) Deductions under Chapter VI-A from GTI

Meaning of Head Office expenditure

Executive and general administration expenditure incurred by the NR outside India, including:

(a) Rent, rates, taxes, repairs or insurance of any premises outside India used for business or profession

(b) Salary, wages, perquisites etc. to any employee or other person managing the affairs of any office outside India

(c) Travelling expenditure by any employee or other person managing the affairs of any office outside India

(d) Such other executive and general administration expenditure prescribed

ILLUSTRATION 8

The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2020 was a loss of ₹ 100 lakhs after charge of head office expenses of ₹ 200 lakhs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 2020-21.

SOLUTION

Section 44C restricts the allowability of the head office expenses to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India.

For the purpose of computing the adjusted total income, the head office expenses of ₹ 200 Lakhs charged to the profit and loss account have to be added back.

The amount of income to be declared by the assessee for A.Y. 2020-21 will be as under:

Particulars	₹
Net loss for the year ended on 31.03.2020	(100 lakhs)
Add: Amount of head office expenses to be considered separately as per section 44C	200 lakhs
Adjusted total income	100 lakhs
Less: Head Office expenses allowable under section 44C is the lower of - (i) ₹ 5 lakhs, being 5% of ₹ 100 lakhs, or (ii) ₹ 200 lakhs.	5 lakhs
Income to be declared in return	**95 lakhs**

(6) Special provision for computing income by way of royalties etc. in case of non-residents [Section 44DA]

(i) Eligible assessee: Section 44DA provides the method of computation of income by way of royalty or fees for technical services arising from the agreement made by the non-resident with the Indian company or Government of India after 31.03.2003 where:

(a) such non-resident carries business/ profession in India through permanent establishment or fixed place of profession; and

(b) the right, property or contract in respect of which the royalty or fees for technical services are paid is effectively connected with such permanent establishment or fixed place of service.

(ii) Expenses not allowed as deduction: While computing the income chargeable to tax under this section, the following expenses are not allowed as deduction:

- expenditure or allowance incurred which is not wholly and exclusively for such permanent establishment or fixed place of service in India

- amount paid (otherwise than Reimbursement of actual expenses) by the permanent establishment to head office or to any of its other offices.

(iii) Non-applicability of section 44BB: The provisions of section 44BB do not apply in respect of income covered by this section.

(iv) Mandatory requirement to maintain books of account and get them audited: Under this section, the non-resident is mandatorily required to keep and maintain the books of account under section 44AA and get them audited and furnish a report of such audit.

2.5 CAPITAL GAINS TAXATION FOR NON RESIDENTS

Any person including a foreign company or non-corporate non-resident is liable to capital gains tax in India, if there is a transfer of a property (capital asset) in India which results in profit or gain. The provisions relating non-residents in respect of capital gains taxation are discussed in detail in Chapter 7: Capital Gains at Module 1 of Part I: Direct Tax Laws.

First Proviso to Section 48 read with Rule 115A:-

In order to give protection to non-residents who invest foreign exchange to acquire capital assets, the first proviso to section 48 provides that capital gains arising from the transfer of shares or debentures of an Indian company is to be computed as follows:

- The cost of acquisition, the expenditure incurred wholly and exclusively in connection with the transfer and the full value of the consideration are to be converted into the same foreign currency with which such shares or debentures were acquired.
- The resulting capital gains shall be reconverted into Indian currency.

The aforesaid manner of computation of capital gains shall be applied for every purchase and sale of shares or debentures in an Indian company.

Benefit of indexation will not be applied in this case.

Rule 115A of the Income-tax Rules, 1962 provides that the average of the telegraphic transfer buying rate and telegraphic transfer selling rate of the foreign currency initially utilized in purchase of the capital asset as on the date specified in column (3) in the table below, shall be used to convert rupees into foreign currency for the purpose of computation of capital gains.

(1)	(2)	(3)
S. No.	**Item**	**Date**
(a)	Cost of acquisition of capital asset	Date of acquisition of capital asset
(b)	Expenditure incurred wholly and exclusively in connection with transfer of capital asset	Date of transfer of capital asset
(c)	Full value of consideration received or accruing as a result of transfer of a capital asset	Date of transfer of capital asset

For reconverting capital gains computed in the foreign currency initially utilized in the purchase of the capital asset into rupees, the telegraphic transfer buying rate of such currency, as on the date of transfer of the capital asset, is to be considered.

Meaning of certain terms

Term	Meaning
Telegraphic transfer buying rate	The rate or rates of exchange adopted by the State Bank of India for buying foreign currency having regard to the guidelines specified from time to time by the RBI for buying foreign currency where such currency, made available to that bank through a telegraphic transfer.

Telegraphic transfer selling rate	The rate of exchange adopted by the State Bank of India for selling foreign currency where such currency is made available by that bank through telegraphic transfer.

However, the benefit of indexation and currency fluctuation would not be available in respect of capital gains arising from the transfer of the following long term capital assets referred to in section 112A –

(i) equity share in a company on which STT is paid both at the time of acquisition and transfer

(ii) unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer.

Other Important Points:

a. It is also provided that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every re-investment thereafter in and sale of shares in or debentures of an Indian company.

b. If the total income of an assessee includes any income chargeable under the head 'Capital Gains' arising from transfer of a capital asset being an equity share in a company or unit of an equity oriented fund or unit of a business trust, then, tax on short term capital gains shall be payable at the rates specified in section 111A if transaction of sale of such security has been entered on or after October 1, 2004 on which STT is chargeable; and tax on long-term capital gains shall be payable on such securities as per section 112A, if STT has been paid both at the time of acquisition and transfer of equity share or at the time of transfer of unit of equity oriented fund or unit of business trust.

c. Section 50CA provides that where the consideration received or accruing as a result of transfer of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share determined in such manner as may be prescribed, such fair market value shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

   This provision would, however, not be applicable to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.

d. Section 50D provides that, in case where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

e. The shares and debentures (whether listed or non-listed) of Indian companies only are covered under this proviso. Indian company shall include Government company. However, bonds of Central Government/State Government and RBI are not covered for this purpose.

ILLUSTRATION 9

Mr. A, a non-resident Indian remits US $ 40,000 to India on 16.09.2005. The amount is partly utilised on 3.10.2005 for purchasing 10,000 equity shares in A Ltd, an Indian Company, at the rate of ₹ 12 per share. These shares are sold for ₹ 48 per share on 30.03.2020. Fair Market value of these shares on 31.01.2018 was ₹ 35 per share.

The telegraphic transfer buying and selling rate of US dollars adopted by the State Bank of India is as follows :-

Date	*Buying Rate (1 US$)*	*Selling Rate (1 US $)*
16.09.2005	*18*	*20*
3.10.2005	*19*	*21*
30.3.2020	*59*	*61*

Compute Capital gain chargeable to tax for the A.Y. 2020-21 on the assumption that –

(a) These shares have not been sold through a recognised stock exchange

(b) These shares have been purchased and sold through a recognised stock exchange.

SOLUTION

(a) Where the shares are not sold through recognised stock exchange

Particulars	US $
Sale consideration (₹ 4,80,000/60)	8000
Less: Cost of Acquisition (1,20,000/20)	6000
Long term capital gain	**2000**

Long-term capital gain converted into $ 2000 x ₹ 59 = ₹ 1,18,000

(b) **Where the shares are purchased and sold through a recognised stock exchange**

Particulars		₹
Sale consideration		4,80,000
Less: Cost of Acquisition		
Higher of the following		
Cost of acquisition	1,20,000	
Lower of Fair market value as on 31.1.2018 and Full value of consideration (i.e., lower of ₹ 3,50,000 and ₹ 4,80,000)	3,50,000	3,50,000
Long term capital gain		**1,30,000**

Long term capital gains upto ₹ 1,00,000 would be exempt. Long term capital gains exceeding ₹ 1,00,000, i.e., ₹ 30,000 is taxable @10% under section 112A.

Fourth Proviso to Section 48

As a measure to enable Indian companies to raise funds from outside India, the RBI has permitted them to issue rupee denominated bonds outside India. Accordingly, in case of non-resident assessees, any gains arising on account of appreciation of rupee between the date of purchase and the date of redemption of rupee denominated bond of an Indian company held by him against foreign currency in which investment is made shall not be included in computation of full value of consideration. This would provide relief to the non-resident investor who bears the risk of currency fluctuation.

> ***Note*** *- Non-corporate non-residents and foreign companies to be subject to tax at a concessional rate of 10% (without indexation benefit or currency fluctuation) on long-term capital gains arising from transfer of unlisted securities or shares of a company in which public are not substantially interested [Section 112]*

2.6 SPECIAL PROVISIONS PRESCRIBED UNDER CHAPTER XII-A

Chapter XII-A, introduced in the Income-tax Act 1961 with effect from June 01, 1983, contains seven sections viz. 115C, 115D, 115E ,115F,115G,115H and115-I. The provisions of this Chapter are applicable to a non-resident Indian who derives investment income from a foreign exchange asset and/ or long term capital gains in respect thereof.

(1) Definitions [Section 115C]

	Terms	Meaning
(a)	Convertible foreign exchange	Foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the Foreign Exchange Management Act, 1999, and any rules made thereunder.
(b)	Foreign exchange asset	Any specified asset which the assessee has acquired or purchased with, or subscribed to in, convertible foreign exchange
(c)	Investment income	Any income derived (other than dividends referred to in section 115-O) from a foreign exchange asset.
(d)	Long-term capital gains	Income chargeable under the head "Capital gains" relating to a capital asset, being a foreign exchange asset which is not a short-term capital asset.
(e)	Non-resident Indian	An individual, being a citizen of India or a person of Indian origin who is not a "resident. A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grand-parents, was born in undivided India
(f)	Specified asset	Any of the following assets, namely: (i) Shares in an Indian company;

		(ii) Debentures issued by an Indian company which is not a private company (iii) Deposits in an Indian Company which is not a private company (iv) Any security of the Central Government (v) Any other asset which the Central Government may notify

(2) Special provisions relating to taxation of investment income and on long term capital gains of a non-resident [Sections 115D to 115F]

(i) **On gross basis [Section 115D(1)]:** Section 115D deals with the computation of total income of non-residents. In computing the investment income of non-resident Indian, no deduction is to be allowed under any provision of the Act in respect of any expenditure or allowance thereabout.

(ii) **No deduction allowed [Section 115D(2)]:** No deduction under Chapter VI-A shall be allowed and indexation benefit will **not** be available, where the gross total income of a non-resident Indian consists only of investment income or/and long term capital gain.

However, where the gross total income includes investment incomes or/and long term capital gain, the deduction under Chapter VI-A shall be allowed only on that portion of gross total income which does not include the investment income and long term capital gain.

(iii) **Tax rate on investment income and long term capital gains [Section 115E]:** Under section 115E, the investment income and long-term capital gains of non-resident Indians are to be treated as a separate block and charged to tax at flat rates.

Tax payable by shall be aggregate of –

(a) income-tax on Investment income at 20%;

(b) income-tax on long term capital gains from transfer of specified assets (i.e., purchased in foreign currency) at 10%; and

(c) income-tax on his other total income

Investment Income

↓

20% + Surcharge (if applicable) + Health and Education Cess@4%

Long-term Capital Gain on Foreign Exchange Assets

↓

10% + Surcharge (if applicable) + Health and Education Cess@4%

(iv) Exemption for long-term capital gains [Section 115F]

Where a non-resident Indian has transferred a long-term foreign exchange asset and has within a period of six months after the date of such transfer, invested the whole or part of the net consideration in any specified asset then

(a) If the cost of the new asset is not less than the net consideration in respect of the original asset , the whole of the capital gains shall not be charged to tax under section 45

(b) If the cost of the new asset is less than the net consideration in respect of the original asset, the amount as calculated below shall not be charged to tax under section 45

$$\text{Capital Gains x} \frac{\text{Cost of acquisition of new asset}}{\text{Net Consideration}}$$

Important points:

1. Net consideration means the full value of consideration from transfer less expenditure incurred wholly and exclusively in connection with transfer.

2. Where the new asset is transferred or converted into money within a period of 3 years from the date of its acquisition, the amount of capital gains arising from the transfer of original asset not charged to tax earlier shall be deemed to be the income under the head “Capital Gains ‘’ relating to long term capital assets. The same shall be charged to tax in the previous year in which new asset is transferred or converted into money.

ILLUSTRATION 10

A non-resident Indian acquired shares in an Indian company, A Ltd., on 1.1.2009 for ₹ 1,00,000 in foreign currency. These shares are sold by him on 1.1.2019 for ₹ 3,00,000. He invests ₹ 3,00,000 in shares on 31.03.2019 and these shares are sold by him on 30.06.2019 for ₹ 3,50,000. Discuss the tax implications. Ignore the effect of first proviso to section 48.

SOLUTION

Computation of Long term Capital Gain for Assessment Year 2019-20

Particulars	Amount (₹)
Sale consideration	3,00,000
Less: Cost of Acquisition	1,00,000
Long term capital gain	2,00,000
Less: Exemption under section 115F	2,00,000
Exempt long-term capital gain	**NIL**

Capital Gain for Assessment year 2020-21:

1. LTCG of ₹ 2,00,000 which was exempt in A.Y.2019-20 becomes taxable this year.
2. STCG of ₹ 50,000 is also taxable this year.

ILLUSTRATION 11

Mr. John, a non-resident Indian, purchased unlisted shares of an Indian Company at a cost of ₹ 70,000 on 01.07.20010 in foreign currency. Mr. John sold the said shares for a consideration of ₹ 2,50,000 on 01.08.2019 and the expenditure incurred wholly or exclusively in connection with the transfer is ₹ 10,000. Compute the taxable capital gain if he deposited in specified assets ₹ 1,50,000 out of sale consideration. Ignore the effect of first proviso to section 48.

SOLUTION

Particulars	Amount (₹)
Sale Consideration	2,50,000
Less: Transfer Expenses	10,000
Net Consideration	2,40,000
Less: Cost of Acquisition	70,000
Long-term capital gain	1,70,000
Less: Exemption u/s 115F	1,06,250*
Taxable long-term capital gain	**63,750**

$$\frac{*\ 1{,}70{,}000 \times 1{,}50{,}000}{2{,}40{,}000} = ₹\ 1{,}06{,}250$$

(v) **Option not to file income-tax return [Section 115G]**

A non-resident Indian need not furnish a return of income under section 139(1) if he satisfies the following two conditions:-

(a) His total income consists only of investment income or income by way of long-term capital gains or both; and

(b) Tax deductible at source has been deducted from such income.

(vi) **Continuance of benefits after the non-resident becomes a resident [Section 115H]**

(a) Where a person who is NRI in any previous year becomes assessable as a resident in any subsequent year, then he may furnish a declaration in writing along with the return of income under section 139 for the year in which he is so assessable.

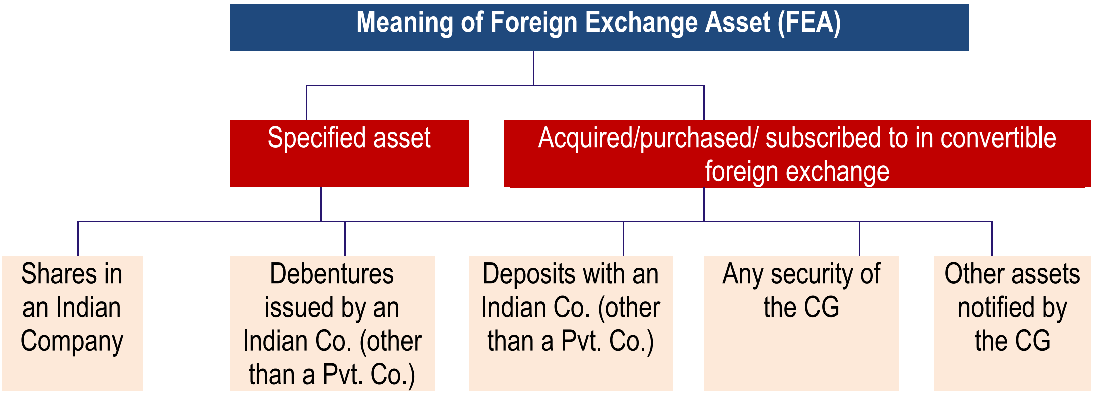
(b) The declaration shall be to the effect that the provisions of this chapter shall continue to apply to him in respect of the investment income derived from foreign exchange assets being debentures, deposits, securities of Central Government and such other notified assets as specified under section 115C.

(c) If he does so, the provisions of this chapter shall continue to apply to him in relation to such income for that assessment year and every subsequent year until the transfer or conversion into money of such assets.

(vii) Option to opt out of Chapter XII-A [Section 115-I]

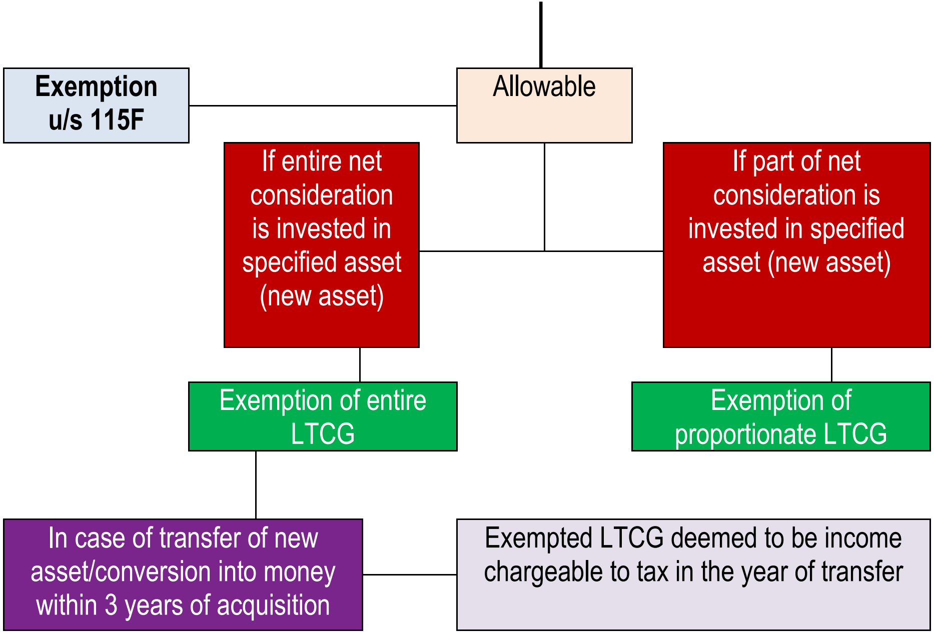
This section gives an option to a non-resident Indian to elect that he should not be governed by the special provisions of Chapter XII-A for any particular assessment year by furnishing his return of income for that assessment year under section 139 declaring therein that the provisions of Chapter XII-A shall not apply to him for that assessment year. In case where such an option is exercised by a non-resident Indian, his total income for that assessment year would be charged to tax under the general provisions of the Act.

Summary


Meaning of Foreign Exchange Asset (FEA)
Specified asset
Acquired/purchased/ subscribed to in convertible foreign exchange
Shares in an Indian Company
Debentures issued by an Indian Co. (other than a Pvt. Co.)
Deposits with an Indian Co. (other than a Pvt. Co.)
Any security of the CG
Other assets notified by the CG

Special Provisions relating to certain incomes of non-resident individual, being a citizen of India or person of Indian Origin

	Investment Income[2] from FEA	LTCG relating to FEA, being a LTCA	LTCG of an asset, other than a specified asset	Other Income
Rate of tax	20%	10%	20%	Normal rates of tax
Deduction for expenses or allowance	Not allowable	Allowable. However, benefit of indexation of COA is not available.	Allowable. Benefit of indexation of COA is available.	Allowable
Deduction under Chapter VI-A	Not allowable	Not allowable	Not allowable	Allowable



Exemption u/s 115F

Allowable

If entire net consideration is invested in specified asset (new asset)

If part of net consideration is invested in specified asset (new asset)

Exemption of entire LTCG

Exemption of proportionate LTCG

In case of transfer of new asset/conversion into money within 3 years of acquisition

Exempted LTCG deemed to be income chargeable to tax in the year of transfer

[2] Other than dividend referred to in section 115-O

2.7 DETERMINATION OF TAX IN CERTAIN SPECIAL CASES [CHAPTER XII]

Sections 111A, 112 and 112A have already been discussed Module 1 of Part I – Direct Tax Laws. The special provisions contained in other sections under Chapter XII are discussed hereunder -

(1) Special provisions for computing tax on income by way of royalty, fees for technical service, interest etc. [Section 115A]

(i) **Tax on dividend and interest in case of non-corporate non-residents and foreign companies:**

Where the total income of a foreign company or a non-corporate non- resident includes any income by way of	Rate of Tax
(1) Dividends [other than dividend referred to in section 115-O]	20%
(2) Interest received from the Government or an Indian concern on moneys borrowed or debt incurred by the Government /Indian concern in foreign currency, other than 3 and 4 mentioned below	20%
(3) Interest received from an infrastructure debt fund referred to in section 10(47)	5%
(4) Interest referred to in section 194LC received from an Indian company or business trust – - in respect of monies borrowed by an Indian company or business trust in foreign currency from sources outside India • Under a loan agreement between 1.7.2012 and 30.6.2020 or • by way of issue of long-term infrastructure bonds between 1.7.2012 and 30.9.2014 or • by way of issue of long-term bonds including long term infrastructure bond between 1.10.2014 and 30.6.2020 as approved by the Central Government - in respect of monies borrowed from sources outside India by way of rupee denominated bond before 1.7.2020	5%
(5) Interest referred to in section 194LD payable between 1.6.2013 and 30.6.2020 to a Foreign Institutional Investor or Qualified Foreign Investor on investment made in – - Rupee denominated bond of an Indian company - Government security	5%
(6) Interest referred to in section 194LBA(2), being interest income of a business trust from a SPV, distributed by business trust to non-resident unit holders of a business trust	5%

(7) Income received in respect of units purchased in foreign currency of a mutual fund specified under section 10(23D) or of the Unit Trust of India	20%

(ii) **Tax on royalty or fees for technical services in case of non-residents**

Where the total income of a foreign company or a non-corporate non-resident includes any income by way of royalty or fees for technical services (FTS) other than the income referred to in section 44DA	**Applicable Rate of Tax**
(1) Received from the Government in pursuance of an agreement made by the non-resident/ foreign company with the Government	10% of such royalty or FTS. However, if DTAA provides for a rate lower than 10%, then, the provisions of DTAA would apply.
(2) Received from the Indian concern in pursuance of an agreement made by the non-resident/ foreign company with the Indian concern and the agreement is approved by the Central Government or where it relates to industrial policy of Government of India, the agreement in accordance with that policy.	

Important Points:

1. Special rate of tax is applicable on the above mentioned incomes. The remaining income of the assessee will be chargeable to tax at normal rates applicable to assessee.

2. No deduction in respect of any expenditure or allowance shall be allowed to the assessee under sections 28 to 44C and section 57 in computing the above income.

3. Deduction under Chapter VI-A is not available in respect of dividend and interest referred to in (i) above. ***However, this condition would not be applicable to deduction allowed to a unit of an International Financial Services Centre (IFSC) under section 80LA i.e., a unit of an IFSC can claim deduction under section 80LA against dividend and interest referred to in (i) above.***

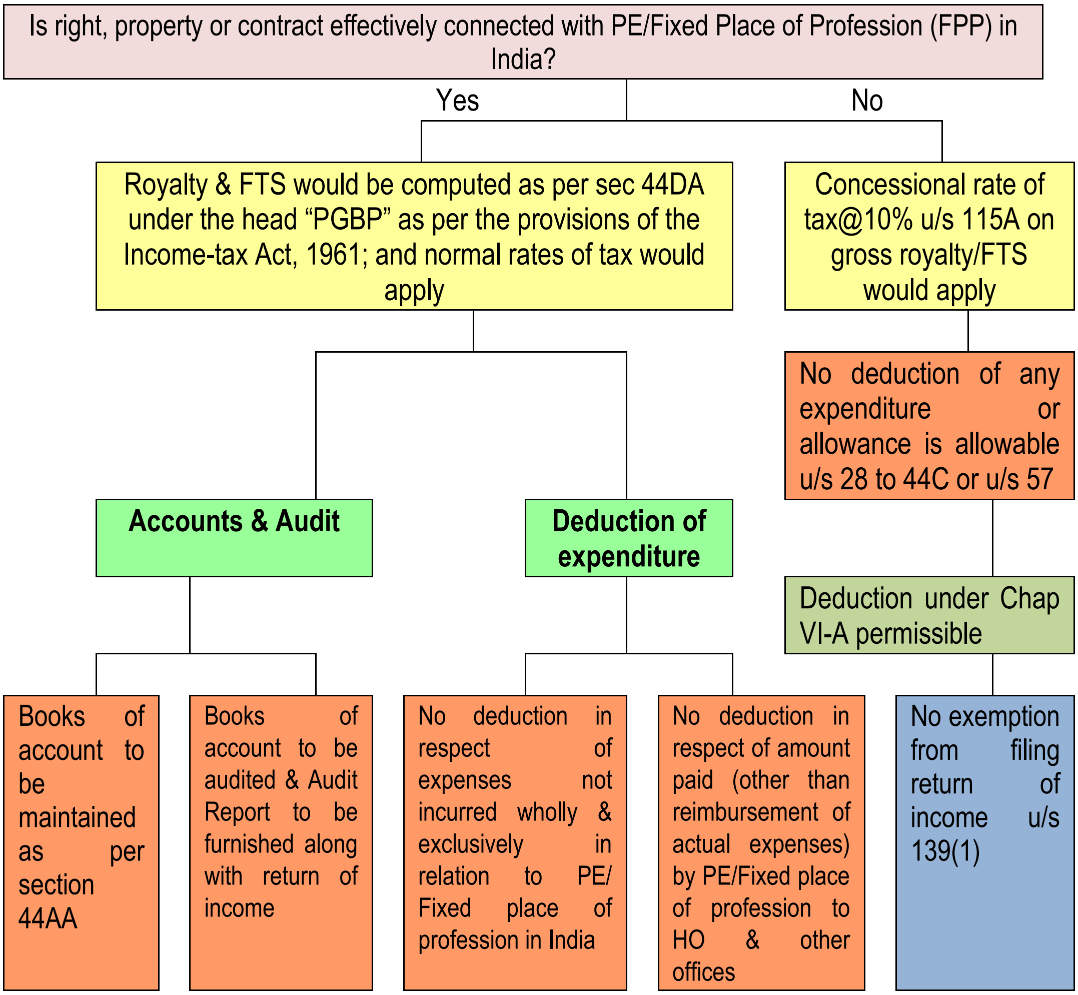
4. It shall not be necessary for the assessee to furnish a return of income if the following conditions are satisfied :

   (a) The total income consists of only the interest or dividend income referred to in (i) above

   (b) Tax deductible at source has been deducted from such income.

Summary

Tax treatment of Royalty & Fees for technical service received from Government / Indian concern in pursuance of approved agreement


Is right, property or contract effectively connected with PE/Fixed Place of Profession (FPP) in India?
Yes
No
Royalty & FTS would be computed as per sec 44DA under the head "PGBP" as per the provisions of the Income-tax Act, 1961; and normal rates of tax would apply
Concessional rate of tax@10% u/s 115A on gross royalty/FTS would apply
No deduction of any expenditure or allowance is allowable u/s 28 to 44C or u/s 57
Accounts & Audit
Deduction of expenditure
Deduction under Chap VI-A permissible
Books of account to be maintained as per section 44AA
Books of account to be audited & Audit Report to be furnished along with return of income
No deduction in respect of expenses not incurred wholly & exclusively in relation to PE/ Fixed place of profession in India
No deduction in respect of amount paid (other than reimbursement of actual expenses) by PE/Fixed place of profession to HO & other offices
No exemption from filing return of income u/s 139(1)

(2) Special provision for computing tax on income from units purchased in foreign currency or capital gains arising from their transfer in case of offshore fund [Section 115AB]

Where the total income of an overseas financial organisation (Offshore Fund) includes the following incomes namely-

(i) Income received in respect of units purchased in foreign currency or

(ii) by way of long term capital gains arising from the **transfer of units** of a mutual fund specified under section 10(23D) or units of UTI purchased in **foreign currency**,

Then, the income tax payable shall be the aggregate of the following:

(a) **10%** on income referred to above

(b) the amount of income-tax with which the Offshore Fund would have been chargeable had its total income been reduced by the amount of Long term Capital Gains and income received referred to above.

Important Points:

(i) The benefit of indexation shall **not** be available in the computation of long term capital gains.

(ii) No deduction shall be allowed to the assessee under sections 28 to 44C or section 57(i)/(iii) or under Chapter VI-A in computing the above income.

(iii) Where the gross total income of the Overseas Financial Organisation consists of other incomes, then, the deduction under Chapter VI- A will be available in respect of other incomes. The normal provisions of the Income-tax Act,1961 will apply for computation of other income.

(iv) **"Overseas Financial Organisation''** means any fund, institution, association or body, whether incorporated or not, established under the laws of a country outside India, which has entered into an arrangement for investment in India with any public sector bank or public financial institution or a mutual fund specified under section 10(23D). Such arrangement should be approved by the Securities and Exchange Board of India.

(v) It may be noted that long term capital gains upto ₹ 1,00,000 on units of equity oriented fund would be exempt and long term capital gains exceeding ₹ 1,00,000 shall be taxable @10% under section 112A provided securities transaction tax has been paid on the sale of such units.

(vi) It may be noted that short term capital gains on units of equity oriented fund are taxable @15% under section 111A provided securities transaction tax has been paid on the sale of such units.

(3) Special provision for computing tax on income from bonds or Global Depository Receipts purchased in foreign currency or capital gains arising from their transfer [Section 115AC]

(i) Eligible assessee and special rate of tax: According to section 115AC(1), where the total income of an assessee, being a non-resident includes:

(a) income by way of interest on bonds of an Indian company issued in accordance with such scheme as the Central Government may notify or on bonds of a public sector company sold by the Government, and purchased by him in foreign currency; or

(b) income by way of dividends, other than dividends referred to in section 115-O, on Global Depository Receipts-

(1) issued in accordance with such scheme as the Central Government may specify against the initial issue of shares of an Indian company and purchased by him in foreign currency through an approved intermediary; or

(2) issued against the shares of a public sector company sold by the Government and purchased by him in foreign currency through an approved intermediary; or

(3) issued or re-issued in accordance with such scheme as the Central Government may specify against the existing shares of an Indian company purchased by him in foreign currency through an approved intermediary; or

(c) income by way of long-term capital gains arising from the transfer of above bonds or GDRs,

then, income-tax will be charged at the rate of 10% on the above income.

(ii) **Deductions not allowable [Section 115AC(2)]:** Where the gross total income of the non-resident consists only the aforesaid interest or dividend income referred to in (a) and (b) of (i) above, no deduction shall be allowed to him under section 28 to 44C or section 57(i) or 57(iii) or under Chapter VIA.

Deduction under Chapter VI-A is also **not** allowable against long term capital gains arising from transfer of bonds or GD₹

Where the gross total income of the non-resident consists of incomes other than interest, dividend and long term capital gains referred to in (a), (b) and (c) of (i) above, then, the deduction under Chapter VI-A will be available in respect of other incomes

(iii) **Non-availability of indexation benefit and computation of capital gains in foreign currency [Section 115AC(3)]:** The indexation benefit and benefit of computation of capital gains in foreign currency, shall not be available for the computation of long-term capital gains arising out of the transfer of long term asset, being bonds or GD₹

(iv) **Filing of Return of Income not required [Section 115AC(4)]:** It shall not be necessary for a non-resident to furnish under section 139(1), a return of income if his total income in respect of which he is assessable under the Act during the previous year consisted only of aforesaid interest or dividend income, and the tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.

(v) **Concessional tax treatment for GDR/Bonds acquired in course of Amalgamation [Section 115AC(5)]:** Where the assessee acquired GDR or bonds in an amalgamated or resulting company by virtue of his holding GDR or bonds in the amalgamating or demerged company, in accordance with the provisions of 115AC(1) the concessional tax treatment would apply to such GDR or bonds.

(vi) **Meaning of Global Depository Receipts:** "Global Depository Receipts" means any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India and issued to investors against the issue of —

(a) ordinary shares of issuing company, being a company listed on a recognised stock exchange in India; or

(b) foreign currency convertible bonds of issuing company;

(4) Special provisions for computing tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer [Section 115AD]

(i) **Special rate of tax:** Where the total income of a Foreign Institutional Investor includes the income referred to in column (2), the same would be subject to tax at the rate mentioned in column (3):

(1)	(2)	(3)
S. No.	**Income**	**Rate of Tax**
(a)	Income received in respect of securities **other than** • income by way of dividends ref u/s 115-O • income on units ref u/s 115AB i.e., units of Mutual Fund specified u/s 10(23D) or UTI • Interest referred u/s 194LD	20%
(b)	Interest referred u/s 194LD	5%
(c)	Income by way of Short term capital gains arising from the transfer of securities (other than Short term capital gains u/s 111A)	30%
(d)	Income by way of Short term capital gains u/s 111A	15%
(e)	Income by way of Long term capital gains arising from the transfer of securities (other than Long term capital gains u/s 112A)	10%
(f)	Income by way of Long term capital gains u/s 112A exceeding ₹ 1 lakh	10%
(g)	Other income of FII	At normal rates of tax

> ***Note** - The Finance (No. 2) Act, 2019 has levied an enhanced surcharge of 25% and 37%, where the total income of an individual/HUF/AOP/BOI exceeds ₹ 2 crores and ₹ 5 crores, respectively. However, the enhanced surcharge of 25% and 37% has been withdrawn on tax payable at special rate under section 115AD by the FPI on the capital gains arising from the transfer of derivatives (Future & Options).*
>
> *In case of assessee other than FPI, derivatives are not treated as capital asset and the income arising from the transfer of the derivatives is treated as business income. Further, it has been clarified that the business income arising from the transfer of derivatives to a person other than FPI would be liable to enhanced surcharge **[Press Release dated 24-8-2019]***

(ii) **No deduction is allowed [Section 115AD(2)]:** Where the gross total income of the Foreign Institutional Investor comprises only of the aforesaid interest or dividend income from securities, no deduction shall be allowed to it under sections 28 to 44C or section 57(i) or 57(iii) or under Chapter VI-A.

Deduction under Chapter VI-A is also not allowable in case of short term capital gain or long term capital gain arising from transfer of securities.

Where the gross total income of the Foreign Institutional Investor consists of incomes other than income referred to in (a), (b) and (c) of table in (i) above, then, the deduction under Chapter VI-A will be available in respect of other incomes.

(iii) **First and second provisos to section 48 shall not apply [Section 115AD(3)]:** The benefit of computation of capital gains in foreign currency and the benefit of indexation would not be available for the computation of capital gains arising on transfer of securities.

(5) Special provision for computing tax on non-resident sportsmen or sports associations [Section 115BBA]

(i) **Eligible assessee and special rate of tax:** Where the total income of an assessee, referred to in column (2) includes income referred to in column (3) of the table below, such income would be chargeable to tax@20%.

	Assessee	Income
(1)	(2)	(3)
(a)	A sportsman (including an athlete), who is not a citizen of India and is a non-resident	Any income received or receivable by way of— (i) participation in India in any game (other than a game the winnings wherefrom are taxable under section 115BB, being winning from crossword puzzles, races including horse races, card games and other games of any sort of gambling or betting) or sport; or (ii) advertisement; or

		(iii) contribution of articles relating to any game or sport in India in newspapers, magazines or journals;
(b)	A non-resident sports association or institution	Any amount guaranteed to be paid or payable to such association or institution in relation to any game (other than a game the winnings wherefrom are taxable under section 115BB) or sport played in India
(c)	An entertainer who is not a citizen of India and is a non-resident	Any income received or receivable from his performance in India

(ii) **Deduction of expenditure not permissible:** No deduction in respect of any expenditure or allowance shall be allowed under any provision of this Act in computing the income referred to in (*a*) or (b) or (c) in the table given above.

(iii) **Filing of return of income not required:** The assessee is **not** required to furnish under section 139(1) a return of his income if—

(a) his total income in respect of which he is assessable under this Act during the previous year consisted **only** of income referred to in (a) or (b) or (c) above; and

(b) the tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.

Note: The issue as to whether the non-resident match referees and umpires in the games played in India fall within the meaning of "sportsmen" to attract taxability under the provisions of section 115BBA, and consequently attract the TDS provisions under section 194E in the hands of the payer was taken up by the Calcutta High Court in Indcom v. CIT (TDS) (2011) 335 ITR 485.

In order to attract the provisions of the section 194E, the person should be a non-resident sportsperson or non-resident sports association or institution whose income is taxable as per the provisions of section 115BBA.

Umpires and match referees can be described as professionals or technical persons who render professional or technical services, but they cannot be said to be either non-resident sportsmen (including an athlete) or non-resident sports association or institution so as to attract the provisions of section 115BBA and consequently, the provisions of tax deduction at source under section 194E are can not be attracted.

The Calcutta High Court held that although the payments made to non-resident umpires and the match referees are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA and thus, the assessee is not liable to deduct tax under section 194E.

It may be noted that since income has accrued and arisen in India to the non-resident umpires and match referees, the TDS provisions under section 195 would be attracted and tax would be deductible at the rates in force.

ILLUSTRATION 12

During the financial year 2019-20, Nadal, a tennis professional and a non-Indian citizen participated in India in a Tennis Tournament and won prize money of ₹ 15 lakhs. He contributed articles on the tournament in a local newspaper for which he was paid ₹ 1 lakh. He was also paid ₹ 5 lakhs by a Soft Drink company for appearance in a T.V. advertisement. Although his expenses in India were met by the sponsors, he had to incur ₹ 3 lakhs towards his travel costs to India. He was a non-resident for tax purposes in India.

What would be his tax liability in India for A.Y. 2020-21? Is he required to file his return of income?

SOLUTION

Under section 115BBA, all the three items of receipts in India viz. prize money of ₹ 15 lakhs, amount received from newspaper of ₹ 1 lakh and amount received towards TV advertisement of ₹ 5 lakhs - are chargeable to tax. No expenditure is allowable as deduction against such receipts. The rate of tax chargeable under section 115BBA is 20%, *plus* health and education cess @4%. The total tax liability works out to ₹ 4,36,800 being 20.8% of ₹ 21 lakhs. Thus, Nadal will be liable to tax on the income earned in India

He is not required to file his return of income if -

(a) his total income during the previous year consists only of income arising under section 115BBA; **and**

(b) the tax deductible at source under the provisions of Chapter XVII-B have been deducted from such incomes.

ILLUSTRATION 13

Smith, a foreign national and a cricketer came to India as a member of Australian cricket team in the year ended 31st March, 2020. He received ₹ 5 lakhs for participation in matches in India. He also received ₹ 1 lakh for an advertisement of a product on TV. He contributed articles in a newspaper for which he received ₹ 10,000. When he stayed in India, he also won a prize of ₹ 20,000 from horse racing in Mumbai. He has no other income in India during the year.

(i) Compute tax liability of Smith for Assessment Year 2020-21.

(ii) Are the income specified above subject to deduction of tax at source?

(iii) Is he liable to file his return of income for Assessment Year 2020-21?

(iv) What would have been his tax liability, had he been a match referee instead of a cricketer?

SOLUTION

(i) **Computation of tax liability of Smith for the A.Y.2020-21**

Particulars	₹	₹
Income taxable under section 115BBA		
Income from participation in matches in India	5,00,000	
Advertisement of product on TV	1,00,000	
Contribution of articles in newspaper	10,000	
Income taxable under section 115BB		
Income from horse races	20,000	
Total income	**6,30,000**	
Tax@ 20% under section 115BBA on ₹ 6,10,000		1,22,000
Tax@ 30% under section 115BB on income of ₹ 20,000 from horse races		6,000
		1,28,000
Add: Health and Education cess@4%		5,120
Total tax liability of Smith for the A.Y.2020-21		**1,33,120**

(ii) Yes, the above income is subject to tax deduction at source.

Income referred to in section 115BBA (i.e., ₹ 6,10,000, in this case) is subject to tax deduction at source@ 20% under section 194E.

Income referred to in section 115BB (i.e., ₹ 20,000, in this case) is subject to tax deduction at source@30% under section 194BB.

Since Smith is a non-resident, the amount of tax to be deducted calculated at the prescribed rates mentioned above, would be increased by health and education cess@4%.

(iii) Section 115BBA provides that if the total income of the non-resident sportsman comprises of only income referred to in that section and tax deductible at source has been fully deducted, it shall not be necessary for him to file his return of income. However, in this case, Mr. Smith has income from horse races as well. Therefore, he cannot avail the benefit of exemption from filing of return of income as contained in section 115BBA. Hence, he would be liable to file his return of income for A.Y.2020-21.

(iv) The Calcutta High Court in *Indcom v. CIT (TDS)(2011) 335 ITR 485* has held that 'match referee' would not fall within the meaning of "sportsmen" to attract the provisions of section 115BBA. Therefore, although the payments made to non-resident 'match referee' are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA. They are subject to the normal rates of tax.

Particulars		₹
Tax@30% under section 115BB on winnings of ₹ 20,000 from horse races		6,000
Tax on ₹ 6,10,000 at the rates in force		
Upto ₹ 2,50,000	Nil	
2,50,000 – 5,00,000 @5%	12,500	
5,00,000 – 6,10,000 @ 20%	22,000	34,500
		40,500
Add: Health and Education cess@4%		1,620
Total tax liability		**42,120**

2.8 SPECIAL PROVISIONS RELATING TO CONVERSION OF INDIAN BRANCH OF A FOREIGN BANK INTO A SUBSIDIARY COMPANY [CHAPTER XII-BB]

(1) Conversion of an Indian branch of foreign company into subsidiary Indian company [Section 115JG(1)]

(i) The provisions of this section apply to a foreign company engaged in banking business in India through its branch situated in India, which is converted into an Indian subsidiary company in accordance with the scheme framed by RBI.

(ii) If the conditions notified by the Central Government in this behalf are satisfied, then capital gains arising from such conversion would not be chargeable to tax in the assessment year relevant to the previous year in which such conversion takes place.

(iii) Also, the provisions of the Act relating to computation of income of foreign company and Indian subsidiary company would apply with such exceptions, modifications and adaptations as specified in the notification.

(iv) Further, the benefit of set-off of unabsorbed depreciation, set-off or carry forward and set-off of losses, tax credit in respect of tax paid on deemed income relating to certain companies available under the Act shall apply with such exceptions, modifications and adaptations as specified in the notification.

Accordingly, the Central Government has, vide notification no. 85/2018, specified the conditions to be fulfilled –

(1) For Capital Gains exemption:

Where a foreign company is engaged in the business of banking through its Indian branch and converts such Indian branch into its Indian subsidiary company in accordance with the scheme framed by RBI, the capital gains arising from such conversion would not be chargeable to tax, if -

(a) the Indian branch amalgamates with the Indian subsidiary company in accordance with the scheme of amalgamation approved by the shareholders of the foreign company and the Indian subsidiary company and sanctioned by the RBI[3]

(b) all the assets and liabilities of the Indian branch immediately before conversion would become the assets and liabilities of the Indian subsidiary company;

(c) the asset and liabilities of the Indian branch are transferred to the Indian subsidiary company at values appearing in the books of account of the Indian branch immediately before its conversion.

***Note** - Any change in the value of assets consequent to their revaluation would not be considered while determining the value of the assets.*

(d) the foreign bank or its nominee shall hold the whole of the share capital of the Indian subsidiary company during the period beginning from the date of conversion and ending on the last day of the previous year in which the conversion took place and continue to hold the shares of Indian subsidiary company carrying not less than 51% of the voting power for a period of five years immediately succeeding the said previous year;

(e) the foreign company does not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the Indian subsidiary company.

(2) Application of the provisions of the Income-tax Act, 1961 with modifications/exceptions

The provisions of the Income-tax Act, 1961 relating to unabsorbed depreciation, set off or carry forward and set off of losses, tax credit in respect of tax paid on deemed income relating to certain companies and the computation of income in case of foreign company and Indian subsidiary company shall apply with following modifications, exceptions and adaptation –

	Purpose	*Modification/exception/adaptation*
(a)	*Allowance of depreciation under*	*The aggregate deduction, in respect of depreciation on buildings, machinery, plant or furniture, being tangible assets, or know-how,*

[3] under paragraph 20(h) of the Framework for setting up of wholly owned subsidiaries by foreign banks in India issued by the Reserve Bank of India *vide* Press release number 2013-2014/936 dated 6th day of November, 2013

	section 32	patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets, allowable to the Indian branch and the Indian subsidiary company shall not exceed in any previous year the deduction calculated at the prescribed rates as if the conversion had not taken place. Such deduction would be apportioned between the Indian branch and the Indian subsidiary company in the ratio of the number of days for which the assets were used by them;
(b)	Set-off and c/f of loss and depreciation	The **accumulated loss** and the **unabsorbed depreciation** of the Indian branch would be deemed to be the loss or allowance for depreciation of the Indian subsidiary company for the previous year in which conversion was effected; and provisions of the Income-tax Act, 1961, relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.
(c)	Determination of actual cost u/s 43(1)	The actual cost of the block of assets in the case of the Indian subsidiary company shall be the written down value of the block of assets as in the case of the Indian branch on the **date of its conversion** into the Indian subsidiary company The actual cost of any capital asset on which deduction has been allowed or is allowable under section 35AD, shall be treated as 'nil' in the case of the Indian subsidiary company if the capital asset became the property of the Indian subsidiary company as a result of conversion of the Indian branch
(d)	Cost of acquisition of other capital assets	Where the capital asset other than those referred to in (c) above became the property of the Indian subsidiary company as a result of conversion of the Indian branch, the cost of acquisition of the asset for the purposes of computation of capital gains shall be deemed to be the cost for which the Indian branch acquired it or, as the case may be, the cost for which **previous owner** has acquired it.
(e)	Tax credit	The **tax credit** of the Indian branch shall be deemed to be the tax credit of the Indian subsidiary company for the purpose of the previous year in which conversion was effected; and the provisions of section 115JAA of the Income-tax Act, 1961 shall apply accordingly.
(f)	Amortisation of VRS Expenditure	The provisions of 35DDA of the Act shall be, as far as may be, apply to the Indian subsidiary company, as they would have applied to the Indian branch, if the conversion had not taken place
(g)	Deemed credit balance in provision for bad and doubtful debts	The credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia) of the Indian branch on the date of conversion shall be deemed to be the credit balance of the Indian subsidiary company and the provisions of section 36 of the Income-tax Act, 1961, shall apply accordingly

(h)	*Non-applicability of section 56(2)(x)*	*The provisions of section 56(2)(x) shall not apply to the transaction of receipt of shares in the Indian subsidiary company by the foreign company or its nominee in consequence of the conversion of the Indian branch into the Indian subsidiary company.*

Meaning of certain terms (given in bold in the above table):

Term	***Meaning***
Accumulated loss	*So much of the loss of the Indian branch before its conversion into Indian subsidiary company under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such Indian branch would have been entitled to carry forward and set off under the provisions of section 72, if the conversion had not taken place.*
Unabsorbed depreciation	*So much of the allowance for depreciation of the Indian branch before its conversion into Indian subsidiary company, which remains to be allowed and which would have been allowed to the Indian branch under the provisions of the Act, if the conversion had not taken place.*
Previous owner	*In relation to any capital asset owned by the Indian subsidiary company means the last previous owner of the capital asset who acquired it by a mode of acquisition other than those referred in section 49(1)(i)/(ii)/(iii)/(iv) or section 115JG(1).*
Tax credit	*So much of the tax credit of the Indian branch before conversion into Indian subsidiary company which such Indian branch would have been entitled to carry forward and set off under the provisions of section 115JAA of the Act, if the conversion had not taken place.*
Date of conversion	*The date, which the Reserve Bank of India appoints for the vesting of undertaking of the Indian branch in Indian subsidiary company*[4]

(2) Consequences of failure to comply with the specified conditions [Section 115JG(2)]

If the conditions specified in the scheme of RBI or notification issued by the Central Government are not complied with, then, all the provisions of the Act would apply to the foreign company and Indian subsidiary company without any benefit, exemption or relief under this section.

(3) Consequences of subsequent failure to comply with the conditions [Section 115JG(3)]

(i) If the benefit, exemption or relief has been granted to the foreign company or Indian subsidiary company in any previous year and thereafter, there is a failure to comply with any of the conditions specified in the scheme or notification, then, such benefit, exemption or relief shall be deemed to have been wrongly allowed.

[4] under paragraph 20(i) of the Framework for setting up of wholly owned subsidiaries by foreign banks in India issued by the Reserve Bank of India vide press release number 2013-2014/936 dated 6th day of November, 2013.

(ii) In such a case, the Assessing Officer is empowered to re-compute the total income of the assessee for the said previous year and make the necessary amendment. This power is notwithstanding anything contained in the Income-tax Act, 1961.

(iii) The provisions of rectification under section 154, would, accordingly, apply and the four year period within which such rectification should be made has to be reckoned from the end of the previous year in which the failure to comply with such conditions has taken place.

(iv) Every notification under issued under this section shall be laid before each House of Parliament.

2.9 WITHHOLDING TAX PROVISIONS FOR NON-RESIDENTS

(1) Salary payable in foreign currency [Section 192]

By virtue of section 9(1)(ii), salary is deemed to accrue or arise in India, if services are rendered in India. Therefore, if a non-resident renders services in India, the salary income would be chargeable to tax in India and the person responsible for paying the salary income i.e., the employer, has to deduct withholding tax in accordance with the provisions of Section 192.

Such income-tax has to be calculated at the average rate of income-tax computed on the basis of the rates in force for the relevant financial year in which the payment is made, on the estimated total income of the assesse.

Average rate of income-tax means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.

Section 192(6) deals with the provisions of withholding tax in case of salary payable in foreign currency. In case, where salary is payable in foreign currency, the amount of tax deducted is to be calculated after converting the salary payable into Indian currency at the telegraphic transfer buying rate as adopted by State Bank of India on the last day of the month immediately preceding the month in which the salary is due, or is paid in advance or in arrears [Rule 26 read with Rule 115].

Students may note that the Rule 26 and Rule 115 have been given as Annexure – 2 at the end of this material.

(2) Income from units [Section 196B]

The person responsible for making the following payment to an Offshore Fund shall deduct tax @ 10% plus surcharge, wherever applicable, *plus* health and education cess@4% at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

- income in respect of units referred to in section 115AB or
- income by way of long-term capital gains arising from the transfer of such units

(3) Income from foreign currency bonds or shares of Indian company [Section 196C]

The person responsible for making the following payment to a non-resident has to deduct tax @ 10% plus surcharge, wherever applicable, *plus* health and education cess@4% at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

- income by way of interest or dividends in respect of bonds or Global Depository Receipts referred to in section 115AC or
- income by way of long-term capital gains arising from the transfer of such bonds or Global Depository Receipts.

However, no deduction shall be made in respect of any dividends referred to in section 115-O.

(4) Income of foreign institutional investors from securities [Section 196D]

(i) The person responsible for making the payment in respect of securities referred to in section 115AD(1)(a) to a Foreign Institutional Investor has to deduct tax @20% *plus* surcharge, wherever applicable, *plus* health and education cess@4% at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

(ii) However, no deduction shall be made in respect of the following

- any dividends referred to in section115-O
- income, by way of capital gains arising from the transfer of securities referred to in section 115AD, payable to a Foreign Institutional Investor.

The summary of withholding tax provisions relating to non-residents is given below. These provisions are discussed in detail in the following chapters mentioned in Column (4):

Section	Nature of payment	Rate of TDS	Chapter
(1)	(2)	(3)	(4)
192	Salary	Normal Slab rates	15: Deduction, Collection and Recovery of Tax (Module 3: Part I- Direct Tax Laws)
192A	Premature withdrawal from EPF, aggregating to ₹ 50,000 or more	10%	
194B	Income by way of winnings from lotteries, crossword puzzles, card games and other games of any sort, where payment to a person > ₹ 10,000	30%	
194BB	Income by way of winnings from horse races, where payment to a person > ₹ 10,000	30%	
194E	Specified payments referred under section 115BBA to non-resident sportsmen/sports	20%	

	association or an entertainer		
194G	Commission etc. on the sale of lottery tickets, where payment to a person > ₹ 15,000	5%	
194LB	Payment of interest on infrastructure debt fund	5%	
194LBA(2)	Distribution any interest income, received or receivable by a business trust from a SPV, to its unit holders.	5%	12: Assessment of Various Entities (Module 2 Part I- Direct Tax Laws)
194LBA(3)	Distribution of any income received from renting or leasing or letting out any real estate asset directly owned by the business trust, to its unit holders.	At the rates in force	
194LBB	Investment fund paying income to a unit holder [other than income which is exempt under section 10(23FBB)].		
194LBC(2)	Income in respect of investment made in a securitisation trust (specified in *Explanation* to section 115TCA)		
194LC	Payment of interest by an Indian Company or a business trust to a non-corporate non-resident or foreign company - in respect of money borrowed in foreign currency from a source outside India • under a loan agreement between 1.7.2012 and 30.6.2020 or • by way of issue of long term bonds (including long term infrastructure bond) between 1.10.2004 and 30.6.2020 as approved by Central Government or - in respect of money borrowed from source outside India by way of rupee denominated bond before 1.7.2020	5%	15: Deduction, Collection and Recovery of Tax (Module 3: Part I- Direct Tax Laws)
	Interest payable by an Indian company or a business trust to a non-resident, including a foreign company, in respect of rupee denominated bond issued outside India during the period from 17.9.2018 to 31.3.2019	Nil (Since such interest is exempt u/s 10(4C), no tax is deductible u/s 194LC)	
194LD	Payment of interest between 1.6.2013 and 30.6.2020 on rupee denominated bond of an Indian Company or Government securities to a	5%	

	Foreign Institutional Investor or a Qualified Foreign Investor		
194N	On withdrawal of cash in excess of ₹ 1 crore	2% on amount exceeding ₹ 1 crore	
195	Payment of any other sum to a non-resident	At the rates in force	
196B	Income from units of a mutual fund or UTI purchased in foreign currency (including long term capital gain on transfer of such units) payable to an Offshore Fund	10%	1: Non Resident Taxation (Module 4: Part II- International Taxation)
196C	Income by way of interest on bonds of an Indian company or public sector company sold by the Government and purchased by a non-resident in foreign currency or GDRs referred to in section 115AC (including long term capital gain on transfer of such bonds or GDRs payable to a non-resident	10%	
196D	Income of foreign Institutional Investors from securities (not being income by way of interest referred to in section 194LD, dividend referred under section 115-O or capital gain arising from such securities)	20%	

Note: *In all the above cases, the rate of tax would be increased by surcharge, wherever applicable, and health and education cess @4%.*

2.10 MISCELLANEOUS PROVISIONS

(1) Recovery of tax in respect of non- resident from his assets [Section 173]

In a case where the person entitled to the income arising from any business connection in India or from any property in India or through or from any asset or source of income in India or through the transfer of a capital asset situated in India is a non-resident, the tax chargeable thereon, whether in his name or in the name of his agent who is liable as a representative assessee, may be recovered by deduction under any of the provisions of Chapter XVII-B. Further, any arrears of tax may be recovered also in accordance with the provisions of this Act from any assets of the non-resident which are, or may at any time come, within India. These provisions are without prejudice to the provisions of section 161(1) or of section 167.

(2) Recovery against the assessee's property in foreign countries [Section 228A]

Where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may, if the assessee ***is a resident of a country*** (being a country with which the Central Government has entered into an agreement for the recovery of income tax under this Act and the corresponding law in force in that country) ***or has any property in that country***, forward to the CBDT a certificate drawn up by him under section 222. Thereafter, the CBDT may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

Similarly, the Government of the other country or any authority under that Government may send to the CBDT a certificate of recovery of any tax due under such corresponding law from a person having property in India and the CBDT may forward such certificate to Tax Recovery Officer ***having jurisdiction over the resident or*** within whose jurisdiction such property is situated, for recovery of such tax. Tax Recovery Officer can proceed to recover the amount specified in the Certificate by –

(a) attachment and sale of assessee's movable or immovable property

(b) arrest of the assessee and his detention in prison.

(c) appointing a receiver for the management of assessee's movable and immovable property.

He shall thereafter remit the sum so recovered to the CBDT.

(3) Submission of statement by a non-resident having liaison office [Section 285]

(i) A non-resident can operate in India through a branch or a liaison office set up after getting the approval of the Reserve Bank of India. Since the branch constitutes a permanent establishment of the non-resident, it has to file its return of income. However, prior to 1.6.2011, there was no such requirement as regards a liaison office since no business activity is allowed to be carried out in India *via* a liaison office of a non-resident.

(ii) With effect from 1.6.2011, such a non-resident is required to file a statement in the prescribed form [Form No.49C] to the Assessing Officer having jurisdiction, within 60 days from the end of the financial year, providing the details in respect of activities carried out by the liaison office in India during the financial year.

(iii) This requirement has to be complied with by every person, being a non-resident having a liaison office in India set up in accordance with the guidelines issued by the RBI under the Foreign Exchange Management Act, 1999.

(iv) The statement of a particular financial year should be filed on or before 30th May, of the succeeding financial year in electronic form along with digital signature. For example, the statement for F.Y. 2019-20 should be filed on or before 30th May, 2020. Further, the statement is to be verified by a Chartered Accountant or by the Authorized Signatory i.e., the person authorized by the non-resident in this behalf.

(4) Furnishing of information or documents by an Indian Concern [Section 285A]

(i) There shall be a reporting obligation on the Indian concern through or in which the Indian assets are held by a foreign company or entity.

(ii) For the purposes of determination of any income accruing or arising in India under section 9(1)(i), an Indian concern has to furnish, within the prescribed period to the prescribed income-tax authority, the information or documents, in prescribed manner, if -

- 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 section 9(1)(i), and

- such company or, entity, holds, directly or indirectly, such assets in India through, or in, the Indian concern.

(iii) The information has to be furnished in Form No.49D electronically within a period of 90 days from the end of the financial year in which the transfer of such share or interest referred to above takes place.

(iv) If any Indian concern fails to furnish the information or documents, the income-tax authority, as may be prescribed under the said section, may direct that such Indian concern shall pay, by way of penalty under section 271GA,—

(a) @2% 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;

(b) ₹ 5,00,000 in any other case.

Note – *Rule 114DB prescribes the time limit and Information or documents to be furnished under section 285A*[5].

The other miscellaneous provisions relating to non-residents are discussed in detail in the following chapters:

Section	Provision	Chapter
160	Who may be regarded as Representative Assessee?	22: Liability in Special Cases (Module 3 of Part I - Direct Tax Laws)
161	Liability of Representative Assessee	
162	Rights of representative assessee to recover tax paid	
163	Who may be regarded as agent?	

[5] For detailed reading of Rule 114DB of the Income-tax Rules, 1962, students may visit https://www.incometaxindia.gov.in/Pages/default.aspx

EXERCISE

Question 1

Peeyush, returned to India on 12th June, 2019 for permanently residing in India after a stay of about 20 years in U.K., provides the sources of his various incomes and seeks your opinion to know about his liability to income tax thereon in India in assessment year 2020-21:

(i) Income of rent of the flat in London which was deposited in a bank there. The flat was given on rent by him after his return to India since July, 2019.

(ii) Dividends on the shares of three German Companies which are being collected in a bank account in London. He proposes to keep the dividend on shares in London with the permission of the Reserve Bank of India.

(iii) He has got two sons, one of whom is of 12 years and other 19 years. Both his sons are staying in London and not returning to India with him. Each of his sons is having income of ₹ 75,000 in U.K. in foreign currency (not received in India) and of ₹ 20,000 in India.

(iv) During the preceding accounting year when he was a non-resident, he had sold 1000 shares which were acquired by him in British Pound Sterling and the sale proceeds were repatriated. The profit in terms of British Pound Sterling on sale of these 1000 shares was 175% of the cost at ₹ 37,500 while in terms of Indian Rupee it was ₹ 50,000.

Answer

Peeyush returned to India on 12th June 2019 for permanently residing in India after staying in UK for 20 years. During the P.Y.2019-20, he stays in India for 294 days. Since he has stayed in India for a period of 182 days or more during the previous year 2019-20, he would be a resident in India for the A.Y.2020-21. However, he would be a resident but not ordinarily resident, assuming that he was a non-resident in nine out of ten previous years preceding P.Y.2019-20 and his stay in India during the seven previous years is less than 730 days. The residential status of Peeyush for A.Y.2020-21 is, therefore, **Resident but Not Ordinarily Resident.**

As per section 5(1), only income which is received/ deemed to be received/ accrued or arisen/ deemed to accrue or arise in India is taxable in case of a Resident but not Ordinarily Resident. Income which accrues or arises outside India shall not be included in his total income, unless it is derived from a business controlled in, or a profession set up in, India.

(i) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.

(ii) Dividends from shares of three German Companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.

(iii) As per section 64(1A), all income accruing or arising to a minor child is includible in the hands of the parent, after providing for deduction of ₹ 1,500 per child under section 10(32).

Accordingly, income of ₹ 20,000 accruing to his minor son, aged 12 years, in India is includible in the income of Peeyush, after providing deduction of ₹ 1,500. Therefore, ₹18,500 is includible in the income of Peeyush. Income accruing to the minor child outside India (which is also received outside India) is not includible in the income of Peeyush.

Since the other son is major, his income is not includible in the income of Peeyush.

(iv) Repatriation of sale proceeds of 1000 shares sold in the preceding accounting year, when Peeyush was a non-resident, is not taxable in the A.Y.2020-21 since it is not the income of the P.Y.2019-20.

Consequently, only the income includible under section 64(1A) would form part of the total income of Mr. Peeyush for A.Y.2020-21. Since his total income (i.e., ₹ 18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y.2020-21.

Question 2

Mr. David, a citizen of India, serving in the Ministry of External Affairs in India, was transferred to Indian Embassy in Canada on 31.03.2019. He did not visit India any time during the previous year 2019-20. He has received the following income for the Financial Year 2019-20:

S.No.	*Particulars*	*₹*
(i)	*Salary (Computed)*	*5,00,000*
(ii)	*Foreign Allowance*	*4,00,000*
(iii)	*Interest on fixed deposit from bank in India*	*1,00,000*
(iv)	*Income from agriculture in Pakistan*	*2,00,000*
(v)	*Income from house property in Pakistan*	*2,50,000*

Compute his gross total income for Assessment Year 2020-21.

Answer

As per section 6(1), Mr. David is a non-resident for the A.Y. 2020-21, since he was not present in India at any time during the previous year 2019-20.

As per section 5(2), a non-resident is chargeable to tax in India only in respect of following incomes:

(i) Income received or deemed to be received in India; and

(ii) Income accruing or arising or deemed to accrue or arise in India.

In view of the above provisions, income from agriculture in Pakistan and income from house property in Pakistan would not be chargeable to tax in the hands of David, assuming that the same were received in Pakistan.

Income from 'Salaries' payable by the Government to a citizen of India for services rendered outside India is deemed to accrue or arise in India as per section 9(1)(iii). Hence, such income is taxable in the hands of Mr. David, even though he is a non-resident.

However, allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering service outside India is exempt under section 10(7). Hence, foreign allowance of ₹ 4,00,000 is exempt under section 10(7).

Gross Total Income of Mr. David for A.Y. 2020-21

Particulars	₹
Salaries	5,00,000
Income from other sources (Interest on fixed deposit in India)	1,00,000
Gross Total Income	**6,00,000**

Question 3

Mr. A, a citizen of India, left for USA for the purposes of employment on 1.5.2019. He has not visited India thereafter. Mr. A borrows money from his friend Mr. B, who also left India for employment purpose one week before Mr. A's departure, to the extent of ₹ 10 lakhs and buys shares in X Ltd., an Indian company. Discuss the taxability of the interest charged @10% in B's hands where the same has been received in New York.

Answer

An individual is said to be resident in India in any previous year, if he -

(i) has been in India during that year for a total period of 182 days or more, or

(ii) has been in India during the four years immediately preceding that year for a total period of 365 days or more and has been in India for at least 60 days in that year.

In the case of an Indian citizen leaving India for the purposes of employment outside India during the previous year, the period of stay during the previous year in condition (ii) above, to qualify as a resident, would be 182 days instead of 60 days.

In this case, Mr. A is an Indian citizen who left India for employment outside India on 01.05.2019. Mr. A has been in India only from 1.4.2019 to 01.05.2019 i.e. for 31 days. Since his stay in India during the previous year 2019-20 is only 31 days, he does not satisfy the minimum criterion of 182 days stay in India for being a resident. Hence, his residential status for A.Y. 2020-21 is Non-Resident. Mr. B, who left India one week before A's departure, is also a non-resident for the same reasons.

Section 9(1)(v) provides that income by way of interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India shall be deemed to accrue or arise in India.

Therefore, interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purpose of making or earning any income from any source other than a business or profession carried on by him in India, shall not be deemed to accrue or arise in India. Therefore, interest payable by Mr. A on money borrowed from Mr. B to invest in shares of an Indian company shall not be deemed to accrue or arise in India and hence, is not taxable in India in the hands of Mr. B.

Question 4

JJ Limited, a company incorporated in Australia has entered into an agreement with KK Limited, an Indian company for rendering technical services to the latter for setting up a fertilizer plant in Orissa. As per the agreement, JJ Limited rendered both off-shore services and on-shore services to KK Limited at fee of ₹ 1 crore and ₹ 1.5 crore, respectively. JJ Limited is of the view that it is not liable to tax in India in respect of fee of ₹ 1 crore as it is for rendering services outside India. Discuss the correctness of the view of JJ Limited.

Answer

The *Explanation* below section 9(2) clarifies that income by way of, *inter alia*, fees for technical services from services utilized in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

In this case, the technical services rendered by the foreign company, JJ Ltd., were for setting up a fertilizer plant in Orissa. Therefore, the services were utilized in India. Consequently, as per the *Explanation* below section 9(2), the fee of ₹ 2.5 crore for technical services rendered by JJ Ltd. (both off-shore and on-shore services) to KK Ltd. is deemed to accrue or arise in India and includible in the total income of JJ Ltd.

Therefore, the view of JJ Ltd. that it is not liable to tax in India in respect of fee of ₹ 1 crore (as it is for rendering services outside India) is not correct.

Question 5

Examine with reasons whether the following transactions attract income-tax in India, in the hands of recipients under section 9 of Income-tax Act, 1961:

(i) A non-resident German company, which did not have a permanent establishment in India, entered into an agreement for execution of electrical work in India. Separate payments were made towards drawings & designs, which were described as "Engineering Fee". The assessee contended that such business profits should be taxable in Germany as there is no business connection within the meaning of section 9(1)(i) of the Income-tax Act, 1961.

(ii) A firm of solicitors in Mumbai engaged a barrister in UK for arguing a case before Supreme Court of India. A payment of 5000 pounds was made as per terms of professional engagement.

(iii) Amount paid by Government of India for use of a patent developed by Mr. A, who is a non-resident.

(iv) Sai Engineering, a non-resident foreign company entered into a collaboration agreement on 25/6/2019, with an Indian Company and was in receipt of interest on 8% debentures for ₹ 20 lakhs, issued by Indian Company, in consideration of providing technical know-how utilised in its business in Mumbai during previous year 2019-20.

Answer

(i) Fees for technical services is taxable under section 9(1)(vii). In this case, the separate payments made towards drawings and designs (described as "engineering fee") are in the nature of fee for technical services and, therefore, it is taxable in India by virtue of section 9(1)(vii), since the services are utilized for execution of electrical work in India *[Aeg Aktiengesllschaft v. CIT (2004) 267 ITR 209 (Kar.)].*

As per *Explanation* to section 9, where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of the non-resident German company, regardless of whether it has a residence or place of business or business connection in India.

(ii) As per section 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India.

In this case, there was a professional connection between the firm of solicitors in Mumbai and the barrister in UK. The expression "business" includes not only trade and manufacture; it includes, within its scope, "profession" as well. Therefore, the existence of professional connection amounts to existence of "business connection" under section 9(1)(i). It was so held by the Supreme Court in *Barendra Prasad Roy v. ITO (1981) 129 ITR 295.*

Hence, the amount of 5,000 pounds paid to the barrister in UK as per the terms of the professional engagement constitutes income which is deemed to accrue or arise in India under section 9(1)(i). Hence, it is taxable in India.

(iii) As per section 9(1)(vi), income by way of royalty payable by the Government of India is deemed to accrue or arise in India. "Royalty" means consideration for, *inter alia*, use of patent. Therefore, the amount paid by Government of India for use of patent developed by Mr. A, a non-resident, is deemed to accrue or arise in India. Hence, it is taxable in India in the hands of Mr. A.

(iv) ₹ 20 lakhs, being the value of debentures issued by an Indian company in consideration of providing technical know-how for use in its business in India, is in the nature of fee for technical services, deemed to accrue or arise in India to Sai Engineering, a non-resident foreign company, under section 9(1)(vii). Hence, it is taxable in India.

Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident of India is deemed to accrue or arise in India. Therefore, interest income from debentures of an Indian company is deemed to accrue or arise in India in the hands of Sai Engineering by virtue of section 9(1)(v). Hence, it is taxable in India.

Note – *Since the question specifically requires the candidates to examine the taxability of the above transactions under section 9, the provisions of double taxation avoidance agreement, if any, applicable in the above cases, have not been taken into consideration.*

Question 6

Z, an American tourist, comes to India for the first time on June 17, 2019. He leaves India on September 29, 2019. Determine his residential status for the assessment year 2020-21. Does it make any difference if he comes to India on a business trip or if he is an Indian citizen?

Answer

Previous year 2019-20:	105 [14+31+31+29]
Previous year 2018-19:	Nil
Previous year 2017-18:	Nil

and so on ……

He is non-resident for the assessment year 2020-21 as he does not satisfy any of the basic conditions. It does not make any difference if he comes on a business trip to India.

Further, in this case, it does not make any difference if he is an Indian citizen as far as the answer of non-resident is concerned. However, there is a difference in application of basic conditions as an Indian citizen who comes on a visit to India during the previous has the option of only one basic condition of 182 days to become a resident.

Question 7

M/s. Global Airlines incorporated as a company in USA operated its flights to India and vice versa during the year 2019-20 (April, 2019 to March, 2020) and collected charges of ₹ 125 lakhs for carriage of passengers and cargo out of which ₹ 65 lakhs were received in New York in U.S Dollars for the passenger fare booked from New York to Mumbai. The total expenses for the year on operation of such flights were ₹ 195 lakhs. Compute the income chargeable to tax of the foreign airlines.

Answer

As per section 44BBA, in case of a non-resident engaged in the business of operation of aircraft, 5% of the following amounts would be deemed to be the profits and gains from such business:

(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

In the present case, the income chargeable to tax of M/s Global Airlines applying the provisions of section 44BBA are as follows:

Particulars	Fare booked from India to outside India whether received in India or not (₹)	Fare booked from New York to Mumbai (₹)
Fare	60,00,000 (1,25,00,000 – 65,00,000)	65,00,000
Deemed income @5% u/s 44BBA	3,00,000 (60,00,000 × 5%)	Nil (since the amount not received in India)

Question 8

Atlant Italy, a company incorporated in France, was engaged in manufacture, trade and supply equipment and services for GSM Cellular Radio Telephones Systems. It supplied hardware and software to various entities in India. Software licensed by assessee embodied the process which is required to control and manage the specific set of activities involved in the business use of its customers, and also made available to its customers, who used it to carry out their business activities. The Assessing Officer contented that the consideration for supply of software embedded in hardware is 'royalty' under section 9(1)(vi)

Examine the correctness of the action of the Assessing Officer assuming that the software that was loaded on the hardware and embedded in the system does not have any independent existence.

Answer

The issue under consideration in this case is whether consideration for supply of software embedded in hardware would tantamount to 'royalty' for attracting deemed accrual of income under section 9(1)(vi).

As per section 9(1)(vi), income by way of royalty payable by a person who is a resident in India would be deemed to accrue or arise in India. However, where it is payable for the transfer of any right or the use of any property or information or for the utilization of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India, the amount payable by way royalty would not be deemed to accrue or arise in India, in the hands of non-resident.

For this purpose, 'royalty' includes transfer of all or any right for use or right to use a computer software irrespective of the medium through which such right is transferred.

The facts of the case are similar to the facts in *CIT v. Alcatel Lucent Canada (2015) 372 ITR 476*, wherein the above issue came up before the Delhi High Court. The Court observed that the software supply is an integral part of GSM mobile telephone system and is used by the cellular operators for providing cellular services to its customers. Where payment is made for hardware in which the software is embedded and the software does not have independent functional existence, no amount could be attributed as 'royalty' for software in terms of section 9(1)(vi).

In this case, since the software that was loaded on the hardware and embedded in the system does not have any independent existence, there could not be any independent use of such software. Therefore, the rationale of the Delhi High Court ruling can be applied to the case on hand. Accordingly, the action of the Assessing Officer in treating the consideration for supply of software embedded in hardware as royalty under section 9(1)(vi) is **not** correct.

CHAPTER 3

DOUBLE TAXATION RELIEF

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- ❑ **appreciate** the need for double taxation relief;
- ❑ **appreciate** the types of double taxation relief available;
- ❑ **comprehend and apply** the provisions relating to double taxation relief contained in the Income-tax Act, 1961 and Income-tax Rules, 1962 in problem solving and addressing related issues;
- ❑ **comprehend** the procedure for claiming deduction where there is no double taxation avoidance agreement between India and the other country where the income has been taxed and **compute** the amount of deduction;
- ❑ **appreciate** the concept of Permanent Establishment under double taxation avoidance agreements and its relevance.

3.1 CONCEPT OF DOUBLE TAXATION RELIEF

In the present era of cross-border transactions across the globe, the effect of taxation is one of the important considerations for any trade and investment decision in other countries. One of the most significant results of globalisation is the visible impact of one country's domestic tax policies on the economy of another country. This has led to the need for continuously assessing the tax regimes of various countries and bringing about necessary reforms.

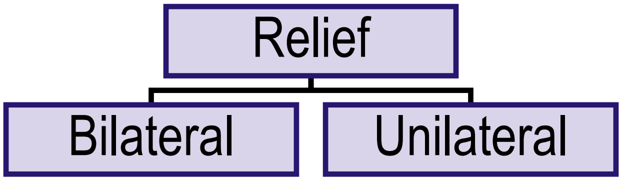
Where a taxpayer is resident in one country but has a source of income situated in another country it gives rise to possible double taxation. This arises from the two basic rules that enables the country of residence as well as the country where the source of income exists to impose tax namely, (i) the source rule and (ii) the residence rule. The source rule holds that income is to be taxed in the country in which it originates irrespective of whether the income accrues to a resident or a non-resident whereas the residence rule stipulates that the power to tax should rest with the country in which the taxpayer resides. If both rules apply simultaneously to a business entity and it were to suffer tax at both ends, the cost of operating on an international scale would become prohibitive and would deter the process of globalisation. It is from this point of view that Double Taxation Avoidance Agreements (DTAA) become very significant.

DTAAs lay down the rules for taxation of the income by the source country and the residence country. Such rules are laid for various categories of income, for example, interest, dividend, royalties, capital gains, business income etc. Each such category is dealt with by separate article in the DTAA.

Double taxation means taxing the same income twice in the hands of an assessee. In India, a person is taxed on the basis of his residential status. Likewise, it may so happen that he is taxed on this basis or some other basis in another country on the same income. However, it is a universally accepted principle that the same income should not be subjected to tax twice. In order to take care of such situations, the Income-tax Act, 1961 has provided for double taxation relief.

3.2 TYPES OF RELIEF

Relief from double taxation can be provided in mainly two ways:



(1) **Bilateral Relief**: Under this method, the Governments of two countries can enter into an agreement to provide relief against double taxation by mutually working out the basis on which the relief is to be granted. India has entered into agreements for relief against or avoidance of double taxation with more than 100 countries which include Sri Lanka, Switzerland, Sweden, Denmark, Japan, Federal Republic of Germany, Greece, etc.

Bilateral Relief may be granted in either one of the following methods:

Exemption Method

- A particular income is taxed in only one of the two countries.

Tax Credit Method

- Income is taxable in both countries in accordance with their respective tax laws read with double taxation avoidance agreement.
- The country of resident of the tax payer, however, allows him credit for the tax charged thereon in the country of source.

In India, double taxation relief is provided by a combination of the two methods.

(2) **Unilateral Relief:** This method provides for relief of some kind by the home country even where no mutual agreement has been entered into by the two countries.

3.3 DOUBLE TAXATION RELIEF PROVISIONS UNDER THE INCOME TAX ACT, 1961

Sections 90 and 91 of the Income-tax Act, 1961 provide for double taxation relief in India.

(1) Agreement with foreign countries or specified territories - Bilateral relief [Section 90]

(i) Section 90(1) provides that the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—

(a) for the granting of relief in respect of—

(i) income on which income-tax has been paid both in India and in that country or specified territory; or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory to promote mutual economic relations, trade and investment; or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory; or

Accordingly, the Central Government has notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement *[Notification No. 91/2008, dated 28.8.2008]*.

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory or investigation of cases of such evasion or avoidance; or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory.

The Central Government may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(ii) Where the Central Government has entered into such an agreement with the Government of any country outside India or specified territory outside India for granting relief of tax, or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

(iii) However, the provisions of Chapter X-A, General Anti-Avoidance Rule, shall apply to the assessee even if such provisions are not beneficial to him.

(iv) **Meaning of terms used in any DTAA with a foreign country or specified territory**

	Particulars	Meaning of the term
(1)	Term used in any DTAA with a foreign country or specified territory, and not defined in the agreement or the Act but assigned a meaning in the notification issued by the Central Government in the Official Gazette, which is still in force.	The term shall have the meaning assigned in the said notification and the meaning shall be deemed to have effect from the date on which the DTAA came into force.
(2)	Term used in any DTAA with a foreign country or specified territory, which is defined in the DTAA itself.	The term shall have the same meaning assigned to it in the DTAA.
(3)	Term used in any DTAA with a foreign country or specified territory, which is not defined in the said DTAA, but defined in the Income-tax Act, 1961.	The term shall have the meaning assigned to it in the Income-tax Act, 1961 and explanation, if any, given to it by the Central Government.

(v) The DTAAs under section 90 are intended to provide relief to the taxpayer, who is resident of one of the contracting country to the agreement. Such tax payer can claim relief by applying the beneficial provisions of either the treaty or the domestic law. However, in many cases, taxpayers who were not residents of a contracting country also resorted to claiming the benefits under the agreement entered into by the Indian Government with the Government of the other country. In effect, third party residents claimed the unintended treaty benefits.

Therefore, section 90(4) provides that the non-resident to whom the agreement referred to in section 90(1) applies, shall be allowed to claim the relief under such agreement if a Tax Residence Certificate (TRC) obtained by him from the Government of that country or specified territory, is furnished declaring his residence of the country outside India or the specified territory outside India, as the case may be.

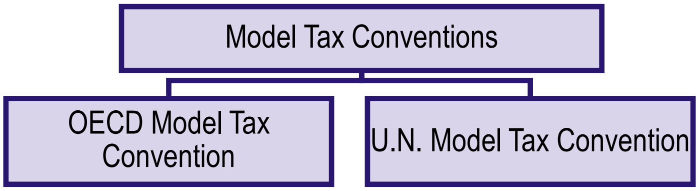
(vi) Therefore, a certificate issued by the Government of a foreign country would constitute proof of tax residency, without any further conditions regarding furnishing of "prescribed particulars" therein. In addition to such certificate issued by the foreign Government, the assessee would be required to provide such other documents and information, as may be prescribed, for claiming the treaty benefits.

(vii) The charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

(viii) *Circular No. 333 dated 2.4.1982*, issued by CBDT provides that a specific provision of the DTAA will prevail over the general provisions of the Income-tax Act, 1961. Therefore, where a DTAA provides for a particular mode of computation of income, this mode will take precedence over the Income-tax Act, 1961. However, where there is no specific provision in the treaty, then the Income-tax Act will apply.

(ix) *Notification No. 91/2008 dated 28.8.2008* issued by CBDT states that any income of a resident of India which "may be taxed" in the other country (Source Country) as per the DTAA shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961. Thereafter, relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

Tax treaties are generally based on certain models. The most common ones are:



Model Tax Conventions

OECD Model Tax Convention

U.N. Model Tax Convention

These model tax conventions will be discussed in detail in Chapter 9 "Overview of Model Tax Conventions".

ILLUSTRATION 1

Examine the correctness or otherwise of the following statement with reference to the provisions of Income-tax Act, 1961.

The double taxation avoidance treaties entered into by the Government of India override the domestic law.

SOLUTION

The statement is correct.

Section 90(2) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee.

In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 1961, the provisions of the DTAA would prevail over the Act in view of the provisions of section 90(2), to the extent they are more beneficial to the assessee [*CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC)].*

(2) Double taxation relief to be extended to agreements between specified associations adopted by the Central Government [Section 90A]

(i) Section 90A provides that any specified association in India may enter into an agreement with any specified association in the specified territory outside India and the Central Government may, by notification in the Official Gazette, make the necessary provisions for adopting and implementing such agreement for -

(a) grant of double taxation relief,

(b) avoidance of double taxation of income,

(c) exchange of information for the prevention of evasion or avoidance of income- tax, or

(d) recovery of income-tax.

Section 90A(1) provides that an agreement may be entered into by any specified association in India with any specified association in the specified territory outside India which may be adopted by the Central Government by way of notification in the Official Gazette, for granting relief of tax or, as the case may be, for avoidance of double taxation.

The Central Government has, vide *Notification No.90/2008 dated 28.8.2008*, notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

(ii) In relation to any assessee to whom the said agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

(iii) However, the provisions of Chapter X-A, General Anti-avoidance rule, shall apply to the assesse even if such provisions are not beneficial to him.

(iv) **Meaning of terms used in any agreement which any specified association in India may enter into with any specified association in the specified territory outside India for double taxation relief**

	Particulars	Meaning of the term
(1)	Term used in any such agreement, and not defined in the agreement or the Act but assigned a meaning in the notification issued by the Central Government in the Official Gazette, which is still in force	The term shall have the meaning assigned in the said notification and the meaning shall be deemed to have effect from the date on which the agreement came into force.
(2)	Term used in any such agreement, which is defined in the agreement itself	The term shall have the same meaning assigned to it in the said agreement
(3)	Term used in any such agreement, which is not defined in the said agreement, but defined in the Income-tax Act, 1961	The term shall have the meaning assigned to it in the Income-tax Act, 1961 and explanation, if any, given to it by the Central Government

(v) The DTAAs under section 90A are intended to provide relief to the taxpayer, who is resident of one of the contracting country to the agreement. Such tax payer can claim relief by applying the beneficial provisions of either the treaty or the domestic law. However, in many cases, taxpayers who were not residents of a contracting country also resorted to claiming the benefits under the agreement entered into by the Indian Government with the Government of the other country. In effect, third party residents claimed the unintended treaty benefits.

Therefore, section 90A(4) provides that the non-resident to whom the agreement referred to in section 90A(1) applies, shall be allowed to claim the relief under such agreement if a Tax Residence Certificate (TRC) obtained by him from the Government of that country or specified territory is furnished, declaring his residence of the country outside India or the specified territory outside India, as the case may be.

(vi) Therefore, a certificate issued by the Government of a foreign country would constitute proof of tax residency, without any further conditions regarding furnishing of “prescribed particulars” therein. In addition to such certificate issued by the foreign Government, section 90A(5) requires the assessee to provide such other documents and information, as may be prescribed, for claiming the treaty benefits.

Documents and information, to be furnished by the assessee for claiming treaty benefits, prescribed by CBDT vide *Notification No. 57/2013 dated 01.08.2013*:

(i) Status (individual, company, firm etc.) of the assessee;

(ii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);

(iii) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident;

(iv) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and

(v) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (iv) above, is applicable.

However, the assessee may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in section 90(4) or section 90A(4).

The assessee shall keep and maintain such documents as are necessary to substantiate the information provided. An income-tax authority may require the assessee to provide the said documents in relation to a claim by the said assessee of any relief under an agreement referred to in section 90(1) or section 90A(1), as the case may be.

(vii) The charge of tax at a higher rate for a company incorporated in the specified territory outside India as compared to a domestic company would not be considered as less favourable charge or levy of tax in respect of such company.

(viii) For the purpose of this section, the 'specified association' means any institution, association or body, whether incorporated or not, functioning under any law for the time being in force in India or the laws of the specified territory outside India and which may be notified as such by the Central Government and 'specified territory' means any area outside India which may be notified by the Central Government.

(3) Countries with which no agreement exists – Unilateral Agreements [Section 91] In the case of income arising to an assessee in countries with which India does not have any double taxation agreement, relief would be granted under Section 91 provided all the following conditions are fulfilled:

(a) The assessee is a resident in India during the previous year in respect of which the income is taxable.

(b) The income accrues or arises to him outside India.

(c) The income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.

(e) The assessee has paid tax on the income in the foreign country.

(f) There is no agreement for relief from double taxation between India and the other country where the income has accrued or arisen.

In such a case, the assessee shall be entitled to a deduction from the Indian income-tax payable by him. The deduction would be a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax in the said country, whichever is lower, or at the Indian rate of tax if both the rates are equal.

Meaning of important terms:

(i) "Indian rate of tax" means the rate determined by dividing the amount of Indian income-tax after deduction of any relief due under the provisions of the Act but before deduction of any double taxation relief due to the assessee.

(ii) "Rate of tax of the said country" means income-tax and super-tax actually paid in that country in accordance with the corresponding laws in force in the said country after deduction of all relief due, but before deduction on account of double taxation relief due in the said country, divided by the whole amount of income assessed in the said country.

(iii) The expression "income-tax" in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

ILLUSTRATION 2

Nandita, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well-known dramatist deriving income of ₹ 1,10,000 from theatrical works played abroad. Tax of ₹ 11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to ₹ 6,10,000. In view of tax planning, she has deposited ₹ 1,50,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC ₹ 32,000. She also contributed ₹ 28,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of ₹ 26,000 to insure the health of her father, a non-resident aged 84 years, who is not dependent on her. Compute the tax liability of Nandita for the Assessment year 2020-21.

SOLUTION

Computation of tax liability of Nandita for the A.Y. 2020-21

Particulars	₹	₹
Indian Income		6,10,000
Foreign Income		1,10,000
Gross Total Income		**7,20,000**

Less: Deduction under section 80C		
Deposit in PPF	1,50,000	
Under section 80CCC		
Contribution to approved Pension Fund of LIC	32,000	
	1,82,000	
Under section 80CCE		
The aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to ₹ 1,50,000	1,50,000	
Under section 80D		
Contribution to Central Government Health Scheme ₹ 28,000 is also allowable as deduction under section 80D. Since she is a resident senior citizen, the deduction is allowable to a maximum of ₹ 50,000 **(See Note 1)**	28,000	
Medical insurance premium of ₹ 26,000 paid for father aged 84 years. Since the father is a non-resident in India, he will not be entitled for the higher deduction of ₹ 50,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of ₹ 25,000.	25,000	2,03,000
Total Income		**5,17,000**
Tax on Total Income		
Income-tax (See Note below)		13,400
Add: Health and Education Cess @4%		536
		13,936
Average rate of tax in India (i.e. ₹ 13,936/ ₹ 5,17,000 × 100)	2.696%	
Average rate of tax in foreign country (i.e. ₹ 11,000/ ₹ 1,10,000 ×100)	10%	
Deduction under section 91 on ₹ 1,10,000 @ 2.696% (lower of average Indian-tax rate or average foreign tax rate)		2,966
Tax payable in India (₹ 13,936 – ₹ 2,966)		**10,970**

Notes:

1. Section 80D allows a higher deduction of up to ₹ 50,000 in respect of the medical premium paid to insure the heath of a senior citizen. Therefore, Nandita will be allowed deduction of ₹ 28,000 under section 80D, since she is a resident Indian of the age of 60 years.

2. The basic exemption limit for senior citizens is ₹ 3,00,000 and the age criterion for qualifying as a "senior citizen" for availing the higher basic exemption limit is 60 years. Accordingly, Nandita is eligible for the higher basic exemption limit of ₹ 3,00,000, since she is 60 years old.

3. An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-

(a) The assessee is a resident in India during the relevant previous year.

(b) The income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, since all the above conditions are satisfied, Nandita is eligible for deduction u/s 91.

(4) Foreign Tax Credit [Rule 128 of Income-tax Rules, 1962]

(i) Year of availability of credit for foreign tax paid

An assessee, being a resident shall be allowed a credit for the amount of any foreign tax paid by him in a country or specified territory outside India, by way of deduction or otherwise, in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India, in the manner and to the extent as specified in this rule.

However, in a case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.

(ii) Meaning of "Foreign tax":

	Country/Specified Territory	Foreign Tax
(i)	in respect of a country or specified territory outside India with which India has entered into an agreement for the relief or avoidance of double taxation of income in terms of section 90 or section 90A	the tax covered under the said agreement
(ii)	in respect of any other country or specified territory outside India	the tax payable under the law in force in that country or specified territory in the nature of income-tax referred to in section 91. For this purpose, income-tax in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

(iii) Components of income-tax in respect of which FTC is available

Foreign Tax Credit (FTC) is available against the amount of tax, surcharge and cess payable under the Income-tax Act, 1961. However, it is not available in respect of any sum payable by way of interest, fee or penalty.

(iv) Manner of computing FTC

The credit of foreign tax would be the aggregate of the amounts of credit computed separately for each source of income arising from a particular country or specified territory outside India and shall be given effect to in the following manner:-

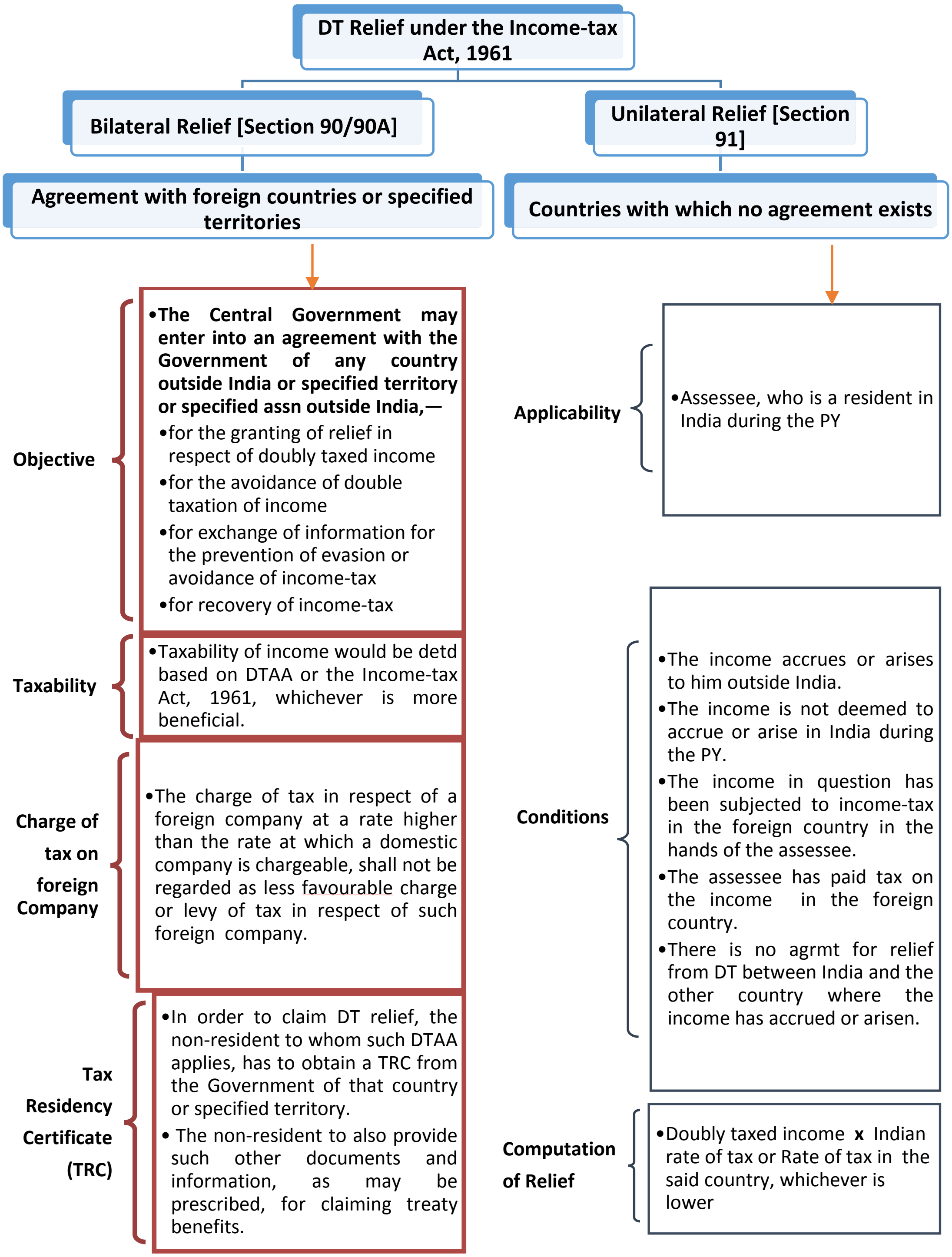
(a) the credit would be the lower of the tax payable under the Income-tax Act, 1961 on such income and the foreign tax paid on such income.

However, where the foreign tax paid exceeds the amount of tax payable in accordance with the provisions of the agreement for relief or avoidance of double taxation, such excess has to be ignored.

(b) the credit would be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.

Note – *Students are advised to refer to Rule 128 of Income-tax Rules, 1961 given as Annexure 1 at the end of the Study Material.*

Summary



DT Relief under the Income-tax Act, 1961

Bilateral Relief [Section 90/90A]

Agreement with foreign countries or specified territories

Objective

- **The Central Government may enter into an agreement with the Government of any country outside India or specified territory or specified assn outside India,—**
  - for the granting of relief in respect of doubly taxed income
  - for the avoidance of double taxation of income
  - for exchange of information for the prevention of evasion or avoidance of income-tax
  - for recovery of income-tax

Taxability

- Taxability of income would be detd based on DTAA or the Income-tax Act, 1961, whichever is more beneficial.

Charge of tax on foreign Company

- The charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

Tax Residency Certificate (TRC)

- In order to claim DT relief, the non-resident to whom such DTAA applies, has to obtain a TRC from the Government of that country or specified territory.
- The non-resident to also provide such other documents and information, as may be prescribed, for claiming treaty benefits.

Unilateral Relief [Section 91]

Countries with which no agreement exists

Applicability

- Assessee, who is a resident in India during the PY

Conditions

- The income accrues or arises to him outside India.
- The income is not deemed to accrue or arise in India during the PY.
- The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.
- The assessee has paid tax on the income in the foreign country.
- There is no agrmt for relief from DT between India and the other country where the income has accrued or arisen.

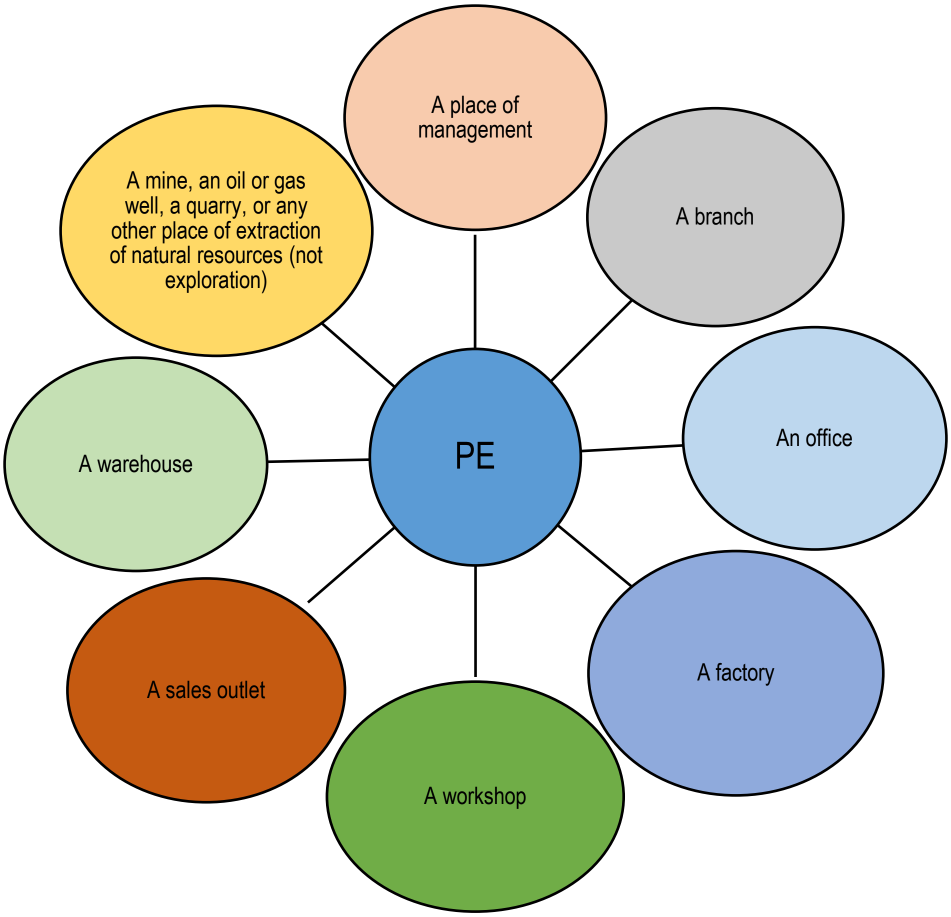
Computation of Relief

- Doubly taxed income **x** Indian rate of tax or Rate of tax in the said country, whichever is lower

3.4 CONCEPT OF PERMANENT ESTABLISHMENT

In order to determine the taxability of business income of foreign enterprises operating in India, it is important to determine the existence of a Permanent Establishment ('PE'). Article 5(1) of the DTAA provides that for the purpose of this convention the term 'Permanent Establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term 'Enterprise' has been defined in section 92F(iii) [See discussion under section 92A in Chapter 1].

According to Article 5(2), the term PE includes

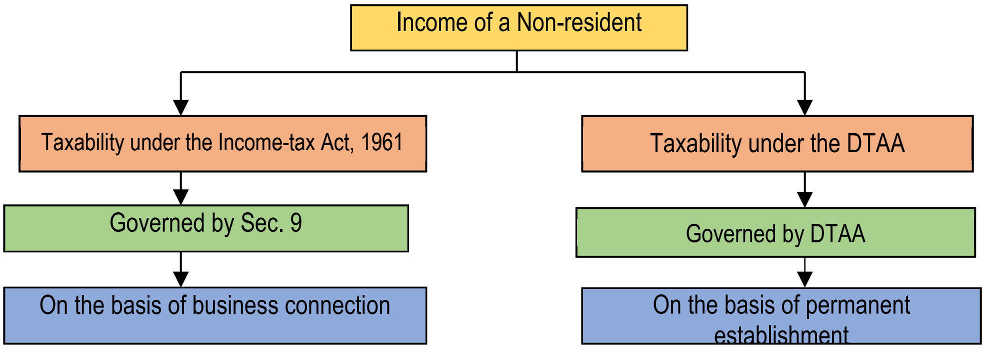

A place of management
A branch
An office
A factory
A workshop
A sales outlet
A warehouse
A mine, an oil or gas well, a quarry, or any other place of extraction of natural resources (not exploration)
PE

(1) Permanent establishment means a fixed place of business through which the business of an enterprises is wholly or partly carried on.

(2) Every DTAA has a specific clause, which will deal with an explanation of permanent establishment for the purpose of such DTAA.

(3) Business Income of a non-resident will not be taxed in India, unless such non-resident has a permanent establishment in India.

(4) Taxability of income under business connection and permanent establishment is explained here below:


Income of a Non-resident
Taxability under the Income-tax Act, 1961
Taxability under the DTAA
Governed by Sec. 9
Governed by DTAA
On the basis of business connection
On the basis of permanent establishment

3.5 TAXATION OF BUSINESS PROCESS OUTSOURCING UNITS IN INDIA

The provisions containing taxation of IT-enabled business process outsourcing units are not contained in the Income-tax Act, 1961 but are given in *Circular No.5/2004 dated 28.9.2004* issued by CBDT. The provisions are briefed hereunder -

(a) A non-resident entity may outsource certain services to a resident Indian entity. If there is no business connection between the two, the resident entity may not be a Permanent Establishment of the non-resident entity, and the resident entity would have to be assessed to income-tax as a separate entity. In such a case, the non-resident entity will not be liable under the Income-tax Act, 1961.

(b) However, it is possible that the non-resident entity may have a business connection with the resident Indian entity. In such a case, the resident Indian entity could be treated as the Permanent Establishment of the non-resident entity.

(c) The non-resident entity or the foreign company will be liable to tax in India only if the IT enabled BPO unit in India constitutes its Permanent Establishment.

(d) A non-resident or a foreign company is treated as having a Permanent Establishment in India if the said non-resident or foreign company carries on business in India through a branch, sales office etc. or through an agent (other than an independent agent) who habitually exercises an authority to conclude contracts or regularly delivers goods or merchandise or habitually secures orders on behalf of the non-resident principal. In such a case, the profits of the non-resident or foreign company attributable to the business activities carried out in India by the Permanent Establishment becomes taxable in India.

(e) If a foreign enterprise carries on business in another country through a Permanent Establishment situated therein, the profits of the enterprise may be taxed in the other country but only so much of them as is attributable to the Permanent Establishment.

(f) Profits are to be attributed to the Permanent Establishment as if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a Permanent Establishment.

(g) In determining the profits of a Permanent Establishment there shall be allowed as deduction, expenses which are incurred for the purposes of the Permanent Establishment including executive and general administrative expenses so incurred, whether in the State in which the Permanent Establishment is situated or elsewhere.

(h) The expenses that are deductible would have to be determined in accordance with the accepted principles of accountancy and the provisions of the Income-tax Act, 1961.

(i) The profits to be attributed to a Permanent Establishment are those which that Permanent Establishment would have made if, instead of dealing with its Head Office, it had been dealing with an entirely separate enterprise under conditions and at prices prevailing in the ordinary market. This corresponds to the "arm's length principle".

(j) Hence, in determining the profits attributable to an IT-enabled BPO unit constituting a Permanent Establishment, it will be necessary to determine the price of the services rendered by the Permanent Establishment to the Head office or by the Head office to the Permanent Establishment on the basis of "arm's length principle".

EXERCISE

Question 1

Cosmos Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2019. The Indian branch has filed return of income for assessment year 2020-21 disclosing income of ₹ 50 lacs. It paid tax at the rate applicable to domestic company i.e. 30% plus higher education cess@4% on the basis of paragraph 2 of Article 24 (Non-Discrimination) of the Double Taxation Avoidance Agreement between India and Mauritius, which reads as follows:

"The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances."

However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a foreign company i.e. 40% plus higher education cess@4%.

Is the action of the Assessing Officer in accordance with law?

Answer

Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to the assessee. Thus, in view of paragraph 2 of Article 24 (Non-discrimination of the DTAA, it appears that the Indian branch of Cosmos Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).

However, *Explanation 1* to section 90 clarifies that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this *Explanation*, the action of the Assessing Officer in levying tax@40% on the Indian branch of Cosmos Ltd. is in accordance with law.

Question 2

Kalpesh Kumar, a resident individual, is a musician deriving income of ₹ 7,50,000 from concerts performed outside India. Tax of ₹ 1,00,000 was deducted at source in the country where the concerts were performed. India does not have any double tax avoidance agreement with that country. His income in India amounted to ₹ 30,00,000. Compute tax liability of Kalpesh Kumar for the assessment year 2020-21 assuming he has deposited ₹ 1,50,000 in Public Provident Fund and *paid medical insurance premium in respect of his father, resident in India, aged 65 years, ₹ 52,000.*

Answer

Computation of tax liability of Mr. Kalpesh for A.Y.2020-21

Particulars	₹	₹
Indian Income		30,00,000
Foreign Income		7,50,000
Gross Total Income		**37,50,000**
Less: **Deduction under section 80C**		
PPF Contribution	1,50,000	
Deduction under section 80D		
Medical insurance premium of father, being a resident senior citizen, restricted to	50,000	2,00,000
Total Income		**35,50,000**
Tax on total income		8,77,500
Add: Health and Education cess @4%		35,100
		9,12,600
Average rate of tax in India [i.e., ₹ 9,12,600 /₹ 35,50,000 x 100]	25.71%	
Average rate of tax in foreign country [i.e. ₹ 1,00,000/ ₹ 7,50,000 x 100]	13.333%	
Doubly taxed income	7,50,000	
Deduction under section 91 on ₹ 7,50,000 @13.33% (lower of average Indian tax rate and foreign tax rate]		1,00,000
Tax payable in India [₹ 9,12,600 – ₹ 1,00,000]		**8,12,600**

Note: An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-

(a) The assessee is a resident in India during the relevant previous year.

(b) The income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, Kalpesh Kumar is eligible for deduction under section 91 since all the above conditions are fulfilled.

Question 3

The following are the particulars of income earned by Miss Vivitha, a resident Indian aged 25, for the assessment year 2020-21:

	(₹ In lacs)
Income from playing snooker matches in country L	*12.00*
Tax paid in country L	*1.80*
Income from playing snooker tournaments in India	*19.20*
Life Insurance Premium paid	*1.10*
Medical Insurance Premium paid for her father aged 62 years (paid through credit card)	*0.54*

Compute her total income and tax liability for the assessment year 2020-21. There is no Double Taxation Avoidance Agreement between India and country L.

Answer

Computation of total income and tax liability of Miss Vivitha for the A.Y. 2020-21

Particulars	₹	₹
Indian Income [Income from playing snooker tournaments in India]		19,20,000
Foreign Income [Income from playing snooker matches in country L]		12,00,000
Gross Total Income		**31,20,000**
Less: Deduction under Chapter VIA		
Deduction under section 80C		
Life insurance premium of ₹ 1,10,000 paid during the previous year deduction, is within the overall limit of ₹ 1.5 lakh. Hence, fully allowable as deduction	1,10,000	
Deduction under section 80D		
Medical insurance premium of ₹ 54,000 paid for her father aged 62 years. Since her father is a senior citizen, the deduction is allowable to a maximum of ₹ 50,000 (assuming that her father is also a resident in India). Further, deduction is allowable where payment is made by any mode other than cash. Here payment is made by credit card hence, eligible for deduction.	50,000	1,60,000
Total Income		**29,60,000**
Tax on Total Income		
Income-tax		7,00,500
Add: Health and education cess @4%		28,020
		7,28,520

Average rate of tax in India	24.61%	
(i.e. ₹ 7,28,520/₹ 29,60,000 × 100)		
Average rate of tax in foreign country	15.00%	
(i.e. ₹ 1,80,000/ ₹12,00,000 ×100)		
Deduction under section 91 on ₹ 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)		1,80,000
Tax payable in India (₹ 7,28,520 – ₹ 1,80,000)		**5,48,520**

Note: Miss Vivitha shall be allowed deduction under section 91, since the following conditions are fulfilled:-

(a) She is a resident in India during the relevant previous year.

(b) The income accrues or arises to her outside India during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign country L in her hands and she has paid tax on such income in the foreign country L.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and country L where the income has accrued or arisen.

Question 4

The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Examine the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreements (DTAA).

Answer

Double Taxation Avoidance Agreements (DTAAs) generally contain an Article providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment in the country of source, and such income can be attributed to the permanent establishment.

As per section 92F(iiia), the term “Permanent Establishment” includes a fixed place of business through which the business of an enterprise is wholly or partly carried on.

As per this definition, to constitute a permanent establishment, there must be a place of business which is fixed and the business of the enterprise must be carried out wholly or partly through this place.

Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs however provide that business income is taxable only if there is a permanent establishment in India.

Therefore, in cases covered by DTAAs, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i).

However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

Question 5

An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists, asks you to examine whether the credit for the tax paid on the foreign income will be allowed against his income-tax liability in India.

Answer

The assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, section 91 specifies that if a person resident in India has paid tax in any country with which no agreement under section 90 exists, then, for the purpose of relief or avoidance of double taxation, **a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such foreign country, whichever is lower, or at the Indian rate of tax, if both the rates are equal.** Accordingly, the assessee shall not be given any credit of the tax paid on the income in other country, but shall be allowed a deduction from the Indian income-tax payable by him as per the scheme of section 91 read with Rule 128 on Foreign Tax Credit.

Question 6

The Income-tax Act, 1961 provides for taxation of a certain income earned in India by Mr. X, a non-resident. The Double Taxation Avoidance Agreement, which applies to Mr. X provides for taxation of such income in the country of residence. Is Mr. X liable to pay tax on such income earned by him in India? Examine.

Answer

Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement with a country outside India, then **in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee.** This means that where tax liability is imposed by the Act, the Double Taxation Avoidance Agreement may be resorted to for reducing or avoiding the tax liability.

However, as per section 90(4), the assessee, in order to claim relief under the agreement, has to obtain a certificate [Tax Residence Certificate (TRC)] from the Government of that country, declaring the residence of the country outside India. Further, he also has to provide the following information in Form No. 10F:

(i) Status (individual, company, firm etc.) of the assessee;

(ii) PAN of the assessee, if allotted;

(iii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);

(iv) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident;

(v) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and

(vi) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (v) above, is applicable.

However, the assessee may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in section 90(4) or section 90A(4).

The Supreme Court has held, in *CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654,* that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act, 1961. Mr. X is, therefore, not liable to pay tax on the income earned by him in India provided he submits the Tax Residence Certificate obtained from the government of the other country, and provides such other documents and information as may be prescribed.

Question 7

Arif is a resident of both India and another foreign country in the previous year 2019-20. He owns immovable properties (including residential house) in both the countries. He earned income of ₹ 50 lacs from rubber estates in the foreign country during the financial year 2019-20. He also sold some house property situated in foreign country resulting in short-term capital gain of ₹ 10 lacs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of ₹ 6 lacs from property let out in India and he has a house in Lucknow where he stays during his visit to India.

Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Arif is a resident, provides that "where an individual is a resident of both the Contracting States, then, he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)".

You are required to examine with reasons whether the business income of Arif arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India.

Answer

Section 90(1) of the Income-tax Act, 1961 empowers the Central Government to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

Arif has residential houses both in India and foreign country. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with foreign country provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

Arif owns rubber estates in a foreign country from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore his personal and economic relations with foreign country are closer, since foreign country is the place where –

(a) the property is located and

(b) the permanent establishment (PE) has been set-up

Therefore, he shall be deemed to be resident of the foreign country for A.Y. 2020-21.

The fact of the case and issues arising therefrom are similar to that of *CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654*, where the Supreme Court held that if an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

However, as per section 90(4), in order to claim relief under the agreement, Arif has to obtain a certificate [Tax Residency Certificate (TRC)] declaring his residence of the country outside India from the Government of that country. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, Arif is not liable to income tax in India for assessment year 2020-21 in respect of business income and capital gains arising in the foreign country provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

Question 8

Mr. Kamesh, an individual resident in India aged 52 years, furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year 2019-20. India has not entered into double taxation avoidance agreement with these two countries.

Particulars	*₹*
Income from profession carried on in India	*7,50,000*
Agricultural income in Country "X" (gross)	*50,000*
Dividend received from a company incorporated in Country "Y" (gross)	*1,50,000*
Royalty income from a literary book from Country "X" (gross)	*6,00,000*
Expenses incurred for earning royalty	*50,000*
Business loss in Country "Y" (Proprietary business)	*65,000*
Rent from a house situated in Country "Y" (gross)	*2,40,000*
Municipal tax paid in respect of the above house in Country "Y" (not allowed as deduction in country "Y")	*10,000*

***Note:** Business loss in Country "Y" not eligible for set off against other incomes as per law of that country.*

The rates of tax in Country "X" and Country "Y" are 10% and 20%, respectively.

Compute total income and tax payable by Mr. Kamesh in India for Assessment Year 2020-21.

Answer

Computation of total income of Mr. Kamesh for A.Y.2020-21

Particulars	₹	₹
Income from House Property [House situated in country Y]		
Gross Annual Value[1]	2,40,000	
Less: Municipal taxes	10,000	
Net Annual Value	2,30,000	
Less: Deduction under section 24 – 30% of NAV	69,000	
		1,61,000
Profits and Gains of Business or Profession		
Income from profession carried on in India	7,50,000	
Royalty income from a literary book from Country X (after deducting expenses of ₹ 50,000)	5,50,000	
Less: Business loss in country Y set-off[2]	65,000	
		12,35,000

[1] Rental Income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.

[2] As per section 70(1), inter-source set-off of income is permitted.

Income from Other Sources		
Agricultural income in country X	50,000	
Dividend received from a company in country Y	1,50,000	2,00,000
Gross Total Income		**15,96,000**
***Less:* Deduction under Chapter VIA**		
Under section 80QQB – Royalty income of a resident from literary work[3]		3,00,000
Total Income		**12,96,000**

Computation of tax liability of Mr. Kamesh for A.Y.2020-21

Particulars	₹
Tax on total income [30% of ₹ 2,96,000 + ₹ 1,12,500]	2,01,300
Add: Health and Education cess@4%	8,052
	2,09,352
Less: Deduction under section 91 **(See Working Note below)**	69,739
Tax Payable	**1,39,613**
Tax payable (rounded off)	1,39,610

Working Note: Calculation of Rebate under section 91

	₹	₹
Average rate of tax in India [i.e., ₹ 2,09,352 / ₹ 12,96,000 x 100]	**16.154%**	
Average rate of tax in country X	**10%**	
Doubly taxed income pertaining to country X		
Agricultural Income	50,000	
Royalty Income [₹ 6,00,000 – ₹ 50,000 (Expenses) – ₹ 3,00,000 (deduction under section 80QQB)][4]	2,50,000	
	3,00,000	
Deduction under section 91 on ₹ 3,00,000 @10% [being the lower of average Indian tax rate (16.154%) and foreign tax rate (10%)]		30,000
Average rate of tax in country Y	**20%**	

[3] It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.

[4] Doubly taxed income includes only that part of income which is included in the assessee's total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount – *CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).*

Doubly taxed income pertaining to country Y		
Income from house property	1,61,000	
Dividend	1,50,000	
	3,11,000	
Less: Business loss set-off	65,000	
	2,46,000	
Deduction u/s 91 on ₹ 2,46,000 @16.154% (being the lower of average Indian tax rate (16.154%) and foreign tax rate (20%)]		39,739
Total rebate under section 91 (Country X + Country Y)		**69,739**

Note: Mr. Kamesh shall be allowed deduction u/s 91, since the following conditions are fulfilled:-

(a) He is a resident in India during the relevant previous year (i.e., P.Y.2019-20).

(b) The income in question accrues or arises to him outside India in foreign countries X and Y during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign countries X and Y in his hands and it is presumed that he has paid tax on such income in those countries.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Countries X and Y where the income has accrued or arisen.

CHAPTER 4

ADVANCE RULINGS

LEARNING OUTCOMES

After studying this Chapter, you will be able to–

❑ **comprehend** the meaning and scope of the term “advance ruling” and the need for obtaining advance ruling;

❑ **appreciate** the constitution of Authority for Advance Rulings;

❑ **appreciate** the procedure for making an application to the Authority for Advance Rulings and the procedure to be followed by the Authority on receipt of application;

❑ **appreciate** the restricted binding nature of an Advance Ruling;

❑ **know** the circumstances when an advance ruling can be declared void.

4.1 INTRODUCTION

Chapter XIX-B, consisting of sections 245N to 245V provides a scheme for giving advance rulings in respect of transactions involving non-residents and specified residents with a view to avoiding needless litigation and promoting better tax-payer relations.

4.2 DEFINITIONS

(1) **Advance Ruling [Section 245N(a)]:** The meaning of Advance Ruling is detailed hereunder:

Section	Determination by the Authority
245N(a)(i)	in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant.
245N(a)(ii)	in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident and such determination shall include the determination of any question of law or of fact specified in the application.
245N(a)(iia)	in relation to the tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant and such determination shall include the determination of any question of law or of fact specified in the application.
245N(a)(iii)	in respect of an issue relating to computation of total income which is pending before any Income-tax Authority or the Appellate Tribunal and such determination or decision shall include the determination or decision of any question of law or fact in relation to such computation of total income specified in the application.
245N(a)(iv)	or decision whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

(2) **Applicant [Section 245N(b)(A)]:** 'Applicant' means any person who –

(i) is a non-resident referred to in section 245N(a)(i) above; or

(ii) is a resident referred to in section 245N(a)(ii) above; or

(iii) is a resident referred to in section 245N(a)(iia) above falling within any such class or category of persons as the Central Government may, by notification in the Official Gazette, specify.

[A resident in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or is proposed to be undertaken would be an applicant – Notification No.73/2014 dated 28.11.2014]; or

(iv) is a resident falling within such class or category of persons as the Central Government may, by notification in the Official Gazette, specify in this behalf *[Public sector company as defined under section 2(36A) of the Income-tax Act, 1961 – Notification No. 725(E) dated 3.8.2000]*; or

(v) is referred to in section 245N(a)(iv) above; and

who makes an application for advance ruling under section 245Q(1).

On account of the merger of Authority for Advance Rulings for income-tax, central excise, customs duty and service tax, the definition of applicant would now also include an applicant defined under the Central Excise Act, 1944, Customs Act, 1962 and the Finance Act, 1994[1].

Who can be an applicant in relation to different clauses of section 245N(a) defining advance ruling?

S. No.	Applicant u/s 245N(b)	Advance Ruling u/s 245N(a) means determination by the AAR in relation to
(i)	Non-resident (NR)	A transaction which has been undertaken or is proposed to be undertaken by him.
(ii)	Resident	The tax liability of a NR arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such NR and such determination shall include the determination of any question of law or of fact specified in the application.
(iii)	Resident of class or category of persons notified by Central Government	The tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant and such determination shall include the determination of any question of law or of fact specified in the application.
	Note: *The Central Government notified a resident, in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total.*	
(iv)	Resident of class or category of persons notified by Central Government	an issue relating to computation of total income which is pending before any Income-tax Authority or the Appellate Tribunal and such determination or decision shall include the determination or decision of any question of law or fact in relation to such computation of total income specified in the application.
	Note: *A public sector undertaking has been notified by the Central Government.*	
(v)	Resident or NR	whether an arrangement, which is proposed to be undertaken by any person being a resident or a NR, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

[1] No amendment has been made in pursuance of GST being effective from 01.07.2017

Restrictions on Appellate Authority: Section 245RR provides that where a resident applicant has made an application to AAR in respect of an issue for decision of AAR, then, any Income-tax Authority or Tribunal shall not take any decision in respect of such issues. In other words, a resident assessee cannot pursue both the remedies, i.e. an appeal or revision before Income-tax Authority/Appellate Authority as well as an application for Advance Ruling to AAR, in respect of an issue.

4.3 AUTHORITY FOR ADVANCE RULINGS [SECTION 245-O]

The Authority for Advance Rulings shall be constituted by the Central Government.

Particulars	Provisions
Composition of AAR	AAR to consist of a Chairman and such number of Vice Chairmen, revenue Members and law Members as the Central Government may, by notification, appoint. **Qualifications for appointment**: (a) **Chairman –** a person who has been a judge of the Supreme Court or the Chief Justice of a High Court or for at least seven years a judge of a High Court; (b) **Vice Chairman –** a person who has been a Judge of a High Court; (c) **A Revenue Member from the Indian Revenue Service** – a person who is, or is qualified to be, a Member of the Board on the date of occurrence of vacancy; (d) **A Revenue Member from the Indian Customs and Central Excise Service** – a person who is, or is qualified to be a Member of the Central Board of Excise and Customs on the date of occurrence of vacancy. (e) **A law Member from the Indian legal service** – a person who is, or is qualified to be, an Additional Secretary to the Government of India ('GOI') on the date of occurrence of vacancy. ***Note** – The above qualifications are relevant for appointments made before 26.5.2017. Appointments made on or after 26.5.2017 shall be governed by section 184 of the Finance Act, 2017 **[Refer para 4.4 below]***
Terms & Conditions	The terms and conditions of service and the salaries and allowances payable to the Members shall be such as may be prescribed. ***Note** – The terms and conditions in respect of appointments made on or after 26.5.2017 shall be governed by section 184 of the Finance Act, 2017 **[Refer para 4.4 below]***

Officers & Employees	The Central Government shall provide to the Authority with such officers and employees, as may be necessary, for the efficient discharge of the functions of the Authority under the Act.
Location of AAR and benches	The Authority shall be located in the National Capital Territory of Delhi and its benches shall be located at places as notified by the Central Government.
Constitution of Benches	The powers and functions of the AAR may be discharged by its Benches as may be constituted by the Chairman from amongst its Members thereof.
Composition of Benches	A Bench shall consist of the Chairman or the Vice-Chairman and one revenue and one law Member. However, where the **Authority is dealing** with an application seeking advance ruling in **any matter relating to the Income-tax Act**, the **revenue member** of the Bench shall be such **Member from the Indian Revenue Service**, who is, or is qualified to be, a member of the Board.
Any vacancy in the office of the Chairman by reason of his death, resignation or otherwise	The senior-most Vice Chairman shall act as the Chairman until the date on which a new Chairman, appointed in accordance with the provisions of the Act to fill such vacancy, enters upon his office
In case the Chairman is unable to discharge his functions owing to absence, illness or other cause	The senior-most Vice Chairman shall discharge the functions of the Chairman until the date on which the Chairman resumes his duties.

4.4 QUALIFICATIONS, TERMS AND CONDITIONS OF SERVICE OF CHAIRMAN, VICE CHAIRMAN AND MEMBERS [SECTION 245-OA]

The qualifications, appointment, term of office, salaries and allowances, resignation, removal and the other terms and conditions of service of the Chairman, Vice-Chairman and other Members of the Authority appointed on or after 26.05.2017, being the date on which the provisions of Part XIV of Chapter VI of the Finance Act, 2017 came into force, shall be governed by the provisions of section 184 of Finance Act 2017.

However, the Chairman, Vice-Chairman and Member appointed before 26.05.2017 shall continue to be governed by the provisions of the Act and the rules made thereunder as if the provisions of section 184 of the Finance Act, 2017 had not come into force.

Section 184 of Finance Act, 2017

(1) **Power to Central Government to make rules:** The Central Government may, by notification, make rules to provide for qualifications, appointment, term of office, salaries and allowances, resignation, removal and the other terms and conditions of service of the Chairman, Vice-Chairman or Member of the Authority.

(2) **Term of Chairman, Vice-Chairman or Member of the Authority:** The Chairman, Vice-Chairman or Member of the Authority shall hold office for such term as specified in the rules made by the Central Government but not exceeding 5 years from the date on which he enters upon his office and shall be eligible for reappointment.

(3) **Age Criteria of Chairman, Vice-Chairman or Member of the Authority:** No Chairman, Vice-Chairman or Member of the Authority shall hold office as such after he has attained such age as specified in the rules made by the Central Government which shall not exceed -

In case of	*Age*
Chairman	*seventy years*
Vice-Chairman or any other Member	*sixty-seven years*

Accordingly, the Central Government had notified "Tribunal, Appellate Tribunal and other Authorities (Qualifications, Experience and other Conditions of Service of Members) Rules, 2017", to specify the qualifications, appointment, term of office, salaries and allowances, resignation, removal and the other terms and conditions of service of the Chairman, Vice-Chairman and other Members of the Authority. Qualifications and term of office of the Chairman, Vice-Chairman and other Members of the Authority is as follows:

Particulars	*Provisions*
Qualifications for appointment	(a) ***Chairman*** *– a person who* - *is or has been or is qualified to be a judge of the Supreme Court or* - *is or has been a Chief Justice of a High Court or* - *has, for at least 7 years, been a Judge of a High Court or* - *has, for at least 3 years, been a Vice-Chairman, Revenue Member or Law Member of the Authority for Advance Ruling or* - *is a person of ability, integrity and standing, and having special knowledge of, and professional experience of not less than 25 years in economics, business, commerce, law, finance, accountancy, management, industry, public affairs, administration,*

<table>
<tr><td></td><td><i>taxation or any other matter which in the opinion of the Central Government is useful to the Authority.</i>
(b) <i>Vice Chairman</i> <i>– a person who is, or has been, or is qualified to be, a Judge of a High Court;</i>
(c) <i>Revenue Member</i>
- <i>from the Indian Revenue Service is qualified to be a Member of the Central Board of Direct Taxes Board and</i>
- <i>an officer of the Indian Customs and Central Excise Service, who is qualified to be a Member of the Central Board of Excise and Customs.</i>
(d) <i>A law Member from the Indian legal service</i> <i>– a person who is an Additional Secretary to the Government of India (‘GOI’).</i></td></tr>
<tr><td><i>Term of Chairman, Vice-Chairman or Member of the Authority</i></td><td><i>The Chairman, Vice-Chairman or Member of the Authority shall hold office for a term of three years.</i></td></tr>
<tr><td><i>Age Criteria of Chairman, Vice-Chairman or Member of the Authority</i></td><td><table>
<tr><th><i>In case of</i></th><th><i>Age</i></th></tr>
<tr><td><i>Chairman</i></td><td><i>70 years</i></td></tr>
<tr><td><i>Vice-Chairman</i></td><td><i>65 years</i></td></tr>
<tr><td><i>Member</i></td><td><i>62 years</i></td></tr>
</table></td></tr>
</table>

4.5 VACANCIES, ETC., NOT TO INVALIDATE PROCEEDINGS [SECTION 245P]

No proceeding before, or pronouncement of advance ruling by, the Authority shall be questioned or shall be invalid on the ground merely of the existence of any vacancy or defect in the constitution of the Authority.

4.6 APPLICATION FOR ADVANCE RULING [SECTION 245Q]

Section 245Q(1) provides that an applicant desirous of obtaining an advance ruling may make an application stating the question on which the advance ruling is sought in the prescribed form and in the prescribed manner.

As per section 245Q(2), the application shall be made in quadruplicate and be accompanied by a fee of ₹ 10,000 or such fee as may be prescribed, whichever is higher.

Rule 44E prescribes the fees mentioned in column (3) to be paid by the applicant mentioned in column (1) in the cases of column (2).

Category of applicant	Category of case	Fee
(1)	(2)	(3)
An applicant referred to in sub-clauses (i) or (ii) or (iia) of clause (b) of section 245N	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought does not exceed ₹ 100 crore.	₹ 2 lacs
	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought exceeds ₹ 100 crore but does not exceed ₹ 300 crore.	₹ 5 lacs
	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought exceeds ₹ 300 crore.	₹ 10 lacs
Any other applicant	In all cases	₹ 10000

Rule 44E prescribes the form of application for obtaining an advance ruling. Every application under Rule 44E shall be accompanied by the proof of payment of fees.

Section 245Q(3) provides that an applicant may withdraw an application within 30 days from the date of the application.

4.7 PROCEDURE ON RECEIPT OF APPLICATION [SECTION 245R]

The Authority on receipt of an application will send a copy to the Principal Commissioner or Commissioner concerned and wherever considered necessary, also call upon the Principal Commissioner or Commissioner to furnish relevant records. Such records will be returned to the Principal Commissioner or Commissioner as soon as possible.

The Authority may either allow or reject an application. However, the Authority **shall not allow** an application where the question raised in the application is:

Pending with income-tax authorities/ tribunal/court	is already pending before any income-tax authority, or Appellate Tribunal or any court. However, a resident falling within any class or category of persons as notified by the Central Government i.e., a public sector undertaking can seek for advance ruling even if question raised is pending before any income-tax authority or Appellate.

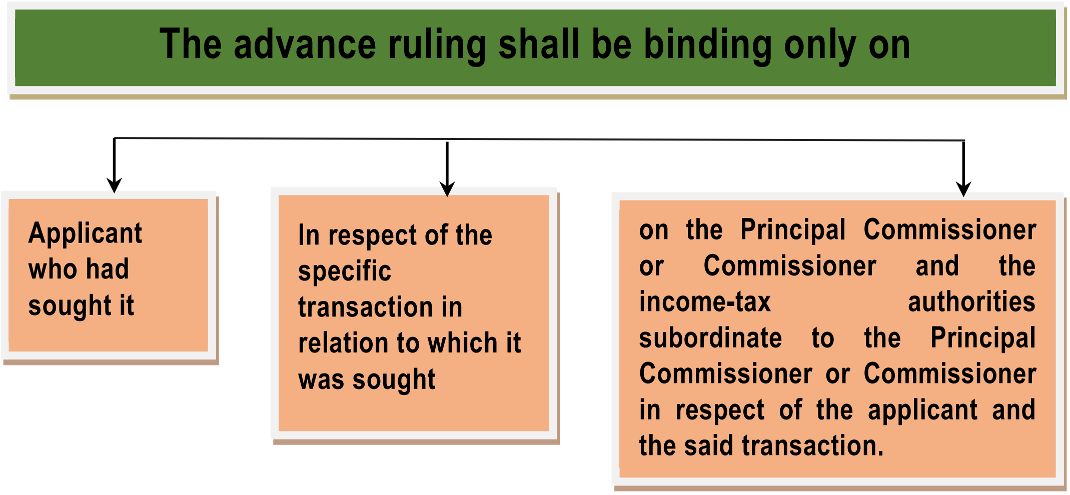
Determination of Fair Market Value	involves the determination of the fair market value of any property;
Transaction designed for avoidance of income-tax	relates to a transaction or issue which is designed *prima facie* for avoidance of income-tax (except in case of a resident applicant falling within any class or category of persons as notified by the Central Government i.e., a public sector undertaking or in the case of resident or a non-resident for determination of whether an arrangement, which is proposed to be undertaken is an impermissible avoidance arrangement).

However, no application shall be rejected unless an opportunity has been given to the applicant of being heard. Further, where an application is rejected, the reason for rejection shall be given in the order. A copy of every order shall be sent to the applicant and to the PCIT/CIT.

Where an application is allowed, the Authority would pronounce its advance ruling on that question specified in the application, after examining such further material as may be placed before it by the applicant or obtained by the Authority.

An applicant on request can appear either in person or can be represented through a duly authorised representative. The authority will pronounce the advance ruling **within 6 months** from the receipt of application by the authority and the copy of advance ruling pronounced, duly signed by the Members and certified, shall be sent to the applicant and to the PCIT/CIT.

4.8 APPLICABILITY OF ADVANCE RULING [SECTION 245S]



The advance ruling shall be binding only on

Applicant who had sought it

In respect of the specific transaction in relation to which it was sought

on the Principal Commissioner or Commissioner and the income-tax authorities subordinate to the Principal Commissioner or Commissioner in respect of the applicant and the said transaction.

The advance ruling will continue to remain in force unless there is a change either in law or in fact on the basis of which the advance ruling was pronounced.

4.9 ADVANCE RULING TO BE VOID IN CERTAIN CIRCUMSTANCES [SECTION 245T]

Where the Authority finds, on a representation made to it by the PCIT/CIT or otherwise, that an advance ruling has been obtained by the applicant by fraud or misrepresentation of facts, the Authority may, by order, declare such ruling to be *void ab initio.* The provisions of the Act shall apply (excluding the period beginning with the date of such advance ruling and ending with the date of order under this section) to the applicant as if such advance ruling had never been made. A copy of this order shall be sent to the applicant and the Principal Commissioner or Commissioner.

4.10 POWERS OF THE AUTHORITY [SECTION 245U]

The Authority shall have all the powers of the Civil Court in respect of discovery and inspection, enforcing the attendance of any person, including any officer of a banking company and examining on oath, issuing commissions and compelling the production of books of accounts and other documents. The Authority shall be deemed to be a Civil Court for the purposes of section 195 of the Code of Criminal Procedure, 1973 which provides for prosecution for contempt of lawful authority of public servants, for offences against public justice. Every proceeding before the Authority shall be deemed to be a judicial proceeding under the Indian Penal Code.

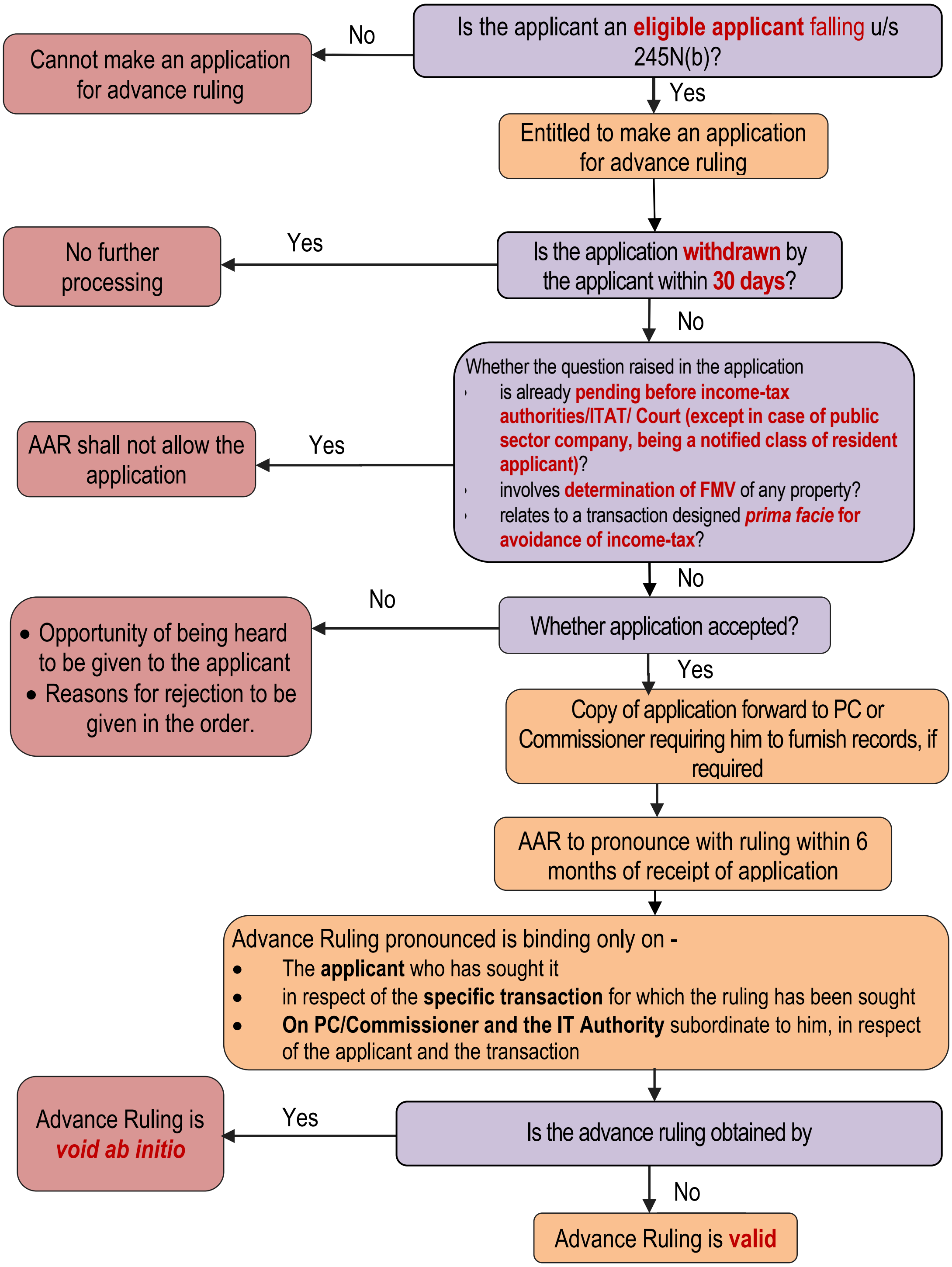
However, the Authority shall not be deemed to a Civil Court for the purpose of Chapter XXVI of the Code of Criminal Procedure, 1973 containing the provisions as to offences affecting the administration of justice.

4.11 PROCEDURE OF AUTHORITY [SECTION 245V]

The Authority shall, subject to the provisions of this Chapter, have power to regulate its own procedure in all matters arising out of the exercise of its powers under the Act.

For ease of reference, the process of application for Advance Ruling is explained below in a summarized form:

Overview of Advance Ruling Procedure



Is the applicant an **eligible applicant** falling u/s 245N(b)?

No → Cannot make an application for advance ruling

Yes → Entitled to make an application for advance ruling

Is the application **withdrawn** by the applicant within **30 days**?

Yes → No further processing

No → Whether the question raised in the application

- is already **pending before income-tax authorities/ITAT/ Court (except in case of public sector company, being a notified class of resident applicant)**?
- involves **determination of FMV** of any property?
- relates to a transaction designed ***prima facie* for avoidance of income-tax**?

Yes → AAR shall not allow the application

No → Whether application accepted?

No →

- Opportunity of being heard to be given to the applicant
- Reasons for rejection to be given in the order.

Yes → Copy of application forward to PC or Commissioner requiring him to furnish records, if required

AAR to pronounce with ruling within 6 months of receipt of application

Advance Ruling pronounced is binding only on -

- The **applicant** who has sought it
- in respect of the **specific transaction** for which the ruling has been sought
- **On PC/Commissioner and the IT Authority** subordinate to him, in respect of the applicant and the transaction

Is the advance ruling obtained by

Yes → Advance Ruling is ***void ab initio***

No → Advance Ruling is **valid**

EXERCISE

Question 1

Examine whether a person resident in India can seek advance ruling from the Authority for Advance Ruling.

Answer

A resident can make an application to the Authority for Advance Ruling to seek an advance ruling in the following cases:

(i) Section 245N(b)(A)(III) enables a resident referred in section 245N(a)(iia) falling within any such class or category of persons as may be notified by the Central Government to make an application to Authority for Advance Rulings. Such notified resident applicant can seek ruling in relation to his tax liability arising out of a transaction which has been undertaken or is proposed to be undertaken by **such applicant**, and such determination shall include the determination of any question of law or of fact specified in the application.

A resident in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(ii) Section 245N(b)(A)(IV) enables a resident falling within any such class or category of persons as may be notified by the Central Government to make an application for Advance Ruling. Such notified resident applicant can seek ruling in respect of issues relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal. Such a resident applicant can make an application to seek determination or decision by the AAR on a question of law or a question of fact relating to such computation of total income specified in the application.

"Public sector companies" as defined in section 2(36A) of the Income-tax Act, 1961 have been notified as applicant for this purpose.

(iii) A resident can also make an application seeking advance ruling in relation to the tax liability of a non-resident arising out of a transaction undertaken or proposed to be undertaken by him with such non-resident.

(iv) A resident can make an application seeking advance ruling on whether an arrangement proposed to be undertaken by him is an impermissible avoidance arrangement under Chapter X-A.

Question 2

Q, a non-resident, made an application to the Authority for Advance Rulings on 2.7.2019 in relation to a transaction proposed to be undertaken by him. On 31.8.2019, he decides to withdraw the said application. Can he withdraw the application on 31.8.2019?

Answer

Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since more than 30 days have elapsed since the date of application by Q to the Authority for Advance Rulings, he cannot withdraw the application.

However, the Authority for Advance Rulings (AAR*),* in *M.K.Jain AAR No.644 of 2004*, has observed that though section 245Q(3) provides that an application may be withdrawn by the applicant within 30 days from the date of the application, this, however, does not preclude the AAR from permitting withdrawal of the application after the said period, if the circumstances of the case so justify.

Question 3

Examine when can an advance ruling pronounced by the Authority for Advance Rulings be declared void. What is the consequence?

Answer

As per section 245T, an advance ruling can be declared to be *void ab initio* by the Authority for Advance Rulings if, on a representation made to it by the Principal Commissioner or Commissioner or otherwise, it finds that the ruling has been obtained by fraud or misrepresentation of facts. Thereafter, all the provisions of the Act will apply as if no such advance ruling has been made. A copy of such order shall be sent to the applicant and the Principal Commissioner or Commissioner.

Question 4

Mr. Balram is a non-resident. The appeal pertaining to the assessment year 2018-19 is pending before the Income-tax Appellate Tribunal, the issue involved being computation of export profit and tax thereon. The same issue persists for the assessment year 2019-20 as well. Mr. Balram's brother Mr. Krishna has obtained an advance ruling under Chapter XIX - B of Income-tax Act, 1961 from the Authority for Advance Rulings on an identical issue. Mr. Balram proposes to use the said ruling for his assessment pertaining to the assessment year 2019-20. Can he do so?

Answer

As per section 245S(1), the advance ruling pronounced under section 245R by the Authority for Advance Rulings shall be binding only on the applicant who had sought it and in respect of the specific transaction in relation to which advance ruling was sought. It shall also be binding on the Principal Commissioner/Commissioner and the income-tax authorities subordinate to him, in respect of the concerned applicant and the specific transaction.

In view of the above provision, Mr. Balram cannot use the advance ruling, obtained on an identical issue by his brother, for his assessment pertaining to the assessment year 2019-20.

Note – *Though the ruling of the Authority for Advance Rulings is not binding on others but there* *is no bar on the Tribunal taking a view or forming an opinion in consonance with the reasoning of the Authority for Advance Rulings dehors the binding nature [CIT v. P. Sekar Trust (2010) 321 ITR 305 (Mad.)].*

Question 5

The Authority for Advance Rulings has the powers of compelling the production of books of account – Examine the correctness or otherwise of this statement.

Answer

The statement is correct.

Under section 245U, the Authority for Advance Rulings shall have all the powers vested in the Civil Court under the Code of Civil Procedure, 1908 as are referred to in section 131.

Accordingly, the Authority for Advance Rulings shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely -

(1) discovery and inspection;

(2) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;

(3) compelling the production of books of account and other documents; and

(4) issuing commissions.

Therefore, the Authority for Advance Ruling has the powers of compelling the production of books of account.

Question 6

The term 'Advance Ruling' includes within its scope, a determination by the Authority for Advance Rulings only in relation to a transaction undertaken by a non-resident applicant. Examine the correctness of this statement, with reference to the provisions of the Income-tax Act 1961.

Answer

The statement is not correct.

The term 'Advance Ruling' has been defined in section 245N(a) to mean:-

(a) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a **non-resident applicant**; or

(b) a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken **by a resident applicant with such non-resident**; and such determination shall include the determination of any question of law or of fact specified in the application or

(c) a determination by the Authority in relation to the tax liability of a **resident applicant**, arising out of a transaction which has been undertaken or is proposed to be undertaken by **such applicant**, and such determination shall include the determination of any question of law or of fact specified in the application

A resident in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(d) a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision on any question of law or of fact relating to such computation of total income specified in the application.

(e) a determination or decision by the Authority whether an arrangement, which is proposed to be undertaken by **any person being a resident** or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

Question 7

An Irish company, Phi plc., entered into a contract with an Indian company, Beta Ltd., for provision of technical know-how and made an application to the Authority for Advance Rulings for advance ruling on the rate of withholding tax on receipts from Beta Ltd. Beta Ltd. had also made an application to the Assessing Officer for determination of the rate at which tax is deductible on the said payment to Phi plc. The Authority for Advance Rulings rejected the application of Phi plc. on the ground that the question raised in the application is already pending before an income tax authority. Is the rejection of the application of Phi plc. justified in law?

Answer

This issue came up before the AAR in, *Nuclear Power Corporation of India Ltd. In Re, [2012] 343 ITR 220*, wherein it was held that an advance ruling is not only applicant specific, but is also transaction specific. The advance ruling is on a transaction entered into or undertaken by the applicant. That is why section 245S specifies that a ruling is binding on the applicant, **the transaction** and the Principal Commissioner or Commissioner of Income-tax and those subordinate to him, and not only on the applicant.

What is barred by the first proviso to section 245R(2) of the Act in the context of clause (i) thereof is the allowing of an application under section 245R(2) of the Act where "the question raised in the application is already pending before any Income-tax authority, or Appellate Tribunal or any court". The significance of the dropping of the words, "in the applicant's case" with effect from June 1, 2000, cannot be wholly ignored.

On the basis of this view expressed by the AAR in the above case, explaining the impact of the dropping of the words "in the applicant's case" with effect from 1.6.2000, a view can be taken that the AAR can reject the application made by Phi plc. before the AAR on the ground that similar issue is pending before the Assessing Officer in respect of the same transaction i.e., provision of technical know to Beta Ltd.

Note *– The issue relates to the admission or rejection of the application filed before the Advance Rulings Authority on the grounds specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.*

The first proviso to section 245R(2) has been substituted by the Finance Act, 2000 with effect from 1.6.2000. Clause (i) of the first proviso, prior to and post amendment, reads as follows:

Prior to 1.6.2000	***On or After 1.6.2000***
Provided that the Authority shall not allow the application ***except in the case of a resident applicant*** *where the question raised in the application is already pending* ***in the applicant's case*** *before any income-tax authority, the Appellate Tribunal or any court;*	*Provided that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court.*

The words "except in the case of a resident applicant" and "in the applicant's case" has been removed in clause (i) of the first proviso with effect from 1.6.2000. However, the Explanatory Memorandum to the Finance Act, 2000, explaining the impact of the substitution, reads as follows "It is proposed to substitute the proviso to provide that the Authority shall not allow the application when the question raised is already pending in the applicant's case before any income-tax authority, Appellate Tribunal or any court in regard to a non-resident applicant and resident applicant in relation to a transaction with a non-resident". Therefore, according to the intent expressed in the Explanatory Memorandum, the AAR shall not allow the application both in the case of resident and non-resident applicant if the question raised is already ***pending in the applicant's case*** *before any income-tax authority. Thus, as per the Explanatory Memorandum, it is possible to take a view that even post-amendment, the Authority shall not allow the application only where a question is* ***pending in the applicant's case*** *before any income-tax authority. Thus, an alternative view is possible on the basis of the AAR ruling in Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203, which continues to hold good even after the amendment, if we consider the intent expressed in the Explanatory Memorandum.* ***Accordingly, based on this view, the AAR can allow the application made by Phi plc., even if the question raised in the application is pending before the Assessing Officer in Beta Ltd.'s case****.*

CHAPTER 5

EQUALISATION LEVY

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **appreciate** the issues in taxing e-commerce transactions;
- **comprehend** the OECD recommendations for taxing e-commerce transactions under Action Plan 1 of Base Erosion and Profit Shifting (BEPS) project;
- **appreciate** the need for equalization levy;
- **appreciate** the meaning of "specified services" which are subject to equalisation levy;
- **comprehend and apply** the provisions of equalisation levy contained in Chapter VIII of the Finance Act, 2016 and the relevant Rules in problem solving and addressing related issues.

5.1 GROWTH OF E-COMMERCE AND CONCERNS EMERGING THEREFROM

(1) The rapid growth of information and communication technology has resulted in substantial expansion of the supply and procurement of digital goods and services globally, including India. The digital economy is growing at approximately 10% per annum, significantly faster than the global economy as a whole.

(2) At present, in the digital domain, business may be conducted without regard to national boundaries and may dissolve the link between an income-producing activity and a specific location. Hence, business in digital domain doesn't actually occur in any physical location but instead takes place in "cyberspace." Persons carrying business in digital domain could be located anywhere in the world. Entrepreneurs across the world have been quick to evolve their business to take advantage of these changes. It has also made it possible for the businesses to conduct themselves in ways that did not exist earlier, and given rise to new business models that rely more on digital and telecommunication network, do not require physical presence, and derives substantial value from data collected and transmitted from such networks.

5.2 TAXATION ISSUES RELATING TO E-COMMERCE

These new business models have created new tax challenges. The typical taxation issues relating to e-commerce are:

(1) the difficulty in characterizing the nature of payment and establishing a nexus or link between taxable transaction, activity and a taxing jurisdiction,

(2) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

The digital business, thus, challenges physical presence-based permanent establishment rules. If permanent establishment principles are to remain effective in the new economy, the fundamental PE components developed for the old economy i.e. place of business, location, and permanency must be reconciled with the new digital reality.

5.3 OECD RECOMMENDATIONS UNDER ACTION PLAN 1 OF THE BEPS PROJECT

The OECD has recommended several options to tackle the direct tax challenges which include:

(1) Modifying the existing definition of permanent establishment to provide for whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.

(2) Introducing the concept of a virtual fixed place of business in the concept of permanent establishments i.e., creation of a permanent establishments when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.

(3) Imposition of a final withholding tax on gross basis in case of certain payments made for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having permanent establishment in other contracting state.

Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.

5.4 EQUALISATION LEVY - CHAPTER VIII IN THE FINANCE ACT, 2016

In order to address these challenges, Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having PE in India, from a resident in India who carries out business or profession, or from a non-resident having PE in India.

The CBDT issued a notification dated 27 May, 2016, stating that the provisions of Chapter VIII relating to the equalisation levy would come into effect from 1st June 2016. This Chapter extends to the whole of India except Jammu and Kashmir. It applies in respect of consideration received or receivable for specified services provided on or after 1.6.2016.

The key aspects related to Equalisation Levy have been discussed below.

(1) Meaning of “Equalisation Levy” [Section 164(d) of the Finance Act, 2016]:

Equalisation levy means the tax leviable on consideration received or receivable for any specified service

(2) Meaning of “Specified Service” [Section 164(i) of the Finance Act, 2016]:

(i) Online advertisement;

(ii) Any provision for digital advertising space or any other facility or service for the purpose of online advertisement;

(iii) Any other service as may be notified by the Central Government.

Note – ‘Online’ means a facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network.

(3) Charge of Equalisation Levy [Section 165 of Finance Act, 2016]:

(i) Equalisation levy @6% is leviable on the amount of consideration for specified service received or receivable by a person, being a non-resident from -

(a) a person resident in India and carrying on business or profession; or

(b) a non-resident having a PE in India.

(ii) Equalisation levy is not chargeable, where –

(a) the non-resident providing the specified service has a PE in India and the specified service is effectively connected with such PE;

(b) the aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident from a person resident in India and carrying on business or profession, or from a non-resident having a PE in India, does not exceed ₹ 1 lakh; or

(c) where the payment for the specified service by the person resident in India, or the PE in India is not for the purposes of carrying out business or profession.

(4) Relief to small players in the digital domain:

In order to reduce burden of small players in the digital domain, it is also provided that no such levy shall be made if the aggregate amount of consideration for specified services received or receivable by a non-resident from a person resident in India and carrying on business or profession or from a non-resident having a permanent establishment in India does not exceed ₹ 1 lakh in any previous year.

Further, equalisation levy shall not be charged where the payment for the specified service by the person resident in India or the permanent establishment in India, is not for the purposes of carrying out business or profession.

(5) Provisions of Chapter on Equalisation Levy:

Section	Subject	Provisions
166	**Collection and recovery of equalisation levy**	
	Person responsible for deduction of equalisation levy	Every person, being a resident and carrying on business or profession or a non-resident having a permanent establishment in India shall deduct equalisation levy from the amount paid or payable to a non-resident in respect of the specified service.
	Rate of equalisation levy	6% of the amount of consideration for specified service paid or payable to a non-resident in respect of specified

		service by a person resident in India and carrying on business or profession or a non-resident having a PE in India. The amount of consideration of specified services, equalisation levy, interest and penalty payable and refund shall be **rounded off to the nearest multiple of ten rupees**. [Rule 3 of Equalisation Levy Rules, 2016]
	Threshold limit	Equalisation levy is deductible if the aggregate amount of consideration for specified service in a previous year exceeds **one lakh rupees**.
	Time period for remittance of equalisation levy	The equalisation levy so deducted during any calendar month shall be paid by every assessee to the credit of the Central Government **by the 7th of the month immediately following the said calendar month**. Equalisation levy deducted during any calendar month is to be paid to the credit of the Central Government by remitting it to the Reserve Bank of India or the State Bank of India or any other authorised bank, accompanied by an equalisation levy challan. [Rule 4 of Equalisation Levy Rules, 2016]
	Consequence of failure to deduct equalisation levy	Any assessee who fails to deduct equalisation levy shall, notwithstanding such failure, be liable to pay the levy to the credit of the Central Government by the 7th of the month immediately following the said calendar month. Thus, if the assessee responsible for deducting equalisation levy, fails to so deduct, he has, in any case, to pay such levy to the credit of the Central Government by the 7th of the month immediately following the said calendar month.
167	**Furnishing of statement**	
	Statement in prescribed form within time	Every assessee shall, within the prescribed time after the end of each financial year, prepare and deliver or cause to be delivered to the Assessing Officer or to any other authority or agency authorised by the Board in this behalf, a statement in the prescribed form, verified in the prescribed manner and setting forth the prescribed particulars in respect of all specified services during such financial year. The statement in respect of all specified services chargeable to equalisation levy during any financial year is required to be furnished electronically in **Form No. 1** (verified through either

		a digital signature or an electronic verification code) **on or before 30th June** immediately following that financial year [Rule 5 of Equalisation Levy Rules, 2016]
	Time limit for filing a revised statement	An assessee who has not furnished the statement on or before 30th June immediately following the financial year or having furnished a statement within that time, notices any omission or wrong particulars therein, may furnish a statement or a revised statement, as the case may be. Such statement or revised statement has to be filed at any time **before the expiry of two years from the end of the financial year** in which the specified service was provided.
	Time limit for filing a statement in response to notice issued by the Assessing Officer	Where any assessee fails to furnish the statement within the prescribed time, the Assessing Officer may serve a notice upon such assessee requiring him to furnish the statement in the prescribed form, verified in the prescribed manner and setting forth the prescribed particulars, within such time, as may be prescribed. The Assessing Officer has been empowered to issue notice for furnishing such statement, which then has to be furnished, **within 30 days from date of serving of such notice** [Rule 6 of Equalisation Levy Rules, 2016]
168	**Processing of statement.**	
	Manner of processing of statement	Where a statement has been made under section 167 by the assessee, such statement shall be processed in the following manner, namely:— (a) the equalisation levy shall be computed after making the adjustment for any arithmetical error in the statement; (b) the interest, if any shall be computed on the basis of sum deductible as computed in the statement; (c) the sum payable by, or the amount of refund due to, the assessee shall be determined after adjustment of interest computed against the equalisation levy paid under section 166(2) or interest paid section 170 and any amount paid otherwise by way of tax or interest; (d) an intimation shall be prepared or generated and sent to the assessee specifying the sum determined to be payable by, or the amount of refund due to him; and (e) the amount of refund due to the assessee in pursuance of such determination shall be granted to

		him. However, no such intimation shall be sent after the expiry of **one year from the end of the financial year** in which the statement is furnished.
	Prescribed form for service of notice of demand on the taxpayer	Where any levy, interest or penalty is payable under the equalisation levy provisions, a notice of demand in Form No. 2 specifying the sum so payable shall be served upon the taxpayer. Further, intimation issued upon processing of the statement of specified services shall also be deemed to be a notice of demand. [Rule 7 of Equalisation Levy Rules, 2016]
	Scheme for centralised processing of statements	For the purposes of processing of statements, the CBDT may make a scheme for centralised processing of such statements to expeditiously determine the tax payable by, or the refund due to, the assessee as required thereunder.
169	**Rectification of mistake**	
	Time limit for amending an intimation	With a view to rectifying any mistake apparent from the record, the Assessing Officer may amend any intimation issued under section 168. Such intimation can be amended within **one year from the end of the financial year** in which the intimation sought to be amended was issued.
	Amendment can be made *suo motu* or brought to notice by the assessee	The Assessing Officer may make an amendment to any intimation, either *suo motu* or on any mistake brought to his notice by the assessee.
	Opportunity of being heard to be given by the Assessing Officer before amending an intimation	An amendment to any intimation, which has the effect of increasing the liability of the assessee or reducing a refund, shall not be made unless the Assessing Officer has given notice to the assessee of his intention so to do and has given the assessee a reasonable opportunity of being heard.
		Where any such amendment to any intimation has the effect of enhancing the sum payable or reducing the refund already made, the Assessing Officer shall make an order specifying the sum payable by the assessee and the provisions of this Chapter shall apply accordingly.
170	**Interest on delayed payment of equalisation**	An assessee who fails to credit the equalisation levy or any part thereof within 7th of the month following the calendar month in which it is deducted, to the account of

<table>
<tr><td></td><td>levy</td><td>the Central Government, has to pay simple interest at the rate of 1% of such levy for every month or part of a month by which such crediting of the tax or any part thereof is delayed.</td></tr>
<tr><td>171</td><td>Penalty for failure to deduct or pay equalisation levy.</td><td>
<table>
<tr><th>Nature of default</th><th>Penalty</th></tr>
<tr><td>Failure to deduct whole or part of equalisation levy</td><td>In addition to payment of equalisation levy under section 166(3) and interest under section 170, penalty equal to the amount of equalisation levy that he failed to deduct would be leviable</td></tr>
<tr><td>Failure to remit equalisation levy to the Central Government on or before 7th of the following month, after deduction</td><td>In addition to paying the equalisation levy under section 166(2) and interest under section 170, a penalty of ₹ 1,000 for every day during which the failure continues is leviable.
However, such penalty shall not exceed the amount of equalisation levy that he failed to pay.</td></tr>
</table>
</td></tr>
<tr><td>172</td><td>Penalty for failure to furnish statement</td><td>For failure to furnish the statement within 30th June of the immediately following year or within 30 days from the date of service of notice by the Assessing Officer, penalty of ₹100 for each day during which the failure continues is leviable.</td></tr>
<tr><td>173</td><td>Circumstances when penalty cannot be imposed under section 171 and 172</td><td>No penalty for failure to deduct or pay equalisation levy or failure to furnish statement shall be imposable, if the assessee proves to the satisfaction of the Assessing Officer that there was reasonable cause for the said failure.
Further, no order imposing a penalty under this Chapter shall be made unless the assessee has been given a reasonable opportunity of being heard.</td></tr>
<tr><td>174</td><td>Appeal to Commissioner of Income-tax (Appeals).</td><td></td></tr>
<tr><td></td><td>Time limit for filing of appeal against</td><td>An assessee aggrieved by an order imposing penalty under this Chapter, may appeal to the Commissioner of</td></tr>
</table>

	an order imposing penalty	Income-tax (Appeals) within a period of **30 days from the date of receipt of the order** of the Assessing Officer
	Fee for filing appeal	An appeal shall be in the prescribed form [Form 3] and verified in the prescribed manner. It shall be accompanied by a **fee of ₹1,000**. It may be filed electronically under digital signature or electronically through EVC. Any document accompanying Form No.3 has to be furnished in the manner in which Form No.3 is furnished.[Rule 8 of Equalisation Levy Rules, 2016]
	Provisions of the Income-tax Act, 1961 applicable in case of such appeals	Where an appeal has been filed, the provisions of sections 249 to 251 of the Income-tax Act, 1961 would, as far as may be, apply to such appeal. Section 250 specifies the procedure in appeal and section 251 enlists the powers of the Commissioner (Appeals).
175	**Appeal to Appellate Tribunal**	
	Assessee/CIT may file appeal to Appellate Tribunal against an order passed by Commissioner (Appeals) under section 174	An assessee aggrieved by an order made by the Commissioner of Income-tax (Appeals) under section 174 may appeal to the Appellate Tribunal against such order. The Commissioner of Income-tax may, if he objects to any order passed by the Commissioner of Income-tax (Appeals) under section 174, direct the Assessing Officer to appeal to the Appellate Tribunal against such order.
	Time limit for filing appeal	An appeal shall be filed within **60 days** from the date on which the order sought to be appealed against is received by the assessee or by the Commissioner of Income-tax, as the case may be.
	Fee for filing appeal	The appeal shall be in the prescribed form [Form No.4] and verified in the prescribed manner. In the case of an appeal filed by an assessee, it shall be accompanied by a **fee of ₹1,000**. Also, the form of appeal, the grounds of appeal and the form of verification appended thereto shall be signed by the person specified in Form No.4 [Rule 9 of Equalisation Levy Rules, 2016]
	Provisions of the Income-tax Act, 1961 applicable in case of such appeals	Where an appeal has been filed before the Appellate Tribunal under sub-section (1) or sub-section (2), the provisions of sections 253 to 255 of the Income-tax Act, 1961 would, as far as may be, apply to such appeal.

<table>
<tr><td>176</td><td>Punishment for false statement</td><td>If a person -
(a) <i>makes a false statement in any verification</i> under this Chapter or any rule made thereunder; or
(b) <i>delivers an account or statement, which is false</i>, and which he either knows or believes to be false, or does not believe to be true,
he shall be punishable with imprisonment for a term which may extend to three years and with fine.</td></tr>
<tr><td></td><td></td><td>An offence so punishable shall be deemed to be non-cognizable within the meaning of the Code of Criminal Procedure. This is irrespective of anything contained in the Code of Criminal Procedure, 1973.</td></tr>
<tr><td>177.</td><td>Institution of prosecution</td><td>Prior sanction of the Chief Commissioner of Income-tax is required for instituting prosecution against any person for any offence under section 176.</td></tr>
<tr><td>178.</td><td>Application of certain provisions of Income-tax Act, 1961</td><td>The following provisions of the Income-tax Act, 1961 shall so far as may be, apply in relation to equalisation levy, as they apply in relation to income-tax.
<table>
<tr><th>Section</th><th>Content</th></tr>
<tr><td>120</td><td>Jurisdiction of income-tax authorities</td></tr>
<tr><td>131</td><td>Power regarding discovery, production of evidence, etc.</td></tr>
<tr><td>133A</td><td>Power of survey</td></tr>
<tr><td>138</td><td>Disclosure of information respecting assessees</td></tr>
<tr><td>156</td><td>Notice of demand</td></tr>
<tr><td>Chapter XV</td><td>Liability in special cases</td></tr>
<tr><td>220-227</td><td>- When tax payable and when assessee deemed in default,
- Penalty payable when tax in default,
- Certificate to Tax Recovery Officer,
- Tax Recovery Officer by whom recovery is to be effected,
- Validity of certificate and cancellation or amendment thereof,
- Stay of proceedings in pursuance of certificate and amendment or cancellation thereof,</td></tr>
</table>
</td></tr>
</table>

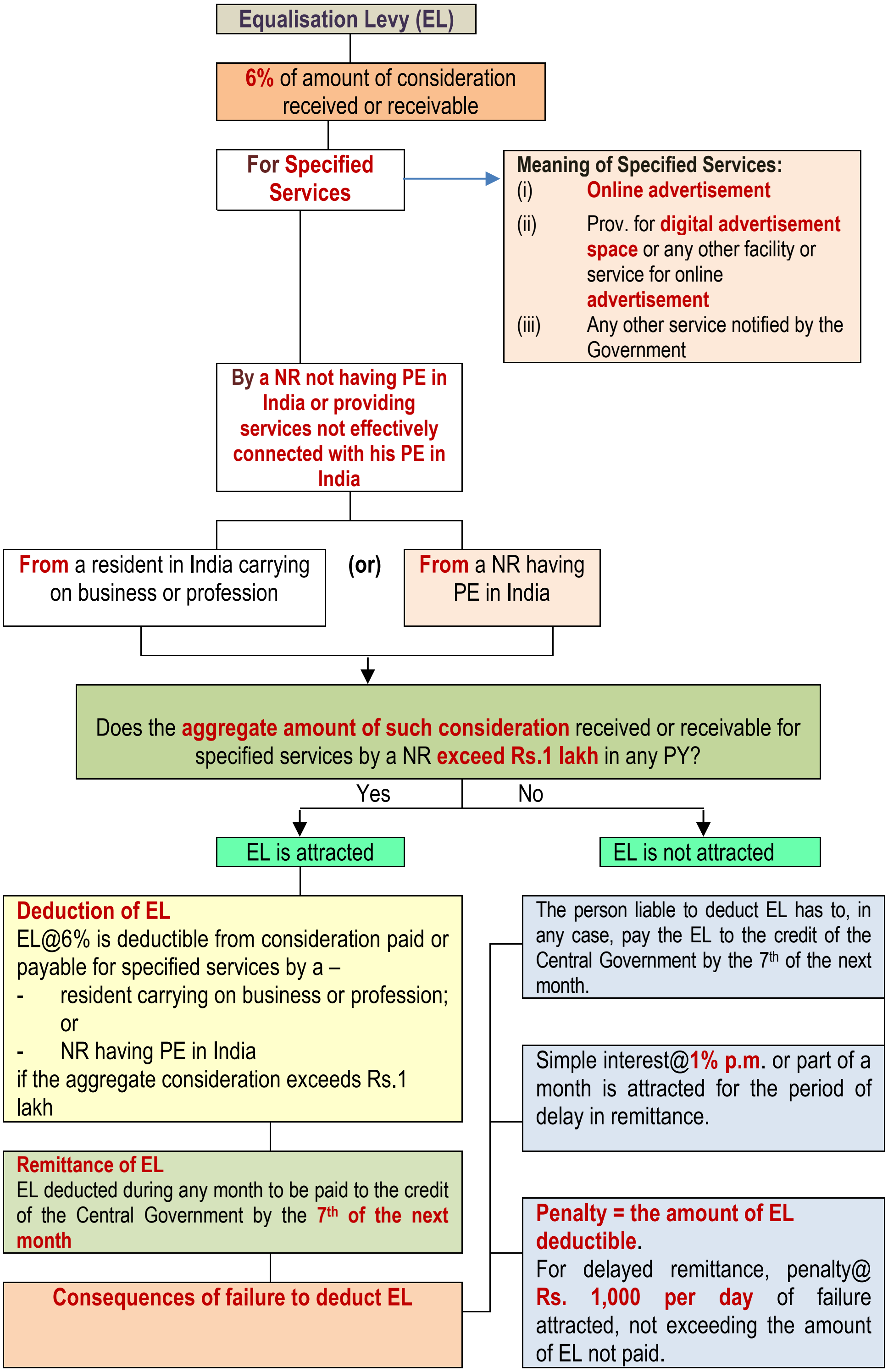
			- Other modes of recovery, - Recovery through State Government.
		229	Recovery of penalties, fine, interest and other sums
		232	Recovery by suit or under other law not affected.
		260A	Appeal to High Court
		261	Appeal to Supreme Court
		262	Hearing before Supreme Court
		265 to 269	- Tax to be paid notwithstanding reference etc., - Execution for costs awarded by Supreme Court, - Amendment of assessment on appeal - Exclusion of time taken for copy, - Filing of appeal or application for reference by income-tax authority, - Definition of "High Court"
		278B	Offences by companies
		280A	Special Courts
		280B	Offences triable by Special Court
		280C	Trial of offences as summons case
		280D	Application of Code of Criminal Procedure, 1973 to proceedings before Special Court
		282	Service of notice generally
		288 to 293	- Appearance by authroised representative, - Rounding off of income, - Rounding off of amount payable and refund due, - Receipt to be given, - Indemnity, - Power to tender immunity from prosecution, - Cognizance of offences, - Section 360 of the Code of Criminal Procedure, 1973 and the Probation of Offenders Act, 1958, not to apply,

		- Return of income, etc., not to be invalid on certain grounds, - Notice deemed to be valid in certain circumstances, - Presumption as to assets, books of account etc., - Authorisation and assessment in case of search or requisition, - Bar of suits in civil courts
179	**Power to make rules**	The Central Government is empowered to make rules for the purposes of carrying out the provisions of this Chapter. Also, every Rule made under this Chapter shall be laid before each House of Parliament.
		In particular, such rules may also provide for all or any of the following matters, namely:— (a) the time within which and the form and the manner in which the statement shall be delivered or caused to be delivered or furnished under section 167; (b) the form in which an appeal may be filed and the manner in which it may be verified under sections 174 and 175; (c) any other matter which is to be, or may be, prescribed.
		Every rule made under this Chapter shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of **30 days**. This period of 30 days may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree: (i) in making any modification in the rule, then, the rule shall thereafter have effect only in such modified form; (ii) that the rule should not be made, then, the rule would be of no effect. However, any such modification or annulment would be without prejudice to the validity of anything previously done under that rule.

180	**Power to remove difficulties**	The Central Government is empowered to remove any difficulty which arises in giving effect to the provisions of this Chapter. It may, by order published in the Official Gazette, not inconsistent with the provisions of this Chapter, remove the difficulty. However, no such order shall be made after the expiry of a period of **two years from the date on which the provisions of this Chapter come into force**. Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

(6) Consequential provisions in the Income-tax Act, 1961:

	Section	Provision
(i)	10(50)	In order to avoid double taxation, section 10(50) provides to exempt any income arising from providing any specified service on or after the date on which the provisions of Chapter VIII of the Finance Act, 2016 comes into force, and chargeable to equalisation levy under that Chapter.
(ii)	40(a)(ib)	In order to ensure compliance with the provisions this Chapter, section 40(a)(ib) provides that if any consideration is paid or payable to a non-resident for a specified service on which equalisation levy is deductible, and such levy has not been deducted or after deduction, has not been paid on or before the due date under section 139(1), then, such expenses incurred by the assessee towards consideration for specified service shall not be allowed as deduction. However, where in respect of such consideration, if the equalisation levy has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified under section 139(1), such sum shall be allowed as deduction in computing the income of the previous year in which such levy has been paid.



Equalisation Levy (EL)

6% of amount of consideration received or receivable

For Specified Services

Meaning of Specified Services:

(i) **Online advertisement**

(ii) Prov. for **digital advertisement space** or any other facility or service for online **advertisement**

(iii) Any other service notified by the Government

By a NR not having PE in India or providing services not effectively connected with his PE in India

From a resident in India carrying on business or profession

(or)

From a NR having PE in India

Does the **aggregate amount of such consideration** received or receivable for specified services by a NR **exceed Rs.1 lakh** in any PY?

Yes

No

EL is attracted

EL is not attracted

Deduction of EL

EL@6% is deductible from consideration paid or payable for specified services by a –

- resident carrying on business or profession; or
- NR having PE in India

if the aggregate consideration exceeds Rs.1 lakh

Remittance of EL

EL deducted during any month to be paid to the credit of the Central Government by the **7th of the next month**

Consequences of failure to deduct EL

The person liable to deduct EL has to, in any case, pay the EL to the credit of the Central Government by the 7th of the next month.

Simple interest@**1% p.m.** or part of a month is attracted for the period of delay in remittance.

Penalty = the amount of EL deductible.

For delayed remittance, penalty@ **Rs. 1,000 per day** of failure attracted, not exceeding the amount of EL not paid.

EXERCISE

Question 1

Explain the core reasons for difference between the e-commerce transactions and the traditional business transactions causing difficulty to tax the income of e-commerce transactions.

Answer

The core reasons for difference between e-commerce transactions and traditional business transactions causing difficulty to tax the income from e-commerce transactions under the Income-tax Act, 1961 are absence of national boundaries, no requirement of physical presence of goods and no requirement of physical delivery (in certain cases). Since e-commerce transactions are completed in cyberspace, it is often not clear as to the place where the transaction is effected, thereby causing difficulty in implementing source rule taxation.

Question 2

E-commerce transactions have replaced concepts generally associated with international transactions traditionally. Discuss briefly the issues involving such transactions.

Answer

The typical taxation issues relating to e-commerce are:

(1) the difficulty in characterizing the nature of payment and establishing a nexus or link between taxable transaction, activity and a taxing jurisdiction,

(2) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

Question 3

ABC ltd., an Indian company, is carrying on the business of manufacture and sale of teakwood furniture under the brand name "PUREWOOD". In order to expand its overseas sales/exports, it launched a massive advertisement campaign of its products. For the purpose of online advertisement, it utilized the services of PQR Inc., a London based company. During the previous year 2019-20, ABC Ltd. Paid ₹ 5 lakhs to PQR Inc. for such services. Discuss the tax implications/TDS implications of such payment and receipt in the hands of ABC Ltd. and PQR Inc., respectively, if –

(i) PQR Inc. has no permanent establishment in India

(ii) PQR Inc. has a permanent establishment in India, and the service is effectively connected to the permanent establishment in India

Answer

Chapter VIII of the Finance Act, 2016, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

“Specified Service” means

(1) online advertisement;

(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and

(3) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-

- where the non-resident providing the specified services has a permanent establishment in India and the specified service is effectively connected with such permanent establishment.
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed ₹ 1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession

(i) Where PQR Inc. has no permanent establishment in India

In the present case, equalisation levy @6% is chargeable on the amount of ₹ 5,00,000 received by PQR Inc., a non-resident not having a PE in India from ABC Ltd., an Indian company. Accordingly, ABC Ltd. is required to deduct equalisation levy of ₹ 30,000 i.e., @6% of ₹ 5 lakhs, being the amount paid towards online advertisement services provided by PQR Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.

(ii) Where PQR Inc. has permanent establishment in India and the service is effectively connected to the permanent establishment in India

Equalisation levy would not be attracted where the non-resident service provider (PQR Inc., in this case) has a permanent establishment in India and the service is effectively connected to the permanent establishment in India. Therefore, the ABC Ltd. is not required to deduct equalisation levy on ₹ 5 lakhs, being the amount paid towards online advertisement services to PQR Inc, in this case.

However, tax has to be deducted by ABC Ltd. at the rates in force under section 195 in respect of such payment to PQR Inc. Non-deduction of tax at source under section 195 would attract disallowance under section 40(a)(i) of 100% of the amount paid while computing business income.

CHAPTER 6

APPLICATION AND INTERPRETATION OF TAX TREATIES

LEARNING OUTCOMES

After studying this chapter, you would be able to

❑ **identify** the connecting factors of double taxation;

❑ **appreciate** the meaning of, and need for, tax treaties;

❑ **appreciate** the basic principles of interpretation of tax treaties;

❑ **identify** the extrinsic aids to interpretation of a tax treaty;

❑ **appreciate** the importance of commentaries in interpretation of tax treaties;

❑ **appreciate** the role of Vienna Convention in application and interpretation of tax treaties.

6.1 INTRODUCTION

Article 38(1) of the International Court of Justice[1] provides that the court shall apply the following in deciding on a particular matter –

International Convention(s) [general or particular]

- establishing rules expressly recognised by the contesting states

International Customs

- serving as evidence of general practice accepted as law

General principles

- recognised by civilised nations

Judicial decisions and teachings of highly qualified publicists of various nations

- serving as subsidiary means for determination of rules of law

Success of any law depends upon the manner in which it is interpreted and administered. In order to interpret any law or agreement, one needs to understand the philosophy of law which has been kept in mind at the time of passing such law in a country or at the time of forming an agreement between the two countries on a particular aspect. This gives rise to the principles of public international law (example – U.N principles on business and human rights).

Tax has been a consequence of business for several hundreds of years; some of the principles would definitely have their bearing on the manner in which law is passed. International tax law has evolved so that conflict of national interests can be resolved (double taxation being the primary issue).

Source(s) of International Tax Law

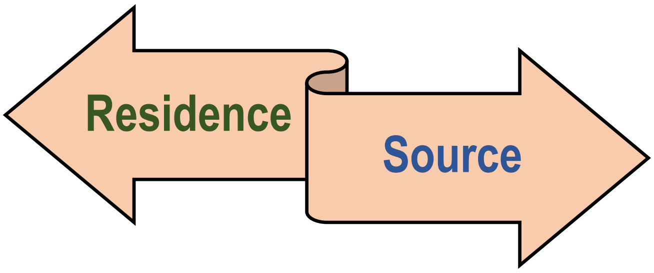
S. No.	Source	Particulars relating to the source/origin
(i)	Multilateral international agreements	For example, the Vienna Convention on Law of Treaties (VCLT)
(ii)	Double Taxation Avoidance	DTAAs may be comprehensive or otherwise. It is to be noted that along with the DTAA, it is the protocols, memorandum of

[1] https://www.icj-cij.org/en/statute#CHAPTER_II

	Agreement (DTAA)	understanding, and exchange of information, etc. forming part of the DTAA which enables interpretation of a DTAA.
(iii)	Customary international law and general principles of law	For example, principles of law recognised by civilized nations in their national legal systems, customary law and judicial decisions and the practices of international organizations. Customary international law is the aspect of international law that derives from customs and convention. Along with general principles of law and treaties, custom is also considered by the International Court of Justice, jurists, the United Nations, and its member states to be among the primary sources of international law. The vast majority of the world's governments accept, in principle, the existence of customary international law, although there are many differing opinions as to what rules are contained therein.

6.2 DOUBLE TAXATION AND CONNECTING FACTORS

The taxability of a foreign entity in any country depends upon two distinct factors, namely, whether it is doing business **with that country** or **in that country**. Internationally, the term used to determine the jurisdiction for taxation is "connecting factors". There are two types of connecting factors, namely, "Residence" and "Source". It means a company can be subject to tax either on its residence link or its source link with a country. Broadly, if a company is doing business **with** another country (i.e. host/source country), then it would be subject to tax in its home country alone, based on its residence link. However, if a company is doing business **in a** host/source country, then, besides being taxed in the home country on the basis of its residence link, it will also be taxed in the host country on the basis of its source link.



- **Juridical double taxation**

  When source rules overlap, double taxation may arise i.e. tax is imposed by two or more countries as per their domestic laws in respect of the same transaction, income arises or is deemed to arise in their respective jurisdictions. This is known as "juridical double taxation".

In order to avoid such double taxation, a company can invoke provisions of Double Taxation Avoidance Agreements (DTAAs) (also known as **Tax Treaty** or Double Taxation Convention–DTC) with the host/source country, or in the absence of such an agreement, an Indian company can invoke provisions of section 91, providing unilateral relief in the event of double taxation.

Example

Company ICO is a resident of India. It has set up a branch in UK. Here, India would be the country of residence for ICO, whereas UK would be the country of source. UK would tax the profits earned by the branch of ICO located in UK, whereas ICO would be taxed on worldwide basis in India, including profits of its UK branch. However, ICO can claim relief in respect of taxes paid in UK while filing its tax return in India under the Indo-UK Double Taxation Avoidance Agreement.

If, instead of UK, ICO has a branch in a state with which India does not have tax treaty, then it can claim unilateral relief under section 91 of the Income-tax Act, 1961 in respect of taxes paid by its branch in that state.

- **Economic double taxation**

  ‘Economic double taxation’ happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different persons (because of lack of subject identity)

Example

When one state attributes an income/capital to its legal owner whereas the tax law of other state attributes it in the hands of the person in possession or having economic control over the income, it leads to economic double taxation.

Yet another classic example is tax on distributed surplus by a company which is taxed in the hands of the company distributing such surplus, while the other jurisdiction taxes the said income from distribution in the hands of the shareholder, thus leading to double taxation of the same income albeit in the hands of different persons.

6.3 TAX TREATIES: AN OVERVIEW

(1) Definition of “Treaty”

Treaty is a generic term embracing all instruments binding under international law, regardless of their formal designation, concluded between two or more international juridical persons.

The application of the term treaty signifies that the parties intend to create rights and obligations enforceable under international law.

Article 2 of Vienna Convention on Law of Treaties, 1969 defines a “treaty” as an international **agreement** concluded between States **in written form** and **governed by international law**, whether embodied in a **single instrument or in two or more related instruments** and whatever its particular designation.

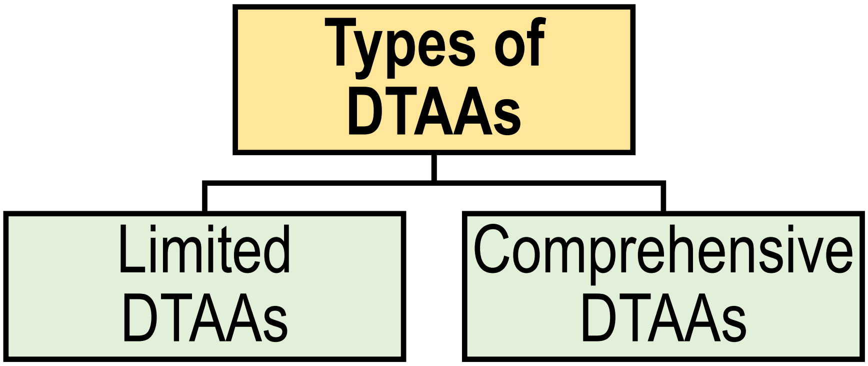
(2) Role of Tax Treaties

“Treaty” represents various compromises agreed upon by the respective Contracting States depending upon the economic expediency of a particular country.

Tax, in the country of source is considered as a cost, whereas the same is an obligation in the country of residence. Therefore, there is need to achieve tax efficiency. Double Tax Avoidance Agreements come into play to mitigate hardship caused by subjecting the same income to double taxation.

Tax Treaties attempt to eliminate double taxation and try to achieve balance and equity. They aim at sharing of tax revenues by the concerned states on a rational basis. Tax treaties do not always succeed in eliminating Double Taxation, but contain the incidence to a tolerable level.

(3) Types of DTAAs



Limited DTAAs are those which are limited to certain types of incomes only. e.g., DTAA between India and Pakistan is limited to income from international air transport only.

Comprehensive DTAAs are those which cover almost all types of incomes covered by any model convention. Many a time, a treaty also covers wealth tax, gift tax, surtax, etc.

(4) Directive Principles set out in the Indian Constitution

In the Indian context, Article 51 of the Indian Constitution has, *inter alia*, set out some directive principles which must be followed by the State in the context of International agreements and relationships. It has been provided that-

"The State shall endeavor to -

(a) Promote international peace and security;

(b) Maintain just and honourable relations amongst nations;

(c) Foster respect for international law and treaty obligations in the dealings of organised people with one another; and

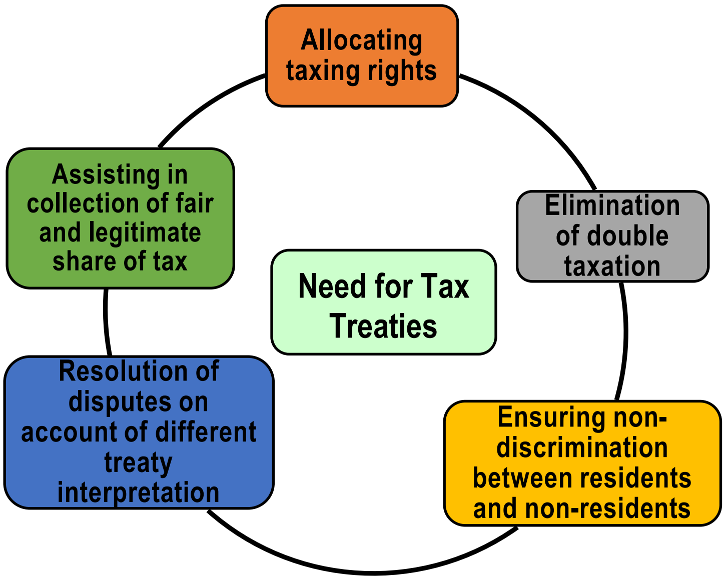
(d) Encourage settlement of international disputes by arbitration.

It is pertinent to note that entries 10 and 14 of List I of the Seventh Schedule to the Constitution of India confer the power on Parliament to legislate treaties with foreign countries. Further, this power of Parliament has been delegated to the Central Government vide sections 90 and 90A of the Income-tax Act, 1961.

(5) Need for tax treaties

The concept of source and residence prevailing in a majority of the countries is the root cause of double taxation. Hence, there is a need to have tax treaties in force. In addition to allocating the taxing rights and eliminating double taxation, there are various other important considerations as mentioned below:

- Ensuring non-discrimination between residents and non-residents
- Resolution of disputes arising on account of different interpretation of tax treaty by the treaty partner.
- Providing assistance in the collection of the fair and legitimate share of tax.


Allocating taxing rights
Elimination of double taxation
Ensuring non-discrimination between residents and non-residents
Resolution of disputes on account of different treaty interpretation
Assisting in collection of fair and legitimate share of tax
Need for Tax Treaties

Further, in addition to above, there are some other principles which must be considered by countries in their tax system –

(i) **Equity and fairness:** Same income earned by different taxpayers must be taxed at the same rate regardless of the source of income.

(ii) **Neutrality and efficiency:** Neutrality factor provides that economic processes should not be affected by external factors such as taxation. Neutrality is two-fold.

(a) Capital export neutrality and

(b) Capital import neutrality (CIN).

Capital export neutrality (CEN) provides that business decision must not be affected by tax factors between the country of residence and the target country; whereas CIN provides that the level of tax imposed on non-residents as well as the residents must be similar.

(iii) **Promotion of mutual economic relation, trade and investment:** In some cases, it is observed that avoidance of double taxation is not the only objective. The other objective may be to give impetus to a country's overall economic growth and development.'

6.4 APPLICATION AND INTERPRETATION OF TAX TREATIES

Application of Tax Treaties

In various countries, unless the context otherwise requires, the provisions of the DTAA shall prevail over the domestic tax provisions. No two treaties between the countries are alike. DTAA signed by India with USA is different in comparison to the DTAA signed with other countries like Netherlands. These differences include taxpayers to resort to tax arbitrage strategies. This frustrates Government's objective and results in unintended tax benefits. Therefore, in specified circumstances, treaty benefits are denied. Some of the circumstances in the Indian context induce (i) General Anti-Avoidance Rules (GAAR)[2] (ii) Targeted anti avoidance rules (transfer pricing), etc. (iii) Beneficial Ownership Conditions (iv) Entitlement to Benefits/Limitation on Benefits Clause/ Articles, etc.

In recent past, India has re-negotiated DTAAs with countries like Mauritius, Singapore, etc. to prevent fiscal evasion with respect to taxes on income and capital gains of the investor[3].

(1) Article 4 of DTAA – Gateway to avail tax benefits

It is a well-accepted proposition in a tax treaty scenario that a person shall be entitled to a tax treaty only if he is a resident of one or both of the Contracting States.

[2] GAAR provisions in India are applicable from Assessment Year 2018-19

[3] Effective from 01 April 2017

This provision aims at curbing the 'treaty shopping' practices. It must be noted that though 'Article 4' of the tax treaty deals with residential status of a person, it does not provide rules for determination of residence. Instead, it refers to the determination in accordance with the provisions of domestic tax law of the respective Contracting State. This is clear from the language which provides that "*the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature.............*". Therefore, the primary requirement is for a person to qualify as a resident under the law of the concerned Contracting State.

Determination of residential status of a person is crucial since it is ultimately the country of residence that may have full right to tax the worldwide income of its resident. Further, in addition to taxing the global income, the country of residence would grant relief in respect of tax paid in the country of source.

Place of effective management is an important criterion for availing treaty benefits by a corporate. India-U.A.E DTAA (as revised) further limits the application of treaty by providing that the treaty would be applicable to U.A.E company only if it is incorporated in U.A.E and is controlled wholly in U.A.E. Only such company would be regarded as resident of U.A.E. Further, the India–U.A.E DTAA provides that if a person other than an individual is resident of both the States, then it should be deemed to be resident of the State in which its Place of effective management is situated.

(2) Computation of income liable for the purpose of taxation

The provisions of tax treaty *inter alia* allocates taxing rights between the treaty partners, provides relief or reduces or eliminates the harmful effects of double taxation. However, it is to be noted that except for the provisions under *'Article 7 i.e. Business Profits taxation',* generally the treaty does not provide rules for computation of income. It would depend upon the domestic tax law provisions. Treaties, at best, distribute the taxing rights between two states. It may limit the rate of tax (generally, in the state of source) or provide the upper limit up to which taxes can be levied. Certain treaties do reduce the incidence of tax by providing or restricting the scope of the subject matter of taxation.

(3) Distributive Rule

Tax treaties only distribute or assign taxing jurisdiction. It does not impose tax. Having assigned the jurisdiction of tax between the State of Residence and State of Source, the domestic tax laws of the respective State determine taxing rules. Taxing experts in early 1920 appointed by the League of Nations describe the method of classification as Contracting States dividing tax sources and tax objects amongst themselves by mutually binding themselves not to levy taxes or to tax only to a limited extent.

English lawyers called it "Classification and Assignment Rule", whereas German jurists called it the **"Distributive Rule".** According to this principle, "to the extent that an exemption is agreed to, its effect is, in principle, independent of whether the Contracting States imposes a tax, in the situation to which the exemption applies, and irrespective of whether the State actually levies the tax". The point here is that having agreed to give the right of tax to the other state, that state may or may not levy tax and if the state in whose favour right to tax is devolved, chooses not to tax such income, then, it may result in double non-taxation. The argument in favour of double non-taxation is that income would be subject to tax in the exempt state as and when the exemption is withdrawn or tax is levied. Thus, this rule ensures that double taxation does not arise in future also, if the source state decides to levy tax.

(A) Treaties are entered into for "Mutual Benefits"

Apart from the allocation of tax between the treaty partners, tax treaties can also help to resolve problems and can obtain benefits which cannot be achieved unilaterally.

Treaties are negotiated and entered into at a political level and have several considerations as their basis. Thus, treaties should be seen in the context of aiding commercial relations between treaty partners.

(B) A tax treaty provision may have an unequal effect4

State A imposes tax but state B does not impose a tax, yet wordings of the treaty are reciprocal – so that if and when State 'B' does introduce such a tax, the treaty rates would be operative in State 'B'. Until such time there would be an unequal effect. Moreover, State 'A' may make a distributive rule operative upon fulfilment of certain condition or comparable feature.

Interpretation of Tax Treaties

Tax treaties are signed between two sovereign nations by competent authorities under delegated powers from the respective Governments. Thus, an international agreement has to be respected and interpreted in accordance with the rules of international law as laid down in the Vienna Convention on Law of Treaties (VCLT). These rules of interpretation are not restricted to tax treaties but also apply to any treaty between two countries. Therefore, any dispute between two nations in respect of Article 25 relating to Mutual Agreement Procedure of the OECD/UN Model Conventions has to be solved in the light of the VCLT.

However, when it comes to application of a tax treaty in the domestic forum, the appellate authorities and the courts are primarily governed by the laws of the respective countries for interpretation.

In India, even before insertion of Section 90(2) by the Finance (No.2) Act, 1991, with retrospective effect from 1-4-1972, CBDT had clarified *vide Circular No. 333 dated 2-4-1982* that where a specific provision is made in the DTAA, the provisions of the DTAA will prevail over the general provisions contained in the Act and where there is no specific provision in the DTAA, it is the basic law i.e. the provisions of the Act, that will govern the taxation of such income.

The Income-tax Act, 1961 provides that where the Indian Government has entered into DTAAs which are applicable to the taxpayers, then, the provisions of the Act shall apply to the extent they are more beneficial to the taxpayer.

[4] Tax Treaty Interpretation – The International Tax Treaties Service"

Interpretation of any statute, more so international tax treaties, requires that we follow some rules of interpretation. In subsequent paragraphs, we shall deal with rules of interpretation of tax treaties.

(1) Basic Principles of Interpretation of a Treaty

Principles or rules of interpretation of a tax treaty would be relevant only where terms or words used in treaties are ambiguous, vague or are such that different meanings are possible. If words are clear or unambiguous, then there is no need to resort to different rules for interpretation.

Prior to the Vienna Convention, treaties were interpreted according to the customary international law. Just as each country's legal system has its own canons of statutory construction and interpretation, likewise, several principles exist for the interpretation of treaties in customary international law. We would be discussing some of the rules of interpretation of Vienna Convention on law of Treaties in the later part of this chapter.

Some of the important principles of Customary International law in interpretation of tax treaties are as follows:

(i) **Golden Rule – Objective Interpretation:** Ideally, any term or word should be interpreted keeping its objective or ordinary or literal meaning in mind. The term has to be interpreted contextually.

Words and phrases are in the first instance to be construed according to their plain and natural meaning. However, if the grammatical interpretation would result in an absurdity, or in marked inconsistency with other portions of the treaty, or would clearly go beyond the intention of the parties, it should not be adopted[5].

(ii) **Subjective Interpretation:** Under this approach, the terms of a treaty are to be interpreted according to the common intention of the contracting parties at the time the treaty was concluded. The intention must be ascertained from the words used in the treaty and the context thereof.

In *Abdul Razak A. Meman's case [2005] 276 ITR 306,* the Authority for Advance Rulings [the AAR] relied on the speeches delivered by the Finance Ministers of India as well as UAE to arrive at the intention of parties in signing the India-UAE Tax Treaty.

(iii) **Purposive Interpretation:** In this approach the treaty is to be interpreted so as to facilitate the attainment of the aims and objectives of the treaty. This approach is also known as the 'objects and purpose' method.

In case of *Union of India v. Azadi Bachao Andolan 263 ITR 706,* the Supreme Court of India observed that "the principles adopted for interpretation of treaties are not the same as those in interpretation of statutory legislation. The interpretation of provisions of an international treaty, including one for double taxation relief, is that the treaties are entered into at a political level and have several considerations as their bases."

[5] Prof. J. G. Starke in Introduction to International Law 10th Edition

The Apex Court also agreed with the contention of the Appellant that "the preamble to the Indo-Mauritius DTAA recites that it is for 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty".

(iv) **The Principle of Effectiveness:** According to this principle, a treaty should be interpreted in a manner to have effect rather than make it void.

This principle, particularly stressed by the Permanent Court of International Justice, requires that the treaty should be given an interpretation which 'on the whole' will render the treaty 'most effective and useful', in other words, enabling the provisions of the treaty to work and to have their appropriate effects[6].

(v) **Principle of *Contemporanea Expositio:*** A treaty's terms are normally to be interpreted on the basis of their meaning at the time the treaty was concluded. However, this is not a universal principle.

In *Abdul Razak A. Meman's* case *[2005] 276 ITR 306*, the AAR observed that "there can be little doubt that while interpreting treaties, regard should be had to material *contemporanea exposition,* which means that a statute is best explained by following the construction put upon it by judges at the time it was made, or soon after. This proposition is embodied in Article 32 of the Vienna Convention, referred to above, and is also referred to in the decision of the Hon'ble Supreme Court in *K. P. Varghese v. ITO [1981] 131 ITR 597*."

(vi) **Liberal Construction:** It is a general principle of construction with respect to treaties that they shall be liberally construed so as to carry out the apparent intention of the parties.

In *John N. Gladden v. Her Majesty the Queen* [7], the principle of liberal interpretation of tax treaties was reiterated by the Federal Court, which observed that "contrary to an ordinary taxing statute a tax treaty or convention must be given a liberal interpretation with a view to implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated in so far as the particular item under consideration is concerned."

The Court further recognised that "we cannot expect to find the same nicety or strict definition as in modern documents, such as deeds, or Acts of Parliament, it has never been the habit of those engaged in diplomacy to use legal accuracy but rather to adopt more liberal terms."

(vii) **Treaty as a Whole – Integrated Approach:** A treaty should be construed as a whole and effect should be given to each word which would be construed in the same manner wherever it occurs. Any provision should not be interpreted in isolation; rather the entire treaty should be read as a whole to arrive at its object and purpose.

[6] Prof. J. G. Starke in Introduction to International Law 10th Edition

[7] 85 D.T.C. 5188 at 5190, Source: UOI v. Azadi Bachao Andolan 263 ITR 706 (SC)

(viii) **Reasonableness and consistency[8] :** Treaties should be given an interpretation in which the reasonable meaning of words and phrases is preferred, and in which a consistent meaning is given to different portions of the instrument. In accordance with the principles of consistency, treaties should be interpreted in the light of existing international law.

An important aspect to be noted regarding the rules of interpretation is that they are not rules of law and are not to be applied like the rules enacted by the legislature in an Interpretation Act.

(2) Extrinsic Aids to Interpretation of a Tax Treaty

A wide range of extrinsic material is permitted to be used in interpretation of tax treaties. According to Article 32 of the Vienna Convention, the supplementary means of interpretation include the preparatory work of the treaty and the circumstances of its conclusion.

According to Prof. Starke, one may resort to following extrinsic aids to interpret a tax treaty provided that clear words are not thereby contradicted:

(i) Interpretative Protocols, Resolutions and Committee Reports, setting out agreed interpretations;

(ii) A subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions [Art. 31(3) of the VCLT];

(iii) Subsequent conduct of the state parties, as evidence of the intention of the parties and their conception of the treaty;

(iv) Other treaties, in *pari materia* (i.e., relating to the same subject matter), in case of doubt.

(i) Provisions in Parallel Tax Treaties

If the language used in two tax treaties (say treaties: X and Y) are same and one treaty is more elaborative or clear in its meaning (say treaty X) can one rely on the interpretation/explanations provided in a treaty X while applying provisions of a treaty Y?

The views of the Indian Judiciary are, however, not consistent in this respect. There are contradictory judgments by Indian courts/Tribunal in this regard.

(ii) International Articles/Essays/Reports

International Article/Essays/Reports are referred as extrinsic aid for interpretation of tax treaties. Like, in case of *CIT v. Vishakhapatnam Port Trust (1983) 144 ITR 146 (AP)*, the High Court obtained "useful material" through international articles.

(iii) Cahiers published by International Fiscal Association (IFA), Netherlands

"Cahiers de Droit Fiscal International" is the main publication of the IFA, which is published annually and deals with two major topics each year. Cahiers were relied upon in case of *Azadi Bachao Andolan's* (supra) case by the Supreme Court.

[8] Prof. J. G. Starke in Introduction to International Law 10th Edition

(iv) Protocol

Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues.

A protocol is an integral part of a tax treaty and has the same binding force as the main clauses therein.

Protocol to India France treaty contains the Most Favoured Nation Clause. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision.

MFN clause is usually found in Protocols and Exchange of Notes to DTCs. Under this clause a country agrees to extend the benefits to the residents of the other country, which it had (first country) promised to the residents of third country. It tries to avoid discrimination between residents of different countries.

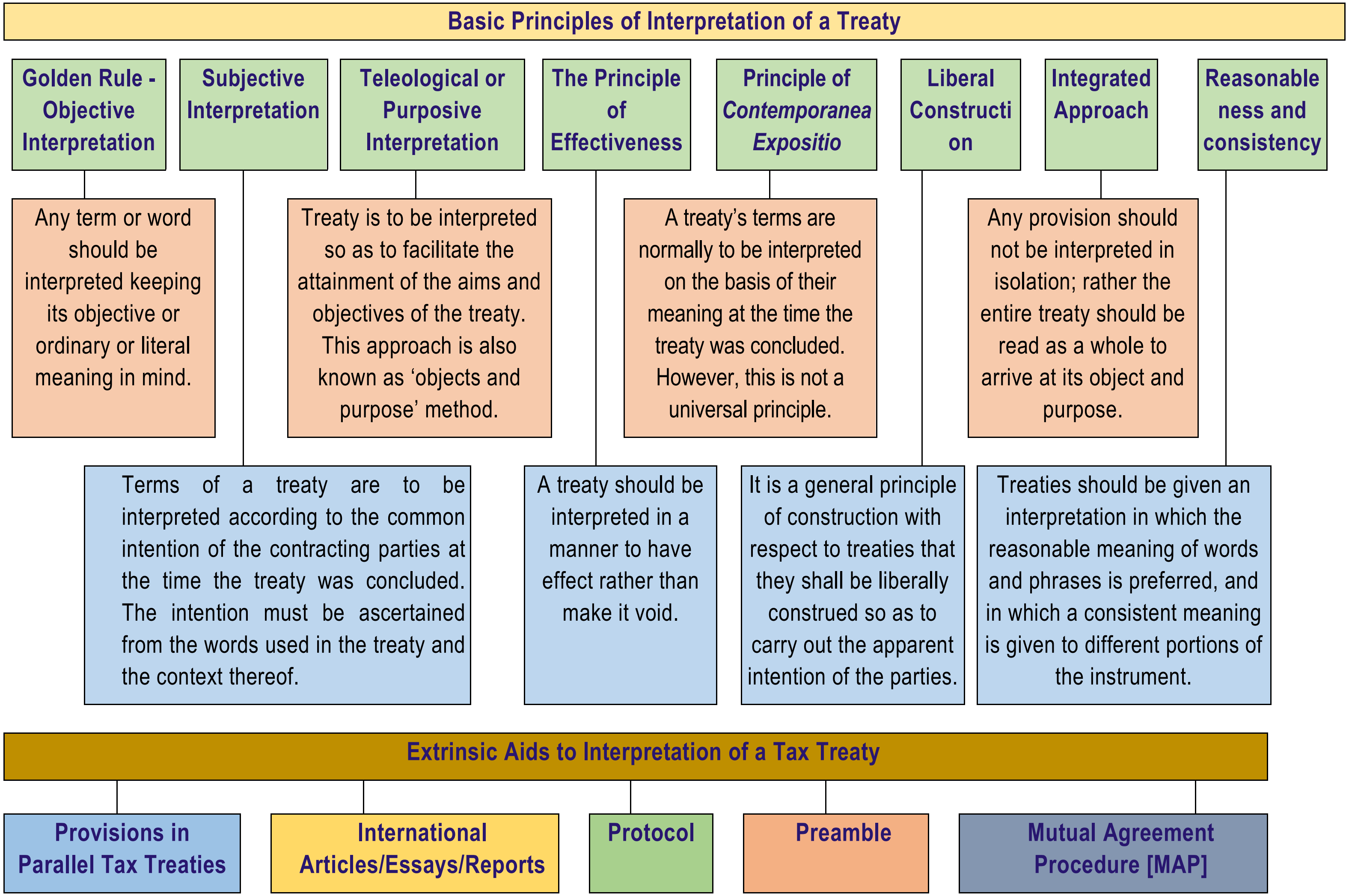
Normally, the benefit under this clause is restricted to a specific group like OECD countries or developing countries. The nature of benefits under MFN clause could either be application of lower rate of tax or narrowing the scope of the income liable to tax or allowing higher deduction in respect of executive and general administrative expenses of head office.

(v) Preamble

Preamble to a tax treaty could guide in interpretation of a tax treaty. In case of *Azadi Bachao Andolan*, the Apex Court observed that 'the preamble to the Indo-Mauritius Double Tax Avoidance Treaty recites that it is for the 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty'. These observations are very significant whereby the Apex Court has upheld 'economic considerations' as one of the objectives of a Tax Treaty.

(vi) Mutual Agreement Procedure [MAP]

MAP helps to interpret any ambiguous term/provision through bilateral negotiations. MAP is more authentic than other aids as officials of both countries are in possession of materials/documents exchanged at the time of signing the tax treaty which would clearly indicate the object or purpose of a particular provision. Successful MAPs also serve as precedence in case of subsequent applications.



Basic Principles of Interpretation of a Treaty

Golden Rule - Objective Interpretation

Any term or word should be interpreted keeping its objective or ordinary or literal meaning in mind.

Subjective Interpretation

Terms of a treaty are to be interpreted according to the common intention of the contracting parties at the time the treaty was concluded. The intention must be ascertained from the words used in the treaty and the context thereof.

Teleological or Purposive Interpretation

Treaty is to be interpreted so as to facilitate the attainment of the aims and objectives of the treaty. This approach is also known as 'objects and purpose' method.

The Principle of Effectiveness

A treaty should be interpreted in a manner to have effect rather than make it void.

Principle of *Contemporanea Expositio*

A treaty's terms are normally to be interpreted on the basis of their meaning at the time the treaty was concluded. However, this is not a universal principle.

Liberal Construction

It is a general principle of construction with respect to treaties that they shall be liberally construed so as to carry out the apparent intention of the parties.

Integrated Approach

Any provision should not be interpreted in isolation; rather the entire treaty should be read as a whole to arrive at its object and purpose.

Reasonableness and consistency

Treaties should be given an interpretation in which the reasonable meaning of words and phrases is preferred, and in which a consistent meaning is given to different portions of the instrument.

Extrinsic Aids to Interpretation of a Tax Treaty

- Provisions in Parallel Tax Treaties
- International Articles/Essays/Reports
- Protocol
- Preamble
- Mutual Agreement Procedure [MAP]

(3) Commentaries on OECD/UN Models and their importance

Interpretation of any statute, more so international tax treaties requires that we follow some rules of interpretation. Commentaries are one of the important rules of interpretation of tax treaties.

There are two commentaries available – one by OECD and the other by UN, based on their respective models. OECD Commentary is authentic and revised from time to time. UN Commentary is by and large based on OECD commentary. UN commentary was published in 1980 and has been revised from time to time. One can refer to the commentaries for interpretation and application of various provision contained in a DTAA.

Views expressed in the commentaries carry great authority. Where Contracting States adopt the text of the Article as per OECD Model convention without any change, and if these countries happen to be OECD Countries, the OECD commentary is directly applicable. In case of a DTAA between developed and developing countries, normally UN model is followed. UN Model and UN Commentary both being largely based on OECD Model and Commentary respectively, OECD Commentary is also quite helpful in interpretation of treaties based on UN Model.

OECD Model Commentary has been widely used in interpretation of tax treaties. The Commentary on the OECD Model Convention states that: "the Commentaries have been cited in the published decisions of the courts of the great majority of Member countries. In many decisions, the Commentaries have been extensively quoted and analysed, and have frequently played a key role in the judge's deliberations."

The OECD has framed a model convention to guide countries to draft DTAAs. In the *Azadi Bachao Andolan* case, the Supreme Court has made reference to the OECD convention while interpreting terms used in DTAA.

Both UN and OECD Model Commentaries are a great help in interpretation of tax treaties. Their importance in interpretation of tax treaties can hardly be over emphasized *[Credit Lyonnais v. DCIT (2005) 94 ITD 401 (Mum)]*. OECD, however, plays a greater role in providing standardized or systematized approach in interpretation of tax treaties.

Model Commentaries give the authoritative interpretation of the provisions of DTAAs *[Sonata Information Technology Ltd. v. ACIT (2006) 103 ITD 324 (Bang)]*

(4) Foreign Courts' Decisions

In *CIT v. Vishakhapatnam Port Trust's* case *[1983] 144 ITR 146*, the Andhra Pradesh High Court observed that, "in view of the standard OECD Models which are being used in various countries, a new area of genuine 'international tax law' is now in the process of developing. Any person interpreting a tax treaty must now consider decisions and rulings worldwide relating to similar treaties. The maintenance of uniformity in the interpretation of a rule after its international adoption is just as important as the initial removal of divergences. Therefore, the judgments rendered by courts in other countries or rulings given by other tax authorities would be relevant."

In the under-noted cases, foreign court cases have extensively been quoted for interpretation of treaty provisions:

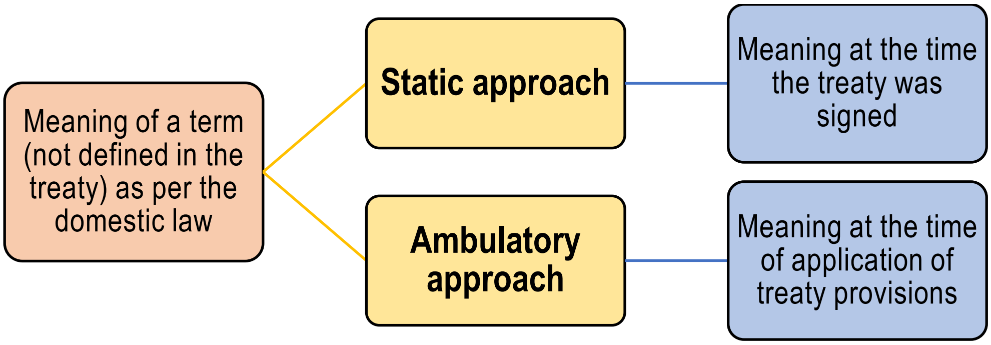
Union of India v. Azadi Bachao Andolan [2003] 263 ITR 706 (SC)

CIT v. Vishakhapatnam Port Trust [1983] 144 ITR 146

Abdul Razak A. Meman's case [2005] 276 ITR 306(AAR)

(5) Ambulatory v. Static Approach

Whenever a reference is made in a treaty to the provisions of domestic tax laws for assigning meaning to a particular term, a question often arises what meaning to be assigned to the said term – the one which prevailed on the date of signing a tax treaty or the one prevailing on the date of application of a tax treaty. There are two views on the subject, namely, Static and Ambulatory.


Meaning of a term (not defined in the treaty) as per the domestic law
Static approach
Meaning at the time the treaty was signed
Ambulatory approach
Meaning at the time of application of treaty provisions

All Model Commentaries including the Technical Explanation on US Model Tax Convention favors ambulatory approach, however with one caution and that is ambulatory approach cannot be applied when there is a radical amendment in the domestic law thereby changing the sum and substance of the term.

India-Australia Treaty, in Article 3(2) adds the expression "from time to time in force" to provide for an "ambulatory" interpretation.

6.5 ROLE OF VIENNA CONVENTION IN APPLICATION AND INTERPRETATION OF TAX TREATIES

The International Law Commission initiated the work on the Vienna Convention on Law of Treaties in the year 1949 which was completed in the year 1969. It came into force in the year 1980. As of January, 2018, it was ratified by 116 Countries.

Since tax treaty is a part of international law, its interpretation should be based on certain set of principles and rules of interpretation. The Vienna Convention on Law of Treaties provides the basic rules of interpretation of any international agreement (including a tax treaty). Therefore, it would be worthy to understand some of the Articles of the Vienna Convention of Law of Treaties which would help appreciate the manner of application and interpretation of tax treaties.

Principles enunciated in the Vienna Convention on Law of Treaties[9]

Article No.	Article Heading	Principle enunciated
26	***Pacta Sunt Servanda (in good faith)***	Every treaty in force is binding upon the parties and must be followed by them in good faith.
28	**Non-retroactivity of treaties**	Unless a different intention appears from the treaty or is otherwise established, treaty provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party. In other words, unless otherwise provided, treaties cannot have retrospective application
29	**Territorial Scope of Treaties**	Unless a different intention appears from the treaty or is otherwise established, a treaty is binding upon each party in respect of its entire territory.
31	**General Rule of Interpretation**	• A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms thereof in the context and in the light of its object and purpose. • The context for the purpose of interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexure (a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty; (b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related thereto. • The following shall be taken into account, together with the context in that: (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; (b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; (c) Any relevant rules of international law applicable to relation between the parties.

[9] https://treaties.un.org/doc/Publication/UNTS/Volume%201155/volume-1155-I-18232-English.pdf

Article No.	Article Heading	Principle enunciated
		• A special meaning shall be given to a term if it is established that the parties so intended.
32	**Supplementary means of interpretation**	Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable.
33	**Interpretation of Treaties Authenticated in two or more languages**	• When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail. • A version of the treaty in a language other than the one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree. • The terms of the treaty are presumed to have the same meaning in each authentic text. • Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference in meaning which the application of Articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.
34	**General Rule regarding third states**	A treaty does not create either obligations or rights for a third State without its consent.
42	**Validity and Continuance in force of treaties**	• The validity of a treaty or of the consent of a State to be bound by a treaty may be impeached only through the application of the Convention· • The termination of a treaty, its denunciation or the withdrawal of a party, may take place only as a result of the application of the provisions of the treaty or of the Convention. The same rule applies to suspension of the operation of a treaty
60	**Termination or Suspension of the**	• A material breach of a bilateral treaty by one of the

Article No.	Article Heading	Principle enunciated
	operation of a treaty as a consequence of a breach	parties entitles the other to invoke the breach as a ground for terminating the treaty or suspending its operation in whole or in part. • A material breach of a multilateral treaty by one of the parties entitles: (a) the other parties by unanimous agreement to suspend the operation of the treaty in whole or in part or to terminate it either: (i) in the relations amongst themselves and the defaulting State, or (ii) as between all the parties; (b) a party specially affected by the breach to invoke it as a ground for suspending the operation of the treaty in whole or in part in the relations between itself and the defaulting State; (c) any party other than the defaulting State to invoke the breach as a ground for suspending the operation of the treaty in whole or in part with respect to itself if the treaty is of such a character that a material breach of its provisions by one party radically changes the position of every other party with respect to further performance of its obligations under the treaty. • A material breach of a treaty, for the purposes of this Article, consists in: (a) a repudiation of the treaty not sanctioned by the Convention; or (b) the violation of a provision essential to the accomplishment of the object or purpose of the treaty. • The foregoing paragraphs are without prejudice to any provision in the treaty applicable in the event of a breach.
61	**Supervening impossibility of performance**	• A party may invoke the impossibility of performing provision of a treaty as a ground for terminating or withdrawing from it, if the impossibility results from the permanent disappearance or destruction of an object indispensable for the execution of the treaty. If the impossibility is temporary, it may be invoked only as a ground for suspending its operation.

Article No.	Article Heading	Principle enunciated
		• Impossibility of performance may not be invoked by a party as a ground for terminating, withdrawing from or suspending the operation of a treaty if the impossibility is the result of a breach by that party either of an obligation under the treaty or of any other international obligation owed to any other party thereto.
62	**Fundamental change of circumstances**	• A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless – (a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and (b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty. • A fundamental change of circumstances may not be invoked as a ground for terminating or withdrawing from a treaty – (a) if the treaty establishes a boundary; or (b) if the fundamental change is the result of a breach by the party invoking it either of an obligation under the treaty or of any other international obligation owed to any other party to the treaty. • If, under the foregoing paragraphs, a party may invoke a fundamental change of circumstances as a ground for terminating or withdrawing from a treaty it may also invoke the change as a ground for suspending its operation.
64	**Emergence of new peremptory norm of general international law**	If a new peremptory norm of general international law emerges, any existing treaty which is in conflict with that norm becomes void and stands terminated

EXERCISE

Question 1

What do you mean by double taxation? Discuss the connecting factors which lead to double taxation.

Answer

The taxability of a foreign entity in any country depends upon two distinct factors, namely, whether it is doing business **with that country** or **in that country**. Internationally, the term used to determine the jurisdiction for taxation is "connecting factors". There are two types of connecting factors, namely, "Residence" and "Source". It means a company can be subject to tax either on its residence link or its source link with a country. Broadly, if a company is doing business **with** another country (i.e. host/source country), then it would be subject to tax in its home country alone, based on its residence link. However, if a company is doing business **in a** host/source country, then, besides being taxed in the home country on the basis of its residence link, it will also be taxed in the host country on the basis of its source link.

- **Juridical double taxation:** When source rules overlap, double taxation may arise i.e. tax is imposed by two or more countries as per their domestic laws in respect of the same transaction, income arises or is deemed to arise in their respective jurisdictions. This is known as "juridical double taxation".

  In order to avoid such double taxation, a company can invoke provisions of Double Taxation Avoidance Agreements (DTAAs) (also known as **Tax Treaty** or Double Taxation Convention–DTC) with the host/source country, or in the absence of such an agreement, an Indian company can invoke provisions of section 91, providing unilateral relief in the event of double taxation.

- **Economic double taxation:** 'Economic double taxation' happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different persons (because of lack of subject identity)

Question 2

"In addition to allocating the taxing rights and elimination of double taxation, there are various other important considerations while entering into tax treaty". Elucidate.

Answer

In addition to allocating the taxing rights and elimination of double taxation, there are various other important considerations while entering into a tax treaty, as mentioned below:

- Ensuring non-discrimination between residents and non-residents

- Resolution of disputes arising on account of different interpretation of tax treaty by the treaty partner.

- Providing assistance in the collection of the fair and legitimate share of tax.

Further, in addition to above, there are some other principles which must be considered by countries in their tax system –

(i) **Equity and fairness:** Same income earned by different taxpayers must be taxed at the same rate regardless of the source of income.

(ii) **Neutrality and efficiency:** Neutrality factor provides that economic processes should not be affected by external factors such as taxation. Neutrality is two-fold.

(a) Capital export neutrality and

(b) Capital import neutrality (CIN).

Capital export neutrality (CEN) provides that business decision must not be affected by tax factors between the country of residence and the target country; whereas CIN provides that the level of tax imposed on non-residents as well as the residents must be similar.

(iii) **Promotion of mutual economic relation, trade and investment:** In some cases, it is observed that avoidance of double taxation is not the only objective. The other objective may be to give impetus to a country's overall economic growth and development.

Question 3

What is the General Rule of Interpretation under Vienna Convention of Law of Treaties?

Answer

Article 31 of Vienna Convention of Law of Treaties contains the General Rule of Interpretation. It lays down that following general rule of interpretation:

- A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms thereof in the context and in the light of its object and purpose.
- The context for the purpose of interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexure

  (a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

  (b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related thereto.
- The following shall be taken into account, together with the context in that:

  (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) Any relevant rules of international law applicable to relation between the parties.

- A special meaning shall be given to a term if it is established that the parties so intended.

Question 4

What are the Extrinsic Aids to interpretation of a tax treaty?

Answer

A wide range of extrinsic material is permitted to be used in interpretation of tax treaties. According to Article 32 of the Vienna Convention, the supplementary means of interpretation include the preparatory work of the treaty and the circumstances of its conclusion.

According to Prof. Starke, one may resort to following extrinsic aids to interpret a tax treaty provided that clear words are not thereby contradicted:

(i) Interpretative Protocols, Resolutions and Committee Reports, setting out agreed interpretations;

(ii) A subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions [Art. 31(3) of the VCLT];

(iii) Subsequent conduct of the state parties, as evidence of the intention of the parties and their conception of the treaty;

(iv) Other treaties, in *pari materia* (i.e., relating to the same subject matter), in case of doubt.

Provisions in Parallel Tax Treaties

If the language used in two tax treaties (say treaties: X and Y) are same and one treaty is more elaborative or clear in its meaning (say treaty X) can one rely on the interpretation/explanations provided in a treaty X while applying provisions of a treaty Y?

However, the views of the Indian Judiciary are not consistent in this respect. There are contradictory judgments by Indian courts/tribunal in this regard.

International Articles/Essays/Reports

International Article/Essays/Reports are referred as extrinsic aid for interpretation of tax treaties. Like, in case of *CIT v. Vishakhapatnam Port Trust (1983) 144 ITR 146 (AP)*, the High Court obtained "useful material" through international articles.

Cahiers published by International Fiscal Association (IFA), Netherlands

"Cahiers de Droit Fiscal International" is the main publication of the IFA, which is published annually and deals with two major topics each year. Cahiers were relied upon in case of *Azadi Bachao Andolan's* (supra) case by the Supreme Court.

Protocol

Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues.

A protocol is an integral part of a tax treaty and has the same binding force as the main clauses therein.

Protocol to India France treaty contains the Most Favoured Nation Clause. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision.

Preamble

Preamble to a tax treaty could guide in interpretation of a tax treaty. In case of *Azadi Bachao Andolan*, the Apex Court observed that 'the preamble to the Indo-Mauritius Double Tax Avoidance Treaty recites that it is for the 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty'. These observations are very significant whereby the Apex Court has upheld 'economic considerations' as one of the objectives of a Tax Treaty.

Mutual Agreement Procedure [MAP]

MAP helps to interpret any ambiguous term/provision through bilateral negotiations. MAP is more authentic than other aids as officials of both countries are in possession of materials/documents exchanged at the time of signing the tax treaty which would clearly indicate the object or purpose of a particular provision. Successful MAPs also serve as precedence in case of subsequent applications.

CHAPTER 7

FUNDAMENTALS OF BEPS

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- ❑ **gain** a broad understanding of the concept of Base Erosion and Profit Shifting (BEPS);
- ❑ **appreciate** the significance of action plans of BEPS;
- ❑ **comprehend and appreciate** the provisions incorporated in the Indian tax laws in line with the different Action Plans of BEPS.

7.1 BACKGROUND

Impact of Globalisation

Globalisation has benefited our domestic economies, boosted trade and increased foreign direct investments in many countries. The unrestricted movement of capital and labour, the shift of manufacturing bases from high-cost to low-cost locations, the gradual removal of trade barriers, technological and telecommunication developments, and the ever-increasing importance of managing risks and of developing, protecting and exploiting intellectual property, have had an important impact on the way cross-border activities take place. In this way, it accelerated growth, created jobs and fostered innovation. Globalisation is not new, but the pace of integration of national economies and markets has increased substantially in recent years. It has a significant impact on a country's corporate income tax regimes.

Growth of E-Commerce and consequent aggressive tax planning

Way back in 1920s, the League of Nations recognised that the interaction of domestic tax systems can lead to double taxation with adverse effects on growth and global prosperity. Globally, countries concur on the need to eliminate double taxation and the need to achieve this on the basis of accepted international laws that are clear and predictable, giving certainty to both governments and businesses. International tax law is, therefore, a pillar in facilitating the development of the global economy. With the economy, the enterprises also became more globally integrated. Multi-national enterprises (MNE) now represent a significant proportion of global GDP. Further, intra-firm trade comprises of a growing proportion of overall trade. Also, the increasing significance of the service component of the economy, and of digital products which are deliverable over the Internet, has made it much easier for businesses to locate many productive activities in geographic locations that are distant from the physical location of their customers. These developments have been accompanied by the increasing sophistication of tax planners in identifying and exploiting the legal arbitrage opportunities and the boundaries of acceptable tax planning, thus, encouraging MNEs to minimise their tax burden by resorting to aggressive tax planning.

Adverse Effects of BEPS

Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid. This has become a critical issue since governments have to cope with less revenue and a higher cost to ensure compliance. Moreover, BEPS undermines the integrity of the tax system, as reporting of low corporate taxes is considered to be unfair. In developing countries, the lack of tax revenue leads to significant under-funding of public investment that could help foster economic growth. Further, when tax laws permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers, especially individual taxpayers in that jurisdiction bear a greater share of the burden. This gives rise to tax fairness issues on account of individuals having to bear a higher tax burden. Also, enterprises that operate only in domestic markets, including family-owned businesses or new innovative businesses, may have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

Need for international collaboration to protect tax sovereignty of its countries

Taxation is at the core of countries' sovereignty, but the interaction of domestic tax laws in certain cases leads to gaps and frictions. While developing their domestic tax laws, sovereign states may not adequately take into consideration the effect of other countries' laws. The interaction of separate sets of laws enforced by sovereign countries causes frictions, including potential double taxation for corporations operating in many countries. It also causes gaps, in cases where corporate income is untaxed, both in the country of source and in the country of residence, or is taxed only at nominal rates. In the domestic context, coherence is generally achieved through a principle of matching – a payment that is deductible by the payer is usually taxable in the hands of the recipient, unless explicitly exempted. There is no similar principle of coherence at the international level, which leaves considerable scope for arbitrage by taxpayers, though sovereign states have united to ensure coherence in a narrow field, namely, to prevent double taxation. BEPS relates primarily to instances where the interaction of different tax rules leads to double non-taxation. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place. International standards have tried to reduce these frictions in a manner that respects tax sovereignty; however, gaps still remain. Therefore, there is a need for countries to collaborate on tax matters so that they are able to get their due share of taxes.

8.2 OVERVIEW OF BEPS

In the background of the above repercussions, in February 2013, the OECD published a report on "Addressing Base Erosion and Profit Shifting" iterating the need for analyzing the issue of tax base erosion and profit shifting by global corporations. The OECD followed it up with publishing draft Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan) in July 2013 which came to final fruition in October 2015. The BEPS action plan identifies fifteen actions to address BEPS in a comprehensive manner and sets a deadline to implement those actions.

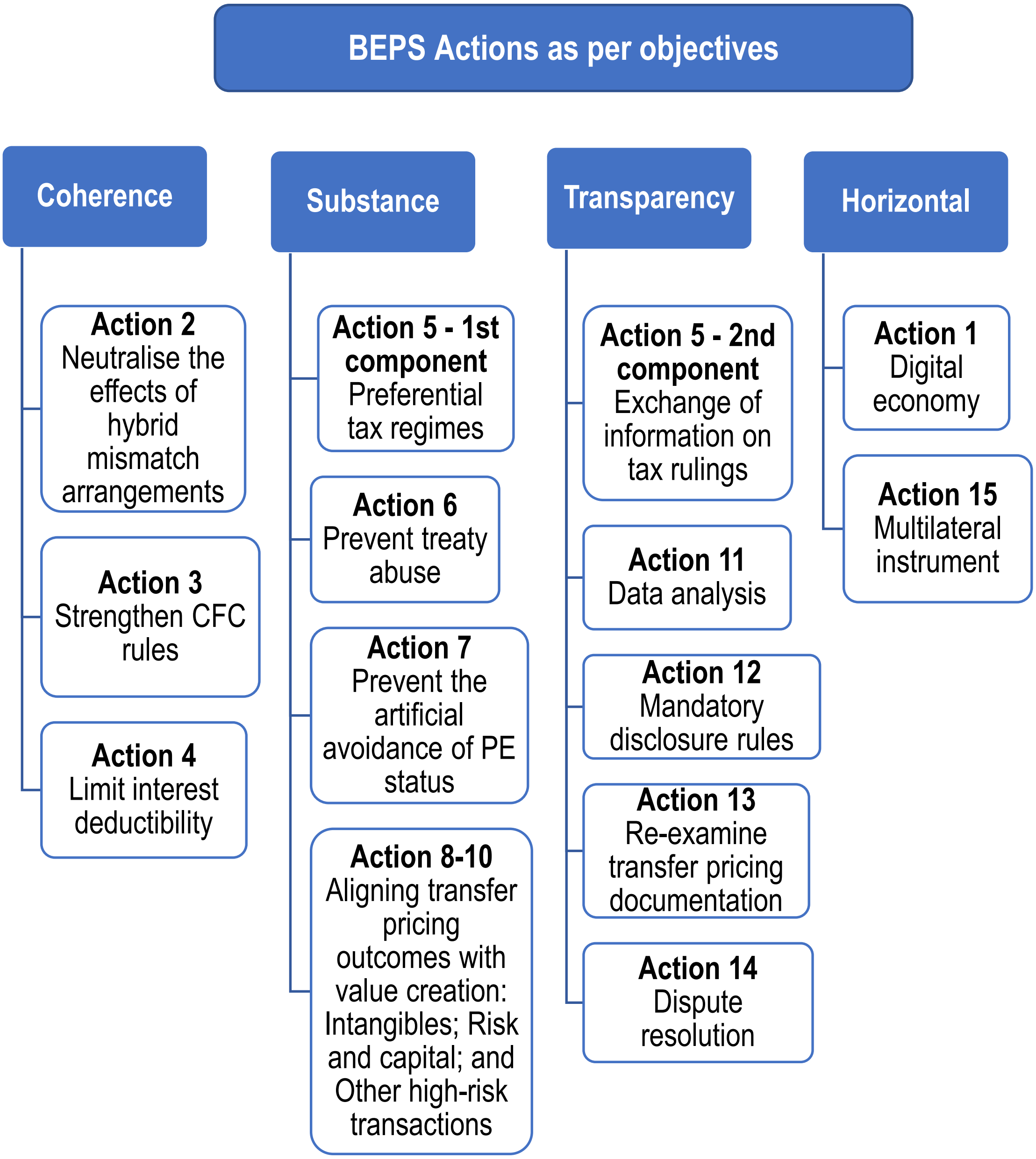
The Action Plans were structured around three fundamental pillars viz.:

(i) Introducing coherence in the domestic rules that affect cross-border activities.

(ii) Reinforcing of 'substance' requirements in existing international standards; Alignment of taxation with location of value creation and economic activity; and

(iii) Improving transparency and tax certainty.

A brief classification of the various action plans based on the fundamental pillars is as under:



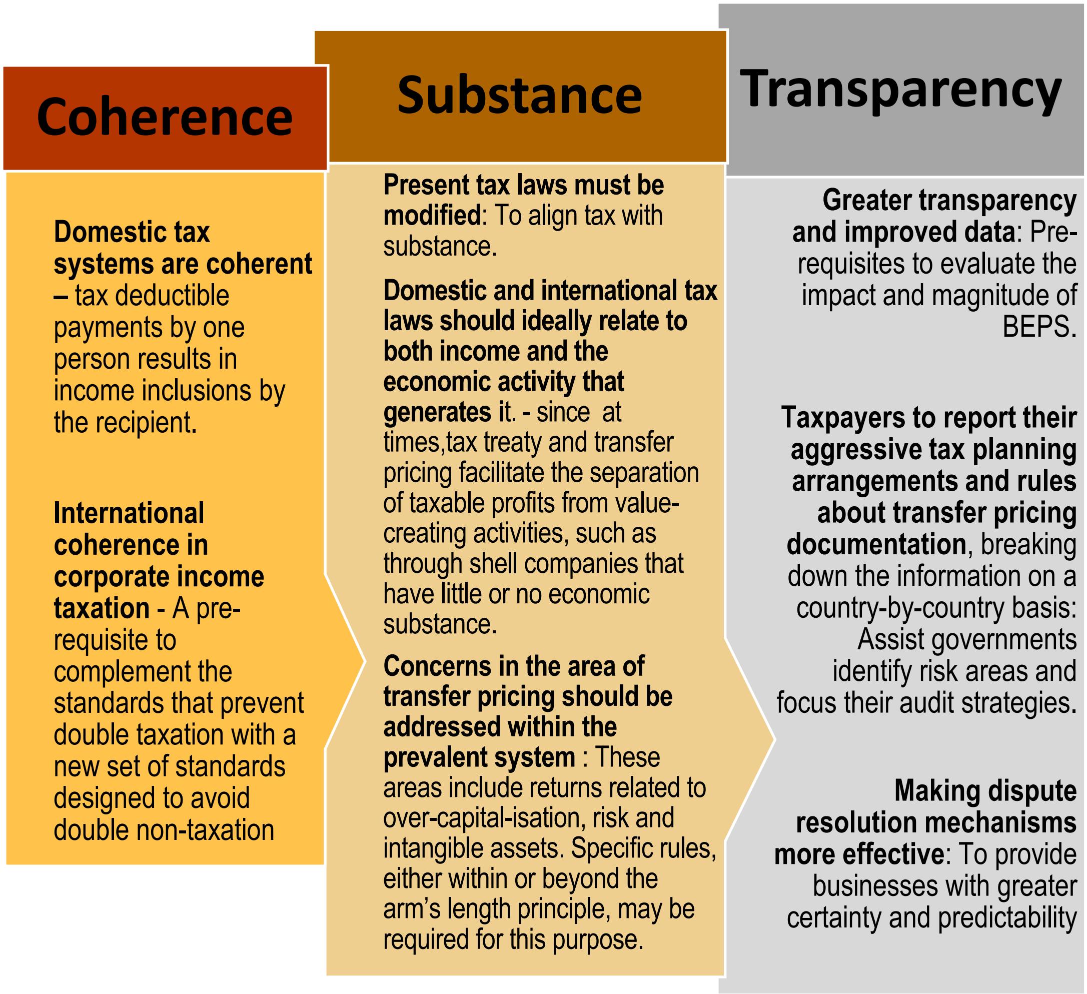
BEPS Actions as per objectives

Coherence
- **Action 2** Neutralise the effects of hybrid mismatch arrangements
- **Action 3** Strengthen CFC rules
- **Action 4** Limit interest deductibility

Substance
- **Action 5 - 1st component** Preferential tax regimes
- **Action 6** Prevent treaty abuse
- **Action 7** Prevent the artificial avoidance of PE status
- **Action 8-10** Aligning transfer pricing outcomes with value creation: Intangibles; Risk and capital; and Other high-risk transactions

Transparency
- **Action 5 - 2nd component** Exchange of information on tax rulings
- **Action 11** Data analysis
- **Action 12** Mandatory disclosure rules
- **Action 13** Re-examine transfer pricing documentation
- **Action 14** Dispute resolution

Horizontal
- **Action 1** Digital economy
- **Action 15** Multilateral instrument



Coherence

**Domestic tax systems are coherent – ** tax deductible payments by one person results in income inclusions by the recipient.

International coherence in corporate income taxation - A pre-requisite to complement the standards that prevent double taxation with a new set of standards designed to avoid double non-taxation

Substance

Present tax laws must be modified: To align tax with substance.

Domestic and international tax laws should ideally relate to both income and the economic activity that generates it. - since at times,tax treaty and transfer pricing facilitate the separation of taxable profits from value-creating activities, such as through shell companies that have little or no economic substance.

Concerns in the area of transfer pricing should be addressed within the prevalent system : These areas include returns related to over-capital-isation, risk and intangible assets. Specific rules, either within or beyond the arm's length principle, may be required for this purpose.

Transparency

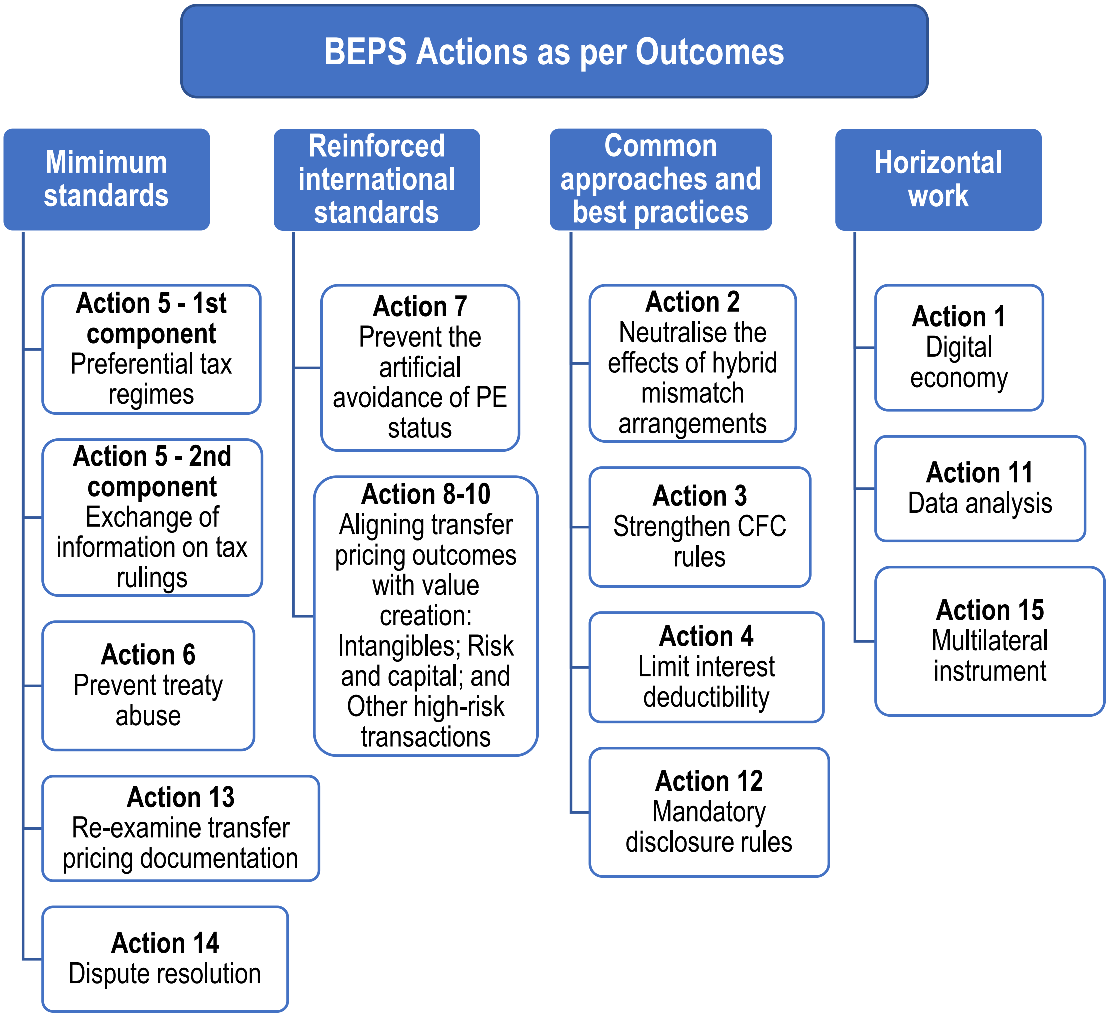
Greater transparency and improved data: Pre-requisites to evaluate the impact and magnitude of BEPS.

Taxpayers to report their aggressive tax planning arrangements and rules about transfer pricing documentation, breaking down the information on a country-by-country basis: Assist governments identify risk areas and focus their audit strategies.

Making dispute resolution mechanisms more effective: To provide businesses with greater certainty and predictability

The BEPS measures range from new minimum standards to a revision of pre-existing international standards, and to common approaches which will facilitate the convergence of national rules and guidance drawing on best practices.

A brief classification of the various action plans based on the basis of outcomes is as under:



BEPS Actions as per Outcomes

Mimimum standards

- **Action 5 - 1st component** Preferential tax regimes
- **Action 5 - 2nd component** Exchange of information on tax rulings
- **Action 6** Prevent treaty abuse
- **Action 13** Re-examine transfer pricing documentation
- **Action 14** Dispute resolution

Reinforced international standards

- **Action 7** Prevent the artificial avoidance of PE status
- **Action 8-10** Aligning transfer pricing outcomes with value creation: Intangibles; Risk and capital; and Other high-risk transactions

Common approaches and best practices

- **Action 2** Neutralise the effects of hybrid mismatch arrangements
- **Action 3** Strengthen CFC rules
- **Action 4** Limit interest deductibility
- **Action 12** Mandatory disclosure rules

Horizontal work

- **Action 1** Digital economy
- **Action 11** Data analysis
- **Action 15** Multilateral instrument

An unprecedented amount of interest and participation has been witnessed by OECD with more than sixty countries, both OECD members and G-20 countries, being directly involved as a part of technical groups in the development of congruent international tax standards. The Inclusive Framework on BEPS works to ensure that the international tax framework for MNEs remains relevant for today and the future, thereby promoting economic efficiency and global welfare. It will also ensure that governments continue to efficiently raise revenues not only from traditional but also from digital businesses, both for direct tax and indirect tax purposes.

The summary explanatory statement indicates the level of political commitment by OECD, G20 and other States involved in the 2015 work to the various reports. The OECD has iterated the following terms to indicate the commitment by various participant countries:

New minimum standard - New minimum standard implies application of a new rule to be implemented by all states, since non-implementation may result in negative spill overs (including adverse impact of competitiveness) on other countries. Each of the four BEPS minimum standards [namely, Actions 5, 6, 13 and 14] is subject to peer review in order to ensure timely and accurate implementation and thus safeguard the level playing field. All members of the Inclusive Framework on BEPS commit to implementing the minimum standards, and commit to participating in the peer review.

Revision of a standard which already exists – Existing standards have been updated and will be implemented but with the caveat that all BEPS participants have not endorsed the underlying standards on tax treaties or transfer pricing; and

Best practice – A best practice is not a standard but optional recommendation for states to follow. Guidance based on best practices will support those countries proposing to act in the areas of mandatory disclosure initiatives or controlled foreign company (CFC) legislation.

(1) ACTION PLAN 1 – ADDRESSING THE CHALLENGES OF THE DIGITAL ECONOMY

Digital economy: Dissolving link between income-producing activity and physical location

At present, in the digital domain, business may be conducted without regard to national boundaries and may dissolve the link between an income-producing activity and a specific location. Hence, business in digital domain doesn't actually occur in any physical location but instead takes place in "cyberspace." Given the rise of e-commerce, an entire digital economy has emerged in the last decade. Since there is a concept of 'intangibility' attached to the digital model of business, tax authorities often faced challenges rightly bringing to tax the profits earned from a digital business. To address the same, the first action plan of the BEPS project was developed by the OECD which outlines the methods and principles based on which physical and digital economies can be taxed at par. Before the same, physical locations of the servers of such digital businesses were considered to establish the tax jurisdiction in which the profits of digital businesses could be taxed. However, it was observed that servers were therefore placed in tax efficient jurisdictions, even though the main income generation and customers were from other jurisdictions.

Taxation issues in E-Commerce

These new business models have created new tax challenges. The typical taxation issues relating to e-commerce are:

(i) the difficulty in characterizing the nature of payment and establishing a nexus or link between a taxable transaction, activity and a taxing jurisdiction,

(ii) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

The digital business, thus, challenges physical presence-based permanent establishment rules. If permanent establishment (PE) principles are to remain effective in the new economy, the fundamental PE components developed for the old economy i.e., place of business, location, and permanency must be reconciled with the new digital reality.

OECD Recommendations under Action Plan 1 of the BEPS project

The The OECD has recommended several options to tackle the direct tax challenges which include:

Modifying the existing Permanent Establishment (PE) rule to provide whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.

A virtual fixed place of business PE in the concept of PE i.e., creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website

Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider or **imposition of a equalisation levy** on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having PE in other contracting state.

Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.

Indian Taxation Regime

Insertion of Chapter VIII in the Finance Act, 2016 on Equalisation Levy to address this challenge

In order to address the challenges of the digital economy, Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

Meaning of "Specified Service"

(1) Online advertisement;

(2) Any provision for digital advertising space or any other facility or service for the purpose of online advertisement;

Specified Service also includes any other service as may be notified by the Central Government.

Further, in order to reduce burden of small players in the digital domain, it is also provided that no such levy shall be made if the aggregate amount of consideration for specified services received or receivable by a non-resident from a person resident in India or from a non-resident having a permanent establishment in India does not exceed ₹ 1 lakh in any previous year.

"Significant economic presence" to constitute "business connection"

The scope of provisions of section 9(1)(i), prior to amendment by the Finance Act, 2018, were restrictive as it essentially provided for physical presence based nexus rule for taxation of business income of the non-resident in India. *Explanation 2* to the said section which defines 'business connection' was also narrow in its scope since it limited the taxability of certain activities or transactions of non-resident to those carried out through a dependent agent. Therefore, emerging business models such as digitized businesses, which do not require physical presence of itself or any agent in India, were not covered within the scope of section 9(1)(i).

In view of the above, the Finance Act, 2018 has amended section 9(1)(i) to provide that 'significant economic presence' in India shall also constitute 'business connection'. For this purpose, "significant economic presence" means-

	Transaction/activity	Condition
(i)	any transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India	the aggregate of payments arising from such transaction or transactions during the previous year exceeds the amount as may be prescribed
(ii)	systematic and continuous soliciting of its business activities or engaging in interaction with users in India through digital means	The users would be of such number as may be prescribed.

Notes:

(i) Only so much of income as is attributable to such transactions or activities shall be deemed to accrue or arise in India.

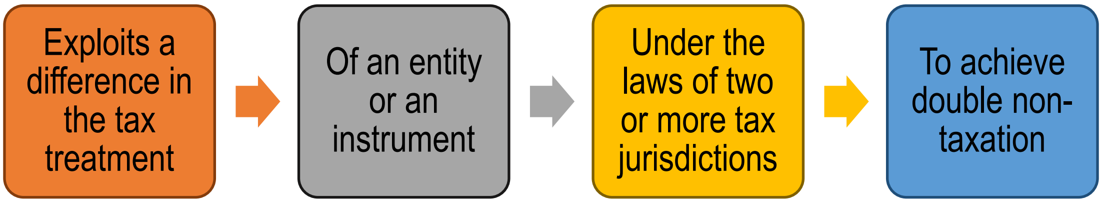
(ii) Such transactions or activities shall constitute significant economic presence in India, whether or not the agreement for such transactions or activities is entered in India or whether or not the non-resident has a residence or place of business in India or renders services in India.

(2) ACTION PLAN 2 - NEUTRALISE THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS

Before understanding what Action Plan 2 recommends, we must understand what a hybrid mismatch is.

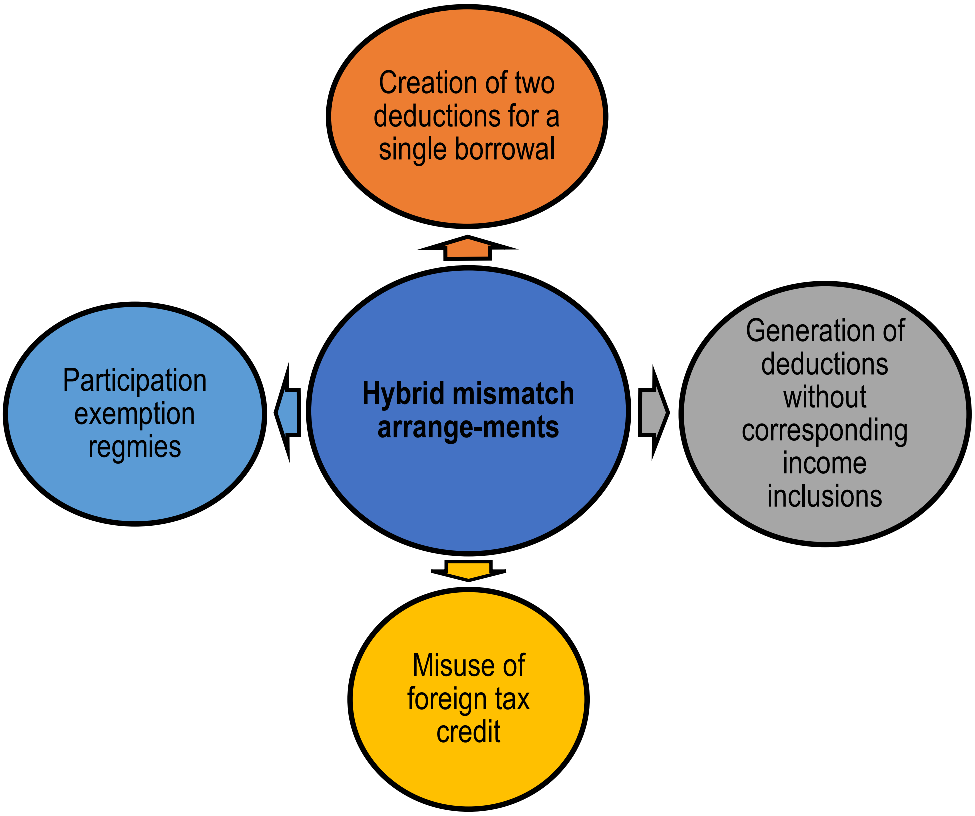
Hybrid Mismatch Arrangement: Meaning

A hybrid mismatch is an arrangement that:



Exploits a difference in the tax treatment → Of an entity or an instrument → Under the laws of two or more tax jurisdictions → To achieve double non-taxation

Hybrid mismatch arrangements are sometimes used to achieve unintended double non-taxation or long-term tax deferral in one or more of the following ways -



Hybrid mismatch arrange-ments

Creation of two deductions for a single borrowal

Generation of deductions without corresponding income inclusions

Misuse of foreign tax credit

Participation exemption regmies

Specific country laws that allow taxpayers to opt for the tax treatment of certain domestic and foreign entities may aid hybrid mismatches. It may not be easy to find out which country has in fact lost tax revenue, since the laws of each country involved have been complied with; however, there is a reduction of the overall tax paid by all parties involved as a whole, which ultimately has an adverse effect on competition, economic efficiency, transparency and fairness.

Recommended general amendments are as follows:

- **A rule denying transparency to entities where the non-resident investors' resident country treats the entity as opaque;**

Example

Let us say, X Co., a parent company in country X indirectly holds Y Co., an operating company in country Y. Between X Co. and Y Co. is a hybrid entity that is treated as transparent or disregarded for country X tax purposes and as non-transparent for country Y tax purposes. X Co. holds all or almost all equity interest in the hybrid entity which in turn holds all or almost all equity interests in Y Co. The hybrid entity borrows money from a third party and the loan is used to invest equity into Y Co (or to buy the shares in Y Co from either another company of the same group or from an unrelated third party). The hybrid entity pays interest on the loan. Except for the interest, the hybrid entity does not claim any other significant deduction and does not have any significant income.

With respect to Country Y, for tax purposes, Hybrid Entity is subject to corporate income tax. Its interest expenses can be used to offset other country Y group companies' income under the country Y group tax relief regime. On the other hand, country X treats the hybrid entity as transparent or disregarded, with the result that its interest expenses are allocated to X Co, which deducts the interest expense to offset unrelated income. The net effect is that there are two deductions for the same contractual obligation in two different countries.

Therefore, by virtue of rule denying transparency to an entity which is treated as opaque in the subsidiary company's country, the double deduction can be avoided.

- **A rule denying an exemption or credit for foreign underlying tax for dividends that are deductible by the payer;**

Example

N Co, a company resident in country N is funded by M Co., a company resident in country M with an instrument that qualifies as equity in country M but as debt in country N. A payment made under the instrument would be deductible as interest expense for N Co under country N tax law. The corresponding receipts are treated as exempt dividends under the tax laws of country M. Consequently, deduction is available under the tax laws of country N without a corresponding income inclusion in country M.

Therefore, by virtue of rule denying an exemption or credit for foreign underlying tax for dividends that are deductible by the payer, exemption of such income in country M would not be possible.

- **A rule denying a foreign tax credit for withholding tax where that tax is also credited to some other entity**; and
- **Amendments to CFC and similar regimes attributing local shareholders the income of foreign entities that are treated as transparent under their local law.**

Treaty changes **-** Action Plan 2 recommends a new provision in the case of income earned by a transparent entity. As per the new provision, treaty benefits will only be afforded to so much of the income of the entity as the income of a resident of that State. A specific or general saving rule is proposed so that a State can tax a resident entity generally unrestricted by treaty.

Anti-hybrid rules - The report further issued a series of dedicated domestic anti-hybrid rules which would work in two stages. The primary rules would deny deductions to payers in situations where either

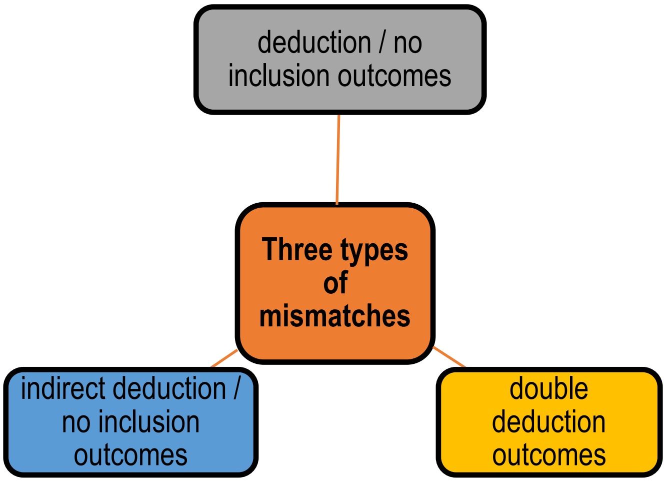
(i) Those payments will not be included in the recipient's ordinary income, or

(ii) The same amount is being simultaneously deducted by another entity.

Treatment of Branch mismatches : 2017 Report

Branch mismatches arise where the ordinary rules for allocating income and expenditure between the branch and head office result in a portion of the net income of the taxpayer escaping the charge to taxation in both the branch and residence jurisdiction. These branch mismatches occur where two jurisdictions take a different view as to the existence of, or the allocation of income or expenditure between, the branch in head office of the same taxpayer.

Unlike hybrid mismatches, which result from conflicts in the legal treatment of entities or instruments, branch mismatches are the result of differences in the way the branch and head office account for a payment made by or to the branch. The 2017 report identifies five basic types of branch mismatch arrangements that give rise to one of three types of mismatches:


deduction / no inclusion outcomes
Three types of mismatches
indirect deduction / no inclusion outcomes
double deduction outcomes

The 2017 report includes specific recommendations for improvements to domestic law intended to reduce the frequency of branch mismatches as well as targeted branch mismatch rules which adjust the tax consequences in either the residence or branch jurisdiction in order to neutralise the hybrid mismatch without disturbing any of the other tax, commercial or regulatory outcomes.

(3) ACTION PLAN 3 - STRENGTHEN CONTROLLED FOREIGN COMPANY (CFC) RULES

Shifting investment income and passive income to subsidiaries in low tax or no tax jurisdictions: Deferral of home country taxation

Under the tax laws of several countries, a shareholder of a corporation is not taxed on the corporation's income until the income is distributed as a dividend. Therefore, it was common for publicly traded companies to form foreign subsidiaries in tax havens and shift "portable" income to those subsidiaries. Generally, income shifted were mainly investment income (interest and dividends) and passive income (rents and royalties), as well as sales and services income involving related parties. Tax in parent country on this income was avoided until the tax haven country paid a dividend to the shareholding company. This dividend could be avoided indefinitely by loaning the earnings to the shareholder without actually declaring a dividend.

Many countries (where global multi-nationals are based) have high tax rates as compared to certain other countries, which used their low tax rates as a means of attracting inward investment. As a result, when dividends were repatriated from these lower tax countries, the recipient generally suffered additional tax on those profits. Therefore, many companies have a tendency to leave the profits from these low-taxed subsidiaries offshore, with the objective of deferring home country taxation.

Obviously, Governments were disturbed that multinationals based in their countries kept large amounts of profits offshore. In order to address this issue, governments in various countries have introduced legislation aimed at eliminating the benefits of deferral, by currently taxing income in the parent country even when the income has not been repatriated or remitted to that country. These rules are generally referred to as Controlled Foreign Corporation (CFC) rules.

CFC Rules: Addressing BEPS

Controlled foreign company (CFC) rules respond to the risk that taxpayers with a controlling interest in a foreign subsidiary can strip the base of their country of residence and, in some cases, other countries by shifting income into a CFC. Without such rules, CFCs provide opportunities for profit shifting and long-term deferral of taxation.

The OECD Final Report does not propose a minimum standard for controlled foreign company (CFC) regimes. However, OECD regards CFC rules as being important in tackling BEPS and has made a series of **best practice recommendations** in relation to the ‘building blocks’ of an effective CFC regime. The major reason why the OECD was unable to provide more than best practice was fundamental disagreement over the policy of CFC regimes, in particular whether states should use the regime to protect other states’ tax bases from earnings stripping.

Indian Taxation Regime

- At present, there are no CFC rules in the Income-tax Act, 1961;
- CFC rules formed part of the proposed Direct Tax Code.
- CFC regime has been debated over last many years in India and is one of the last remaining concepts from the DTC to be incorporated in the Income-tax Act, 1961.
- In order to encourage repatriation of profits, section 115BBD provides a concessional tax rate of 15% (gross basis) on dividends received from a specified foreign company i.e., a foreign company in which the Indian company holds 26% or more in the nominal value of the equity share capital of the company.

(4) ACTION PLAN 4 – INTEREST DEDUCTIONS AND OTHER FINANCIAL PAYMENTS

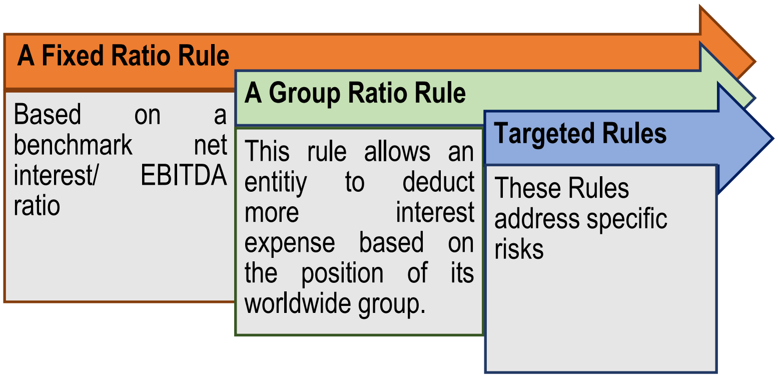
The OECD is concerned that multinational groups are able to erode their tax base (i.e., reduce their taxable profits) with interest expense, for example by:

- Locating third party debt in high tax countries;
- Using intra-group loans to achieve interest deductions in excess of the group's actual third party interest expense;
- Using related party or third party debt to finance the production of exempt or deferred income.

BEPS Action Plan 4 calls for the development of recommendations for the design of domestic rules to prevent tax base erosion through the use of interest expense and other financial payments that are economically equivalent to interest.

Common Approach: Linking an entity's net interest deduction to its level of economic activity

The mobility and fungibility of money enables multinational groups to achieve favourable tax results by adjusting the amount of debt in a group entity. The 2015 Report established a common approach which directly links an entity's net interest deductions to its level of economic activity, based on taxable earnings before interest income and expense, depreciation and amortisation (EBITDA). This approach includes three elements:



A Fixed Ratio Rule

Based on a benchmark net interest/ EBITDA ratio

A Group Ratio Rule

This rule allows an entitiy to deduct more interest expense based on the position of its worldwide group.

Targeted Rules

These Rules address specific risks

Indian Taxation Regime

Section 94B of the Income-tax Act, 1961: Addressing Thin Capitalization

Debt financing of cross-border transactions is often favorable than equity financing for taxpayer. In view of the above, in line with the recommendations of OECD BEPS Action Plan 4, section 94B has been inserted in the Income-tax Act, 1961 by the Finance Act, 2017 to provide a cap on the interest expense that can be claimed by an entity to its associated enterprise. The total interest paid in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise for that previous year, whichever is less, shall not be deductible.

Applicability

The provision is applicable to an Indian company, or a permanent establishment of a foreign company, being the borrower, who pays interest in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower. Further, the debt is deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender, being a non-associated enterprise, or deposits a corresponding and matching amount of funds with such lender.

Carry forward of disallowed interest expenditure

The provision allows for carry forward of disallowed interest expense for 8 assessment years immediately succeeding the assessment year for which the disallowance is first made and deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure.

Threshold limit

In order to target only large interest payments, it provides for a threshold of interest expenditure of ₹ 1 crore in respect of any debt issued by a non-resident associated enterprise exceeding which the provision would be applicable. Banks and Insurance business are excluded from the ambit of the said provisions keeping in view of special nature of these businesses.

(5) ACTION PLAN 5 – COUNTER HARMFUL TAX PRACTICES

The Action 5 Report is one of the four BEPS minimum standards. The minimum standard of the Action 5 Report consists of two parts. One part relates to preferential tax regimes, where a peer review is undertaken to identify features of such regimes that can facilitate base erosion and profit shifting, and therefore have the potential to unfairly impact the tax base of other jurisdictions. The second part includes a commitment to transparency through the compulsory spontaneous exchange of relevant information on taxpayer-specific rulings which, in the absence of such information exchange, could give rise to BEPS concerns.

Indian Taxation Regime

In India, the Finance Act, 2016 has introduced a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development. The purpose of the concessional taxation regime is to encourage entities to retain and commercialise existing patents and for developing new innovative patented products. Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture and exploitation of patents in India.

Section 115BBF of the Income-tax Act, 1961: In line with nexus approach of BEPS Action 5

The nexus approach has been recommended by the OECD under BEPS Action Plan 5. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. Accordingly, section 115BBF of the Income-tax Act, 1961 provides that where the total income of the eligible assessee includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess). For this purpose, developed means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

(6) ACTION PLAN 6 – PREVENTING TREATY ABUSE

Protection against treaty shopping: Minimum Standard

Given the risk to revenues posed by treaty shopping, countries have committed to ensure a minimum level of protection against treaty shopping (the minimum standard). That commitment will require countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

Countries will implement this common intention by including in their treaties:

(i) the combined approach of Limitation of Benefits (LOB) and Principal Purpose Test (PPT) rule,

(ii) the PPT rule alone, or

(iii) the LOB rule supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.

Implementation of Action 6 Minimum Standard

The first peer review on the implementation of the Action 6 minimum standard reveals that a large majority of Inclusive Framework members have begun to translate their commitment on treaty shopping into actions and are now in the process of modifying their treaty network. In total, on 30

June 2018, 82 jurisdictions had some treaties that were already compliant with the minimum standard or that were going to shortly comply.

The first peer review shows the efficiency of the Multilateral Instrument (MLI) [For detailed understanding of MLI, refer to discussion in Action Plan 15] in implementing the minimum standard and the other treaty-related BEPS measures. As per OECD, it is by far the preferred tool of Inclusive Framework members for implementing the minimum standard. The majority of the jurisdictions that have signed the MLI have listed almost all their treaties under the MLI.

As on 1st January, 2019, the provisions of the MLI started to take effect with respect to some treaties. For the treaties for which the MLI is effective, tax administration can now use effective treaty provisions to put an end to treaty-shopping.

Indian Tax Regime

LoB clause introduced in India-Mauritius Tax Treaty - On 10th May, 2016, India and Mauritius has signed a protocol amending the India-Mauritius tax treaty at Mauritius. In the said treaty, for the first time, it has been provided that gains from the alienation of shares acquired on or after 1.4.2017 in a company which is a resident of India may be taxed in India. The tax rate on such capital gains arising during the period from 1.4.2017-31.3.2019 should, however, not exceed 50% of the tax rate applicable on such capital gains in India. A Limitation of Benefit (LOB) Clause has been introduced which provides that a resident of a Contracting State shall not be entitled to the benefits of 50% of the tax rate applicable in transition period if its affairs are arranged with the primary purpose of taking advantage of concessional rate of tax. Further, a shell or a conduit company claiming to be a resident of a Contracting State shall not be entitled to this benefit. A shell or conduit company has been defined as any legal entity falling within the meaning of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State. A resident of a Contracting State is deemed to be a shell/conduit company if its expenditure on operations in that Contracting State is less than Mauritian rupee 15,00,000 or Indian ₹ 7,00,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

LoB clause in India-Singapore Tax Treaty - On similar lines, India and Singapore has signed a protocol amending the India-Singapore tax treaty. Capital gains on alienation of shares would be taxable in a similar manner as laid out in India-Mauritius tax treaty, subject to LoB clause. The transition period benefit is also similar to that contained in India-Mauritius Tax Treaty. In respect of shares acquired after 1.4.2017 and sold before 1.4.2019, the expenditure test needs to be met for the 12 month period immediately preceding the date of transfer.

(7) ACTION PLAN 7 – PREVENT THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT (PE) STATUS

This report includes changes to the definition of permanent establishment (PE) in the OECD Model Tax Convention that will address strategies used to avoid having a taxable presence in a country under tax treaties.

These changes will ensure that where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise will be considered to have a taxable presence in that country unless the intermediary is performing these activities in the course of an independent business. The changes will also restrict the application of a number of exceptions to the definition of permanent establishment to activities that are preparatory or auxiliary nature and will ensure that it is not possible to take advantage of these exceptions by the fragmentation of a cohesive operating business into several small operations; they will also address situations where the exception applicable to construction sites is circumvented through the splitting-up contracts between closely related enterprises.

Thus, the following steps have been advocated:

- ***Reworking exceptions to PE definition*** – An anti-fragmentation rule to be adopted to aggregate all activities carried by an enterprise in a state, along with activities undertaken by its closely related entities undertaking business operation that create tax mismatch and are cohesive in nature. The above test can also be applied to understand whether the activities undertaken by an enterprise in a state are 'preparatory or auxiliary'.

- ***Analyzing arrangements entered through contractual agreements*** –A Commissionnaire arrangement may be broadly defined as an arrangement through which a person sells products in a State in its own name but on behalf of a foreign enterprise that is the owner of these products. Through such an arrangement, a foreign enterprise is able to sell its products in a State without technically having a permanent establishment to which such sales may be attributed for tax purposes and without, therefore, being taxable in that State on the profits derived from such sales. Since the person that concludes the sales does not own the products that it sells, that person cannot be taxed on the profits derived from such sales and may only be taxed on the remuneration that it receives for its services (usually a commission). Commissionnaire arrangements have been a major cause of concern for tax administrations in many countries.

Progress in implementation of BEPS Action Plan 7

The changes to the PE definitions were integrated in the 2017 OECD Model Tax Convention and in Part IV of the MLI (Articles 12 to 15). The Multilateral Instrument (MLI) is a flexible instrument that allows jurisdictions to adopt BEPS treaty-related measures to counter BEPS and strengthen their treaty network. The MLI was signed by nearly 90 jurisdictions and about half of the MLI Signatories have so far adopted the MLI articles that implement the permanent establishment changes [For detailed understanding of MLI, refer to discussion under Action 15].

(8) ACTION PLAN 8-10 - TRANSFER PRICING OUTCOMES IN LINE WITH VALUE CREATION/INTANGIBLES/RISK AND CAPITAL AND OTHER HIGH-RISK TRANSACTIONS

The aforesaid Action plans represent the OECD's work on transfer pricing which has been a core focus of the BEPS Action Plans. The specific Actions focus on Intangibles, Risks and capital and other high-risk transactions. These are the hard areas of transfer pricing and are summarized together in the Final Report 'Aligning Transfer Pricing Outcomes with Value Creation'.

Clarification and Strengthening of existing standards on transfer pricing

Transfer pricing rules, which are set out in Article 9 of tax treaties based on the OECD and UN Model Tax Conventions and the Transfer Pricing Guidelines, are used to determine on the basis of the ALP the conditions, including the price, for transactions within an MNE group. The existing standards in this area have been clarified and strengthened, including the guidance on the arm's length principle and an approach to ensure the appropriate pricing of hard-to-value-intangibles has been agreed upon within the arm's length principle. The work has focused on three key areas.

Action Plan	Details
8	Addresses transfer pricing issues relating to controlled transactions involving intangibles, since intangibles are by definition mobile and they are generally difficult-to-value. Misallocation of the profits generated by valuable intangibles is a significant cause of BEPS.
9	Contractual allocations of risk are respected only when they are supported by actual decision-making and thus exercising control over these risks. Moreover, Action 9 addresses the level of returns to funding provided by a capital-rich MNE group member, where those returns do not correspond to the level of activity undertaken by the funding company.
10	This action focuses on other high-risk areas, which include: the scope for addressing profit allocations resulting from controlled transactions which are not commercially rational, the scope for targeting the use of transfer pricing methods in a way which results in diverting profits from the most economically important activities of the MNE group, and the use of certain type of payments between members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with the value-creation.

OECD Transfer Pricing Guidelines

In addition, the OECD Transfer Pricing Guidelines released in 2017 provide guidance on the application of the "arm's length principle", which represents the international consensus on the valuation, for income tax purposes, of cross-border transactions between associated enterprises. In today's economy where multinational enterprises play an increasingly prominent role, transfer pricing continues to be high on the agenda of tax administrations and taxpayers alike. Governments need to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdiction and that the tax base reported by MNEs in their country reflects the economic activity undertaken therein and taxpayers need clear guidance on the proper application of the arm's length principle.

(9) ACTION PLAN 11 – MEASURING AND MONITORING BEPS

The adverse fiscal and economic impacts of BEPS have been the focus of the OECD/G20 BEPS Project since its inception. While anecdotal evidence has shown that tax planning activities of some multinational enterprises (MNEs) take advantage of the mismatches and gaps in the international tax rules, separating taxable profits from the underlying value-creating activity, The Addressing Base Erosion and Profit Shifting report (OECD, 2013) recognised that the scale of the negative global impacts on economic activity and government revenues have been uncertain.

Although measuring the scale of BEPS proves challenging given the complexity of BEPS and the serious data limitations, the fiscal effects of BEPS are significant. BEPS causes other adverse economic effects, including tilting the playing field in favour of tax-aggressive MNEs, exacerbating the corporate debt bias, misdirecting foreign direct investment, and reducing the financing of needed public infrastructure.

Indicators of BEPS activity

Six indicators of BEPS activity highlight BEPS behaviour using different sources of data, employing different metrics, and examining different BEPS channels. When combined and presented as a dashboard of indicators, they confirm the existence of BEPS, and its continued increase in scale in recent years.

(i) **The profit rates of MNE affiliates located in lower-tax countries are higher than their group's average worldwide profit rate.** For example, the profit rates reported by MNE affiliates located in lower-tax countries are twice as high as their group's worldwide profit rate on average.

(ii) **The effective tax rates paid by large MNE entities are estimated to be lower than similar enterprises with only domestic operations** - This tilts the playing-field against local businesses and non-tax aggressive MNEs, although some of this may be due to MNEs' greater utilisation of available country tax preferences.

(iii) **Foreign direct investment (FDI) is increasingly concentrated - **FDI in countries with net FDI to GDP ratios of more than 200% increased from 38 times higher than all other countries in 2005 to 99 times higher in 2012.

(iv) **The separation of taxable profits from the location of the value creating activity is particularly clear with respect to intangible assets, and the phenomenon has grown rapidly - **For example, the ratio of the value of royalties received to spending on research and development in a group of low-tax countries was six times higher than the average ratio for all other countries, and has increased three-fold between 2009 and 2012.

(v) **Royalties received by entities located in these low-tax countries accounted for 3% of total royalties** - This provides evidence of the existence of BEPS, though not a direct measurement of the scale of BEPS.

(vi) **Debt from both related and third-parties is more concentrated in MNE affiliates in higher statutory tax-rate countries**. The interest-to-income ratio for affiliates of the largest global MNEs in higher-tax rate countries is almost three times higher than their MNE's worldwide third-party interest-to-income ratio.

(10) ACTION PLAN 12 – DISCLOSURE OF AGGRESSIVE TAX PLANNING ARRANGEMENTS

A significant challenge faced by tax authorities worldwide is the lack of timely, comprehensive and relevant information on aggressive tax planning strategies. Timely access to such information would facilitate quick response to tax risks through informed risk assessment, audits, or changes to legislation or regulations. BEPS Action Plan 12 recognises the advantages of tools designed to facilitate the information flow on tax risks to tax administrations and tax policy makers. The Report provides a modular framework for guidance drawn from best practices for use by countries without mandatory disclosure rules to design a regime that suits their requirement to get early information on potentially aggressive or abusive tax planning schemes and their users. The recommendations in this Report do not represent a minimum standard and countries can decide whether or not to introduce mandatory disclosure regimes. Where a country opts for mandatory disclosure rules, the recommendations provide the necessary flexibility to balance a country's need for better and more timely information with the compliance burdens for taxpayers. It also sets out specific best practice recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and co-operation between tax administrations.

(11) ACTION PLAN 13 – RE-EXAMINE TRANSFER PRICING DOCUMENTATION

This report contains revised standards for transfer pricing documentation incorporating a master file, local file, and a template for country-by-country reporting of revenues, profits, taxes paid and certain measures of economic activity. The revised standardised approach requires taxpayers to articulate consistent transfer pricing positions and will provide tax administrations with useful information to assess transfer pricing and other BEPS risks, make determinations about where audit resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries. Country-by-country reports will be disseminated through an automatic government-to-government exchange mechanism. The implementation package included in this report sets out guidance to ensure that the reports are provided in a timely manner, that confidentiality is preserved and that the information is used appropriately, by incorporating model legislation and model Competent Authority Agreements forming the basis for government-to-government exchanges of the reports.

Requirements as per OECD report on Action 13 of BEPS Action Plan

The OECD report provides for:

(a) revised standards for transfer pricing documentation; and

(b) a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity.

Three-tier structure mandated by BEPS

The BEPS report recommends that countries adopt a standardised approach to transfer pricing documentation; it mandates the following three-tier structure:-

	Document	Information
(1)	Master File	Standardised information relevant for all multinational enterprises (MNE) group members. Master file requires MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies. The master file is to be delivered by MNEs directly to local tax administrations.
(2)	Local file	Local file requires maintaining of transactional information specific to each country in detail covering related-party transactions and the amounts involved in those transactions. In addition, relevant financial information regarding specific transactions, a comparability analysis and analysis of the selection and application of the most appropriate transfer pricing method should also be captured. The local file is to be delivered by MNEs directly to local tax administrations.
(3)	Country-by-country report	The BEPS Action 13 report provides a template for multinational enterprises (MNEs) to report annually and for each tax jurisdiction in which they do business the information set out therein. This report is called the Country-by-Country (CbC) Report. To facilitate the implementation of the CbC Reporting standard, the BEPS Action 13 report includes a CbC Reporting Implementation Package which consists of (i) model legislation which could be used by countries to require the ultimate parent entity of an MNE group to file the CbC Report in its jurisdiction of residence including backup filing requirements and (ii) three model Competent Authority Agreements that could be used to facilitate implementation of the exchange of CbC Reports, respectively based on the: a) Multilateral Convention on Administrative Assistance in Tax Matters; b) Bilateral tax conventions; and c) Tax Information Exchange Agreements (TIEAs).

		Following information are required in the CbC report: Information relating to the global allocation of the MNE's income and taxes paid; and Indicators of the location of economic activity within the MNE group. CBC report requires MNEs to provide an annual report of economic indicators viz. the amount of revenue, profit before income tax, income tax paid and accrued in relation to the tax jurisdiction in which they do business. CBC reports are required to be filed in the jurisdiction of tax residence of the ultimate parent entity, being subsequently shared between other jurisdictions through automatic exchange of information mechanism.

Advantages of the three-tier structure [as per BEPS Report]:

(a) Taxpayers will be required to articulate consistent transfer pricing positions;

(b) Tax administrations would get useful information to assess transfer pricing risks;

(c) Tax administrations would be able to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.

Indian Taxation Regime

Transfer Pricing provisions under the Income-tax Act, 1961

Chapter X of the Income-tax Act, 1961 comprising sections 92 to 92F contain provisions relating to transfer pricing regime.

Section 92D requires maintenance of prescribed information and document relating to the international transaction and specified domestic transaction by every person who has entered into an international transaction. ***Also, a constituent entity of an international group is required to keep and maintain the prescribed information and document in respect of the international group.***

Implementation of international consensus in India

India is one of the active members of BEPS initiative and part of international consensus. For the purpose of implementing the international consensus, a specific reporting regime in respect of CbC reporting and also the master file has been incorporated in the Income-tax Act, 1961. The essential elements have been incorporated in the Income-tax Act, 1961 while remaining aspects would be dealt with in detail in the Income-tax Rules, 1962.

Note – *Refer to Chapter 1 Transfer Pricing, wherein the following have been discussed at length -*

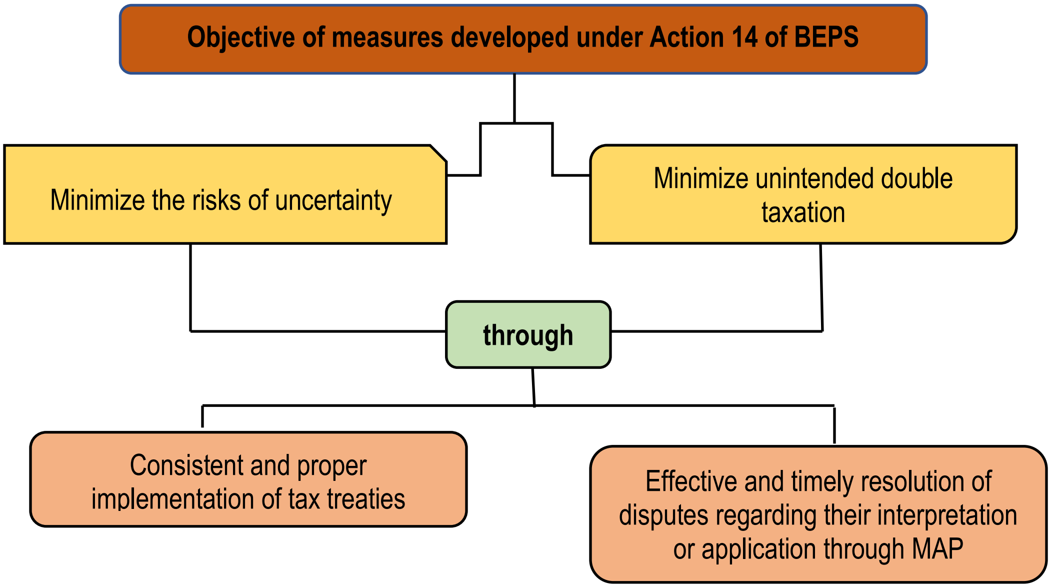
(i) Elements relating to CbC reporting requirement and related matters which have been incorporated in section 286 of the Income-tax Act, 1961

(ii) Maintenance and furnishing of Master file: Consequent provisions incorporated in section 92D of the Income-tax Act, 1961.

Threshold limit of consolidated group revenue for applicability of CbC reporting requirement

The CbC reporting requirement for a reporting year does not apply unless the consolidated revenues of the preceding accounting year of the group, based on consolidated financial statement, exceeds a threshold to be prescribed. The current international consensus is for a threshold of € 750 million equivalent in local currency. This threshold for total consolidated group revenue of the international group prescribed under section 286 of the Income-tax Act, 1961 read with Rule 10DB of the Income-tax Rules, 1962 is ₹ 5,500 crores.

(12) ACTION PLAN 14 – MAKING DISPUTE RESOLUTION MORE EFFECTIVE


Objective of measures developed under Action 14 of BEPS
Minimize the risks of uncertainty
Minimize unintended double taxation
through
Consistent and proper implementation of tax treaties
Effective and timely resolution of disputes regarding their interpretation or application through MAP

Eliminating opportunities for cross-border tax avoidance and evasion and the effective and efficient prevention of double taxation are significant to developing an international tax system that facilitates economic growth and a buoyant global economy. Countries concur that the measures introduced to address BEPS pursuant to the BEPS Action Plans should not result in unnecessary uncertainty for compliant taxpayers and in unintended double taxation. Improving dispute resolution mechanisms is, therefore, a critical component of the work on BEPS issues.

(13) ACTION PLAN 15 – DEVELOPING A MULTILATERAL INSTRUMENT

MLI's role in tackling BEPS

Abuse of tax treaties is an important source of BEPS. The MLI helps the fight against BEPS by implementing the tax treaty-related measures developed through the BEPS project in existing bilateral tax treaties in a synchronized and efficient manner. These measures will prevent treaty abuse, improve dispute resolution, prevent the artificial avoidance of permanent establishment status and neutralize the effects of hybrid mismatch arrangements.

Action 15 of the BEPS Action Plan provides for an analysis of the tax and public international law issues related to the development of a multilateral instrument to enable countries that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties.

Formation of ad hoc Group to develop MLI

Based on this analysis, a mandate for the formation of an ad hoc Group to develop a multilateral instrument on tax treaty measures to tackle BEPS, was approved by the OECD Committee on Fiscal Affairs and endorsed by the G20 Finance Ministers and Central Bank Governors in February 2015.

In line with Action 15 report, an ad-hoc group was formed with a pre-defined purpose of development of such Multilateral Instrument (MLI) and that adopted the text of the Convention and accompanying Explanatory Statement in November 2016. India was part of the Ad Hoc Group of more than 100 countries and jurisdictions from G20, OECD, BEPS associates and other interested countries, which worked on an equal footing on the finalization of the text of the Multilateral Convention, starting May 2015. The text of the Convention and the accompanying Explanatory Statement was adopted by the Ad hoc Group on 24th November 2016.

Signatories to the MLI

Once drafted, the said document was thereafter kept open for signatures from 31 December 2016. In the first signing ceremony of the MLI on 7th June, 2017, 67 countries have signed the MLI and 9 countries have expressed their intention to sign the instrument. As on 27th September, 2018, 84 countries have signed the MLI and 6 countries have expressed their intention to sign the instrument.

At the time of signature, signatories submitted a list of their tax treaties in force that they would like to designate as Covered Tax Agreements (CTAs), i.e. to be amended through the MLI.

The Convention enables all signatories, *inter alia*, to meet treaty-related minimum standards that were agreed as part of the Final BEPS package, including the minimum standard for the prevention of treaty abuse under Action 6.

Features of MLI

The Multilateral Convention is, thus, an outcome of the OECD / G20 Project to tackle Base Erosion and Profit Shifting (the "BEPS Project") i.e., tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

The MLI modifies tax treaties that are “Covered Tax Agreements”. A Covered Tax Agreement is an agreement for the avoidance of double taxation that is in force between Parties to the MLI and for which both Parties have made a notification that they wish to modify the agreement using the MLI.

The MLI is a flexible instrument which will modify tax treaties according to a jurisdiction's policy preferences with respect to the implementation of the tax treaty-related BEPS measures. The MLI provides for different types of flexibility:

(i) jurisdictions can choose amongst alternative provisions in certain MLI articles;

(ii) jurisdictions can choose to apply optional provisions (for instance, the provisions on mandatory binding arbitration);

(iii) jurisdictions may also choose to reserve the right not to apply MLI provisions (to opt out through a "reservation") with respect to all of their Covered Tax Agreements or with respect to a subset of their Covered Tax Agreements. Jurisdictions only have the possibility to opt out of provisions that do not reflect a BEPS minimum standard, with the possibility to withdraw their reservation (and opt in) later.

Amendment of MLI position

The provisional MLI position of each Signatory indicates the tax treaties it intends to cover, the options it has chosen and the reservations it has made. Signatories can amend their MLI position until ratification. Even after ratification, parties can choose to opt in with respect to optional provisions or to withdraw reservations.

Indian Taxation Regime

The Multilateral Convention to implement tax treaty related measures to prevent Base Erosion and Profit Shifting (BEPS) was signed by India at Paris, France on 7th June, 2017. India had ratified the said Convention and had deposited the instrument of ratification along-with the list of Covered Tax Agreements, reservations and notifications (India's Position under the said Convention) to the Depositary on 25th June, 2019. The date of entry into force of the said Convention for India is 1st October, 2019, being the first day of the month following the expiry of a period of three calendar months beginning on 25th June, 2019, being the date of deposit by India of the instrument of ratification.

The provisions of the said Convention would have effect in India with respect to a Covered Tax Agreement in accordance with the provisions of Article 35 of the said Convention. Accordingly, in exercise of the powers conferred by section 90(1) of the Income-tax Act, 1961, the Central Government has, vide Notification No.57/2019 dated 9.8.2019 (available at https://www.incometaxindia.gov.in/communications/notification/notification57_2019.pdf*), notified that the provisions of the said Convention shall be given effect to in the Union of India, in accordance with India's Position under the said Convention, as set out in the Annexure thereto.*

As per Article 35 of the MLI, the provisions of this Convention shall have effect in each Contracting Jurisdiction with respect to a Covered Tax Agreement:

a) *with respect to taxes withheld at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs* ***on or after the first day of the next calendar year*** *that begins on or after the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement; and*

b) *with respect to all other taxes levied by that Contracting Jurisdiction, for taxes levied with respect to taxable periods beginning* ***on or after*** **the expiration of a period of six calendar months** (or a shorter period, if all Contracting Jurisdictions notify the Depositary that they intend to apply such shorter period) from the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement.

Therefore, the earliest date when the provisions of this Convention can take effect in India is 1st April, 2020 (six months from 1st October, 2019, the date of entry into force for India)[1].

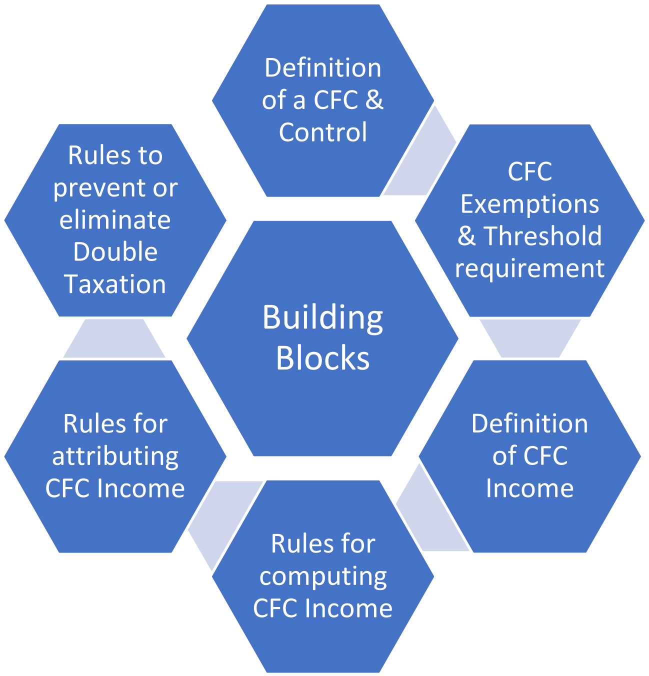
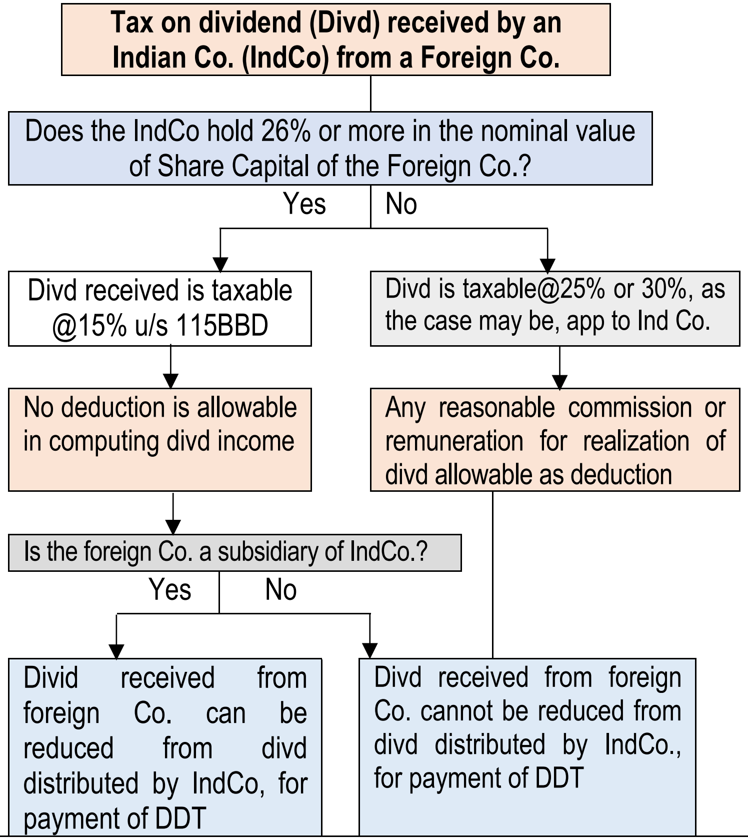
Resources: The discussion on BEPS Action Plans contained in this chapter is essentially based on the Action Plans developed in the context of the OECD/G20 BEPS Project and available at the website http://www.oecd.org/tax/beps/beps-actions.htm

[1] Since the provisions of this Convention takes effect only from F.Y.2020-21, the same have not been discussed in detail in this Study Material.

SUMMARY

<table>
<tr><th colspan="3">BEPS Action Plan 1 : Addressing the challenges of the digital economy</th></tr>
<tr><th colspan="2">OECD Recommendation</th><th>Provision incorporated in Indian Tax Laws</th></tr>
<tr><td>i</td><td>Modifying existing Permanent Establishment (PE) rule to provide whether an enterprise engaged in fully de-materialized digital activities would constitute a PE if it maintained significant digital presence in another country's economy</td><td rowspan="4">“Significant economic presence” (SEP) to constitute “business connection”
<table>
<tr><th>Upto A.Y.2018-19</th><th>From A.Y.2019-20</th></tr>
<tr><td>As per sec 9(1)(i) of the Income-tax Act, 1961, as it stood prior to amendment by the Finance Act, 2018, physical presence in India was necessary to fall within the scope of “business connection” to attract deemed accrual provisions for income of Non-resident to be subject to tax in India.</td><td>The Finance Act, 2018 has amended section 9(1)(i) to provide that significant economic presence would also constitute business connection from A.Y.2019-20[2].</td></tr>
</table>
Equalisation Levy
Chapter VIII of the Finance Act, 2016 provides for Equalisation levy@6% of the amount of consideration for specified services received or receivable by a Non-resident not having PE in India or providing services not effectively connected with PE in India, from:
• a resident in India who carries on business or profession or
• from a Non-resident having PE in India.
The Resident or Non-resident having PE in India has to deduct Equalisation Levy@6% from consideration for specified services paid to Non-resident and remit the same to the Central Government within the prescribed time.</td></tr>
<tr><td>ii</td><td>A virtual fixed place of business PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction & carries on business through that website.</td></tr>
<tr><td>iii</td><td>Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider</td></tr>
<tr><td>iv</td><td>Imposition of a Equalisation Levy on consideration for certain digital transactions received by a Non-resident from a resident or Non-resident having PE in the other contracting state</td></tr>
</table>

[2] Rules in this regard are yet to be notified

BEPS Action Plan 3: Strengthen CFC rules	
OECD Recommendation	**Provisions incorporated in the Income-tax Act, 1961**
CFCs are foreign subsidiaries in tax havens in which the taxpayer has controlling interest. Since tax is generally levied on distributed dividend, tax in parent country could be avoided until the tax haven country actually paid dividend to the shareholders. The OECD regards CFC Rules as important in tackling BEPS and has made a series of best practice recommendations in relation to the building blocks of an effective CFC regime.  Building Blocks Definition of a CFC & Control CFC Exemptions & Threshold requirement Definition of CFC Income Rules for computing CFC Income Rules for attributing CFC Income Rules to prevent or eliminate Double Taxation	There are no CFC Rules in the Income-tax Act, 1961. However, section 115BBD has been inserted in Income-tax Act, 1961 to encourage repatriation of profits by Indian companies which have significant voting power in foreign Companies.  **Tax on dividend (Divd) received by an Indian Co. (IndCo) from a Foreign Co.** Does the IndCo hold 26% or more in the nominal value of Share Capital of the Foreign Co.? Yes: Divd received is taxable @15% u/s 115BBD No deduction is allowable in computing divd income No: Divd is taxable@25% or 30%, as the case may be, app to Ind Co. Any reasonable commission or remuneration for realization of divd allowable as deduction Is the foreign Co. a subsidiary of IndCo.? Yes: Divid received from foreign Co. can be reduced from divd distributed by IndCo, for payment of DDT No: Divd received from foreign Co. cannot be reduced from divd distributed by IndCo., for payment of DDT

BEPS Action Plan 4: Interest deductions and other financial payments

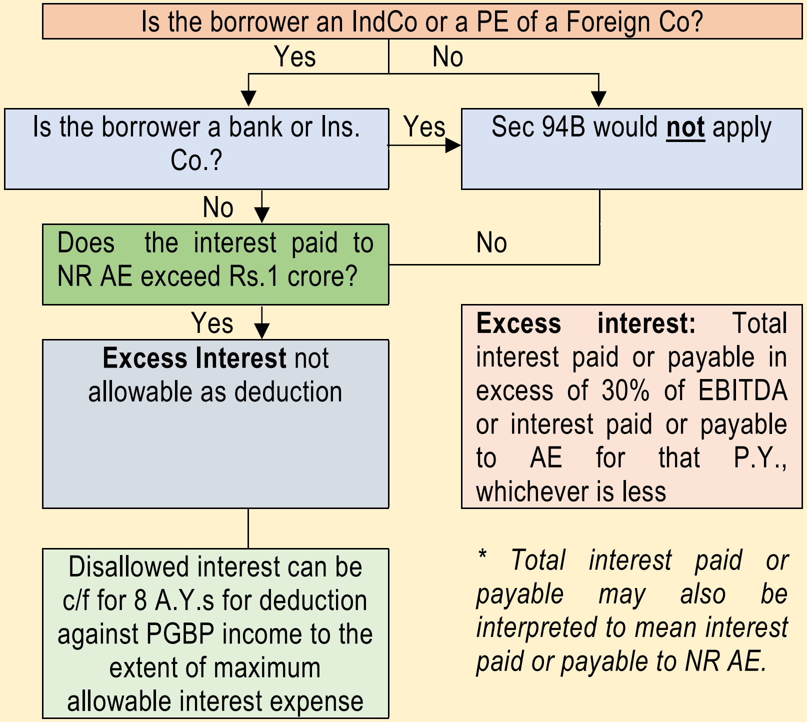
Common Approach in 2015 Report

The common approach which directly links an entity's net interest deductions to its level of economic activity, based on taxable EBITDA includes three elements:

	Rule	Basis
i	**Fixed Ratio Rule**	based on benchmark net interest/EBITDA Ratio
ii	**Group Ratio Rule**	allows an entity to deduct more interest expense based on the position of its world wide group
iii	**Targeted Rules**	address specific risks

Provisions incorporated in the Income-tax Act, 1961

Sec 94B – Limitation of interest deduction [based on Fixed Ratio Rule]



Is the borrower an IndCo or a PE of a Foreign Co?

Yes → Is the borrower a bank or Ins. Co.?

No → Sec 94B would **not** apply

Is the borrower a bank or Ins. Co.? Yes → Sec 94B would **not** apply

No → Does the interest paid to NR AE exceed Rs.1 crore?

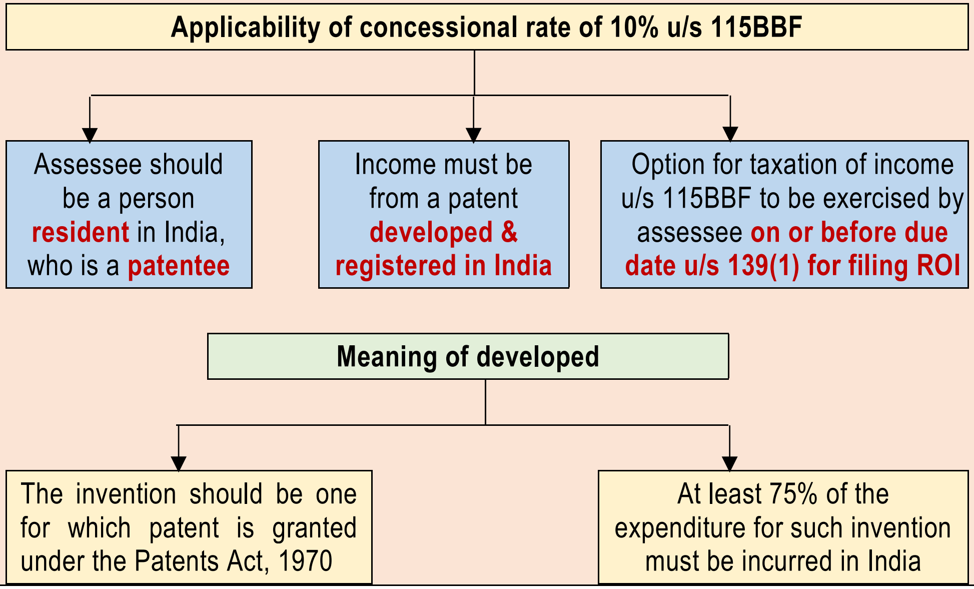
No → Sec 94B would **not** apply

Yes → **Excess Interest** not allowable as deduction

Disallowed interest can be c/f for 8 A.Y.s for deduction against PGBP income to the extent of maximum allowable interest expense

Excess interest: Total interest paid or payable in excess of 30% of EBITDA or interest paid or payable to AE for that P.Y., whichever is less

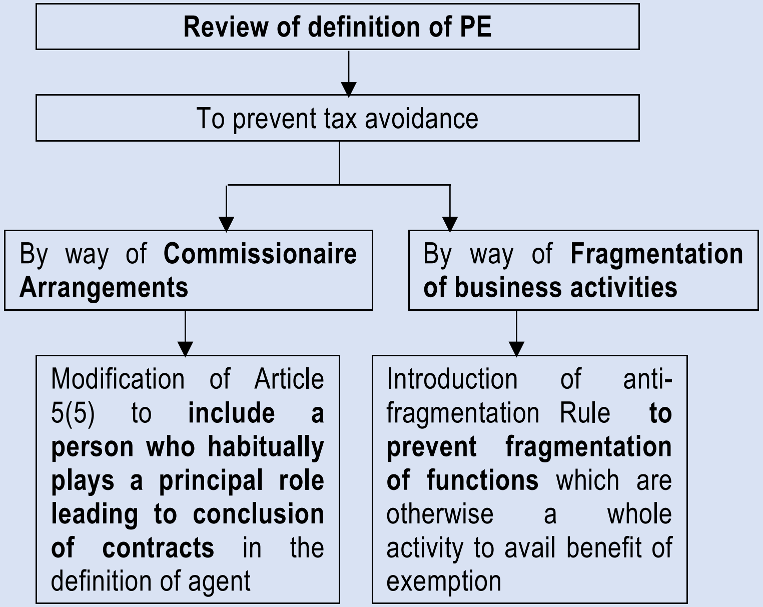
** Total interest paid or payable may also be interpreted to mean interest paid or payable to NR AE.*

<table>
<tr><th colspan="2">BEPS Action Plan 5: Counter harmful tax practices</th></tr>
<tr><th>OECD BEPS Action 5 Report</th><th>Provisions incorporated in the Income-tax Act, 1961</th></tr>
<tr><td>Action 5 report identifies factors for determining a potential harmful tax practice that results in low or no effective tax rate, lack of transparency, negotiable tax rate or base etc.
For instance, in case of R&D activities, the nexus approach recommended by the OECD under BEPS Action 5 requires attribution and taxation of income arising from exploitation of IP in the jurisdiction where substantial R & D activities are undertaken instead of the jurisdiction of legal ownership.</td><td>Sec 115BBF of the Income-tax Act, 1961 – Tax on income from patent
Where the Total Income of the eligible assessee includes any income by way of royalty in respect of a patent developed & registered in India, then, such royalty is taxable@ 10% (plus applicable surcharge & cess).

Applicability of concessional rate of 10% u/s 115BBF
Assessee should be a person resident in India, who is a patentee
Income must be from a patent developed & registered in India
Option for taxation of income u/s 115BBF to be exercised by assessee on or before due date u/s 139(1) for filing ROI
Meaning of developed
The invention should be one for which patent is granted under the Patents Act, 1970
At least 75% of the expenditure for such invention must be incurred in India</td></tr>
</table>

BEPS Action Plan 6: Preventing treaty abuse	
OECD Minimum Standard	**LoB clause incorporated in Indian Tax Treaties**
Given the risk to revenues posed by treaty shopping, countries have committed to ensure a minimum level of protection against treaty shopping by including in their treaties: (i) the combined approach of **Limitation of Benefits (LOB)** and **Principal Purpose Test (PPT)** rule, (ii) the **PPT rule** alone, or (iii) the **LOB rule** supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties	**LoB clause in India-Mauritius Tax Treaty** • On 10.5.2016, the India-Mauritius tax treaty was amended and for the first time, it has been provided that gains from the alienation of shares acquired on or after 1.4.2017 in a company which is a resident of India may be taxed in India. • The tax rate on such capital gains arising from 1.4.2017-31.3.2019 should, however, not exceed 50% of the applicable tax rate on capital gains in India. • LOB Clause provides that a resident of a Contracting State shall not be entitled to the benefits of 50% of the tax rate applicable in transition period if its affairs are arranged with the primary purpose of taking advantage of concessional rate of tax. • A shell or a conduit Co. claiming to be a resident of a Contracting State shall not be entitled to this benefit. • A shell or conduit Co. is any legal entity falling within the meaning of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State. **LoB clause in India-Singapore Tax Treaty** • The India-Singapore tax treaty has been amended to provide that capital gains on alienation of shares would be taxable in a similar manner as laid out in India-Mauritius tax treaty, subject to LoB clause. • The transition period benefit is also similar to that contained in India-Mauritius Tax Treaty.

BEPS Action Plan 7: Prevent the Artificial Avoidance of PE Status

OECD Recommendation



Review of definition of PE

To prevent tax avoidance

By way of **Commissionaire Arrangements**

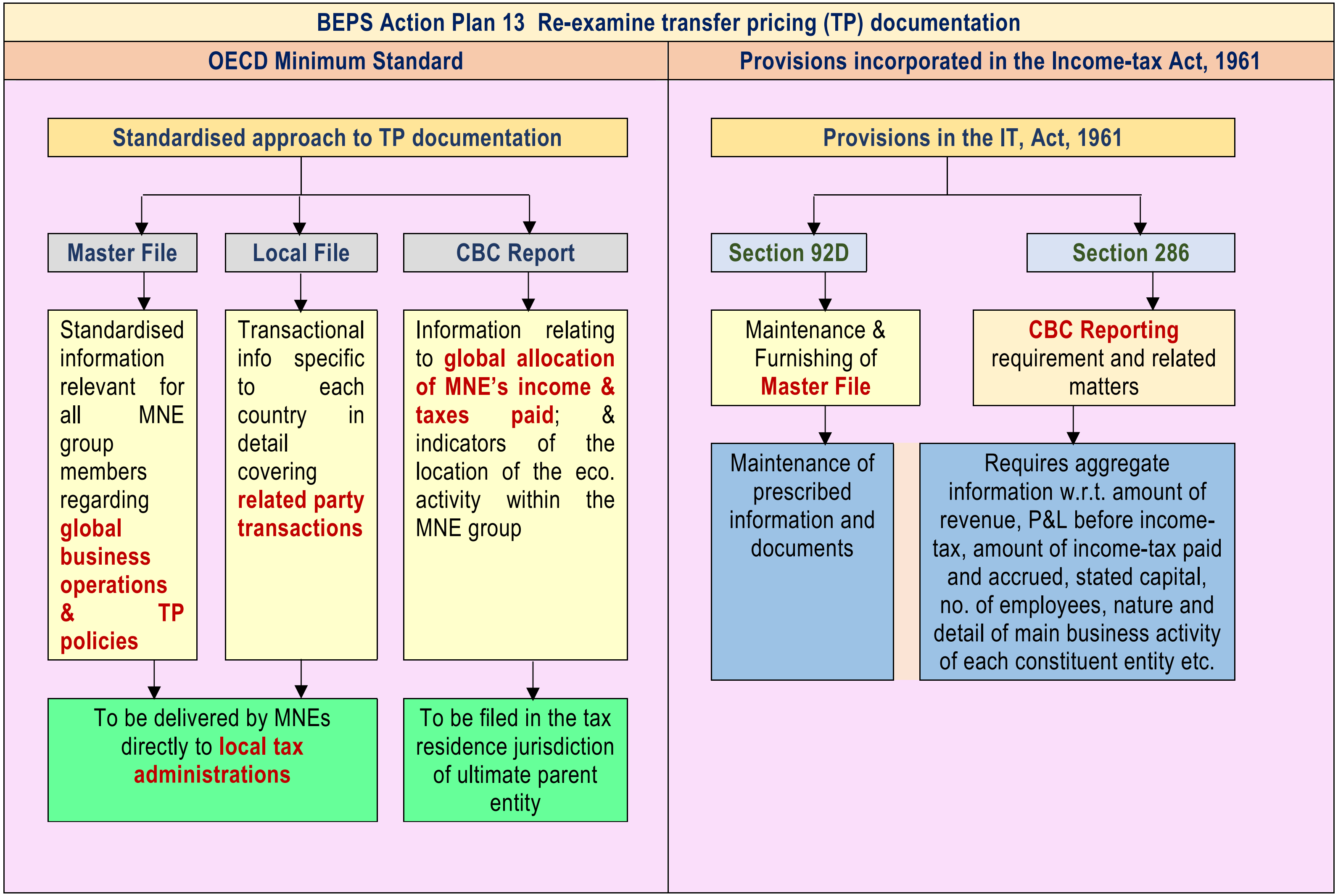
Modification of Article 5(5) to **include a person who habitually plays a principal role leading to conclusion of contracts** in the definition of agent

By way of **Fragmentation of business activities**

Introduction of anti-fragmentation Rule **to prevent fragmentation of functions** which are otherwise a whole activity to avail benefit of exemption

Provision incorporated in the Income-tax Act, 1961

Expanding the scope of business connection (BC) u/s 9(1)(i) of Income-tax Act, 1961	
Upto A.Y.2018-19	**From A.Y.2019-20**
BC is established, inter alia, where a person acting on behalf of NR has and habitually exercises the authority to conclude contracts on behalf of the NR.	BC also include any business activities carried through a person who, acting on behalf of the NR, habitually concludes contracts or **habitually plays the principal role leading to conclusion of contracts** by the NR. Such contracts should be- (i) in the name of the NR; or (ii) for transfer of ownership of, or for the granting of right to use, property owned by that NR or that the NR has the right to use; or (iii) for provision of services by that NR



BEPS Action Plan 13 Re-examine transfer pricing (TP) documentation

OECD Minimum Standard

Standardised approach to TP documentation

Master File

Standardised information relevant for all MNE group members regarding **global business operations & TP policies**

Local File

Transactional info specific to each country in detail covering **related party transactions**

CBC Report

Information relating to **global allocation of MNE's income & taxes paid**; & indicators of the location of the eco. activity within the MNE group

To be delivered by MNEs directly to **local tax administrations**

To be filed in the tax residence jurisdiction of ultimate parent entity

Provisions incorporated in the Income-tax Act, 1961

Provisions in the IT, Act, 1961

Section 92D

Maintenance & Furnishing of **Master File**

Maintenance of prescribed information and documents

Section 286

CBC Reporting requirement and related matters

Requires aggregate information w.r.t. amount of revenue, P&L before income-tax, amount of income-tax paid and accrued, stated capital, no. of employees, nature and detail of main business activity of each constituent entity etc.

BEPS Action Plan 15 Developing a Multilateral Instrument (MLI)	
BEPS Report	**Entry into Force of MLI**
The MLI helps fight against BEPS by implementing tax treaty-related measures developed through the BEPS Project in existing bilateral treaties in a synchronized and efficient manner to – • **prevent treaty abuse,** • **improve dispute resolution** • **prevent the artificial avoidance of PE status** • **neutralize the effects of hybrid mismatch arrangements**. The MLI is flexible instrument which modifies tax treaties that are “**Covered Tax Agreements**”. A Covered Tax Agreement is an agreement for the avoidance of double taxation that is in force between Parties to the MLI and for which both Parties have made a notification that they wish to modify the agreement using the MLI.	➢ The Multilateral Convention to implement tax treaty related measures to prevent Base Erosion and Profit Shifting (BEPS) was signed by India at Paris, France on 7th June, 2017. ➢ India had ratified the said Convention and had deposited the instrument of ratification along-with the list of Covered Tax Agreements, reservations and notifications (India’s Position under the said Convention) to the Depositary on 25th June, 2019. ➢ The date of entry into force of the said Convention for India is 1st October, 2019, being the first day of the month following the expiry of a period of three calendar months beginning on 25th June, 2019, being the date of deposit by India of the instrument of ratification. ➢ The earliest date when the provisions of this Convention can take effect in India is 1st April, 2020 (six months from 1st October, 2019, the date of entry into force for India)

EXERCISE

Question 1

What do you understand by base erosion and profit shifting? Describe briefly its adverse effects.

Answer

Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid.

Adverse Effects of BEPS:

(1) Governments have to cope with less revenue and a higher cost to ensure compliance.

(2) In developing countries, the lack of tax revenue leads to significant under-funding of public investment that could help foster economic growth.

(3) BEPS undermines the integrity of the tax system, as reporting of low corporate taxes is considered to be unfair. When tax laws permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers, especially individual taxpayers in that jurisdiction bear a greater share of the burden. This gives rise to tax fairness issues on account of individuals having to bear a higher tax burden.

(4) Enterprises that operate only in domestic markets, including family-owned businesses or new innovative businesses, may have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

Question 2

What are the significant OECD Recommendations under Action Plan 1 of BEPS? Which recommendation has been adopted in Indian tax laws?

Answer

The OECD has recommended several options to tackle the direct tax challenges which include:

(1) Modifying the existing Permanent Establishment (PE) rule to provide that whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.

(2) A virtual fixed place of business PE in the concept of PE i.e., creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.

(3) Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having permanent establishment in other contracting state.

Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.

In order to address these challenges, Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

Meaning of "Specified Service":

(1) Online advertisement;

(2) Any provision for digital advertising space or any other facility or service for the purpose of online advertisement;

Specified Service also includes any other service as may be notified by the Central Government.

Further, in order to reduce burden of small players in the digital domain, it is also provided that no such levy shall be made if the aggregate amount of consideration for specified services received or receivable by a non-resident from a person resident in India or from a non-resident having a permanent establishment in India does not exceed ₹ 1 lakh in any previous year.

Note: The Finance Act, 2018 has amended section 9(1)(i) to provide that significant economic presence would also constitute business connection from A.Y.2019-20. However, Rules in this regard are yet to be notified

Question 3

Discuss the provision incorporated in the Income-tax Act, 1961 in line with the OECD recommendations under Action Plan 4 of BEPS.

Answer

In line with the recommendations of OECD BEPS Action Plan 4, section 94B has been inserted in the Income-tax Act, 1961 by the Finance Act, 2017 to provide a cap on the interest expense that can be claimed by an entity to its associated enterprise. The total interest paid in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise for that previous year, whichever is less, shall not be deductible.

The provision is applicable to an Indian company, or a permanent establishment of a foreign company, being the borrower, who pays interest in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower. Further, the debt is deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender, being a non-associated enterprise, or deposits a corresponding and matching amount of funds with such lender.

The provision allows for carry forward of disallowed interest expense for 8 assessment years immediately succeeding the assessment year for which the disallowance is first made and deduction against the income computed under the head "Profits and gains of business or profession” to the extent of maximum allowable interest expenditure.

In order to target only large interest payments, it provides for a threshold of interest expenditure of ₹ 1 crore in respect of any debt issued by a non-resident associated enterprise exceeding which the provision would be applicable. Banks and Insurance business are excluded from the ambit of the said provisions keeping in view of special nature of these businesses.

Question 4

Describe the three tier structure for transfer pricing documentation mandated by BEPS Action Plan 13.

Answer

Action 13 contains a three-tiered standardized approach to transfer pricing documentation which consists of:

(a) **Master file**: Master file requires MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies. The master file is to be delivered by MNEs directly to local tax administrations.

(b) **Local file**: Local file requires maintaining of transactional information specific to each country in detail covering related-party transactions and the amounts involved in those transactions. In addition, relevant financial information regarding specific transactions, a comparability analysis and analysis of the selection and application of the most appropriate transfer pricing method should also be captured. The local file is to be delivered by MNEs directly to local tax administrations.

(c) **Country-by-country (CBC) report**: CBC report requires MNEs to provide an annual report of economic indicators viz. the amount of revenue, profit before income tax, income tax paid and accrued in relation to the tax jurisdiction in which they do business. CBC reports are required to be filed in the jurisdiction of tax residence of the ultimate parent entity, being subsequently shared between other jurisdictions through automatic exchange of information mechanism.

Question 5

Explain the nexus approach recommended by OECD in BEPS Action Plan 5 which has been adopted in the Income-tax Act, 1961.

Answer

In India, the Finance Act, 2016 has introduced a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development. The purpose of the concessional taxation regime is to encourage entities to retain and commercialise existing patents and for developing new innovative patented products. Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture and exploitation of patents in India.

The nexus approach has been recommended by the OECD under BEPS Action Plan 5. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. Accordingly, section 115BBF has been inserted in the Income-tax Act, 1961 to provide that where the total income of the eligible assessee (being a person resident in India who is the true and first inventor of the invention and whose name is entered in the patent register as the patentee in accordance with the Patents Act, 1970 and includes every such person, being the true and the first inventor of the invention, where more than one person is registered as patentee under Patents Act, 1970 in respect of that patent.) includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess). For this purpose, developed means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

Question 6

What are the ways in which hybrid mismatch arrangements are used to achieve unintended double non-taxation or long-term tax deferral?

Answer

Hybrid mismatch arrangements are sometimes used to achieve unintended double non-taxation or long-term tax deferral in one or more of the following ways -

(1) Creation of two deductions for a single borrowal;

(2) Generation of deductions without corresponding income inclusions;

(3) Misuse of foreign tax credit; and

(4) Participation exemption regimes.

CHAPTER 8

OVERVIEW OF MODEL TAX CONVENTIONS

LEARNING OUTCOMES

After studying this chapter, you would be able to:

- ❑ **appreciate** the need for Model Tax Convention;
- ❑ **appreciate** the key features of the OECD and UN Model Tax Conventions;
- ❑ **identify** the subject of the various articles of the OECD and UN Model Tax Conventions;
- ❑ **appreciate** the broad similarities and differences between the principles enshrined in certain articles of the OECD Model Tax Convention *vis-à-vis* the corresponding articles of the UN Model Tax Convention.

8.1 INTRODUCTION

In order to enable various countries to enter into treaties, which are standardized to some extent, Organization for Economic Cooperation and Development (OECD) and the United Nations (UN) have developed certain Model Tax Treaties. These treaties can be used by various countries as a starting point in their negotiations with other countries. While these Models are not legally binding, they have been extensively used by various countries as a reference point while entering into Tax Treaties. In some cases, they have been incorporated verbatim or with minor changes. However, in other cases, countries have made suitable changes in the draft model according to their economic environment and commercial and tax considerations.

The significant model conventions have been briefly discussed hereunder:

→ **OECD Model** - The emergence of present form of OECD Model Convention can be traced back to 1927, when the Fiscal Committee of the League of Nations prepared the first draft of Model Form applicable to all countries. In 1946 the model convention was published in Geneva by the Fiscal Committee of U.N. Social & Economic Council and later by the Organisation for European Economic Co-operation (O.E.E.C) in 1963. However, in 1961, the Organisation for Economic Co-operation and Development (O.E.C.D) was established, with developed countries as its members, to succeed the O.E.E.C., and OECD approved the draft presented to the OEEC. In 1977, the final draft was prepared in the present form which has been revised several times; the latest being in the year 2017.

OECD Model is essentially a model treaty **between two developed nations.** This model advocates the residence principle, i.e., it lays emphasis on the right of state of residence to tax the income.

→ **UN Model** – In 1968, the United Nations set up an Adhoc Group of Experts from various developed and developing countries to prepare a draft model convention between developed and developing countries. In 1980, this Group finalised the UN Model Convention in its present form. It has further been revised a number of times, the latest being in the year 2017.

The UN Model is a compromise between the source principle and the residence principle. However, it gives more weight to the source principle as against the residence principle of the OECD Model. UN Model is designed to encourage flow of investments from the developed countries to developing countries. It takes into account sharing of tax-revenue with the country providing capital.

The United Nations Model Convention seeks to be balanced in its approach. As a corollary to the principle of taxation at source, the Articles of the Convention are based on a recognition by the source country that

(a) taxation of income from foreign capital should take into account expenses allocable to the earnings of the income so that such income is taxed on a net basis,

(b) taxation should not be so high as to discourage investment and

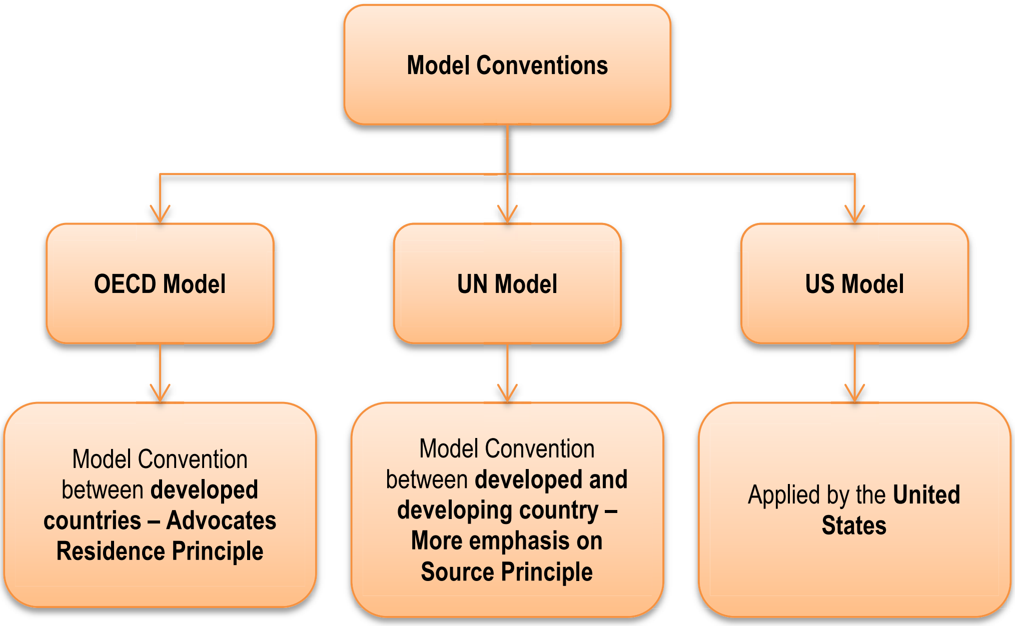
(c) it should take into account the appropriateness of the sharing of revenue with the country providing the capital.

In addition, the United Nations Model Convention embodies the idea that it would be appropriate for the residence country to extend a measure of relief from double taxation through either a foreign tax credit or an exemption, as is also the case with the OECD Model Convention.

→ **US Model** – This Model Convention is used by the United States while entering into tax treaties with various countries. The US Model Convention has been revised in the year 2016.

These Models have a significant influence on international treaty practice, and have important common provisions. The similarities between these Models highlight the areas of consistency. The areas of divergence indicate some critical differences in approach or emphasis which need special focus. These differences are mainly in relation to the taxing rights which would be available to a country under domestic law and the extent to which any country should forego, under a bilateral tax treaty, in order to avoid double taxation and encourage investment.

The above model conventions have been illustrated in the following diagram:


Model Conventions
OECD Model
UN Model
US Model
Model Convention between developed countries – Advocates Residence Principle
Model Convention between developed and developing country – More emphasis on Source Principle
Applied by the United States

OECD Model contains VII chapters comprise of 32 articles and UN Model also contains VII chapters but comprise of 31 articles. List of articles of OECD MC and UN MC is given below:

Article	OECD Model, 2017	UN Model, 2017
	Chapter I : Scope of the Convention	
1	Persons covered	Persons covered
2	Taxes covered	Taxes covered
	Chapter II : Definitions	
3	General definitions	General definitions
4	Resident	Resident
5	Permanent establishment	Permanent establishment
	Chapter III : Taxation of Income	
6	Income from immovable property	Income from immovable property
7	Business profits	Business profits
8	International shipping and air transport	International shipping and air transport (Alternatives A & B)
9	Associated enterprises	Associated enterprises
10	Dividends	Dividends
11	Interest	Interest
12	Royalties	Royalties
12A		Fees for technical services
13	Capital gains	Capital gains
14		Independent personal services
15	Income from employment	Dependent personal services
16	Directors' fees	Directors' fees and remuneration of top-level managerial officials
17	Entertainers and sportspersons	Artistes and sportspersons
18	Pensions	Pensions and social security payments (Alternatives A & B)
19	Government service	Government service
20	Students	Students

21	Other income	Other income
	Chapter IV : Taxation of Capital	
22	Capital	Capital
	Chapter V : Methods for the Elimination of Double Taxation	
23A	Exemption method	Exemption method
23B	Credit method	Credit method
	Chapter VI : Special Provisions	
24	Non-discrimination	Non-discrimination
25	Mutual agreement procedure	Mutual agreement procedure (Alternatives A & B)
26	Exchange of information	Exchange of information
27	Assistance in the collection of taxes	Assistance in the collection of taxes
28	Members of diplomatic missions and consular posts	Members of diplomatic missions and consular posts
29	Entitlement to benefits	Entitlement to benefits
30	Territorial extension	Entry into force
	Chapter VII : Final Provisions	
31	Entry into force	Termination
32	Termination	

Now, let us discuss the comparative analysis of some of the significant Articles in the Model Tax conventions

8.2 COMPARATIVE ANALYSIS OF SOME OF THE SIGNIFICANT ARTICLES OF OECD AND UN MODEL CONVENTIONS

Title and Preamble to the Model Conventions

The title of the UN Model Convention reads as follows:

"Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and capital and the prevention of tax avoidance and evasion"

There is now a specific reference to "the prevention of tax avoidance and evasion" in the title to emphasize its significance in the Model Convention.

The Preamble to the UN Model Convention reads as follows:

"(State A) and (State B),

Desiring to further develop their economic relationship and to enhance their cooperation in tax matters,

Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax avoidance or evasion (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)"

The Title and Preamble to the OECD Model Convention is almost identical to that of the UN Model Convention. The only minor difference is the reference to "tax evasion and avoidance" in the place of "tax avoidance and evasion" in the Title and Preamble.

The Preamble now clearly indicates that the UN and OECD Model Conventions do not intend to create opportunities for non-taxation or reduced taxation through tax avoidance or evasion including through treaty shopping arrangements.

This language of the Preamble would help ensuring that the provisions of the Conventions are interpreted and applied to prevent abusive treaty shopping arrangements.

Significant Articles in the Model Conventions

Over the years, both Model Conventions have seen a lot of convergence and the language is identical in quite a few Articles. However, there are key differences in approach and language in some Articles which will be the focus of our discussion, in the section below.

The jurisdiction or country of residence of the taxpayer is referred to as the Residence State and the jurisdiction or country where the source of income is located is referred to as the Source State.

Article 1: Persons Covered

The OECD and UN Model Convention would apply to persons who are residents of one or both of the Contracting States.

For the purposes of these Conventions, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State. However, the same would be treated as income only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.

Example

State A and State B have concluded a treaty identical to the Model Tax Convention. State A considers that an entity established in State B is a company, and taxes that entity on interest *that it receives from a debtor resident in State A. Under the domestic law of State B, however, the entity is treated as a partnership, and the two members in that entity, who share equally all its income, are each taxed on half of the interest. One of the members is a resident of State B and the other one is a resident of a country with which States A and B do not have a treaty. The paragraph provides that in such case, half of the interest shall be considered, for the purposes of Article 11, to be income of a resident of State B.*

***Note** – The above example forms part of the Commentary to the UN Model Tax Convention.*

With the exception of benefits granted under certain Articles of these conventions, these Conventions would not affect the taxation, by a Contracting State, of its resident.

Article 2: Taxes Covered

The OECD and UN Conventions would apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

Taxes on income and on capital cover all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

The existing taxes to which the Conventions would apply in case of each Contracting State are specifically to be mentioned.

The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of significant changes made to their tax law.

Article 4: Residence

A taxpayer has to demonstrate that he is a resident of one or both Contracting States to be able to gain access to a tax treaty and avail the benefits thereunder.

The concept of 'resident of a Contracting State' has various functions and assumes significance in the following three scenarios:

- In determining a convention's scope of application;
- In solving cases where double taxation arises as a consequence of double residence;
- In solving cases where double taxation arises as a consequence of taxation in the state of residence and also in the state of source of income.

As per paragraph 1 of the UN Model Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

Paragraph 1 of the OECD Model Convention is worded on similar lines. However, it does not contain reference to place of incorporation.

Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows:

(a) He shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);

(b) If the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;

(c) If he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;

(d) If he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

As per paragraph 3 of this Article, where by reason of the provisions of paragraph 1, a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement, the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention. They shall do so having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such mutual agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

The situation of dual residence may arise in case of companies in case where one Contracting State attaches importance to the place of incorporation and the other State to the place of effective management. The tie-breaker rule traditionally has been 'place of effective management'. Even India has used place of effective management in some of its treaties. In the latest update by OECD and UN, this has changed to a case by case approach considering the number of tax avoidance cases involving dual resident companies. Determination under the case by case approach will be requested by the concerned taxpayer through Article 25 (Mutual Agreement Procedure). Competent authorities will then rely on a range of factors to resolve the question of dual residency.

The last sentence of paragraph 3 of this Article provides that in the absence of mutual agreement, the taxpayer would not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States. This will not, however, prevent the taxpayer from being considered a resident of each Contracting State for purposes other than granting treaty reliefs or exemptions to that person.

Article 5: Permanent Establishment

The concept of "Permanent Establishment" (PE), defined in Article 5, has considerable importance as business profits (Article 7) of an enterprise cannot be taxed by a Source State unless it proves the existence of a PE.

The comparable term to PE under the Indian tax law is "business connection" [Section 9(1)(i)]. Generally speaking, the concept of "business connection" is wider than PE and hence, a business connection may exist even without a PE, but the absence of a "business connection" may indicate absence of a PE.

As the PE concept gives the Source State the right to tax, it is an important Article for developing countries. Hence, the UN Model Convention varies from the OECD Model Convention in the following respects:

- As per Article 5(3)(a) of the OECD Model Convention, a building site or construction or installation project constitutes a PE if it lasts more than twelve months. The UN Model Convention is wider as it covers "assembly and installation project" and "supervisory" activities in connection thereto and requires the activity in question to continue only for six months.
- Article 5(3)(b) of the UN Model makes a specific reference to Service PE which is absent in the OECD Model. Article 5(3)(b) of the UN Model reads as follows –

  "The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12 month period commencing or ending in the fiscal year concerned".

  In the absence of a Service PE reference in OECD Model, the presence has to be ascertained through general principles under Article 5(1).
- Article 5(1) states the "basic rule" for a PE and expresses the primary meaning of PE. The definition of PE in Article 5 does not use the qualifying words "unless the context otherwise requires". As such, the definition needs to be followed in all cases unless specifically excluded.

  Paraphrasing Article 5(1), a PE exists if the following conditions are satisfied cumulatively:

  - There is an "enterprise".
  - Such enterprise is carrying on a "business";

- ➢ There is a "place of business";
- ➢ Such place of business is at the disposal of the enterprise (may be owned / rented but must be one which the enterprise has the effective power to use);
- ➢ The place of business is "fixed", that is, it must be established at a distinct place with a certain degree of permanence

The business of the enterprise is carried on wholly or partially through this fixed place of business.

A PE does not exist unless all the aforesaid conditions are satisfied.

- As per Article 5(2), the term "permanent establishment" includes especially:

  a) a place of management;

  b) a branch;

  c) an office;

  d) a factory;

  e) a workshop, and

  f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

- Agency PE under OECD and UN Models targets activities done by a dependent agent of the enterprise in the Source State. The recent update expands the definition of dependent agent PE to include instances when an agent habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts routinely concluded without material modification by the enterprise.

- The UN Model Convention has an additional Article 5(6) relating to insurance which is absent in OECD Model.

  As per this Article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person.

  In the absence of similar Article in the OECD Model, a PE of an insurance Enterprise has to be determined in accordance with provisions of Article 5(1) or 5(2) of the OECD model.

Article 7: Business Profits

Business profits of an enterprise can only be taxed by the Residence State. Right of Source State to tax business profits of an enterprise only exists if a PE exists in its jurisdiction.

As per the approach under the OECD Model Convention, once a PE is proven, the Source State can tax only such profits as are attributable to the PE. The UN Model Convention amplifies this attribution principle by a **limited** Force of Attraction rule (FOA).

The FOA rule implies that when a foreign enterprise sets up a PE in State of Source, it brings itself within the fiscal jurisdiction of that State (State of Source) to such a degree that profits that the enterprise derives from Source State of Source, whether through the PE or not, can be taxed by it (State of Source State).

As per Article 7 of the UN Model Convention, if the enterprise carries on business in the other Contracting State through a PE, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to:

(a) that PE;

(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that PE; or

(c) other business activities carried on in that other State of the same or similar kind as those effected through that PE.

Article 11: Interest

Paragraph 1 of this Article provides the right to Residence State to tax interest. Paragraph 2, however, also confers right to the Source State to tax interest. Generally, the interest is taxed in the Source State at a given rate on gross basis. However, if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged cannot exceed a specified percentage of the gross amount of the interest. The OECD Model specifies the percentage as 10%, but the UN Model leaves this percentage to be established through bilateral negotiations.

It may be noted that the definition of interest in both the models viz. OECD and UN Model is similar in that it essentially means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment are not regarded as interest for the purpose of this Article.

Article 12: Royalties

This Article provides the right of Contracting States to tax income from royalty.

Key differences between the two Models are as follows:

- As per the OECD Model, royalties arising in Source State and beneficially owned by resident of the Residence State are taxable only in Residence State. However, the UN Model provides that royalties may be taxed in the Residence State. Hence, the UN Model departs from the principle of exclusive right to tax provided to Residence State in the OECD Model. Thus, under the UN Model, the Source State may also tax royalties. However, if the beneficial owner is a resident of the Residence State, the tax charged by the Source State cannot exceed the specified percentage of the gross amount of royalties. This specified percentage is to be established through bilateral negotiations.

- The definition of 'royalties' under the OECD Model does not include the following: (a) rentals for films or tapes used for radio or television broadcasting and (b) equipment rentals like rentals for industrial, commercial or scientific equipment.

Article 12A: Fees for Technical Services

India is the pioneer of the FTS concept which was added to the Income-tax Act, 1961 since 1976. Some of our tax treaties do contain a specific provision for FTS.

In its 2017 update, the UN Model has inserted a specific article pertaining to Fees for Technical Services (FTS). There is no specific reference to FTS in the OECD Model.

Paragraph 1 of Article 12A provides that the FTS may be taxed in the Residence State but does not provide that the FTS is exclusively taxable in the Residence State.

Paragraph 2 establishes the right of the country in which FTS arises to tax in accordance with its domestic law, subject to the limitation on the maximum rate of tax, if the beneficial owner is a resident of the other Contracting State. The maximum rate of tax is to be established through bilateral negotiations.

FTS is defined as payments for managerial, technical or consultancy services but excludes payment to an employee, payment for teaching in an educational institution or for teaching by an educational institution, payments by an individual for services for personal use. Management involves application of knowledge, skill or expertise in the control or administration of the conduct of a commercial enterprise or organization. Technical involves the application of specialized knowledge, skill or expertise with respect to a particular art, science, profession or occupation. Fees received for services provided by regulated professions such as law, accounting, architecture, medicine, engineering would constitute FTS. The ordinary meaning of "consultancy" involves the provision of advice or services of a specialized nature.

An example of FTS can be seen from the following facts: R Company is a financial institution resident in State R. R Company provides a wide variety of financial services to its customers, including acceptance of deposits, extension of credit, guarantees, foreign exchange, negotiable instruments. R Company's business is conducted primarily in State R, but it also has clients in other countries, including State S. State R and State S have a tax treaty which contains an article akin to Article 12A. Payments received for services provided by a financial institution would constitute FTS if the services involve use of knowledge, skill and expertise to provide research, analysis or advice to a specific client related to particular circumstances. This has to be distinguished from provision of non-specialized services such as payment and transmission services, debit and credit card services, etc.

Article 13: Capital Gains

This is the most commonly used Article and it provides for the taxation of income arising from transfer of a capital asset, including transfer of shares. The right to tax income from capital gains may be exclusively with the Residence State, or shared between the Residence and Source States.

The Article does not specify what is a capital gain and how is to be computed, this being left to the applicable domestic law. The Article contains rules for taxation of gains made from alienation of different assets such as immovable property, immovable property forming part of a PE, ships and aircrafts, etc. In respect of shares, both Models have been updated and are identical. Rights are conferred to the Source State if more than 50 percent of the value of shares during the preceding 365 days is derived from immovable property in such Source State.

Article 14: Independent Personal Services

Article 14 is only present now in the UN Model. It was deleted from the OECD Model on 29-4-2000 on the basis of OECD Report (2000) on "Issues Related to Article 14 of the OECD Model Tax Convention". The Effect of deletion of Article 14 is that income derived from Professional Services etc., is now dealt with as 'Business Profits' (Article 7) under the OECD MC.

This Article deals with the taxation of income derived by a person for professional or specified services which are offered in the Source State through some presence. This article on Independent personal services in the UN Model states as under:

(1) Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:

    (a) If he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or

    (b) If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.

(2) The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Thus, the Article covers independent activities involving professional skills rendered by individuals on a principal to principal basis. The meaning of the term "professional services" is illustrated by some examples of typical liberal professions. The enumeration has an explanatory character only and is not exhaustive. It excludes industrial and commercial activities that are covered under the Article on Business Profits. Likewise, professional services while in employment which are covered under the Article on Dependent Personal Services, e.g. a physician serving as a medical officer in a factory. Income of Artists, Athletes and Sportsmen, etc. is not covered by this Article. Also, income from Fees from Technical Services is also not covered.

Article 21: Other Income

This Article deals with taxation of items of income which are not specifically taxable under any other specific Article. Key differences are as under:

- OECD approach envisages that the exclusive right to tax is with the Residence State. UN Model contains an additional paragraph, Article 21(3), which provides that Source State may also tax other income.
- Article 21(2) of both OECD and UN Model provides that for income effectively connected with a PE maintained in a Contracting State by a resident of the other Contracting State, taxation is governed by the provisions of Article 7 (Business Profits). Additionally, UN Model provides that if the aforesaid income is effectively connected with a fixed base situated in a Contracting State by a resident of the other Contracting State, taxation would be governed by the provisions of Article 14 (Independent personal services).

Articles 23A & 23B : Elimination of Double Taxation

In many cases, the application of tax treaty may result into double taxation for tax payers. In such a case, in order to provide relief to such tax payers, Articles 23A and 23B which contains provisions relating to elimination of double taxation have to applied. Articles 23A and 23B provide for the mechanism through which tax credit/exemption may be available in the Residence State for taxes deducted in the Source State.

The OECD and UN Model Conventions specify two approaches- Exemption method (Article 23A) and Credit method (Article 23B). Under the exemption method, tax exemption may be available in the Residence State. Under the credit method, tax credit may be available in the Residence State for taxes deducted in the Source State. These methods are not mutually exclusive and there may be cases where a treaty may adopt exemption method for certain types of income and credit method for other incomes.

The double taxation referred to here, is juridical double taxation, meaning the same income or capital is taxable in the hands of the same person by more than one State. It does not thus, encompass situations of economic double taxation, i.e. where two different persons are taxable in respect of the same income or capital. If two States wish to solve problems of economic double taxation, they must do so in bilateral negotiations.

Article 25: Mutual Agreement Procedure

There may be a situation wherein a tax payer may believe that the treatment accorded by either or both Contracting States is not in accordance with the provisions of the tax treaty. In such a case, there is a need for dispute resolution which is addressed by this Article. This Article requires competent authorities of both countries to endeavor to resolve the conflict by engaging in bilateral negotiations.

The UN Model Convention provides two alternatives - Alternative A and Alternative B, for the article on Mutual Agreement Procedure which were introduced in 2011. Under OECD Model the taxpayer may make a request to either Contracting State while UN Model (Alternative A) contemplates taxpayer going to Residence State or the country of his nationality. Alternative B of UN Model Article 25 contemplates reference to an arbitration process as part of the Mutual Agreement Procedure. The decision arrived at, through the process is binding unless a person directly affected does not accept it.

Key differences between the OECD Model Convention (Article 25) and UN Model Convention (Article 25B - Alternative B) are as follows:

- Article 25B(5) of the UN Model provides that an arbitration may be initiated if the competent authorities are unable to reach an agreement on a case within three years from the presentation of that case. However, Article 25(5) of the OECD Model provides a time limit of two years from the date when all the information required by the competent authorities in order to address the case need to be provided to both competent authorities.
- Article 25B(5) of the UN Model provides that arbitration must be requested by the competent authority of one of the Contracting States. Once such a request is made, the taxpayer will be notified. However, as per Article 25(5) of the OECD Model, arbitration must be requested in writing by the person who initiated the case.
- Article 25B(5) of the UN Model allows the competent authorities to depart from the arbitration decision if they agree to do so within six months after the decision has been communicated to them.

Article 26: Exchange of Information

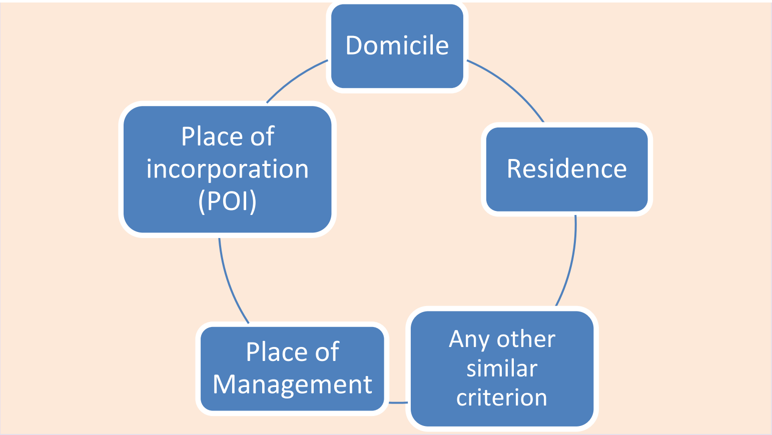
In order to complete tax cases, a country may require certain information which may be available with the treaty partner. Article 26 provides for the information which may be exchanged and the manner in which such a request has to be made. The purpose of Article 26 is to facilitate effective exchange of information between Contracting States. From the perspective of many developing countries, Article 26 is particularly important not only for curtailing cross-border tax evasion and avoidance, but also to curtail the capital flight that is often accomplished through such evasion and avoidance.

The OECD and UN Model Conventions are similar with respect to this Article. A Contracting State cannot be expected to provide confidential financial information to another Contracting State unless it has confidence that the information will not be disclosed to unauthorized persons. A Contracting State can avoid the exchange of information obligations by showing that the information pertains to communication between an attorney and his client which is protected from disclosure under domestic law. However, lack of interest or use in such information cannot form the basis for a Contracting State to not co-operate with the exchange of information obligations.

Resources: The discussion on Model Tax Conventions in the above chapter is essentially based on the text and commentaries of the OECD and UN Model Tax Conventions, 2017 available at the websites http://www.oecd.org/tax/treaties/ and http://www.un.org, respectively.

SUMMARY

<table>
<tr><th colspan="2">Article</th><th>OECD MC <i>vis-à-vis</i> UN MC
Common paras & Significant differences</th></tr>
<tr><td></td><td colspan="2">Chapter I : Scope of the Convention</td></tr>
<tr><td>1</td><td>Persons covered</td><td>✚ Resident of CS - For application of treaty, a person has to be a resident of one or both of the Contracting States (CSs).
✚ Fiscally transparent entity - Income derived by or through a fiscally transparent entity under the tax law of either CS to be considered to be income of a resident of a CS, to the extent such income is treated, for purposes of taxation by that State, as the income of a resident of that State.</td></tr>
<tr><td>2</td><td>Taxes covered</td><td>✚ Taxes on income and capital - The MCs apply to taxes on income and on capital imposed on behalf of a CS or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.
✚ Coverage of taxes - Taxes on income and on capital covers:
<table>
<tr><th>Taxes imposed</th><th>Taxes included</th></tr>
<tr><td>• On total income
• on total capital
• on elements of income or of capital</td><td>• taxes on gains from alienation of movable or immovable property
• taxes on total amounts of wages or salaries paid by enterprises
• taxes on capital appreciation</td></tr>
</table></td></tr>
<tr><td></td><td colspan="2">Chapter II : Definitions</td></tr>
<tr><td>4</td><td>Resident</td><td>✚ Resident of either CS - A taxpayer has to demonstrate that he is a resident of one or both CSs to be able to gain access to a tax treaty and avail benefits thereunder.
✚ Meaning of "Resident of a Contracting State"- Any person who, under the laws of that State, is liable to tax therein by reason of his:</td></tr>
</table>


Domicile
Residence
Any other similar criterion
Place of Management
Place of incorporation (POI)

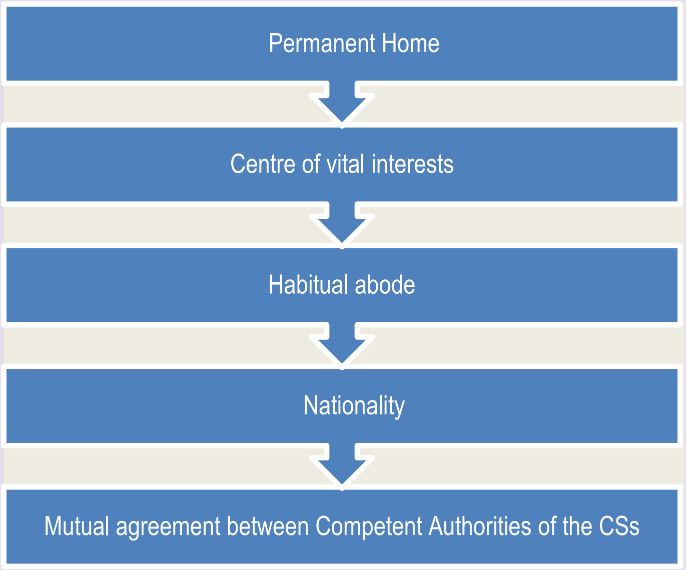
This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

Note *- OECD MC does not contain reference to place of incorporation*

Tie-breaker Rule

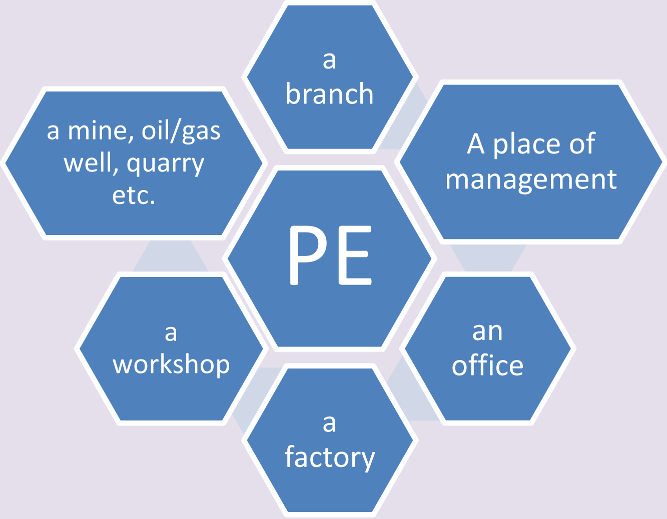
In case of individuals

Where an individual is a resident of both CSs as per domestic tax laws of that CS, then, his residential status shall be determined by applying the tie-breaker rule in the following sequence:


Permanent Home
Centre of vital interests
Habitual abode
Nationality
Mutual agreement between Competent Authorities of the CSs

In case of companies

- Dual residence arises where one CS attaches importance to POI and the other CS to the POEM.
- The tie-breaker test involves a case by case approach considering the no. of tax avoidance cases involving dual resident Cos.

<table>
<tr><td></td><td></td><td>• Request has to be made by the tax payer through Article 25 (MAP).
• Competent Authorities will rely on range of factors to resolve the question of dual residency.</td></tr>
<tr><td>5</td><td>Permanent establishment (PE)</td><td>✚ Meaning of PE [Article 5(1)]
• There should be an “enterprise” (Entr).
• Such Entr should be carrying on a "business";
• There should be a "place of business (POB)";
• Such place of business (POB) should be at the disposal of the Entr (may be owned / rented but must be one which the Entr has the effective power to use);
• The POB should be "fixed", i.e., it must be established at a distinct place with a certain degree of permanence
• The business of the enterprise is carried on wholly or partially through this fixed POB.
A PE does not exist unless all the aforesaid conditions are satisfied.
✚ Specific inclusions in the meaning of PE [Article 5(2)]


PE
a branch
A place of management
an office
a factory
a workshop
a mine, oil/gas well, quarry etc.

✚ Expansion of scope of Agency PE
• Agency PE targets activities done by a dependent agent (DA) of the Entr in the Source State (SS).
• DAPE now includes instances when an agent habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts routinely concluded without material modification by the enterprise.
✚ PE of an Insurance Enterprise
<table>
<tr><th>UN MC</th><th>OECD MC</th></tr>
<tr><td>UN MC has an additional Article 5(6) relating to insurance. An insurance Entr of a CS is deemed to have a PE in</td><td>In the absence of similar Article in the OECD MC, a PE of an insurance Entr is to be determined</td></tr>
</table>
</td></tr>
</table>

the other CS if it collects premiums in the territory of that other CS or insures risks situated therein through a person.	in accord with Article 5(1) or 5(2).

Chapter III : Taxation of Income

7 **Business profits**

- **Right of CS to tax business profits (BPs)**

OECD MC	UN MC
BPs of an Entr can only be taxed by the Residence State **(RS**). Right of Source State **(SS)** to tax BPs of an enterprise only exists if a PE exists in its jurisdiction.	
Once a PE is proven, the **SS** can tax only such profits as are attributable to the PE	- The attribution principle is amplified by a **limited** Force of Attraction rule (FOA). - The FOA rule implies that when a foreign enterprise sets up a PE in SS, it brings itself within the fiscal jurisdiction of that State to such a degree that profits that the Entr derives therefrom, whether through the PE or not, can be taxed by it (i.e., the SS). - Accordingly, if the Entr carries on business in the other CS through a PE, the profits of the Entr may be taxed in the other CS but only so much of them as is attributable to: (a) that PE; (b) sales in that other CS of goods or merchandise of the same or similar kind as those sold through that PE; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that PE.

11 **Interest**

- **Right of CSs to tax interest**

Para of Article	Right of CS to tax interest
1	Confers the right to RS to tax interest
2	Confers right to the SS to tax interest. Generally, interest is taxed in the SS at a given rate on gross basis. However, if the beneficial owner of the interest is a resident of the other CS, the tax so charged ≤ specified % of the gross interest. The specified % as per OECD MC is 10%, but the UN MC leaves this % to be established through bilateral negotiations.

- **Definition of interest in OECD & UN MCs -** Interest means income from debt claims of every kind,
  - whether or not secured by mortgage and
  - whether or not carrying a right to participate in the debtor's profits.

Specific inclusions in the definition of interest as per OECD & UN MCs

- income from govt securities
- income from bonds or debentures
- premiums and prizes attaching to such securities, bonds or debentures.

Note - *Interest does not include penalty charges for late payment*.

12 Royalties (Roy)

	OECD MC	UN MC
Right of CS to tax Roy. income	Roy. arising in SS and beneficially owned by resident of the RS is taxable only in RS. Thus, **RS has exclusive right to tax royalty income**.	Roy **may also be taxed in the SS**. However, if the beneficial owner is a resident of the RS, the tax charged by SS ≤ the specified %, (to be established through bilateral negotiations) of gross royalty.
Definition of Roy	Definition of Royalty does not include: (a) rentals for films/tapes used for radio/ TV broadcasting; and (b) rentals for industrial, commercial or scientific equipment.	Royalty includes: (a) rentals for films or tapes used for radio or TV broadcasting and (b) equipment rentals like rentals for industrial, commercial or scientific equipment.

12A FTS

In its 2017 update, the UN MC has inserted a specific article pertaining to Fees for Technical Services (FTS). There is no specific reference to FTS in OECD MC.

Right of CS to tax FTS [UN Model]

Para of Article	Right of CS to tax FTS
1	Confers right to the RS to tax FTS. However, does not state that FTS is exclusively taxable in the RS.
2	Establishes the right of the SS to tax FTS in accordance with its domestic law, subject to limitation on the max. rate of tax, to be established through bilateral negotiations, if the beneficial owner is a resident of the other CS.

<table>
<tr>
<td></td>
<td></td>
<td>Meaning of FTS [UN Model]
<table>
<tr><td colspan="2">FTS means payments for managerial, technical or consultancy services</td></tr>
<tr><td colspan="2">Exclusions from the meaning of FTS:</td></tr>
<tr><td>i</td><td>payment to an employee</td></tr>
<tr><td>ii</td><td>payment for teaching in an or by an educational institution</td></tr>
<tr><td>iii</td><td>payment by an individual for services for personal use</td></tr>
</table>
</td>
</tr>
<tr>
<td>13</td>
<td>Capital gains</td>
<td>This Article provides for the taxation of income arising from transfer of a capital asset, including transfer of shares.
Right of CS to tax income from Capital Gains
• The right to tax capital gains may be exclusively with the RS, or shared between the RS and SS.
• The Article does not specify what is a capital gain and how is to be computed, this being left to the applicable domestic law.
• The Article contains rules for taxation of gains from alienation of different assets such as immovable property, immovable property forming part of a PE, ships & aircrafts, etc.
• In respect of shares, the 2017 OECD and UN MCs are identical. Rights are conferred to the SS if more than 50% of the value of shares during the preceding 365 days is derived from immovable property in such SS.</td>
</tr>
<tr>
<td>14</td>
<td>Independent personal services</td>
<td>This Article present only in the UN MC deals with the taxation of income derived by a person for professional or specified services which are offered in the SS through some presence.
Right of CS to tax income from professional services (IPS) [UN MC]
<table>
<tr><td>Right of RS</td><td>Income derived by a resident of a CS in respect of professional services or other activities of an independent character is taxable only in the RS.</td></tr>
<tr><td>Right of SS</td><td>In the following circumstances, however, IPS may also be taxed in the other CS (i.e., the SS):
<table>
<tr><th>Circumstance</th><th>Extent of income taxable in SS</th></tr>
<tr><td>If he has a fixed base regularly available to him in the SS for the purpose of performing his activities</td><td>Only so much of the income as is attributable to that fixed base may be taxed in the SS.</td></tr>
<tr><td>If his stay in the SS is for a period > 183 days in any 12 month period commencing or ending in the fiscal year concerned</td><td>Only so much of the income as is derived from his activities performed in the SS may be taxed in that State</td></tr>
</table>
</td></tr>
</table>
</td>
</tr>
</table>

<table>
<tr>
<td></td>
<td></td>
<td>
Definition of “Professional Services” [UN MC]
The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.
<i>Note – OECD MC does not contain a separate article on IPS. The same is dealt with as “Business Profits (Article 7)” under the OECD MC.</i>
</td>
</tr>
<tr>
<td>21</td>
<td>Other income (OI)</td>
<td>
This Article deals with taxation of items of income which are not specifically taxable under any other specific Article [i.e., upto Article 20].
<table>
<tr><th></th><th>OECD MC</th><th>UN MC</th></tr>
<tr><td>Right to tax OI</td><td>Exclusive right to tax is with the RS.</td><td>Contains an additional para, Article 21(3), which provides that SS may also tax other income</td></tr>
<tr><td rowspan="2">Right to tax income [other than income from immovable property] effectively connected with PE</td><td colspan="2">Article 21(2) of both OECD and UN MC provides that for income effectively connected with a PE maintained in a CS by a resident of the other CS, taxation is governed by the provisions of Article 7 (Business Profits).</td></tr>
<tr><td></td><td>Additionally, UN Model provides that if the aforesaid income is effectively connected with a fixed base situated in a CS by a resident of the other CS, taxation would be governed by the provisions of Article 14 (IPS).</td></tr>
</table>
</td>
</tr>
<tr>
<td></td>
<td colspan="2">Chapter V : Methods for the Elimination of Double Taxation</td>
</tr>
<tr>
<td>23A/ 23B</td>
<td>Exemption method/ Credit Method</td>
<td>
In many cases, the application of tax treaty may result into double taxation (DT) for tax payers. In such a case, Articles 23A and 23B provide for the mechanism through which tax credit/exemption may be available in the RS for taxes deducted in the SS.
Two approaches for elimination of DT under MCs:
<table>
<tr><th>Exemption method (Article 23A)</th><th>Credit method (Article 23B)</th></tr>
<tr><td>Tax exemption may be available in the RS for taxes deducted in the SS.</td><td>Tax credit may be available in the RS for taxes deducted in the SS.</td></tr>
</table>
</td>
</tr>
</table>

These methods are not mutually exclusive and there may be cases where a treaty may adopt exemption method for certain types of income and credit method for other incomes.

- **Juridical DT and Economic DT:**

	Juridical DT	Economic DT
Meaning	The same income or capital is taxable in the hands of the same person by more than one State	Two different persons are taxable in respect of the same income or capital
Example	FTS may be taxable in the hands of the recipient both in the RS as well as in SS, based on the domestic laws of the CSs.	In respect of dividend distributed by a Co., DDT may be payable by the Co. in SS, whereas the dividend may be taxable in the hands of the shareholder of the other CS, on the basis of his residence.
Type of DT addressed by Article 23A & 23B	Articles 23A & 23B address Juridical DT.	The Articles do not address Economic DT. If two States wish to solve problems of economic DT, they must do so in bilateral negotiations.

Chapter VI : Special Provisions

25 **Mutual agreement procedure (MAP)**

Where a tax payer believes that the treatment accorded by either or both CSs is not in accordance with the provisions of the tax treaty, this Article provides for dispute resolution through bilateral negotiations between competent authorities (CAS) of both CSs.

	OECD MC	UN MC
Request for MAP	The taxpayer may make a request to either CS	**Alternative A** - Taxpayer has to approach RS or the country of his nationality **Alternative B** - Reference to an arbitration process as part of MAP. The decision arrived at through the process is binding unless a person directly affected does not accept it.
Time limit	Stipulates a time limit of 2 years from the date when all the information required by the CAS in order to address the case need to be provided to both CAS.	An arbitration may be initiated if the competent authorities (CAS) are unable to reach an agreement on a case within 3 years from presentation of that case [Alternative B]

<table>
<tr>
<td></td>
<td></td>
<td>
<table>
<tr><td>Who can request for Arbitration ?</td><td>Arbitration must be requested in writing by the person who initiated the case</td><td>Arbitration must be requested by the CAS of one of the CS. Once such a request is made, the taxpayer will be notified [Alternative B]</td></tr>
<tr><td>Departure from arbitration by CAS</td><td>No specific provision for departure from arbitration.</td><td>The CAS may depart from the arbitration decision if they agree to do so within 6 months after the decision has been communicated to them [Alternative B]</td></tr>
</table>
</td>
</tr>
<tr>
<td>26</td>
<td>Exchange of information (EOI)</td>
<td>
Purpose of Article 26
In order to complete tax cases, a country may require certain info which may be available with the treaty partner.
Article 26 provides for:

the info which may be exchanged
the manner in which such a request has to be made.

Importance of Article 26:

facilitates effective exchange of information between CSs.
curtails cross-border tax evasion and avoidance,
curtails the capital flight that is often accomplished through tax evasion & avoidance. This is particularly relevant in the perspective of developing countries.

Similar provisions contained in OECD and UN MCs

A CS cannot be expected to provide confidential financial info to another CS unless it has confidence that the info will not be disclosed to unauthorized persons.
A CS can avoid the EOI obligations by showing that the info pertains to communication between an attorney and his client which is protected from disclosure under domestic law.
Lack of interest or use in such info cannot, however, form the basis for a CS to not co-operate with the EOI obligations.

</td>
</tr>
</table>

EXERCISE

Question 1

Explain briefly the significant difference between the UN and OECD Model Tax Convention.

Answer

OECD Model is essentially a model treaty between two developed nations whereas UN Model is a model convention between a developed country and a developing country.

Further, OECD Model advocates the residence principle, i.e., it lays emphasis on the right of state of residence to tax the income, whereas the UN Model is a compromise between the source principle and residence principle, giving more weight to the source principle as against the residence principle.

Question 2

When does it become necessary to apply the tie-breaker rule? Discuss the manner of application of the tie-breaker rule.

Answer

Every jurisdiction, in its domestic tax law, prescribes the mechanism to determine residential status of a person. If a person is considered to be resident of both the Contracting States, relief should be sought from Article 4 of the Tax Treaty. A series of tie-breaker rules are provided in Paragraph 2 Article 4 of Model Convention to determine single state of residence for an individual.

The tie-breaker rule would be applied in the following manner:

(i) The first test is based on where the individual has a **permanent home**. Permanent home would mean a dwelling place available to him at all times continuously and not occasionally and includes place taken on rent for a prolonged period of time.

(ii) If that test is inconclusive for the reason that the individual has permanent home available to him in both Contracting States, he will be considered a resident of the Contracting State where his personal and economic relations are closer, in other words, the place where lies **his centre of vital interests**. Thus, preference is given to family and social relations, occupation, place of business, place of administration of his properties, political, cultural and other activities of the individual.

(iii) Paragraph (ii) establishes a secondary criterion for two quite distinct and different situations:

- The case where the individual has a permanent home available to him in both Contracting States and it is not possible to determine in which one he has his centre of vital interests;
- The case where the individual has a permanent home available to him in neither Contracting State.

In the aforesaid scenarios, preference is given to the Contracting State where the individual has an **habitual abode**.

(iv) If the individual has habitual abode in both Contracting States or in neither of them, he shall be treated as a resident of the Contracting State of which he is **a national**.

(v) If the individual is a national of both or neither of the Contracting States, the matter is left to be **considered by the competent authorities** of the respective Contracting States.

Question 3

Explain the meaning of "interest" and "fees for technical services" under the UN Model Convention.

Answer

As per Article 11 of the UN Model Convention, "Interest" essentially means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment are not regarded as interest for the purpose of this Article.

As per Article 12A of the UN Model Convention, "Fees for technical services" is defined as payments for managerial, technical or consultancy services but excludes payment to an employee, payment for teaching in an educational institution or for teaching by an educational institution, payments by an individual for services for personal use.

ANNEXURES

ANNEXURE – 1: Rule 128 - Foreign Tax Credit

ANNEXURE – 2: Rule 115 - Rate of exchange for conversion into rupees of income expressed in foreign currency and Rule 26 - Rate of exchange for the purpose of deduction of tax at source on income payable in foreign currency

ANNEXURE – 1

Rule 128 - Foreign Tax Credit

(1) An assessee, being a resident shall be allowed a credit for the amount of any foreign tax paid by him in a country or specified territory outside India, by way of deduction or otherwise, in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India, in the manner and to the extent as specified in this rule :

Provided *that in a case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.*

(2) The foreign tax referred to in sub-rule (1) shall mean,—

- *(a)* *in respect of a country or specified territory outside India with which India has entered into an agreement for the relief or avoidance of double taxation of income in terms of section 90 or section 90A, the tax covered under the said agreement;*
- *(b)* *in respect of any other country or specified territory outside India, the tax payable under the law in force in that country or specified territory in the nature of income-tax referred to in clause (iv) of the* Explanation *to section 91.*

(3) The credit under sub-rule (1) shall be available against the amount of tax, surcharge and cess payable under the Act but not in respect of any sum payable by way of interest, fee or penalty.

(4) No credit under sub-rule (1) shall be available in respect of any amount of foreign tax or part thereof which is disputed in any manner by the assessee:

Provided *that the credit of such disputed tax shall be allowed for the year in which such income is offered to tax or assessed to tax in India if the assessee within six months from the end of the month in which the dispute is finally settled, furnishes evidence of settlement of dispute and an evidence to the effect that the liability for payment of such foreign tax has been discharged by him and furnishes an undertaking that no refund in respect of such amount has directly or indirectly been claimed or shall be claimed.*

(5) The credit of foreign tax shall be the aggregate of the amounts of credit computed separately for each source of income arising from a particular country or specified territory outside India and shall be given effect to in the following manner:—

- *(i)* *the credit shall be the lower of the tax payable under the Act on such income and the foreign tax paid on such income :*

  Provided *that where the foreign tax paid exceeds the amount of tax payable in accordance with the provisions of the agreement for relief or avoidance of double taxation, such excess shall be ignored for the purposes of this clause;*
- *(ii)* *the credit shall be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.*

(6) In a case where any tax is payable under the provisions of section 115JB or section 115JC, the credit of foreign tax shall be allowed against such tax in the same manner as is allowable against any tax payable under the provisions of the Act other than the provisions of the said sections (hereafter referred to as the "normal provisions").

(7) Where the amount of foreign tax credit available against the tax payable under the provisions of section 115JB or section 115JC exceeds the amount of tax credit available against the normal provisions, then while computing the amount of credit under section 115JAA or section 115JD in respect of the taxes paid under section 115JB or section 115JC, as the case may be, such excess shall be ignored.

(8) Credit of any foreign tax shall be allowed on furnishing the following documents by the assessee, namely:—

(i) a statement of income from the country or specified territory outside India offered for tax for the previous year and of foreign tax deducted or paid on such income in Form No.67 and verified in the manner specified therein;

(ii) certificate or statement specifying the nature of income and the amount of tax deducted therefrom or paid by the assessee,—

(a) from the tax authority of the country or the specified territory outside India; or

(b) from the person responsible for deduction of such tax; or

(c) signed by the assessee:

Provided *that the statement furnished by the assessee in clause (c) shall be valid if it is accompanied by,—*

(A) an acknowledgement of online payment or bank counter foil or challan for payment of tax where the payment has been made by the assessee;

(B) proof of deduction where the tax has been deducted.

(9) The statement in Form No.67 referred to in clause (i) of sub-rule (8) and the certificate or the statement referred to in clause (ii) of sub-rule (8) shall be furnished on or before the due date specified for furnishing the return of income under sub-section (1) of section 139, in the manner specified for furnishing such return of income.

(10) Form No.67 shall also be furnished in a case where the carry backward of loss of the current year results in refund of foreign tax for which credit has been claimed in any earlier previous year or years.

Explanation.—For the purposes of this rule 'telegraphic transfer buying rate' shall have the same meaning as assigned to it in Explanation to rule 26.

ANNEXURE – 2

Rule 115 - Rate of exchange for conversion into rupees of income expressed in foreign currency

(1) The rate of exchange for the calculation of the value in rupees of any income accruing or arising or deemed to accrue or arise to the assessee in foreign currency or received or deemed to be received by him or on his behalf in foreign currency shall be the telegraphic transfer buying rate of such currency as on the specified date.

Explanation: For the purposes of this rule,—

(*1*) "telegraphic transfer buying rate" shall have the same meaning as in the *Explanation* to rule 26;

(*2*) "specified date" means—

(*a*) in respect of income chargeable under the head "Salaries", the last day of the month immediately preceding the month in which the salary is due, or is paid in advance or in arrears;

(*b*) in respect of income by way of "interest on securities", the last day of the month immediately preceding the month in which the income is due;

(*c*) in respect of income chargeable under the heads "Income from house property", "Profits and gains of business or profession" not being income referred to in clause (*d*) and "Income from other sources" (not being income by way of dividends and "Interest on securities"), the last day of the previous year of the assessee;

(*d*) in respect of income chargeable under the head "Profits and gains of business or profession" in the case of a non-resident engaged in the business of operation of ships, the last day of the month immediately preceding the month in which such income is deemed to accrue or arise in India ;

(*e*) in respect of income by way of dividends, the last day of the month immediately preceding the month in which the dividend is declared, distributed or paid by the company;

(*f*) in respect of income chargeable under the head "Capital gains", the last day of the month immediately preceding the month in which the capital asset is transferred :

Provided that the specified date, in respect of income referred to in sub-clauses (*a*) to (*f*) payable in foreign currency and from which tax has been deducted at source under rule 26, shall be the date on which the tax was required to be deducted under the provisions of the Chapter XVII-B.

(2) Nothing contained in sub-rule (1) shall apply in respect of income referred to in clause (*c*) of the *Explanation* to sub-rule (1) where such income is received in, or brought into India by the assessee or on his behalf before the specified date in accordance with the provisions of the Foreign Exchange Regulation Act, 1973 (46 of 1973).

Rule 26 - Rate of exchange for the purpose of deduction of tax at source on income payable in foreign currency

For the purpose of deduction of tax at source on any income payable in foreign currency, the rate of exchange for the calculation of the value in rupees of such income payable to an assessee outside India shall be the telegraphic transfer buying rate of such currency as on the date on which the tax is required to be deducted at source under the provisions of Chapter XVIIB by the person responsible for paying such income.

Explanation : For the purposes of this rule, "telegraphic transfer buying rate", in relation to a foreign currency, means [the rate or rates of exchange] adopted by the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), for buying such currency, having regard to the guidelines specified from time to time by the Reserve Bank of India for buying such currency, where such currency is made available to that bank through a telegraphic transfer.