

SYLLABUS - 2016

FINAL : PAPER -

16

DIRECT TAX LAWS AND INTERNATIONAL TAXATION

FINAL

STUDY NOTES



The Institute of Cost Accountants of India

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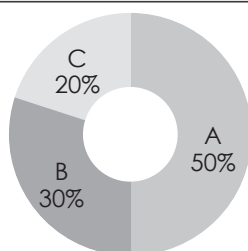
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Syllabus - 2016

PAPER 16 : DIRECT TAX LAWS AND INTERNATIONAL TAXATION

Syllabus Structure

A	Advanced Direct Tax Laws	50%
B	International Taxation	30%
C	Tax Practice and Procedures	20%



ASSESSMENT STRATEGY

There will be written examination paper of three hours.

OBJECTIVES

To gain knowledge about the direct and international tax laws in force for the relevant rules and principles emerging from leading cases, to provide and insight into practical aspects and apply the provisions of laws to various situations :

Learning Aims

The syllabus aims to test the student's ability to :

- ▶ Tax planning and management under Direct Tax
- ▶ Explain case laws governing core provisions of the above Acts
- ▶ Explain tax assessment for various assessee and return filing procedures
- ▶ Explain powers of various assessing authorities
- ▶ Explain international Taxation and other relevant issues

Skill sets required

Level C : Requiring skill levels of knowledge, comprehension, application and analysis, synthesis and evaluation.

Section A: Advance Direct Tax Laws [50 Marks]	50%
1. Assessment of income and Computation of tax liability of Various Entities	
2. Tax Management, Return and Assessment Procedure	
3. Grievance Redressal	
4. Penalties and Prosecutions	
5. Business Restructuring	
6. Different aspect of Tax planning	
7. CBDT & Other Authorities	
8. E-commerce Transaction and liability in special cases	
9. Income Computation and Disclosure Standards (ICDS)	
10. Black Money Act, 2015	
Section B: International Taxation [30 Marks]	30%
11. Double Taxation and Avoidance Agreements [Sec. 90, 90A and 91]	
12. Transfer Pricing	
Section C: Case Study Analysis [20 Marks]	20%

Paper 16 : Direct Tax Laws and International Taxation

Section A: Advance Direct Tax Laws [50 Marks]

1. Assessment of income and Computation of tax liability of Various Entities
 - a. Individual including non-resident
 - b. Company
 - c. Trust
 - d. Mutual Association
2. Tax Management, Return and Assessment Procedure
 - a. Return of Income
 - b. Assessment Procedure
 - c. Interest and fees
 - d. Survey, Search and Seizure
 - e. Refund, demand and recovery
3. Grievance Redressal
 - a. Appeal
 - b. Rectification
 - c. Revision
 - d. Settlement Commission
 - e. Advance Ruling
4. Penalties and Prosecutions
5. Business Restructuring
 - a. Amalgamation
 - b. Demerger
 - c. Slump sale
 - d. Conversion of sole proprietary business to company
 - e. Conversion of firm into company
 - f. Conversion of private limited company / unlisted public company into LLP
6. Different aspect of Tax planning
7. CBDT & Other Authorities
8. E-commerce Transaction and liability in special cases
9. Income Computation and Disclosure Standards (ICDS)
10. Black Money Act, 2015
 - a. Introduction to Black Money Act
 - b. Highlights of Black Money Act

Section B: International Taxation [30 Marks]

11. Double Taxation and Avoidance Agreements [Sec. 90, 90A and 91]
12. Transfer Pricing
 - a. Transfer Pricing including specified domestic transactions
 - b. Application of Generally Accepted Cost Accounting Principles and Techniques for determination of Arm's Length Price
 - c. Advance Pricing Agreement – Concept and Application
 - d. Safe Harbour Rules & their capitalisation

Section C: Case Study Analysis [20 Marks]

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Section A

Advance Direct Tax Laws

(Syllabus - 2016)



STUDY NOTE : 1

ASSESSMENT OF VARIOUS ENTITIES

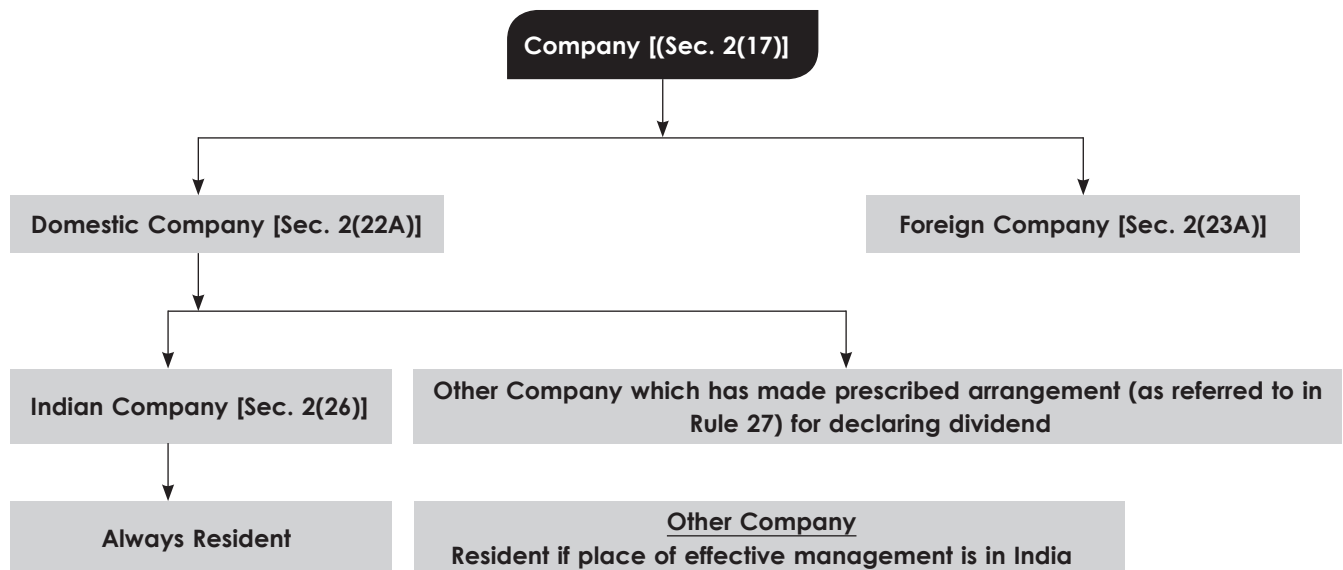


This Study Note includes:

- 1.1 Definitions
- 1.2 Tax on distributed income to unit holders [Sec. 115R]
- 1.3 Tax on income from Securitisation Trusts [Sec. 115TCA]
- 1.4 Tax on income of unit holder and business trust [Sec. 115UA]
- 1.5 Tax on income of investment fund and its unit holders [Sec. 115UB]
- 1.6 Tax on income from Patent [Sec. 115BBF]
- 1.7 Tax on income from transfer of carbon credits [Sec. 115BBG]
- 1.8 Religious or Charitable Trust
- 1.9 Local Authority
- 1.10 Mutual Concern
- 1.11 Assessment of Private Trust

1.1 DEFINITIONS

COMPANY





Company [Sec. 2(17)]

Company means:

- a. any Indian company; or
- b. any body corporate, incorporated under the laws of a foreign country; or
- c. any institution, association or body which is or was assessable or was assessed as a company for any assessment year on or before April 1, 1970; or
- d. any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the Central Board of Direct Taxes to be a company.

Indian Company [Sec. 2(26)]

An Indian company means a company formed & registered under the Companies Act, 1956 & includes

- a. a company formed and registered under any law relating to companies formerly in force in any part of India other than the state of Jammu & Kashmir and the Union territories specified in (c) infra;
- b. a company formed and registered under any law for the time being in force in the State of Jammu & Kashmir;
- c. a company formed and registered under any law for the time being in force in the Union territories of Dadar & Nagar Haveli, Goa, Daman & Diu and Pondicherry;
- d. a corporation established by or under a Central, State or Provincial Act;
- e. any institution, association or body which is declared by the Central Board of Direct Taxes (CBDT) to be a company u/s 2(17).

In the aforesaid cases, a company, corporation, institution, association or body will be treated as an Indian company only if its registered office or principal office, as the case may be, is in India.

Domestic Company [Sec. 2(22A)]

Domestic company means:

- (i) an Indian company; or
- (ii) any other company, which in respect of its income liable to tax under the Act, has made prescribed arrangements for the declaration and payment of dividends (including dividend on preference share), payable out of such income, within India.

Prescribed arrangements for declaration and payment of dividends within India [Rule 27]

The arrangements to be made by a company for the declaration and payment of dividends (including dividends on preference shares) within India shall be as follows:

- a. a. The share-register of the company for all shareholders shall be regularly maintained at its principal place of business within India.
- b. 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.
- c. The dividends declared, if any, shall be payable only within India to all shareholders.

Foreign Company [Sec. 2(23A)]

Foreign company means a company which is not a domestic company.

Company in which public are substantially interested [Sec. 2(18)]

A company is said to be a company in which the public are substantially interested (also known as widely held company):

1. **Government company:** A company owned by the Government or the Reserve Bank of India or in which not less than 40% of the shares are held (whether singly or taken together) by the Government or the Reserve Bank of India or a corporation owned by that bank; or
2. **A company u/s 8:** A company which is registered u/s 8 of the Companies Act, 2013; or
3. **Mutual benefit finance company:** A company
 - a. which carries on, as its principal business, the business of acceptance of deposits from its members; &
 - b. which is declared by the Central Government u/s 620A of the Companies Act, 1956, to be a Nidhi or Mutual Benefit Society; or
4. **Company in which shares are held by co-operative societies:** A company whose equity shares carrying not less than 50% of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant previous year beneficially held by, one or more co-operative societies;
5. **Listed company:** A company which is not a private company as defined in the Companies Act, 1956, and the conditions specified either in item (A) or in item (B) are fulfilled, namely:—
 - A) equity shares in the company were, as on the last day of the relevant previous year, listed in a recognised stock exchange in India;
 - B) equity shares in the company carrying not less than 50% (40% in case of an Indian company whose business consists mainly in the construction of ships or in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power i.e. industrial company) of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant previous year beneficially held by:
 - (a) the Government; or
 - (b) a corporation established by a Central, State or Provincial Act; or
 - (c) any company to which this clause applies or any subsidiary company of such company if the whole of the share capital of such subsidiary company has been held by the parent company or by its nominees throughout the previous year.
6. **Company which is prescribed by Board:** A company having no share capital and if, having regard to its objects, the nature and composition of its membership and other relevant considerations, it is declared by order of the Board to be a company in which the public are substantially interested. [Such company shall be deemed to be a company in which the public are substantially interested only for such assessment year or assessment years as may be specified in the declaration]; or

Rate of Tax for Company Assessee

Income of a company is taxable as under:

Short term capital gain covered u/s 111A	15%
Long term capital gain covered u/s 112A	10%



Other Long term capital gain	20%
Winning from lottery, cross-word puzzles, etc.	30%
Other Income	
- In the case of a domestic company	
■ Where its total turnover or gross receipts during the previous year 2016-17 does not exceed ₹ 250 crores	25%
■ In other case	30%
– In the case of a foreign company:	
■ Royalty received from Government or an Indian concern in pursuance of an agreement made by it with the Indian concern after March 31, 1961, but before April 1, 1976, or fees for rendering technical services in pursuance of an agreement made by it after February 29, 1964, but before April 1, 1976, and where such agreement has in either case been approved by Central Government	50%
■ Other incomes	40%

Surcharge: The amount of tax computed as above shall be further increased by surcharge as per following table:

Total Income	Surcharge as a percentage of Income Tax	
	Domestic Company	Foreign Company
Income less than or equal to ₹ 1,00,00,000	Nil	Nil
Income exceeds ₹ 1 crore but does not exceed ₹ 10 crores	7%	2%
Income exceeds ₹ 10 crores	12%	5%

Health & Education Cess: 4% of 'Tax liability after surcharge' is also levied on every company.

Marginal Relief

Condition: Total income exceeds ₹ 1,00,00,000

Relief: Marginal relief is provided to ensure that the additional income tax payable including surcharge on excess of income over ₹ 1,00,00,000 is limited to the amount by which the income is more than ₹ 1,00,00,000

Similar relief is also available if income exceeds ₹ 10 crores. In that case, in the above, ₹ 1 crore shall be replaced with ₹ 10 crores

Tax on income of certain domestic companies [Sec. 115BA]

Applicable to: Domestic Company

Conditions:

Conditions:

1. The company has been set-up and registered on or after the 01-03-2016.
2. The company is not 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; and
3. The total income of the company has been computed:
 - (a) Without any deduction u/s 10AA or 32(1)(iia) or 32AC or 32AD or 33AB or 33ABA or 35(1)(ii) or 35(1)(iia) or 35(1)(iii) or 35(2AB) or 35(2AA) or 35AC or 35AD or 35CCC or 35CCD or under any provisions of Chapter VI-A under the heading "C.—Deductions in respect of certain incomes" other than the provisions of sec. 80JJAA;

- (b) Without set off of any loss carried forward from any earlier assessment year if such loss is attributable to any of the deductions referred above; and
- (c) Depreciation u/s 32 [other than 32(1)(ia)], is determined in the manner as may be prescribed.
 - Depreciation u/s 32(1)(ii) of any block of assets entitled to more than 40% shall be restricted to 40% on the written down value of such block of assets [Rule 5]

Rate of Tax: 25%

Other Points

- Income taxable at special rate shall be taxable at special rate of tax applicable on that income. E.g., short term capital gain covered u/s 111A is taxable @ 15%.
- The loss referred to in the conditions shall be deemed to have been already given full effect to and no further deduction for such loss shall be allowed for any subsequent year.
- The scheme is optional. The option is exercised by the person in the prescribed manner¹ on or before the due date specified u/s 139(1) for furnishing the first of the returns of income which the person is required to furnish under the provisions of this Act. Further, once the option has been exercised for any previous year, it cannot be subsequently withdrawn for the same or any other previous year.

Tax on certain dividends received from foreign companies [Sec. 115BBD]

- ◆ Dividend [excluding dividend referred to in sec. 2(22)(e)] received by an Indian company from a specified foreign company is taxable @ 15%
- ◆ No deduction in respect of any expenditure or allowance shall be allowed to the assessee while computing such dividend income.
- ◆ **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.

ILLUSTRATION 1

Compute gross total income of Minakshi Ltd. under the head Profits & gains of business or profession for the assessment year 2019-20

Profit & Loss A/c for the year ended 31/3/2019

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening stock	4,00,000	By Sales	17,80,000
To Purchases of raw material	5,00,000	By Closing Stock	5,00,000
To Conversion cost	4,00,000	By Interest on debenture	10,000
To Customs duty	1,70,000	By Bad debt recovery	25,000
To Salary and wages	80,000	(Previously allowed)	
To Bonus to employee	15,000	By Interest on income tax Refund	6,000
To Carriage inward	20,000	By Rent from house property	40,000
To Advertisement	30,000		
To Interest	2,000		

¹ Uploading Form 10-IB



To Carriage outward	38,000		
To Depreciation	50,000		
To Provision for income tax	20,000		
To Compensation paid to director	1,00,000		
To Provision for bad debt	10,000		
To Audit fees	20,000		
To Bad debt	30,000		
To Traveling expenses	25,000		
To Municipal tax	5,000		
To Net profit	4,46,000		
	23,61,000		23,61,000

Additional information

- (a) Minakshi, holder of 21% share, sold goods to the company for ₹ 40,000 though market value is lower by ₹ 10,000. Payment to her made by way of bearer cheque.
- (b) Advertisement expenses relate to purchase of a machinery for advertisement. Depreciation allowed on such machinery is ₹ 2,250.
- (c) Ritu, holder of 21% share, purchased goods from the company for ₹ 30,000 though market value is ₹ 35,000. She made payment by way of bearer cheque.
- (d) Purav, who supplies more than 25% of goods, sold goods to company for ₹ 10,000 however, market value of such goods was ₹ 8,000.
- (e) Outstanding salary ₹ 20,000 was paid on 30-12-2019.
- (f) Bonus is not paid till due date of furnishing return.
- (g) Provision for bad debts is in excess of ₹ 1,000.
- (h) Salary paid in excess of requirement to non-relative ₹ 2,000 and to relative of director ₹ 6,000.
- (i) Traveling expenses is on traveling of Minakshi for 10 days out of which she used 8 days for acquiring a new machine from Jaipur for company and 2 days for meeting her relative. However, Minakshi agreed to refund proportionate cost.
- (j) On 31-7-2018, company purchased a machine from Jaipur costing ₹ 5,00,000.
- (k) Customs duty paid on 30-11-2019. However, company paid ₹ 5,000 on 30-7-2018 outstanding customs duty of earlier year
- (l) Company incurred capital expenditure of ₹ 1,00,000 for promoting family planning among its workers.
- (m) Carriage inward shows the expenditure incurred for acquiring machine from Jaipur.
- (n) Interest paid is related to loan taken for purchasing debenture.
- (o) As on 1-4-2018, company holds following assets –

Assets	Rate	Value
Plant & Machinery	15%	6,00,000
Furniture	10%	1,00,000

Compute gross total income for assessment year 2019-20. Ignore provision of sec. 115JB.

Solution

Computation of gross total income of Minakshi Ltd. for the A.Y. 2019-20

Particulars	Notes	Details	Amount	Amount
Income from house property				
Gross Annual value (Rent received)			40,000	
Less: Municipal tax			5,000	
Net annual value (NAV)			35,000	
Less: Standard deduction u/s 24(a) [30% of NAV]			10,500	24,500
Profits & gains of business or profession				
Net profit as per Profit and Loss A/c			4,46,000	
Add: Expenditure disallowed but debited in P/L A/c				
Depreciation	1	50,000		
Provision for income tax	2	20,000		
Provision for bad debt	3	10,000		
Municipal tax	4	5,000		
Excessive payment to Minakshi	5	10,000		
Cash payment to Minakshi in excess of ₹ 10,000	6	30,000		
Advertisement expenditure	7	30,000		
Bonus	8	15,000		
Excess payment of salary to relative of director	9	6,000		
Travelling expenses	10	25,000		
Customs duty	11	1,70,000		
Carriage inward	10	20,000		
Interest	12	2,000	3,93,000	
			8,39,000	
Less: Expenditure allowed but not debited to P/L A/c				
Customs duty of earlier years	11	5,000		
Expenditure on promoting family planning among employees	13	20,000		
Depreciation u/s 32	1	2,91,250		
Less: Income taxable under other head but credited in P/L A/c				
Rent from house property	14	40,000		
Interest on debenture	14	10,000		
Interest on refund of income tax	14	6,000	3,72,250	4,66,750
Income from other sources				
Interest on debenture		10,000		
Less: Interest on borrowed capital	12	2,000	8,000	
Interest on refund of income tax			6,000	14,000
Gross Total Income				5,05,250



Notes

- Depreciation is allowed as per Income tax Act being calculated as under -

Particulars	Details	Amount
Block 1: Plant and Machinery @ 15%		
W.D.V. as on 1/4/2018	6,00,000	
Add: Purchase during the year	5,40,000 [#]	
	11,40,000	
Less: Sale during the year	-	
	11,40,000	
Depreciation @ 15% [₹ 11,40,000 × 15%]	1,71,000	
Additional depreciation @ 20% [₹ 5,40,000 × 20%]	1,08,000	2,79,000
Block 2: Furniture @ 10%	1,00,000	
W.D.V. as on 1/4/2018	-	
Add: Purchase during the year	1,00,000	
	-	
Less: Sale during the year	1,00,000	
		10,000
Depreciation @ 10% [₹ 1,00,000 × 10%]		2,250
On machinery for advertisement		2,91,250
Depreciation allowed u/s 32		

Computation of actual cost of machinery purchased during the year -

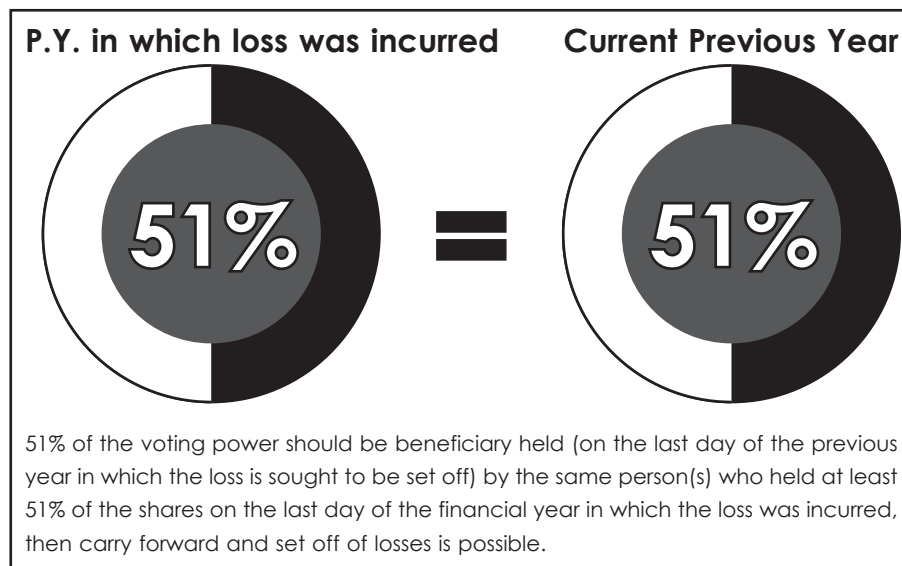
Particulars	Amount
Purchase cost	5,00,000
Carriage inward	20,000
Traveling cost *	<u>20,000</u>
Actual cost of purchased machinery	<u>5,40,000</u>

* Since traveling cost for 10 days was ₹ 25,000. Hence cost for 8 days (used for acquiring the new machine) is ₹ 20,000.

- Income tax is not allowed u/s 40(a).
- Any anticipatory loss is not allowed.
- Municipal tax is not allowed as deduction from business income but allowed from Income from house property.
- Since Minakshi has a substantial interest in the company, hence, excessive payment is disallowed u/s 40A(2).
- Payment of allowed expenditure otherwise than by account payee cheque or demand draft in excess of ₹ 10,000 shall be disallowed u/s 40A(3).
- Any capital expenditure is not allowed.

8. By virtue of sec. 43B, bonus to employees is allowed as deduction on payment basis.
9. Excessive payment to relative of director is disallowed [Sec. 40A(2)].
10. Since traveling expenditure and carriage inward is related to acquisition of machine, hence the same should be added with the cost of machine. Further, personal expenditure of Minakshi being refundable shall not be treated as expenditure.
11. As per sec. 43B, customs duty is allowed as deduction on payment basis.
12. Interest on loan taken for acquisition of debenture is deductible from income from debenture.
13. Any capital expenditure on promoting family planning among employees by a company is allowed in 5 equal installments [Sec. 36(1)(ix)].
14. Rent from house property is taxable under the head Income from house property, whereas interest income (including interest on income tax refund) is taxable under the head Income from other sources.
15. Any excessive payment received from a person who has substantial interest is not governed by sec. 40A(2).
16. A person supplying 25% of raw material is not treated as person who holds substantial interest. Hence excessive payment to Purav is allowed.
17. Compensation paid to director shall be allowed u/s 37(1).
18. Sec. 43B covers bonus and commission paid to employee but does not cover salary paid to employee.

Carry Forward and Set-off of Losses in the case of Closely Held Companies [Sec. 79]



In case of a company in which public are not substantially interested (other than eligible start-up company referred below), no loss shall be carried forward and set off against the income of the previous year, unless at least 51% of the voting power of the company are beneficially held (on the last day of the previous year in which the loss is sought to be set off) by the same person(s) who held at least 51% of the shares on the last day of the financial year in which the loss was incurred.

Taxpoint

- a) Losses under the head 'Capital gains': Sec. 79 applies to all losses, including losses under the head Capital gains.
- b) Unabsorbed depreciation: The above provision is not applicable on unabsorbed depreciation, such unabsorbed depreciation shall be allowed to be carried forward.

Special Provision for eligible start-up company

In the case of eligible start-up company, not being a company in which the public are substantially interested, the loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year, if

- All the shareholders of such company who held shares carrying voting power on the last day of the year or years in which the loss was incurred continue to hold those shares on the last day of such previous year; and
- Such loss has been incurred during the period of 7 years beginning from the year in which such company is incorporated:

Exceptions: However, change in the share holding due to following reasons shall not be considered-

- 1. Transfer due to death:** Where a change in the said voting power takes place in a previous year consequent upon the death of a shareholder
- 2. Transfer by way of gift:** Where a change in the said voting power takes place in a previous year on account of transfer of shares by way of gift to any relative of the shareholder making such gift
- 3. Amalgamation or demerger of foreign company:** Any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that 51% shareholders of the amalgamating or demerged foreign company continues to be the shareholder of the amalgamated or the resulting foreign company.
- 4. Insolvency and Bankruptcy Code:** Where change in the shareholding is taken place 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.



ILLUSTRATION 2

Following are the details of X Pvt Ltd, determine the brought forward loss available for set off during the previous year 2018-19 relevant to the assessment year 2019-20:

Previous Year 2017-18	Previous Year 2018-19
Business Loss = ₹ 12 lakh	Business Profit = ₹ 25 lakh
Unabsorbed depreciation: ₹ 2 lakh	(before adjusting brought forward loss and unabsorbed depreciation)
Details of Shareholders as on 31-03-2018	Details of Shareholders as on 31-03-2019
A = 30%	E = 30%
B = 25%	F = 25%
C = 20%	C = 20%
D = 25%	D = 25%

How shall your view will differ, if Mr. B had gifted the shares to Mr. F, a relative of Mr. B.

Solution

As per sec. 79, in case of a company in which public are not substantially interested, no loss shall be carried forward and set off against the income of the previous year, unless at least 51% of the voting power of the company are beneficially held (on the last day of the previous year in which the loss is sought to be set off) by the same person(s) who held at least 51% of the shares on the last day of the financial year in which the loss was incurred. However, the said provision is not applicable in case of unabsorbed depreciation.

Since, in the given case, shareholders holding 51% shares as on 31-03-2018 (the last day of the previous year in which loss has been incurred) and 31-03-2019 are not beneficially held by the same persons hence such loss shall not be available for set off with the income of the previous year 2018-19. Thus, no brought forward business loss is available for set off during the previous year 2018-19 relevant to the assessment year 2019-20. However, unabsorbed depreciation of ₹ 2 lakh shall be available for adjustment from the business income of the previous year 2018-19. Thus, business income for the assessment year 2019-20 is ₹ 23 lakhs.

If Mr. B had gifted the shares to Mr. F

Transfer of shares by way of gift to a relative is not considered as change in shareholding for the purpose of sec. 79. Hence, the loss of ₹ 12 lakh of previous year 2017-18 shall be available for set off with income of the previous year 2018-19.

ILLUSTRATION 3

A private limited company has share capital in the form of equity share capital. The shares were held until 31st March, 2017 by 4 members A, B, C and D equally. The company made losses/profits for the past three assessment years are as follow:

Asst. Year	Business Loss	Unabsorbed depreciation	Total
2015-16	Nil	₹ 15,00,000	₹ 15,00,000
2016-17	Nil	₹ 12,00,000	₹ 12,00,000
2017-18	₹ 9,00,000	₹ 9,00,000	₹ 18,00,000

The above figures have been accepted by the tax department.

During the previous year 31-3-2018, A sold his shares to Y and during the previous year 31-3-2019, B sold his shares to Z. The profits for the past two years are as follows:

31-3-2018 ₹ 18,00,000 (before charging depreciation ₹ 9,00,000)

31-3-2019 ₹ 45,00,000 (before charging depreciation ₹ 7,50,000)

Compute taxable income for A.Y. 2019-20

Solution

According to sec. 79, loss sustained by the closely held company shall not allowed to be set off unless in the year of such set off the shareholders holding not less than 51% of beneficial interest in share capital of the company in the year of sustaining the loss shall continue to be the shareholders of the company. Accordingly, the taxable income of the company for the A.Y. 2018-19 shall be nil as detailed here below:

Particulars	₹ in lacs
Income before depreciation	18
Less: Depreciation of the current year	9

Income after depreciation	9
Less: Unabsorbed business loss b/f	9
Taxable income	Nil

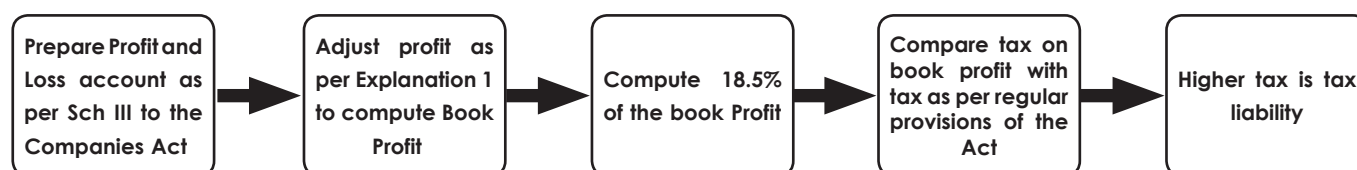
However, the abovementioned condition of beneficial ownership shall not applied for carry forward and set off of unabsorbed depreciation therefore, the company can carry forward and set off the unabsorbed depreciation, even if there is a change in the shareholding pattern between the year in which the loss was suffered and the year in which it seeks to set off such loss. Thus, the taxable income of the company for A.Y. 2019-20 is worked out as follow:

Particulars	Amount	Amount
Income before depreciation		45
Less: Depreciation of the current year		7.5
Income after current year depreciation		37.50
Less: Unabsorbed depreciation		
A.Y. 2015-16	15	
A.Y. 2016-17	12	
A.Y. 2017-18	9	36
Taxable income		1.50

Minimum Alternate Tax (MAT) or Tax on Book Profit [Sec. 115JB]

At times it may happen that a taxpayer, being a company, may have generated income during the year, but by taking the advantage of various provisions of Income-tax Law (like exemptions, deductions, depreciation, etc.), it may have reduced its tax liability or may not have paid any tax at all. Due to increase in the number of zero tax paying companies, MAT was introduced by the Finance Act, 1987 with effect from assessment year 1988-89. Later on, it was withdrawn by the Finance Act, 1990 and then reintroduced by Finance (No. 2) Act, 1996, w.e.f. 1-4-1997.

The objective of introduction of MAT is to bring into the tax net "zero tax companies" which in spite of having earned substantial book profits and having paid handsome dividends, do not pay any tax due to various tax concessions and incentives provided under the Income-tax Law.



Applicable to

Any company (whether Indian or Foreign, resident or non-resident, closely held or widely held company)

Circumstance in which MAT is applicable: Where the income-tax, payable on the total income (being computed under this Act in respect of any previous year) is less than 18.5% of its book profit

Treatment:

- 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 18.5% (plus surcharge, Health & Education cess).

Other Points

- ♦ Unit in IFSC: Where the assessee is a unit located in an International Financial Services Centre and derives its income solely in convertible foreign exchange, the rate of MAT shall be 9%
- ♦ Book Profit should be as per Schedule III to the Companies Act, 2013: Every company shall 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. However, in case of banking, insurance or electricity company, such statement should be prepared as per provisions of the Act which governs such company.
 - ▶ While preparing the annual accounts:
 - a) the accounting policies;
 - b) the accounting standards followed for preparing such accounts;
 - c) the method and rates adopted for calculating the depreciation,shall be the same as have been adopted for the purpose of preparing such accounts and laid before the company at its annual general meeting.
- ♦ Report from Accountant: Every company to which this section applies, shall furnish a report in the prescribed form [Form 29B] from an accountant, certifying that the book profit has been computed in accordance with the provisions of this section along with the return of income filed u/s 139 or along with the return of income furnished in response to a notice u/s 142(1)
- ♦ Life Insurance Business: The provision of this section shall not apply to any income accruing or arising to a company from life insurance business referred to in sec. 115B.
- ♦ Foreign Company: The provisions of this section shall not be applicable and shall be deemed never to have been applicable to an assessee, being a foreign company, if:
 - i. The assessee is a resident of a country or a specified territory with which India has an agreement referred to in sec. 90 or the Central Government has adopted any agreement u/s 90A and the assessee does not have a permanent establishment in India in accordance with the provisions of such agreement; or
 - ii. the assessee is a resident of a country with which India does not have an agreement of the nature referred above and the assessee is not required to seek registration under any law for the time being in force relating to companies.

Taxpoint: The MAT provision is not 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 44BB or 44BBA or 44BBB and such income has been offered to tax at the rates specified in those sections.

- ♦ **No impact of MAT on losses:** Nothing shall affect the determination of the amounts in relation to the relevant previous year to be carried forward to the subsequent year or years under the provisions of sec. 32(2) or 72(1)(ii) or 73 or 74 or 74A(3).
- ♦ When assessing officer has power to alter profit: Where the statement of profit and loss has been prepared in accordance with Schedule III to the Companies Act, 2013 and which has been scrutinised and certified by the statutory auditors and relevant authorities, the Assessing Officer has no power to scrutinise net profit in the statement of profit and loss except to the extent provided in Explanation [Apollo Tyres Ltd. -vs.- CIT (SC)]
- ♦ Other provision will apply: All other provisions of this Act like Advance Tax, interest, etc. shall apply to every company, mentioned in this section.

**ILLUSTRATION 4**

Business income (before adjusting brought forward losses) & Book Profit of X Ltd. for various years are as follow:

	Year 1	Year 2	Year 3
Business Income as per other provisions of the Act	(-) ₹ 2,00,000	₹ 1,50,000	₹ 1,50,000
Book Profit	₹ 1,00,000	₹ 60,000	₹ 2,00,000

In the aforesaid case, tax shall be computed as under:

Particulars	Year 1	Year 2	Year 3
Business Income after set off	(-) ₹ 2,00,000	Nil	₹ 1,00,000
Tax on above @ 30% [A]	Nil	Nil	₹ 30,000
Book Profit	₹ 1,00,000	₹ 60,000	₹ 2,00,000
18.5% of Book Profit [B]	₹ 18,500	₹ 11,100	₹ 37,000
Tax [Higher¹ of A & B]	₹ 18,500	₹ 11,100	₹ 37,000
Add: Surcharge*	Nil	Nil	Nil
Tax & Surcharge	₹ 18,500	₹ 11,100	₹ 37,000
Add: Health & Education Cess	₹ 740	₹ 444	₹ 1,480
Tax Liability (R/off)	₹ 19,240	₹ 11,540	₹ 38,480

*As total income of the company does not exceed ₹ 1 crore, hence surcharge is not applicable.

It is to be noted that when a company is liable to pay tax u/s 115JB, book profit of the company shall be considered as total income of the company.

Computation and Meaning of Book Profit [Explanation 1 to sec. 115JB]

Book profit means the profit as shown in the statement of profit and loss for the relevant previous year:

As increased by (if following amount is debited in the Statement of Profit & Loss):

(a) the amount of income-tax paid or payable, and the provision therefore;

♦ It includes:

- ▶ Any interest under Income Tax Act;
- ▶ Dividend distribution tax
- ▶ Surcharge and education cess on income-tax.

♦ It does not include:

- ▶ Penalty paid or payable under this Act
- ▶ Any tax, interest or penalty paid or payable under Wealth Tax Act or other Act;
- ▶ Securities Transaction Tax;

(b) the amounts carried to any reserves, by whatever name called;

1. There is another view. As per that view, comparison shall be made after applying surcharge and cess in respective tax.

- (c) the amount set aside to provisions made for meeting liabilities, other than ascertained liabilities;
 - ♦ Any provision made to meet unascertained liabilities like provision for gratuity or future losses, etc. should be added back. However, if the provision for gratuity has been made on the basis of actuarial valuation, it becomes ascertained liability, hence should not be added back [Shree Sajjan Mills Ltd. -vs.- CIT (SC)]
- (d) the amount by way of provision for losses of subsidiary companies;
- (e) the amount or amounts of dividends paid or proposed;
- (f) the amount or amounts of expenditure relatable to any income to which sec. 10 or sec. 11 or sec. 12 apply.
- (g) the amount or amounts of expenditure relatable to income being share of profit from AOP, if such share is exempt u/s 86
- (h) expenditure relating to following income of a foreign company if tax payable on such income under normal provision is less than 18.5%:
 - (A) the capital gains arising on transactions in securities; or
 - (B) the interest, royalty or fees for technical services chargeable to tax u/s 115A to 115BBE
- (i) 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 the trust referred to in sec. 47(xvii) or the amount representing notional loss resulting from any change in carrying amount of said units or the amount of loss on transfer of units referred to in sec. 47(xvii)
- (j) the amounts of expenditure relatable to income by way of royalty in respect of patent chargeable to tax u/s 115BBF
- (k) the amount of depreciation
- (l) the amount of deferred tax and provision thereof
- (m) the amount set aside as provision for diminution in the value of any asset (like asset written-off, etc.)
- (n) the amount standing in revaluation reserve relating to revalued asset on the retirement or disposal of such asset (if not credited to the statement of Profit and Loss)
- (o) gain on transfer of units referred to in sec.47(xvii) computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through statement of profit or loss, as the case may be;

As reduced by:

- (i) the amount withdrawn from any reserve or provision if any such amount is credited to the statement of profit and loss.
 - ▶ An amount withdrawn from reserve being created before 1-4-1997 otherwise than by way of a debit to the statement of profit and loss shall not be reduced.
 - ▶ An amount withdrawn from reserves created or provisions made on or after 1-4-1997 shall not be reduced from the book profit unless the book profit of such year has been increased by those reserves or provisions (out of which the said amount was withdrawn) in that year.
- (ii) the amount of income to which any of the provisions of sec. 10 or sec. 11 or sec. 12 apply, if any such amount is credited to the statement of profit and loss.
- (iii) share of profit from AOP, if such share is exempt u/s 86
- (iv) following income of a foreign company if tax payable on such income under normal provision is less than 18.5%:
 - (A) the capital gains arising on transactions in securities; or
 - (B) the interest, royalty or fees for technical services chargeable to tax u/s 115A to 115BBE



(v) the amount representing,—

- (A) notional gain on transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust referred to in sec.47(xvii); or
- (B) notional gain resulting from any change in carrying amount of said units; or
- (C) gain on transfer of units referred to in sec.47(xvii),

if any, credited to the statement of profit and loss; or

- (vi) the amount of loss on transfer of units referred to in sec.47(xvii) computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through statement of profit or loss, as the case may be;
- (vii) the amount of income by way of royalty in respect of patent chargeable to tax u/s 115BBF;
- (viii) the amount of depreciation debited to the statement of profit and loss (excluding the depreciation on account of revaluation of assets);
- (ix) the amount withdrawn from revaluation reserve and credited to the statement of profit and loss, to the extent it does not exceed the amount of depreciation on account of revaluation of assets referred above;
- (x) the amount of brought forward loss or unabsorbed depreciation, whichever is less as per books of account.
 - ▶ the loss shall not include depreciation;
 - ▶ the provisions of this clause shall not apply if the amount of loss brought forward or unabsorbed depreciation, is nil;

Exception:

In case of a company against whom an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under Insolvency and Bankruptcy Code, 2016, the aggregate (not lower) amount of unabsorbed depreciation and brought forward loss shall be reduced while computing book profit.

- (xi) the amount of deferred tax, if any such amount is credited to the statement of profit and loss
- (xii) the amount of profits of sick industrial company for the assessment year commencing on and from the assessment year relevant to the previous year in which the said company has become a sick industrial company and ending with the assessment year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.

Net worth means paid up capital + free reserve

ILLUSTRATION 5

Apple Industries Ltd. provides the following information for the financial year 2018-19:

Net profit as per statement of profit and loss after debiting/crediting the following :	₹ 120 lakh
Proposed dividend	₹ 30 lakh
Profit from unit established in SEZ	₹ 20 lakh
Provision for income-tax	₹ 18 lakh
Provision for deferred tax	₹ 10 lakh
Provision for permanent diminution in value of investments	₹ 3 lakh
Depreciation debited to statement of profit and loss ₹ 10 lakh includes	
depreciation on revaluation of assets to the tune of	₹ 1 lakh

Bought forward losses and unabsorbed depreciation as per books of the company are as follows : (₹ in lakh)

Previous Year	Brought Forward Losses	Unabsorbed Depreciation
2014 – 15	1	4
2015 – 16	1	1
2016 – 17	10	5

Compute the book profit of the company as per section 115JB for the assessment year 2019-20.

Solution

Computation of Book Profit of Apple Industries Ltd. for the A.Y.2019-20 (₹ In lakhs)

Particulars	Details	Amount
Net profit as per books of accounts		120
Add:		
Proposed Dividend	30	
Provision for income tax	18	
Provision for deferred-tax	10	
Provision for permanent diminution in value of investments	3	
Depreciation	10	71
		191
Less:		
Depreciation (ignoring depreciation of revaluation)	9	
Lower of brought forward loss and unabsorbed depreciation	10	19
Book Profit		172

ILLUSTRATION 6

The book profits of a company in the previous year 2018-19 computed in accordance with section 115JB are ₹ 60,00,000. If the total income for the same period computed as per the provisions of the Income-tax Act, 1961 is ₹ 12,00,000 calculate the tax payable by the company in the assessment year 2019-20 and also indicate whether the company is eligible for any tax credit.

Solution

Computation of Tax Liability of for the A.Y. 2019-20

Particulars	Amount
Total Income	12,00,000
Tax on above [A]	3,60,000
Book Profit	60,00,000
Tax on above [B]	11,10,000
Tax liability [Higher of (A) and (B)]	11,10,000



Add: Health & Education Cess	44,400
Tax & Cess payable u/s 115JB [B]	11,54,400

ILLUSTRATION 7

X Ltd. charged depreciation on its fixed assets at the rate prescribed in the income tax rules. However, the Assessing Officer disallowed the same and allowed the rate as prescribed in the Companies Act, 2013 for the purpose of computation of book profit under section 115JB for the previous year 2018-19. Examine the legality of action taken by the Assessing Authority.

Solution

This issue was settled by the Supreme Court in *Malayala Manorama Co. Ltd. -vs.- CIT*. The Apex Court observed that for the purpose of computation of book profit under section 115JB, the Assessing Officer's power is restricted to examining whether the books of account are certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act. Thereafter, he only has the limited power of making additions and deductions as provided for in Explanation 1 to section 115JB. The Assessing Officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account except to the extent provided in Explanation 1 to section 115JB. Where an assessee is consistently charging depreciation in its books of account at the rates prescribed in Income-tax Rules and the accounts of the assessee have been prepared and certified as per the provisions of the Companies Act, the Assessing Officer does not have any jurisdiction under section 115JB to rework the net profit of the assessee by substituting the rates of depreciation prescribed under the Companies Act. Applying the ratio of the Supreme Court decision to this case, it may be concluded that the action of the Assessing Officer is not correct.

ILLUSTRATION 8

The net profit of Renuka Ltd. an Indian company, as per its profit and loss account prepared as per the Income-tax Act, 1961 is ₹ 90,00,000 after debiting and crediting following items :

	(₹)
Provision for income-tax	5,00,000
Provisions for deferred tax	3,00,000
Proposed dividend	7,50,000
Depreciation including depreciation on revaluation of assets ₹ 20,00,000 debited to profit and loss account	60,00,000
Profit from industrial unit in SEZ area	80,000
Provision for permanent diminution in the value of investments	70,000
Compute tax liability under section 115JB for the assessment year 2019-20.	

Solution

Computation of Book Profit for the purpose of Sec. 115JB

Particulars	Details (₹)	Amount (₹)
Net profit as per books of accounts		90,00,000
Add:		
Provision for income tax	5,00,000	

Provisions for deferred tax	3,00,000	
Proposed dividend	7,50,000	
Depreciation	60,00,000	75,50,000
		1,65,50,000
Less:		
Depreciation (without considering depreciation on revaluation)	40,00,000	
Provision for permanent diminution in the value of investments	70,000	
Profit from industrial unit in SEZ area	Nil	40,70,000
Book Profit		1,24,80,000

Computation of Tax Liability under section 115JB

Particulars	Amount
Book profit u/s 115JB	1,24,80,000
18.5% of book profit	23,08,800
Add: Surcharge [As total income exceeds ₹ 1,00,00,000/-]	1,61,616
Tax & Surcharge	24,70,416
Add: Health & Education Cess @ 4%	98,817
Tax Liability u/s 115JB	25,69,233

The tax liability u/s 115JB is required to be compared with tax liability calculated on income calculated as per other provisions of the Act.

ILLUSTRATION 9

Sun bright Ltd., an Indian company furnished following particulars of its income for the previous year 2018-19. Calculate its total income and income tax liability for the assessment year 2019-20:

	(₹)
Income from business	5,20,000
Dividend received during the year:	
— from Indian company	20,000
— from foreign company	5,000
Gains from transfer of capital assets:	
— short term capital gains	25,000
— long term capital gains	50,000
Agricultural income in India	35,000

Additional information:

- (i) Business expenses already charged from business income include ₹ 10,000 revenue expenditure and ₹ 30,000 capital expenditure on family planning programme for employees.



(ii) Company has debited following donations in the profit and loss account of the business of company.

- Rajiv Gandhi Foundation: ₹ 50,000 ; and
- Prime Minister's National Relief Fund: ₹ 25,000.

Solution

Computation of Total Income of Sun Bright Ltd. for the Assessment Year 2019-20

Particulars	Amount (₹)	Amount (₹)
Income from Business		5,20,000
Profit as per Profit & Loss A/c		
Add: Disallowed Expenditure		
(i) Donation	75,000	
(ii) Capital Expenditure on Family Planning (₹ 30,000 - ₹ 6,000)	24,000	99,000
		6,19,000
Capital Gain		
- Long term	50,000	
- Short term	25,000	75,000
Income from Other Sources		
Dividend from		
- Indian Company	Exempt	
- foreign Company*	5,000	
Agricultural Income	Exempt	5,000
Gross Total Income		6,99,000
Less: Deduction u/s		
- 80G (Prime Minister's National Relief Fund + 50% of Rajiv Gandhi Foundation)		50,000
Total Income		6,49,000

Computation of Tax Liability

Particulars	Tax on LTCG	Other Income
Total Income	50,000	5,99,000
Rate	20%	30%
Tax	10,000	1,79,700
Total tax		1,89,700
Surcharge		Nil
Tax including surcharge		1,89,700
Health & Education Cess @ 4%		7,588
Total tax (Rounded Off)		1,97,290

* It is assumed that foreign company is not a specified foreign company u/s 115BBD.

ILLUSTRATION 10

Following is the profit and loss account of Z Ltd. for the year ended on 31-3-2019

Particulars	Amount (₹)	Particulars	Amount (₹)
To Raw material consumed	20,00,000	By Sale	
To Rent	5,00,000	Export	50,00,000
To Salary & Wages	10,00,000	Domestic	30,00,000
To Depreciation	5,00,000	By Closing Stock	10,00,000
To Provision for contingencies	75,000		
To Wealth Tax of earlier year	50,000		
To Loss of subsidiary co.	50,000		
To Custom Duty	40,000		
To Proposed dividend	1,00,000		
To Provision for Income tax	1,05,000		
To Net Profit	45,80,000		
	90,00,000		90,00,000

Additional Information

- (1) Interest on bank loan relating to year 2016-17 has been paid during the previous year ₹ 1,00,000.
- (2) Whole of Custom duty is unpaid.
- (3) Company is entitled to get deduction u/s 80G ₹ 1,00,000
- (4) For the purpose of Income tax, depreciation is ₹ 4,00,000.
- (5) Turnover of the company during the previous year was ₹ 65 crores.
- (6) In past few years, company had suffered losses, following balances are still unabsorbed:

	As per Income tax Act	As per books of Accounts
Depreciation	--	₹ 3,50,000
Losses	₹ 42,50,000	₹ 4,00,000

Compute tax liability of the company.

Solution

Computation of total income of Z Ltd. for the A.Y.2019-20 (as per other provisions of the Act)

Particulars	Details (₹)	Amount (₹)
Net profit as per books of accounts		45,80,000
Add: Expenditure disallowed but debited in P/L A/c		
Excess Depreciation	1,00,000	
Provisions for Contingencies	75,000	
Wealth Tax	50,000	



Loss of subsidiary company	50,000	
Proposed Dividend	1,00,000	
Provision for income tax	1,05,000	
Unpaid customs duty	40,000	5,20,000
		51,00,000
Less: Expenditure allowed but not debited in P/L A/c		
Interest on bank loan of earlier years		1,00,000
		50,00,000
Less: Brought forward business loss		42,50,000
Gross Total Income		7,50,000
Less: Deduction u/s 80G		1,00,000
Total Income		6,50,000

Computation of Book Profit of Z Ltd. for the A.Y.2019-20

Particulars	Details (₹)	Amount (₹)
Net profit as per books of accounts		45,80,000
Add:		
Provision for contingencies	75,000	
Loss of subsidiary company	50,000	
Proposed Dividend	1,00,000	
Provision for income tax	1,05,000	
Depreciation	5,00,000	8,30,000
		54,10,000
Less:		
Depreciation (as assets are not revalued)	5,00,000	
Lower of unabsorbed depreciation and brought forward loss (as per books of account)	3,50,000	8,50,000
Book Profit		45,60,000

Computation of tax liability of Z Ltd.

Particulars	Amount (₹)
Total income as per other provisions of the Act	6,50,000
Tax on above @ 30% [A]	1,95,000
Book profit u/s 115JB	45,60,000
18.5% of book profit [B]	8,43,600
Tax [Higher of A & B]	8,43,600
Add: Surcharge [As total income is only ₹ 45,60,000/-, thus, surcharge is not applicable]	Nil

Tax & Surcharge	8,43,600
Add: Health & Education Cess @ 4%	33,744
Tax Liability (Rounded off)	8,77,340

ILLUSTRATION 11

Following is the profit and loss account of Z Ltd. for the year ended on 31-3-2019

Particulars	Amount (₹)	Particulars	Amount (₹)
To Raw material consumed	23,25,000	By Sale	1,60,00,000
To Rent	3,50,000	By Closing Stock	10,00,000
To Salary & Wages	12,00,000	By Revaluation Reserve	25,000
To Depreciation	5,00,000	By General Reserve	65,000
To Provision for contingencies	75,000	By Dividend from domestic companies	35,000
To Wealth Tax	50,000		
To Provision for bad debts	40,000		
To Proposed dividend	1,00,000		
To Provision for Income tax	1,05,000		
To Net Profit	1,23,80,000		
	1,71,25,000		1,71,25,000

Additional Information

- (1) The amount of depreciation includes depreciation on revaluation of assets ₹ 50,000. Further, for the purpose of Income tax, depreciation is ₹ 4,00,000.
- (2) Turnover of the company during the previous year was ₹ 53 crores.
- (3) In past few years, company had suffered losses, following balances are still unabsorbed:

	As per Income tax Act	As per books of Accounts
Depreciation	₹ 66,00,000	Nil
Losses	₹ 35,50,000	Nil

Compute tax liability of the company.

Solution

Computation of total income of Z Ltd. for the A.Y.2019-20 (as per other provisions of the Act)

Particulars	Details (₹)	Amount (₹)
Net profit as per books of accounts		1,23,80,000
Add: Expenditure disallowed but debited in P/L A/c		
Excess Depreciation	1,00,000	
Provisions for Contingencies	75,000	



Wealth Tax	50,000	
Provision for bad debts	40,000	
Proposed Dividend	1,00,000	
Provision for income tax	1,05,000	4,70,000
		1,28,50,000
Less: Amount credited to P/L A/c		
Revaluation Reserve	25,000	
General Reserve	65,000	
Dividend from domestic companies	35,000	1,25,000
		1,27,25,000
Less: Brought forward business loss		35,50,000
		91,75,000
Less: Unabsorbed Depreciation		66,00,000
Total Income		25,75,000

Computation of Book Profit of Z Ltd. for the A.Y.2019-20

Particulars	Details (₹)	Amount (₹)
Net profit as per books of accounts		1,23,80,000
Add:		
Provision for contingencies	75,000	
Proposed Dividend	1,00,000	
Provision for income tax	1,05,000	
Provision for Bad Debts	40,000	
Depreciation	5,00,000	8,20,000
		1,32,00,000
Less:		
Depreciation (ignoring depreciation on revaluation)	4,50,000	
Amount transferred from Revaluation Reserve	25,000	
Amount transferred from General Reserve	65,000	
Dividend from domestic companies	35,000	5,75,000
Book Profit		1,26,25,000

Computation of tax liability of Z Ltd.

Particulars	Amount (₹)
Total income as per other provisions of the Act	25,75,000
Tax on above @ 30% [A]	7,72,500

Book profit u/s 115JB	1,26,25,000
18.5% of book profit [B]	23,35,625
Tax [Higher of A & B]	23,35,625
Add: Surcharge [As total income is ₹ 1,26,25,000]	1,63,494
Tax & Surcharge	24,99,119
Add: Health & Education Cess @ 4%	99,965
Tax Liability (Rounded off u/s 288B)	25,99,080

Tax Credit in respect of Tax Paid on Deemed Income [Sec. 115JAA]

- Where any amount of tax is paid u/s 115JB by an assessee, being a company, then, credit in respect of tax so paid shall be allowed to him in accordance with the provisions of this section. [Sec. 115JAA(1A)]
- The tax credit to be allowed as above shall be the difference of the tax paid for any assessment year u/s 115JB and the amount of tax payable by the assessee on his total income computed in accordance with the other provisions of this Act. However, no interest shall be payable on the tax credit allowed.
Mathematically, tax credit available = Tax paid u/s 115JB - Tax payable as per other provisions of the Act
- The amount of tax credit determined shall be carried forward and set off but such carry forward shall not be allowed beyond the 15 assessment year immediately succeeding the assessment year in which tax credit becomes allowable.
- The tax credit shall be allowed set-off in a year when tax becomes payable on the total income computed in accordance with the provisions of this Act other than sec. 115JB.
- Set off in respect of brought forward tax credit shall be allowed for any assessment year to the extent of the difference between the tax on his total income and the tax which would have been payable under the provisions of sec. 115JB for that assessment year. In other words, after setting off of MAT credit, tax liability of the year cannot be less than tax would have been payable u/s 115JB for that year.
- The amount of tax credit in respect of any income-tax paid in any country or specified territory outside India u/s 90 or 90A or 91, allowed against the minimum alternate tax, exceeds the amount of the tax credit admissible against the regular income-tax payable by the assessee, then, while computing the amount of credit, such excess amount shall be ignored.

Example

- Tax paid in foreign country: ₹ 70/-
- Tax payable u/s 115JB: ₹ 75/-
- Tax payable under other provisions of the Act: ₹ 10/-

Then,

Foreign tax credit to the extent of ₹ 70/- is available for discharging tax liability u/s 115JB.

While calculating credit u/s 115JAA for subsequent year, ₹ 60/- shall be ignored and credit of ₹ 5 is available as shown below:

Tax payable under other provisions of the Act	A	₹ 10
Less: Foreign Tax Credit	B	₹ 10
Tax Payable after adjustment	C	Nil



Tax payable u/s 115JB	D	₹ 75
Less: Foreign Tax Credit	E	₹ 70
Tax Payable after adjustment	F	₹ 5
MAT Credit available without considering aforesaid provision	D – A	₹ 65
Credit not available due to aforesaid provision	E – B	₹ 60
Credit available in the subsequent year(s)	F – C	₹ 5

- ◆ Where as a result of an order, the amount of tax payable is reduced or increased, the amount of tax credit allowed under this section shall also be increased or reduced accordingly.
- ◆ Aforesaid provisions do not apply to a limited liability partnership which has been converted from a private company or unlisted public company.

MAT on Ind AS compliant Financial Statement [Sec. 115JB(2A)]

A company whose financial statements are drawn up in compliance to the Indian Accounting Standards specified in Annexure to the Companies (Indian Accounting Standards) Rules, 2015, the book profit (as computed above) shall be further:

- 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";
 - ▶ No adjustment shall be made for 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;
 - ▶ However, the book profit of the previous year in which the asset or investment referred above 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 referred above for the previous year or any of the preceding previous years and relatable to such asset or investment.
- 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.

MAT in case of demerger [Sec. 115JB(2B)]

In the case of a resulting company, where the property and the liabilities of the undertaking 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.

First time adoption of Ind AS [Sec. 115JB(2C)]

In case of Ind AS compliant company, the book profit of the year of convergence and each of the following 4 previous years, shall be further increased or decreased, as the case may be, by 1/5th of the transition amount.

- ▶ "Transition Amount" means the amount or the aggregate of the amounts adjusted in the other equity (excluding capital reserve, and securities premium reserve) on the convergence date but not including the following:
 - A. Aggregate of the amounts adjusted in the other comprehensive income on the convergence date which shall be subsequently re-classified to the profit or 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.
- ▶ The book profit of the previous year in which the asset or investment referred to in (B) to (E) (supra) is retired, disposed, realised or otherwise transferred, shall be increased or decreased, as the case may be, by the aggregate of the amounts relatable to such asset or investment.
- ▶ The book profit of the previous year in which the foreign operation referred to in (F) is disposed or otherwise transferred, shall be increased or decreased, as the case may be, by the aggregate of the amounts relatable to such foreign operations.
- ▶ "Year of Convergence" means the previous year within which the convergence date falls;
- ▶ "Convergence Date" means the first day of the first Indian Accounting Standards reporting period as defined in the Indian Accounting Standards 101.

Tax on Distributed Income to Shareholders [Sec. 115QA]

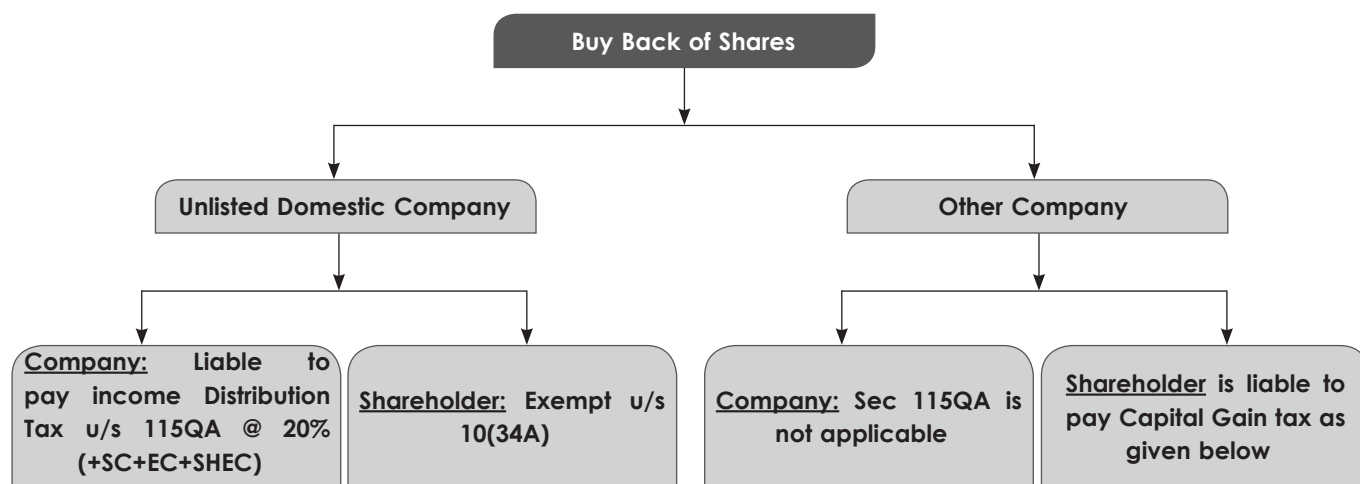
Section 115-O provides for levy of Dividend Distribution Tax (DDT) on the company at the time when company distributes, declares or pays any dividend to its shareholders. Consequent to the levy of DDT the amount of dividend received by the shareholders is not included in the total income of the shareholder (subject to sec. 115BBDA).

The consideration received by a shareholder on buy-back of shares by the company is not treated as dividend but is taxable as capital gains u/s 46A.

A company, having distributable reserves, has two options to distribute the same to its shareholders either by declaration and payment of dividends to the shareholders, or by way of purchase of its own shares (i.e. buy back of shares) at a consideration fixed by it. In the first case, the payment by company is subject to DDT and income in the hands of shareholders is exempt. In the second case the income is taxed in the hands of shareholder as capital gains.

Unlisted Companies, as part of tax avoidance scheme, are resorting to buy back of shares instead of payment

of dividends in order to avoid payment of tax by way of DDT particularly where the capital gains arising to the shareholders are either not chargeable to tax or are taxable at a lower rate.



In order to curb such practice following provisions are made:

- (1) The assessee is a Domestic company
- (2) Its shares are not listed on any recognised stock exchange.
- (3) The assessee-company has distributed income on buy back of its own shares from its shareholders
 - ▶ “Buy-back” means purchase by a company of its own shares in accordance with the provisions of any law for the time being in force relating to companies
 - ▶ “Distributed income” means 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.
- (4) Such company shall be liable to pay additional income-tax @ 20% (+ surcharge + cess) on the distributed income. Such tax is irrespective of the fact that the company is not liable for paying income tax on its income.
- (5) The principal officer of the domestic company and the company shall be liable to pay the tax to the credit of the Central Government within 14 days from the date of payment of any consideration to the shareholder on buy-back of shares.
- (6) The tax on the distributed income by the company shall be treated as the final payment of tax in respect of the said income and no further credit therefor shall be claimed by the company or by any other person in respect of the amount of tax so paid.
- (7) No deduction under any other provision of this Act shall be allowed to the company or a shareholder in respect of the income which has been charged to tax under this section or the tax thereon.

Interest Payable for Non-payment of Tax by Company [Sec. 115QB]

Where the principal officer of the domestic company and the company fails to pay the tax on the aforesaid distributed income within 14 days, he or it shall be liable to pay simple interest @ 1% for every month or part thereof on the amount of such tax 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.

When Company is Deemed to be Assessee in Default [Sec. 115QC]

If any principal officer of a domestic company and the company does not pay tax on distributed income in accordance with the provisions of section 115QA, then, he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it and all the provisions of this Act for the collection and recovery of income-tax shall apply.

Tax on distributed profits by a Domestic Company [Sec. 115-O]

A domestic company for any amount declared as dividends shall be charged to additional income tax at following rate:

Dividend u/s 2(22)(e)	30% + Surcharge @ 12% + Health & Education Cess
Other dividend	15% + Surcharge @ 12% + Health & Education cess Tax on distributed profit shall be computed after grossing up the tax by using following formula: $\frac{\text{Amount Distributed} \times 15\%}{85\%} = 17.647\%$

Taxpoint

- Dividend may be interim or otherwise and distributed out of current or accumulated profits.
- Such tax shall be in addition to income tax for which no deduction is available.
- Dividend distribution tax is applicable even if the company has declared dividend out of its exempted income.
- A shareholder does not get any credit of tax for the tax paid by the company.

Exception: Corporate dividend tax is not required to be paid on:

- The amount of dividend, if any, received by the domestic company during the financial year, from its subsidiary company and such:

Subsidiary Company is	Condition
a domestic company	Subsidiary company has paid the tax which is payable u/s 115-O on such dividend
a foreign company	The tax is payable by the domestic company u/s 115BBD on such dividend

Taxpoint:

- ◆ 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.
 - ◆ The same amount of dividend shall not be taken into account for reduction more than once.
- The amount of dividend, if any, paid to the New Pension System Trust referred to sec. 10(44).
 - Any dividend paid by the specified domestic company to a business trust out of its current income on or after the specified date.
 - ▶ Specified domestic company means a domestic company in which a business trust has become the holder of 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);
 - ▶ Specified Date means the date of acquisition by the business trust of such holding as is referred above.



iv. Dividend paid by a company, being a unit of an International Financial Services Centre deriving income solely in convertible foreign exchange, out of its current income.

- Tax on such dividend is neither paid by the company nor by the person receiving such dividend

Other Procedure

- ◆ The principal officer of the domestic company and the company shall be liable to pay such tax to the credit of the Central Government within 14 days from the date of:
 - (a) declaration of any dividend; or
 - (b) distribution of any dividend; or
 - (c) payment of any dividend,- whichever is earlier.
- ◆ Where the principal officer and the company fails to pay the whole or any part of the tax on distributed profits within the time allowed, he or it shall be liable to pay simple interest at the rate of 1% for every month or part thereof on the amount of such tax 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 [Sec. 115P]
- ◆ Deemed to be in default [Sec. 115Q]: If any principal officer of a domestic company and the company does not pay tax on distributed profits, then, he or it shall be deemed to be an assessee in default.
- ◆ Penalty [Sec. 271C]: If any person fails to pay (the whole or any part of the above tax), then such person shall be liable to pay, by way of penalty, a sum equal to the amount of tax which such person failed to pay.
- ◆ Prosecution [Sec. 276B]: If a person fails to pay to the credit of the Central Government the tax payable by him, he shall be punishable with rigorous imprisonment for a term which shall not be less than 3 months but which may extend to 7 years and with fine.

ILLUSTRATION 12

H Ltd. has received dividend of ₹ 5,00,000 from its subsidiary company S Ltd. Further H Ltd. declares dividend of ₹ 12,00,000 to its shareholders; dividend distribution tax will be paid as under:

Particulars	S Ltd. (₹)	H Ltd. (₹)
Dividend Paid	5,00,000	12,00,000
Less: Dividend received from subsidiary company	Nil	5,00,000
Balance	5,00,000	7,00,000
Tax u/s 115-O [(((Balance Amount x 15 / 85) 112%) x 104%)]	1,02,777	1,43,887

ILLUSTRATION 13

Y Ltd. is a company in which 80% shares are held by G Ltd. declared a dividend amounting to ₹ 30 lakh to its shareholders for the financial year 2017-18 in its annual general meeting held on 18th May, 2018. Dividend distribution tax was paid by Y Ltd. on 20th May, 2018. G Ltd. declared an interim dividend amounting to ₹ 40 lakh on 1st December, 2018 for the year ended 31st March, 2019.

Compute the amount of tax on dividend payable by G Ltd. What would be your answer, if 52% shares of G Ltd. are held by S Ltd., an Indian company?

Solution

Computation of Dividend Distribution Tax Payable by G Ltd.

Particulars	Amount
Dividend declared by G Ltd	40,00,000
Less: Dividend received from Y Ltd. [₹ 30,00,000 x 80%]	24,00,000
	16,00,000
Dividend Distribution Tax [104% (112% (₹ 16,00,000 x 15%/85%))]	3,28,884

1.2 TAX ON DISTRIBUTED INCOME TO UNIT HOLDERS [SEC. 115R]

- Any amount of income distributed by the specified company or a Mutual Fund to its unit holders shall be chargeable to tax and such specified company or Mutual Fund shall be liable to pay additional income-tax on such distributed income at the rate of:

Income distributed by	Income distributed to	Rate
Equity oriented fund	Any Person	10%
Money market mutual fund or a Liquid fund	Individual or a Hindu undivided family	25%
	Any Other Person	30%
Other Fund	Individual or a Hindu undivided family	25%
	Any Other Person	30%

- Tax on distributed profit shall be computed after grossing up the tax
- However, the above provision shall not apply in respect of any income distributed by the Administrator of the specified undertaking (i.e., Unit Scheme, 1964) to the unit holders.
- The person responsible for making payment of the income shall be liable to pay tax to the credit of the Central Government within 14 days from the date of distribution or payment of such income, whichever is earlier.
- No deduction under any other provision of this Act shall be allowed to the Unit Trust of India or to a Mutual Fund in respect of the income, which has been charged to tax u/s 115R(2).
- Redemption or repurchase of units or allotment of additional units by way of bonus units would not be subject to levy of additional income tax u/s 115R [Circular 6/2014 dated 11-02-2014]

Interest payable for non-payment of tax [Sec. 115S]

Where 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 whole or any part of the tax within the time allowed, he or it shall be liable to pay simple interest at the rate of 1% every month or part thereof on the amount of such tax 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.

Unit Trust of India or Mutual Fund to be assessee in default [Sec. 115T]

If any 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, does not pay such tax, then, he or it shall be deemed to be an assessee in default

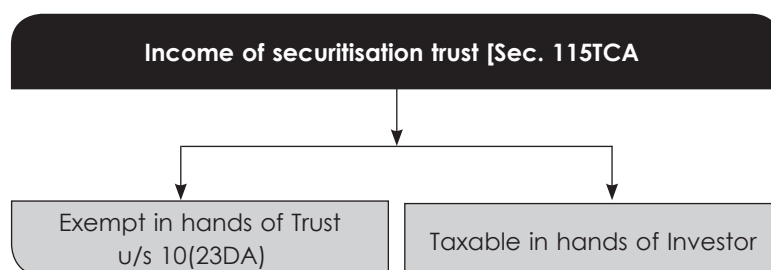
1.3 TAX ON INCOME FROM SECURITISATION TRUSTS [SEC. 115TCA]

Meaning

Securitisation Trust means a trust, being a:

- Special purpose distinct entity as defined in regulation 2(1)(u) of the SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 made under the SEBI Act, 1992 and the Securities Contracts (Regulation) Act, 1956, and regulated under the said regulations; or
- Special Purpose Vehicle as regulated by the guidelines on securitisation of standard assets issued by the RBI; or
- Trust set-up by a securitisation company or a reconstruction company formed, for the purposes of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), or in pursuance of any guidelines or directions issued by the RBI

which fulfils such conditions, as may be prescribed.



Tax Treatment in hands of investor

- ◆ Income of an investor of a securitisation trust, out of investments made in the securitisation trust, 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 by the securitisation trust been made directly by him.
 - Investor means a person who is holder of any securitised debt instrument or securities or security receipt issued by the securitisation trust.
 - Securities means debt securities issued by a Special Purpose Vehicle as referred to in the guidelines on securitisation of standard assets issued by the RBI.
- ◆ **Nature of income:** 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, as if it had been received by, or had accrued or arisen to, the securitisation trust during the previous year.
- ◆ **Deemed Credit:** The income accruing or arising to, or received by, the securitisation trust, during a previous year, if not paid or credited to the investor, shall be deemed to have been credited to the account of the investor on the last day of the previous year in the same proportion in which such investor would have been entitled to receive the income had it been paid in the previous year.
- ◆ **Statement specifying nature of income:** The person responsible for crediting or making payment of the income on behalf of securitisation trust and the securitisation trust shall furnish, within 30th June of the financial year following the previous year during which the income is distributed, to the investor who is liable to tax in respect of such

income and to the prescribed income-tax authority (30th November of the financial year following the previous year during which the income is distributed) , a statement in such form (Form 64E) and verified in such manner, giving details of the nature of the income paid or credited during the previous year and such other relevant details, as may be prescribed.

- ♦ **Double taxation:** Any income which 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, 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.

Tax treatment in hands Securitization Trust

Any income of a securitisation trust from the activity of securitisation is exempt u/s 10(23DA).

TDS on income from Investment in Securitization Fund [Sec. 194LBC]

Who is responsible to deduct tax: The person responsible for making the payment to an investor in respect of an investment in a securitisation trust, being referred to in sec. 115TCA

When tax shall be deducted: At the time of payment or crediting the payee, whichever is earlier.

Rate of TDS:

Payee	Rate of TDS
Resident	
- Individual or HUF	25%
- Other resident	30%
Non-Resident	
- Foreign Company	40%
- Other than foreign company	30%

Exemption or relaxation from the provision

When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax

1.4 TAX ON INCOME OF UNIT HOLDER AND BUSINESS TRUST [SEC. 115UA]

Meaning [Sec. 2(13A)]

Business Trust means a trust registered as:

- i. an Infrastructure Investment Trust under the SEBI (Infrastructure Investment Trusts) Regulations, 2014; or
- ii. a Real Estate Investment Trust under the SEBI (Real Estate Investment Trusts) Regulations, 2014, and the units of which are required to be listed on recognised stock exchange in accordance with the aforesaid regulations.



Tax treatment in hands of Business Trust

1. Following income are exempt:

A. Income of Business Trust [Sec 10(23FC)]

Any income of a business trust by way of

- a) interest received or receivable from a special purpose vehicle; or
- b) dividend referred to in sec. 115-O(7)
 - "Special purpose vehicle" means an Indian company in which the business trust holds controlling interest and any specific percentage of shareholding or interest, as may be required by the regulations under which such trust is granted registration.
 - Special purpose vehicle is not required to deduct tax at source on interest paid to the business trust [Sec. 194A(3)(xi)]. However, business trust is required to deduct tax at source @ 10% (5% in case of non-corporate non-resident or foreign company) on interest component of income distributed to the unitholders [Sec. 194LBA]

B. Income of Real Estate Investment Trust [Sec. 10(23FCA)]

Any income of a business trust, being a real estate investment trust, by way of renting or leasing or letting out any real estate asset owned directly by such business trust.

Taxpoint: Where rent is credited or paid to a business trust, being a real estate investment trust, in respect of any real estate asset, referred to in sec. 10(23FCA), owned directly by such business trust, TDS u/s 194-I is not required to be deducted. Business trust is required to deduct tax at source @ 10% (30% in case of non-corporate non-resident and 40% in case of foreign company) on distribution of such rental income to the unit holders [Sec. 194LBA]

2. Other Income of Business Trust

Subject to the provisions of sec. 111A and sec. 112, the total income of a business trust shall be charged to tax at the maximum marginal rate.

Tax treatment in hands of unit holders

A. Distributed Income to unit holder of a Business Trust [Sec 10(23FD)]

Any distributed income, referred to in section 115UA, received by a unit holder from the business trust excluding proportion of the income which is of the nature referred to in 10(23FC)(a) or 10(23FCA) is exempt

B. 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.

If in any previous year, the distributed income, received by a unit holder from the business trust is of the nature as referred to in sec. 10(23FC)(a) or 10(23FCA)], then, such distributed income shall be deemed to be income of such unit holder and shall be charged to tax as income of the previous year.

Taxpoint: Unitholder, being non-corporate non-resident or foreign company, is liable to tax @ 5% on such interest income u/s 115A.

Other Provisions

- ◆ Any person responsible for making payment of the income distributed on behalf of a business trust to a unit holder shall furnish a statement to the unit holder (within 30th June of the financial year following the previous year during which the income is distributed) and the prescribed authority (within 30th November of the financial year following the previous year during which the income is distributed), in such form and manner as may be

prescribed, giving the details of the nature of the income paid during the previous year and such other details as may be prescribed.

- ◆ Any transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust to the transferor is not regarded as transfer for the purpose of computation of capital gain.
- ◆ Income referred to in sec. 10(23FC)(a) or 10(23FCA) is not taxable in hands of business trust but taxation of such income is passed to the unit holder. On the other hand, all other income of the business trust is taxable in hands of the business trust and distribution thereof to the unit holders is not taxable again in hands of the unitholders.
- ◆ Refer TDS provisions [Sec. 194LC and sec. 194LBA]

ILLUSTRATION 14

DEF is a real estate investment trust (REIT). It owns house properties in different parts of Maharashtra. Besides, it holds controlling interest in A Ltd. (A Ltd., an Indian company, is SPV created by DEF for the purpose of owning commercial properties). Annual income of DEF for the previous year 2018-19 are calculated as under:

	₹ in crore
Rental income from properties directly owned by DEF (computed)	7
Long-term capital gain on sale of land and buildings directly owned by DEF (computed)	20
Short term capital gain on sale of listed shares of A Ltd.	2
Short term capital gain on sale of land and buildings directly owned by DEF (computed)	8
Interest from A Ltd.	13
Dividend from A Ltd.	0.09
Total	50.09

DEF distributes ₹ 50 crore to its unitholders. X is one of the unitholders. He holds 10% units in DEF. Compute income in hands of DEF and X

Solution

Computation of total income and tax liability of DEF for the A.Y. 2019-20

Particulars	₹ in crore
Rental income from properties directly owned by DEF [Exempt u/s 10(23FCA)]	Nil
Long-term capital gain on sale of land and buildings directly owned by DEF	20
Short term capital gain on sale of listed shares of A Ltd.	2
Short term capital gain on sale of land and buildings directly owned by DEF	8
Interest from A Ltd. [Exempt u/s 10(23FC)]	Nil
Dividend from A Ltd. [Exempt u/s 10(23FC)]	Nil
Total Income	30
Tax on above	
- Long term capital gain [(₹ 20 crore × 20%) × 115% × 104%]	4.7840
- Short term capital gain covered u/s 111A [(₹ 2 crore × 15%) × 115% × 104%]	0.3588



-Short term capital gain on sale of land and buildings (₹ 8 crore × 35.88% being MMR)	2.8704
Total	8.0132

Computation of total income of X for the A.Y. 2019-20

Particulars	₹ in crore
Rental income from properties [₹ 5 crore × 7 / 60]	0.58
Long-term capital gain on sale of land and buildings [Exempt u/s 10(23FD)]	Exempt
Short term capital gain on sale of listed shares of A Ltd. [Exempt u/s 10(23FD)]	Exempt
Short term capital gain on sale of land and buildings [Exempt u/s 10(23FD)]	Exempt
Interest from A Ltd. [₹ 5 crore × 13 / 60]	1.08
Dividend from A Ltd.	Exempt
Total Income	1.66

1.5 TAX ON INCOME OF INVESTMENT FUND AND ITS UNIT HOLDERS [SEC. 115UB]

Meaning

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 a Category II Alternative Investment Fund and is regulated under the SEBI (Alternative Investment Fund) Regulations, 2012

Tax treatment in hands of Investment Fund

A. Non-business income of Investment Fund

Any income of an investment fund other than the income chargeable under the head "Profits and gains of business or profession" is exempt u/s 10(23FBA)].

B. The total income of the investment fund shall be charged to tax as follow:

- Where such fund is a company or a firm	Taxable at the rate specified in the Finance Act
- In any other case	Taxable at maximum marginal rate

Other Provisions

- ♦ **Dividend Distribution Tax:** The provisions of dividend or income distribution tax are not applicable on the income paid by an investment fund.
- ♦ **Statement specifying nature of income:** The person responsible for crediting or making payment of the income on behalf of an investment fund and the investment fund shall furnish, within 30th June of the financial year following the previous year during which the income is distributed, to the person who is liable to tax in respect of such income and to the prescribed income-tax authority (within 30th November of the financial year following the previous year during which the income is distributed), a statement in the prescribed form and verified in such manner, giving details of the nature of the income paid or credited during the previous year and such other relevant details, as may be prescribed.

Tax treatment in hands of unitholders

- A. Income, being that proportion of income which is of the same nature as income chargeable under the head "Profits and gains of business or profession" in hands of the investment fund is exempt in hands of the unit holders [Sec. 10(23FBB)].
- B. 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.

Taxpoint:

- **Carry forward of Loss:** If there is a loss [without giving effect to the provisions of sec. 10(23FBA)], after making inter-head adjustment, in hands of the investment fund, then such loss shall be allowed to be carried forward in hands of the fund. Such loss shall not be passed through to the unit holders for aforesaid purpose.

In short, income under the 'Profits and Gains of Business or Profession' is taxable in hands of the fund and exempted in hands of the unit holders. On the other hand, income under other head is exempt in hands of the fund but taxable in hands of the unitholders.

- **Nature of income:** 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 unitholders, as if it had been received by, or had accrued or arisen to, the investment fund during the previous year (subject to adjustment of losses).
- **Deemed Credit:** The income of the investment fund, if not paid or credited to the unit holders, 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.
- **Double Taxation:** Any income which has been included in total income of the unitholder in a previous year, on account of it having accrued or arisen in the said previous year, 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 investment fund.

TDS on income of units of Investment Fund [Sec. 194LBB]

Who is responsible to deduct tax: The person responsible for making the payment of any income, other than that proportion of income which is of the same nature as income referred to in sec. 10(23FBB), to a unit holder in respect of units of an investment fund specified in clause (a) of the Explanation 1 to sec. 115UB

When tax shall be deducted: At the time of payment or crediting the payee, whichever is earlier.

Rate of TDS:

Payee	Rate of TDS
Resident	10%
Non-resident (not being a company)	30%
Foreign Company	40%

Note: Where the payee is a non-resident (not being a company) or a foreign company, deduction shall not be made in respect of any income that is not chargeable to tax.

**Exemption or relaxation from the provision**

When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax

ILLUSTRATION 15

Compute total income of each investment fund for A.Y. 2019-20 from the following details:

Income	Fund A (₹)	Fund B (₹)	Fund C (₹)
Business Income	Nil	5,00,000	(2,00,000)
Capital Gains	20,00,000	15,00,000	(5,00,000)
Income from Other Sources	5,00,000	3,00,000	10,00,000

Further, it is also given that there are 20 unit holder each holding one unit. You are also requested to compute income of unit holder assuming that income from investment fund is the only income of unit holder.

Solution

Computation of total income of the investment fund for the A.Y. 2019-20

Particulars	Fund A (₹)	Fund B (₹)	Fund C (₹)
Business Income	Nil	5,00,000	Nil
Total Income	Nil	5,00,000	Nil

Such income is taxable at the rate @ 30% if the fund is a company or firm else at maximum marginal rate of tax (i.e., 35.88%)

Computation of total income of the unit holder for the A.Y. 2019-20

Particulars	Fund A (₹)	Fund B (₹)	Fund C (₹)
Capital Gains [Income / 20]	1,00,000	75,000	
Income from Other Sources [Income / 20] [[#] (₹ 10 lakh – ₹ 2 lakh) / 20]	25,000	15,000	40,000 [#]
Total Income	1,25,000	90,000	40,000

ILLUSTRATION 16

In case of case C of the aforesaid illustration, if Fund C has earned following income during the previous year 2019-20, compute total income for the assessment year 2020-21

- Business Income: ₹ 2,00,000
- Capital Gains: ₹ 8,00,000
- Income from Other Sources: ₹ 9,00,000

Solution

Computation of total income of the investment fund for the A.Y. 2020-21

Particulars	Amount
Business Income	2,00,000
Total Income	2,00,000

Computation of total income of the unit holder for the A.Y. 2020-21

Particulars	Amount
Capital Gains [(₹ 8 lakh – ₹ 5 lakh i.e., b/f loss) / 20]	15,000
Income from Other Sources [Income / 20]	45,000
Total Income	60,000

1.6 TAX ON INCOME FROM PATENT [SEC. 115BBF]

Where the total income of an eligible assessee includes any income by way of royalty in respect of a patent developed and registered in India, tax @ 10% shall be payable on such royalty income.

- ▶ Eligible Assessee means a person resident in India and who is a patentee;
- ▶ Patentee means the person, being the true and first inventor of the invention, whose name is entered on the patent register as the patentee, in accordance with the Patents Act, and includes every such person, being the true and first inventor of the invention, where more than one person is registered as patentee under that Act in respect of that patent.
- ▶ Developed means at least 75% of the expenditure incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970
- ▶ 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:
 - i. transfer of all or any rights (including the granting of a licence) in respect of a patent; or
 - ii. imparting of any information concerning the working of, or the use of, a patent; or
 - iii. use of any patent; or
 - iv. rendering of any services in connection with the activities referred above
- ▶ Lump sum includes an advance payment on account of such royalties which is not returnable.

Other Provisions

- ◆ No deduction for expenditure: No deduction in respect of any expenditure or allowance shall be allowed to the eligible assessee in computing his royalty income.
- ◆ Option to the assessee: The eligible assessee is required to exercise the option for taxation of such royalty income in accordance with the provisions of this section, in the prescribed manner, on or before the due date for furnishing the return of income for the relevant previous year.
- ◆ Concessional Rate is not applicable: Where an eligible assessee opts for taxation of his royalty income in



accordance with the provision of this section and he offers the royalty income for any of the 5 assessment years relevant to the previous year succeeding the previous year not in accordance with the provisions this section, then, the assessee shall not be eligible to claim the benefit of this section for 5 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 this section.

1.7 TAX ON INCOME FROM TRANSFER OF CARBON CREDITS [SEC. 115BBG]

Where the total income of an assessee includes any income by way of transfer of carbon credits, tax @ 10% shall be payable on the income by way of transfer of carbon credits

- ▶ Carbon credit in respect of one unit shall mean reduction of one tonne of carbon dioxide emissions or emissions of its equivalent gases which is validated by the United Nations Framework on Climate Change and which can be traded in market at its prevailing market price.
- ▶ No deduction for expenditure: No deduction in respect of any expenditure or allowance shall be allowed to the assessee while computing his income by way of transfer of carbon credit

1.8 RELIGIOUS OR CHARITABLE TRUST

Income of a religious or charitable trust or institution is exempt from tax u/s 11. Trust must be created in accordance with law for charitable purposes.

Meaning of Certain Terms

Trust	It is an obligation annexed to the ownership; — arising out of a confidence reposed by the owner; — declared and accepted by him (owner); — for the benefit of another (or of another and the owner). Note: For the purpose of the Income Tax Act, the word trust includes "any other legal obligation"
Author of the trust	The person who reposes or declares the confidence and creates a trust.
Beneficiary	The person for whose benefit the trust is created.
Trustee	The person who accepts the confidence and who is authorised to manage the trust property and to look after the interest of the beneficiary.
Trust property	The property set aside by the trustee, for benefit of the beneficiary, being the subject matter of the trust.
Instrument of trust	The deed or instrument by which the trust is created. Note: No trust in relation to immovable property can be framed unless and until a non-testamentary instrument in writing is signed by the author of the trust or by the will of the author of the trust. However, such instrument is not required in case of a movable property when such property is transferred to the trustee.
Charitable purpose	As per Sec. 2(15), it 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. (discussed in detail later in this chapter)



Public trust	A trust in which beneficiaries are the general public or a class thereof.
Private trust	A trust in which beneficiary is the specific person(s).

Contents

Sec.11	Exemption of income from property held in trust or other legal obligation for religious or charitable purpose(s) wholly.
Sec.12	Exemption of income derived by such a trust from voluntary contribution
Sec.12A / 12AA	Conditions relating to registration of trust.
Sec.13	Withdrawal of exemptions u/s 11 and 12

Conditions for Exemption [Sec. 11]

A. Property must be held under a trust

The income yielding property must be held under a trust or other legal obligations.

Taxpoint:

- **There must be a trust:** If there is neither trust nor any legal obligation, exemption will not be available even if the entire income of the property is applied to charitable or religious purpose.
- **There must be a property:** A mere creation of a trust for generating income is not sufficient. There must be a property held under a trust for generating income.

B. Purpose of the trust

Trust must be created wholly for charitable/religious and lawful purposes. (discussed in detail later in this chapter).

C. Registration of the trust

The trust must be a registered trust. (The procedure of registration is discussed later in this chapter).

D. Audit of Accounts

The accounts of the trust must be audited if its income (before claiming exemption u/s 11 or 12) exceeds exempted ceiling. Audit report must be filed with the income tax authority on or before the due date of filing of return i.e. 30th September. [See Chapter 'Return of Income' for note on paper-less Return]

E. Application of Income

Income must be applied for the purpose of the trust. (a detailed discussion is made later in this chapter)

- Any amount credited or paid to any other trust or institution registered u/s 12AA, being contribution 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 purposes.
- While computing income of the trust, the provisions of sec. 40(a)(ia), sec. 40A(3) and sec. 40A(3A) shall apply as they apply in computing the income chargeable under the head "Profits and gains of business or profession.

F. Return of Income

Income-tax return required to be furnished u/s 139(4A) should be furnished within the due date of filing return of income.

G. Additional condition for charitable trust created on or after 1/4/1962

A charitable trust created on or after 1/4/1962 should satisfy further following conditions:

- It should not be created for the benefit of any particular religious community or caste.



- b. No part of its income should be applied directly or indirectly for the benefit of the settlor or other specified persons.
- c. Its property should be held wholly for charitable purposes.

Trust must be created wholly for charitable/religious and lawful purposes

Meaning of Charitable trust

1. As per Sec. 2(15), 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.

Exception: The advancement of any other object of general public utility shall 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 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:
 - i. such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and
 - ii. the aggregate receipts from such activity or activities during the previous year, do not exceed 20% of the total receipts, of the trust or institution undertaking such activity or activities, of that previous year.
2. In this regard it is to be noted that -

Sec. 10(21) exempts, subject to certain conditions, income of an approved scientific research association, which is applied fully for the purpose of such association.

Sec. 10(23C) exempts, subject to certain conditions, income of a University and other educational institutions or hospital or other institutions existing fully for educational or philanthropic purposes respectively.
 3. If the object is not intended to give relief to the poor or for the advancement of medical or educational field, it may be treated as charitable purpose if it causes the advancement of object of general public utility. As per Bar council of Maharashtra -vs.- CIT meaning of –

General	:	Pertaining to a whole class
Public	:	The body of people at large
Utility	:	Usefulness

4. The expression "object of general public utility" is not restricted to 'the object beneficial to whole of mankind'. An object beneficial to a particular section shall also be deemed as "object of general public utility". However, it must not be beneficial, only to a particular caste or religious community.
5. Charitable purpose includes Promotion of Sports and Games. Therefore, an association engaged in the promotion of games and sports can claim exemption u/s 11.
6. A trust or institution meant for the benefit of Scheduled Castes, Scheduled Tribes, Backward Classes, etc. is eligible for exemption u/s 11.
7. Trust created for charitable or religious purposes, which promotes international welfare in which India is interested, shall be eligible for exemption provided a general or special order has been received from CBDT in this regard

Meaning of Religious Purpose

Sec. 11 provides exemption to income of the trust held for charitable or religious purpose. Religious purpose is different from charitable purpose. A private trust held for religious purpose is not eligible for exemption u/s 11, however, a public trust held for religious purpose can claim exemption u/s 11. A charitable trust created on or after 1/4/1962, should not be created for the benefit of any particular religious community or caste.

As per sec. 80G(5)(iii), deduction is available only for donation to a charitable trust and not to a religious trust. However, u/s 80G(2)(b), any sums paid by the assessee in the previous year as donations for the renovation or repair of any such temple, mosque, gurdwara, church or other place as is notified by the Central Government in the Official Gazette to be a place of public worship of renown throughout any State or States is allowed as deduction.

Meaning of lawful purpose

The trust shall not be treated as lawful if the purpose -

- for which it is created is forbidden by law.
- is fraudulent
- is regarded as immoral or opposed to public policy
- causes injury to others.

Where a trust has two objects one of which is unlawful it shall be treated as illegal trust unless and until it can be separately carried on with legal object.

Exemption [Sec. 11]

As per sec. 11(1)(a), income derived from property held under trust wholly for charitable or religious purpose(s), shall be exempted from tax, to the extent to which such income is applied to such purposes in India.

Taxpoint:

- ▶ Any amount credited or paid to any other trust or institution registered u/s 12AA, being contribution 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 purposes.
- ▶ In order to claim exemption, a trust must apply its income for charitable purpose(s). Income which is not applied for the purpose for which charitable trust is created, shall not be eligible for exemption.
- ▶ Where a trust or an institution has been granted registration and the said registration is in force for any previous year, then, no exemption u/s 10 [other than sec. 10(1) and sec. 10(23C)] is available to such trust or institution
- ▶ Anonymous donation referred u/s 115BBC is not exempt.

Anonymous donation [Sec. 115BBC]

Where the total income of an assessee being -

- Any University or other educational institution referred u/s 10(23C)(iiiad) or (vi)
- Any hospital or other institution referred u/s 10(23C)(iiiae) or (via)
- Any fund or institution referred u/s 10(23C)(iv) or (v)
- Any trust or institution referred u/s 11.
 - includes any income by way of anonymous donation# in excess of specified limit##, such donation shall be taxed @ 30% (+SC+EC+SHEC)



Anonymous donation means any voluntary contribution, where a person receiving such contribution does not maintain a record of the identity indicating the name and address of the person making such contribution and other prescribed particulars.

Specified limit: Anonymous donation received being higher of the following:

- 5% of the total donations received by the assessee; or
- ₹ 1,00,000

Exceptions

The above provision shall not apply to any anonymous donation received by –

- Any trust or institution created wholly for religious purposes
- Any trust or institution created wholly for religious and charitable purposes other than any anonymous donation made with a specific direction that such donation is for any University or other education institution or hospital or other medical institution run by such trust or institution.
- Anonymous donation received upto specified limit.

ILLUSTRATION 17

A charitable trust has furnished following details for computing tax liability:

Particulars	Case 1 (₹)	Case 2 (₹)	Case 3 (₹)
Anonymous Donations received	5,00,000	2,00,000	1,20,000
Other Donations	3,00,000	27,00,000	28,20,000
Other taxable income	7,00,000	4,00,000	(-) 22,00,000

Solution

Computation of tax liability

Particulars	Case 1		Case 2		Case 3	
	Details (₹)	Amount (₹)	Details (₹)	Amount (₹)	Details (₹)	Amount (₹)
Anonymous Donations received		5,00,000		2,00,000		1,20,000
Less: Specified limit being higher of the following:						
- Statutory limit	1,00,000		1,00,000		1,00,000	
- 5% of total donation	40,000	1,00,000	1,45,000	1,45,000	1,47,000	1,20,000 [#]
Taxable Anonymous Donation		4,00,000		55,000		Nil
Tax on above @ 30% [A]		1,20,000		16,500		Nil
Income being other donation & other income		10,00,000		31,00,000		6,20,000
Add: Anonymous Donations [not taxable above]		1,00,000		1,45,000		1,20,000
Other Taxable Income		11,00,000		32,45,000		7,40,000
Tax on above (slab rate) [B]		1,42,500		7,86,000		60,500

Total Tax [A + B]		2,62,500		8,02,500		60,500
Add: Health & Education cess		10,500		32,100		2,420
Tax and cess payable (R/off u/s 288B)		2,73,000		8,34,600		62,920

Subject to maximum of anonymous donations

Free Accumulation of Income

However, trust is allowed to accumulate 15% of its income and such accumulation shall be treated as application of income. For such 15% accumulation of income, trust need not to apply any one. Such accumulation of income is freely allowed.

Taxpoint:

- ▶ In order to claim 100% exemption, trust must apply 85% of its income for charitable purpose(s) for which it is created.
- ▶ For this purpose, income means accounting income and not income as per the Income Tax Act

Example: If a trust has earned income of ₹ 3,00,000 for the year 2018-19, and applied its income for charitable purpose(s) during the year 2018-19, ₹ 1,80,000. The taxable income shall be –

Income of the trust	₹ 3,00,000
Less: 15% free accumulation	₹ 45,000
Balance	₹ 2,55,000
Less: Amount applied for the prescribed purposes	₹ 1,80,000
Taxable income	₹ 75,000

Notes regarding computation of income / Income of trusts or institutions

- a. Voluntary contribution:** As per sec. 12(1), any voluntary contributions (not being contributions made with a specific direction that they shall form part of the corpus of the trust or institution) received by a trust created wholly for charitable or religious purpose(s), shall be deemed to be income of the trust.

Taxpoint: Contributions made with a specific direction that they shall form part of the corpus of the trust shall not be treated as income of the trust.

- b. Value of services:** As per sec. 12(2), the value of any service, being medical or educational service, provided by the charitable or religious trust running a hospital or medical institution or an educational institution, shall be deemed to be income of the trust during the previous year in which such services are provided and shall be chargeable to income-tax.

- c. Business Income of the Trust [Sec.11(4) & (4A)]:** On fulfillment of following two conditions, income of any such undertaking shall not be included in the total income of the trust -

1. The trust or institution can carry out business activities provided such activities are incidental to the object of the trust.
2. Trust needs to maintain separate books of account in respect of such business.
3. The purpose of the trust or institute must be relief to the poor, education or medical relief.

Taxpoint

- ▶ Property held under trust includes a business undertaking so held.



- ▶ The Assessing Officer has power to determine the income of such undertaking in accordance with the provisions of this Act.
- ▶ In case, income so determined is in excess of the income as shown in the accounts of the undertaking, such excess shall deemed to be applied for the purposes other than charitable or religious purposes.

Notes regarding application of income

- ◆ Application of amount may be of revenue or capital nature.
- ◆ Payment of tax shall be treated as application of income for the purpose of trust.
- ◆ Repayment of loan (earlier taken for the purpose of trust) shall be treated as application of income.
- ◆ Loan granted to poor person for education or medical treatment shall be treated as application of income. However, when such loan is repaid, it shall be treated as income of the trust.
- ◆ Amount of excess application of last year can be set-off against the income deficiency of current year. In other words, application of income may be made before accrual of income.
- ◆ Where any income is required to be applied or accumulated or set apart for application, then, for such purposes the income shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as an application of income in the same or any other previous year

ILLUSTRATION 18

Compute taxable income of a charitable trust for the A.Y 2019-20 under following cases:

Particulars	Case 1 (₹)	Case 2 (₹)	Case 3 (₹)
Income other than voluntary contribution	4,00,000	5,00,000	15,00,000
Voluntary contribution	1,00,000	80,000	2,00,000
Voluntary contribution in the corpus of the trust	2,00,000	1,50,000	5,00,000
Income applied for the purpose for which trust is created	4,50,000	4,93,000	2,00,000

Solution

Computation of taxable income of the charitable trust for the A.Y 2019-20

Particulars	Amount		
	Case 1	Case 2	Case 3
Income other than voluntary contribution	4,00,000	5,00,000	15,00,000
Add: Voluntary contribution	1,00,000	80,000	2,00,000
Total income of the trust	5,00,000	5,80,000	17,00,000
Less: 15% Free accumulation	(75,000)	(87,000)	(2,55,000)
Balance	4,25,000	4,93,000	14,45,000
Less: Income exempted to the extent applied for the purpose	4,25,000	4,93,000	2,00,000
Total Income	Nil	Nil	12,45,000
Note: Contribution in corpus of the trust shall not be treated as income of the trust.			

Deferment of application of income [Explanation to Sec. 11(1)]

When due to certain reasons application of income is below 85% of its income, trust has the option to apply for deferment of application of income.

Time limit for application of deferment of income: such option to be exercised before the expiry of the time allowed u/s 139(1) for furnishing the return of income, in prescribed form and manner.

Reasons, Deferment Period and effect of non application of income within the deferred period:

Reasons	Deferred period	Effect when income is not applied within the deferred period
The whole or any part of income has not been received during that year.	The previous year in which such income is actually received and the previous year subsequent to such year.	It shall be treated as income of the year following the previous year in which such income is actually received. Note: The part of income, which is not spent, shall be taxable.
Any other reason	Subsequent to the previous year in which such income is derived.	It shall be treated as income of the year following the previous year in which such income is derived

ILLUSTRATION 19

Bangur Charitable Trust has earned income of ₹ 70 lacs during the previous year 2018-19. It has applied the income of ₹ 15 lacs, during the previous year 2018-19 and also applied before the due date u/s 139(1) for deferment of application of income of -

Case 1) ₹ 32 lacs

Case 2) ₹ 45 lacs

- as such income has not yet been received by the trust.

During the previous year 2021-22 such income is received and applied as under -

Previous Year	Amount applied for charitable purposes	
	Case 1	Case 2
2021-22	₹ 12 lacs	₹ 15 lacs
2022-23	₹ 11 lacs	₹ 10 lacs
2023-24	₹ 9 lacs	₹ 20 lacs

Compute taxable income of the A.Y. 2019-20 and 2023-24

Solution

Computation of income of Bangur Charitable Trust for the A.Y.2019-20

Particulars	Amount	
	Case 1	Case 2
Income earned	70 lacs	70 lacs



Less: Free accumulation of income @ 15%	10.5 lacs	10.5lacs
Balance	59.5 lacs	59.5 lacs
Less: Application of income during the previous year	15 lacs	15 lacs
	44.5 lacs	44.5 lacs
Less: Amount for which deferment is allowed [Max. of taxable income before deferment]	32 lacs	44.5 lacs
Taxable income	12.5 lacs	Nil

Computation of income of Bangur Charitable Trust for the A.Y.2023-24

Particulars	Amount	
	Case 1	Case 2
Amount deferred in the P.Y. 2018-19 and are to be applied till P.Y.2022-23 i.e. one year after the year in which such income is received	32	44.5
Less: Amount applied before 31/3/2023	23	25
Taxable income	9	19.5

Conditional Accumulation [Sec. 11(2)]

Where a trust could not apply its 85% of income for charitable or religious purpose(s), then it may accumulate or set aside its income (in full or in part) for a maximum period of 5 years to be applied for specific purposes. In such case subject to the following conditions income so accumulated shall not be included in total income of the trust:

Conditions

- Statement to the Assessing Officer:** Such person furnishes a statement in the prescribed form (Form 10) 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 to be accumulated or set apart, which shall in no case exceed 5 years.
 - In computing the period of 5 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.
- Time-limit:** The statement shall be furnished on or before the due date specified u/s 139(1) for furnishing the return of income for the previous year.
- Return of income:** The return of income for the previous year is required to be furnished by such person on or before the due date specified u/s 139(1) for furnishing the return of income for the said previous year.
- Investment of accumulated income:** The money so accumulated or set apart is invested or deposited in the forms or modes specified in the following mode being stated in sec.11(5):
 - Investment in Government Savings Certificates and any other securities or certificates issued by the Central Government under the Small Savings Schemes of that Government.
 - Deposit in any account with the Post Office Savings Bank;
 - Deposit in any account with a scheduled bank or 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);
 - Investment in units of the Unit Trust of India;
 - Investment in the Central Government or a State Government securities;
 - Investment in debentures issued by any company or corporation, both the principal whereof and the interest

whereon are fully and unconditionally guaranteed by the Central Government or by a State Government;

- (g) Investment or deposit in any public sector company;
- (h) Deposits with or investment in any bonds issued by a financial corporation which is engaged in providing long-term finance for industrial development in India and which is eligible for deduction u/s 36(1)(viii);
- (i) 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 construction or purchase of houses in India for residential purposes and which is eligible for deduction u/s 36(1)(viii);
- (j) 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;
- (k) Investment in an immovable property. Immoveable property does not include any machinery or plant (other than machinery or plant installed in a building for the convenient occupation of the building) even though attached to or permanently fastened to earth;
- (l) Deposits with the Industrial Development Bank of India;
- (m) Invest in any other form or mode of investment or deposit as may be prescribed e.g. Investment by way of acquiring equity shares of a depository, Units of Mutual Fund, etc.

Application to Assessing Officer for applying the income for the purpose other than the purpose for which it was accumulated [Sec. 11(3A)]

In case where due to circumstances beyond the control of the trust, accumulated income cannot be applied for the purpose for which it was accumulated or set apart, the trust can apply to Assessing Officer to apply such income for other charitable or religious purpose in India in conformity with the objects of the trust. Assessing Officer may, on receipt of such application, allow use of such accumulated income for the purpose(s) as specified in the application.

Withdrawal of benefit of accumulation of income [Sec. 11(3)]

Cases	Tax treatment
When income so set aside is applied for the purpose other than specified purpose	Such income shall be deemed to be the taxable income of the previous year in which it is so applied.
When income so set aside, ceases to be accumulated	Such income shall be deemed to be the taxable income of the previous year in which it so ceases to be accumulated
When income so set aside, ceases to remain so invested or deposited in mode mentioned in Sec. 11(5)	Such income shall be deemed to be the taxable income of the previous year in which it so ceases to be so invested.
When income so set aside is credited or paid to – • any trust/institution registered u/s 12AA; or • to any fund, institution, trust, any university, other educational institution, any hospital or other medical institution referred to in Sec. 10(23C)(iv), (v), (vi) or (via)	Such income shall be deemed to be the taxable income of the previous year in which it is so credited or paid.

Taxpoint: In case the trust or institution, which has accumulated its income, is dissolved, the Assessing Officer may allow application of such income in payment to another trust registered u/s 12AA or institution u/s 10(23C)(iv), (v), (vi), (via) in the year in which such trust or institution was dissolved..

**Tax Treatment of Capital Gains on transfer of Capital Assets**

Capital gain arises on transfer of 'property held under trust for charitable purpose' shall be eligible for exemption if the consideration or part thereof is applied in acquisition of new property. Such amount applied in acquiring the new capital assets shall be held as part of the corpus of the trust. Exemption shall be as per the following table:

Property transferred	Amount to be applied	Exemption
Capital asset being property held under trust for charitable purpose.	The net sale consideration.	Entire Capital gain
	Only a part of the net sale consideration	[(Amount so utilised) – (the cost of acquisition and cost of improvement of the transferred asset)]
Capital asset, being property held under trust in part only for such purposes	The net sale consideration	The proportionate amount of the capital gain.
	Only a part of the net sale consideration	Proportionate amount of - [(Amount so utilised) – (the cost of the transferred asset)]
Notes: Proportionate amount is calculated having regard to the proportion, which the amount of income applicable to charitable purpose bears to the whole of income from such property.		

Registration of Trust [Sec.12A & 12AA]

A trust is required to apply for registration in Form 10A with the Commissioner of Income tax. It is to be noted that exemption will be available from the assessment year relevant to the financial year in which such application is made. However, w.e.f. 01-10-2014, in order to remove hardship in genuine cases, following provision has been inserted:

- Where registration has been granted to the trust or institution, then, the provisions of sec. 11 and 12 shall apply in respect of any income derived from property held under trust of any assessment year preceding the aforesaid assessment year, for which assessment proceedings are pending before the Assessing Officer as on the date of such registration and the objects and activities of such trust or institution remain the same for such preceding assessment year.
- No action u/s 147 shall be taken by the Assessing Officer in case of such trust or institution for any assessment year preceding the aforesaid assessment year only for non-registration of such trust or institution for the said assessment year.
- However, aforesaid benefits are not available in case of any trust or institution which was refused registration or the registration granted to it was cancelled at any time u/s 12AA

Procedure for Registration [Sec.12AA]

The Commissioner, on receipt of an application for registration of a trust or institution shall—

- call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of activities of the trust or institution; and
- make such inquiries as he may deem necessary in this behalf.

Where he is -

- satisfied about the objects of the trust or institution and the genuineness of its activities, he shall pass an order in writing registering the trust or institution. A copy of such order shall be sent to the applicant.
- not so satisfied, he shall pass an order in writing refusing to register the trust or institution. A refusal-order shall not be passed unless the applicant has been given a reasonable opportunity of being heard.

Time limit for registration

Every order granting or refusing registration shall be passed before the expiry of 6 months from the end of the month in which the application was received.

Cancellation of Registration [Sec. 12AA(3)]

Condition: Where a trust or an institution has been granted registration and subsequently the Commissioner is satisfied that the activities of such trust or institution are -

- not genuine; or
- not being carried out in accordance with the objects of the trust or institution.

Procedure: The Commissioner shall pass an order in writing cancelling the registration of such trust.

Note:

- No such order shall be passed unless such trust or institution has been given a reasonable opportunity of being heard.
- Commissioner can cancel the registration obtained u/s 12A or 12AA.

Cancellation of registration [Sec.12AA(4)] [w.e.f. 01-10-2014]

- ♦ Where a trust or an institution has been granted registration and subsequently it is noticed that the activities of the trust or the institution are being carried out in a manner that the provisions of sec. 11 and 12 do not apply to exclude either whole or any part of the income of such trust or institution due to operation of sec. 13(1), then, the Principal Commissioner or the Commissioner may by an order in writing cancel the registration of such trust or institution.
- ♦ The registration shall not be cancelled, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the said manner.

Modification of object

Where a trust has obtained registration at any time and subsequently, it has adopted or undertaken modifications of the objects which do not conform to the conditions of its registration, then the trust should made an application within a period of 30 days from the date of such adoption or modification, to the Principal Commissioner or Commissioner

Forfeiture of Exemption [Sec.13]

Nothing contained in section 11 [or section 12] shall operate in respect of —

- ♦ **Income for private purposes:** Any part of the income from the property held under a trust for private religious purposes, which does not ensure for the benefit of the public.
- ♦ **Income for the benefit of particular religious community:** in the case of a trust for charitable purposes or a charitable institution created or established after the commencement of this Act, any income thereof if the trust or institution is created or established for the benefit of any particular religious community or caste.
- ♦ **Funds are not invested** in securities/deposits as per sec.11(5). It is to be noted that holding shares in a public sector company would not disqualify the trust from claiming exemption.
- ♦ **Income applied for the benefit of Interested person:** in the case of a trust for charitable or religious purposes, any income thereof:
 - if such trust or institution has been created or established after the commencement of this Act and under the



terms of the trust, any part of such income ensures, directly or indirectly for the benefit of interested person#

- if any part of such income or any property of the trust or the institution (whenever created or established) is during the previous year used or applied, directly or indirectly for the benefit of any interested person#.

Note: The above provision shall not apply to a trust or institution created or established before the commencement of this Act, to any use or application, whether directly or indirectly, of any part of such income or any property of the trust or institution for the benefit of any Interested person, if such use or application is by way of compliance with a mandatory term of the trust or a mandatory rule governing the institution

Income applied for the benefit of interested persons

Interested person: Following are the interested persons -

- **Author:** The author of the trust or the founder of the institution.
- **Contributory:** Any person whose total contribution up to the end of the relevant previous year to the trust/institution exceeds ₹ 50,000.
- **Trustee:** Any trustee of the trust or manager (by whatever name called) of the institution.
- **Relatives of Author / Contributory / Trustee:** Any relative of any such author, founder, person, member, trustee or manager as aforesaid.

Note: Where an HUF is the author, founder or any member of such HUF.

- **Other:** Any concern in which any of the above-referred person has a substantial interest.

Income applied for the benefit of interested persons: Income or the property of the trust or any part of such income or property shall be deemed to have been used or applied for the benefit of a person –

- (a) If any part of the income or property of the trust or institution is lent to any interested person for any period during the previous year without either adequate security or adequate interest or both;
- (b) If any land, building or other property of the trust or institution is made available for the use of any interested person, for any period during the previous year without charging adequate rent or other compensation;
- (c) If any amount is paid by way of salary, allowance or otherwise during the previous year to any interested person and the amount so paid is in excess of what may be reasonably paid for such services;
- (d) If the services of the trust or institution are made available to any interested person during the previous year without adequate remuneration or other compensation;
- (e) If any share, security or other property is purchased by or on behalf of the trust or institution from any interested person during the previous year for consideration which is more than adequate;
- (f) If any share, security or other property is sold by or on behalf of the trust or institution to any interested person during the previous year for consideration which is less than adequate;
- (g) If any income or property of the trust or institution is diverted during the previous year in favour of any interested person.

1.9 LOCAL AUTHORITY

Local authority means -

- a. Panchayat; or
- b. Municipality; or

- c. Municipal Committee and District Board; or
- d. Cantonment Board.

Exemption u/s 10(20)

Following income of a local authority is exempt u/s 10(20):

- a. Income chargeable under the head 'Income from house property';
- b. Income chargeable under the head 'Capital gains';
- c. Income chargeable under the head 'Income from other sources';
- d. Income from the supply of commodities (other than water or electricity) or services, within its own jurisdiction (territorial area);
- e. Income from the supply of water services or electricity within or outside its jurisdiction.

Income derived from the supply of commodity or service other than water and electricity outside its own jurisdiction is only taxable income. Tax rate is 30% + Surcharge @ 12% (if total income exceeds ₹ 1 crore and subject to marginal relief) + Cess

1.10 MUTUAL CONCERNS

- ◆ No one 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. The cardinal requirement in the case of mutual association is that all the contributors to the fund must be entitled to participate in the surplus and vice versa.
- ◆ 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 surplus on dissolution. Further, it is not necessary that the surplus should be returned to every member in pro-rata basis.
- ◆ It does not make any difference whether the persons joining together form an association or incorporate a company.
- ◆ Where there is mutuality, the fact that some members alone take advantage of the mutual enterprise would not affect the character of mutual association.
- ◆ A mutual association may carry on non-mutual activity, but exemption is available only to the surplus arising out of mutual activity.
- ◆ However, the Act provides for assessment of income (from mutual activity) of mutual concern in the following cases:
 - ▶ Where the mutual concern is a mutual insurance society and the income is derived from the carrying on of any business of insurance [Sec. 44 read with sec. 2(24)(vii)]
 - ▶ Where the mutual concern is a trade, professional or similar association and the income is derived from specific service performed for its member [Sec. 28(iii) read with sec. 44A]
 - Specific service to its member means some tangible benefits which would not be available to them unless they pay the specific fees charged for such special benefits [CIT -vs.- Calcutta Stock Exchange Association Ltd. (SC)] Hence, entrance fees is not for specific service, it is not taxable u/s 28(iii).



- To some extent, co-operative bank [Deduction u/s 80P]

However, it is to be noted that income derived from non-mutual activity is taxable.

Trade and professional association [Sec. 44A]

A trade association is an association of tradesmen, businessmen or manufacturers for the protection and advancement of their common interest. It is different from trading association [CIT vs Royal Western India Turf Club Ltd. (SC)]

Where income from a particular source is not chargeable to tax, a loss from such source cannot be set off against income chargeable to tax. Sec. 44A provides an exception to this general rule which is as follow:

- ◆ Where the amount received during a previous year by any trade, professional or similar association [other than an association or institution referred in sec. 10(23A)] from its members, whether by way of subscription or otherwise (not being remuneration received for rendering any specific services to such members) falls short of the expenditure incurred by such association during that previous year (not being expenditure deductible in computing the income under any other provision of this Act and not being in the nature of capital expenditure) solely for the purposes of protection or advancement of the common interests of its members, the amount so fallen short (hereinafter referred to as deficiency) shall be allowed as a deduction in computing the income of the association assessable for the relevant assessment year under the head "Profits and gains of business or profession" and if there is no income assessable under that head or the deficiency allowable exceeds such income, the whole or the balance of the deficiency, as the case may be, shall be allowed as a deduction in computing the income of the association assessable for the relevant assessment year under any other head.
 - Sec. 44A is exception of the rule that loss of un-assessable business cannot be adjusted with assessed income.
- ◆ In computing the income of the association for the relevant assessment year effect shall first be given to any other provision of this Act under which any allowance or loss in respect of any earlier assessment year is carried forward and set off against the income for the relevant assessment year.
- ◆ The amount of deficiency to be allowed as a deduction under this section shall in no case exceed $\frac{1}{2}$ of the total income of the association as computed before making any allowance under this section.
- ◆ This section applies only to that trade, professional or similar association the income of which or any part thereof is not distributed to its members except as grants to any association or institution affiliated to it.

ILLUSTRATION 20

A is an association governed by the provisions of sec. 44A of the Income-tax act. The subscription receipts for the year ended 31st March, 2019 were ₹ 60,000. The expenditure in the normal course of its activities was ₹ 85,000. Its other income taxable under the Act works out to ₹ 75,000. On these facts, you are consulted as to:

- How A's taxable income will be determined for assessment year 2019-20.
- In case the association did not have the other income taxable will there be any difference in the computation of its income?

Solution

Computation of total income.

Particulars	Amount
Other Income	75,000
Less: Deficiency (Note 1)	25,000
Total Income	50,000

Note 1: Calculation of deficiency

Particulars	Amount
Subscription received	60,000
Less: Expenditure	85,000
Deficiency	25,000
Maximum deficiency can be set off against other income is lower of the following:	
a. Actual Deficiency i.e. ₹ 25,000	
b. 50% of other income i.e., ₹ 37,500 being 50% of ₹ 75,000	

In case, association do not have any other taxable income, then the total income shall be nil and the deficiency of ₹ 25,000 shall not be carried forward.

Income of professional institutions [Sec. 10(23A)]

Any income (other than income chargeable under the head "Income from house property" or any income received for rendering any specific services or income by way of interest or dividends derived from its investments) of professional association shall be exempt provided -

- Such association or institution is established in India having as its object the control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture or other specified profession;
- Such association or institution applies its income, or accumulates it for application, solely to the objects for which it is established; and
- The association or institution is approved by the Central Government.

Clubs

Social clubs are not trade association hence sec. 28(iii) is not applicable on it. It would be governed by general principle of mutuality. Excess over expenditure received by club from the facilities extended to members as part of advantages attached to such membership shall not be chargeable to tax on the principle of mutuality. [CIT -vs.- Bankipur Club Ltd. (SC)] However, it is to be noted that income derived from non-mutual activity is taxable.

Insurance Business

The profits and gains of any business of insurance, including any such business carried on by a mutual insurance company or by a co-operative society, shall be computed in accordance with the rules contained in the First Schedule of the Income Tax Act, 1961 [Sec. 44]

A. Life Insurance Business

- ♦ In the case of a person who carries on or at any time in the previous year carried on life insurance business, the profits and gains of such person from that business shall be computed separately from his profits and gains from any other business.
- ♦ The profits and gains of life insurance business shall be taken to be the annual average of the surplus arrived at by adjusting the surplus or deficit disclosed by the actuarial valuation made in accordance with the Insurance Act, 1938.
- ♦ Tax on profits and gains of life insurance business [Sec. 115B]

Where the total income of an assessee includes any profits and gains from life insurance business, the income-



tax payable shall be the aggregate of:

- i. the amount of income-tax calculated on the amount of profits and gains of the life insurance business included in the total income @ 12.5%; 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 of the life insurance business.
- ◆ The provision of sec. 115JB (i.e., MAT provisions) shall not apply to any income accruing or arising to a company from life insurance business..

B. Other insurance business

The profits and gains of any business of insurance other than life insurance shall be taken to be the balance of the profits disclosed by the annual accounts, copies of which are required under the Insurance Act, 1938, to be furnished to the Controller of Insurance, subject to the following adjustments:

- ◆ Any expenditure or allowance disallowed u/s 30 to 43B;
- ◆ Any gain or loss on realisation of investments shall be added or deducted, as the case may be, if such gain or loss is not credited or debited to the profit and loss account;
- ◆ Any provision for diminution in the value of investment debited to the profit and loss account, shall be added back
- ◆ Amount carried over to a reserve for unexpired risks shall be allowed as a deduction. As per rule 6E, any business of insurance other than life insurance, the amount carried over to a reserve for unexpired risks (including any amount carried over to any additional reserve) shall not exceed:

Nature of insurance	Ceiling
Fire insurance or engineering insurance and which provides insurance for terrorism risks	100% of the net premium income of such business of the previous year
Fire insurance or miscellaneous insurance other than above	50% of the net premium income of such business of the previous year
Marine insurance	100% of the net premium income of such business of the previous year.

- ▶ Net premium income means the amount of premium received as reduced by the amount of reinsurance premium paid during the relevant previous year.
- ▶ Marine insurance includes the Export Credit Insurance.

C. Non-resident Person carrying of insurance business

The profits and gains of the branches in India of a person not resident in India and carrying on any business of insurance shall be calculated on the basis of reliable data available in respect of such activity. However, in the absence of reliable data, profit may be deemed to be that proportion of the world income of such person, which corresponds to the proportion, which his premium income derived from India bears to his total premium income.

1.11 ASSESSMENT OF PRIVATE TRUST

WHERE BENEFICIARIES SHARE IS KNOWN		WHERE BENEFICIARIES SHARE IS UNKNOWN	
ORAL TRUST			
Income includes business income, then taxable @ Maximum Marginal Rate of tax (MMR) [Sec. 161(1A)]	Income does not include business income or include business income but fall in exception, then beneficiary's share is separately taxable in the hands of trustee or beneficiary (u/s 166) @ applicable to the total income of each beneficiary [Sec. 161(1)]	Taxable @ MMR [Sec. 164A] Oral trust means a trust which is not declared by a duly executed instrument in writing [including any wakf deed] and which is not deemed to be a trust declared by a duly executed instrument in writing However, following oral trust is not treated as oral trust: A trust which is not declared by a duly executed instrument in writing [including wakf deed] shall be deemed to be a trust declared by a duly executed instrument in writing if a statement in writing, signed by trustees, setting out the purpose or purposes of the trust, particulars as to the trustees, the beneficiaries and the trust property, is forwarded to the AO: (i) where the trust has been declared before 1-6-1981, within 3 months from 1-6-81; (ii) in any other case, within 3 months from the date of such declaration. i.e., share is unknown then @ MMR & share is known then @ applicable to beneficiaries.	Income does not include business income and fall in following cases, then @ AOP (i.e., individual rate) a) None of the beneficiaries has income exceeding the max. amount not chargeable to tax in the case of an AOP nor is a beneficiary under any other trust; or b) Income is receivable under a trust declared by any person by will and such trust is the only trust so declared by him; or c) Income is receivable under a trust created before 1-3-1970 by a non-testamentary instrument & the AO is satisfied that the trust was created bona fide exclusively for the benefit of the relatives of settlor, or where settlor is a HUF, exclusively for the benefit of members of family, in circumstances where such relatives or members were mainly dependent on settlor for support and maintenance; or d) the trustee receives income for provident fund, superannuation fund, etc. created bona fide by a person carrying on a business (or profession) exclusively for the benefit of persons employed in such business
Exception If following conditions are satisfied then taxable- @ applicable to the total income of each beneficiary a) The trust is declared by will; b) Such trust is exclusively for the benefit of any relative dependent on him for support and maintenance; and c) Such trust is the only trust declared by him		Assessee falling under these cases (see left) and having business income and satisfying following condition then taxable @ AOP a) The trust is declared by will; b) Such trust is exclusively for the benefit of any relative dependent on him for support and maintenance; and c) Such trust is the only trust declared by him	In any other case having business income or not @ MMR [Sec. 164(1)]



STUDY NOTE : 2

NON RESIDENT



This Study Note includes:

- 2.1 Computation of income on presumptive basis
- 2.2 Capital gain on transfer of shares / debentures by a non-resident [First proviso to Sec. 48 and rule 115A]
- 2.3 TDS on payment to non-resident sportsman or sports associations [Sec. 194E]
- 2.4 TDS on interest from Infrastructure Debt Fund [Sec. 194LB]
- 2.5 TDS on certain income from units of a Business Trust [Sec. 194LBA]
- 2.6 TDS on income of units of Investment Fund [Sec. 194LBB]
- 2.7 TDS on income from Investment in Securitization Fund [Sec. 194LBC]
- 2.8 TDS on interest to non-resident [Sec. 194LC]
- 2.9 Income by way of interest on certain bonds, Govt. securities [Sec. 194LD]
- 2.10 TDS on other sums payable to non-resident [Sec. 195]
- 2.11 TDS on income from units [Sec. 196B]
- 2.12 TDS on income from foreign currency bonds or GDR [Sec. 196C]
- 2.13 TDS on income of FII from securities [Sec. 196D]

"Non-resident" means 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 sec. 6(6) - [Sec. 2(30)]

Residential Status

Assessee	Condition to be a Resident	Condition to be an Ordinarily resident
Individual	Assessee satisfies any one condition of sec. 6(1) i.e. a) He is in India in the previous year for a period of 182 days or more; or b) He is in India for a period of 60 days or more during the previous year and 365 days or more during 4 previous years immediately preceding the relevant previous year. Exceptions In the following cases, (b) is irrelevant: 1. An Indian citizen, who leaves India during the previous year for employment purpose. 2. An Indian citizen, who leaves India during the previous year as a member of crew of an Indian ship.	Assessee satisfies both the conditions of sec. 6(6) a) He has been resident in India in at least 2 out of 10 previous years immediately preceding the relevant previous year; and b) He has resided in India for a period of 730 days or more during 7 previous years immediately preceding the relevant previous year.



	3. An Indian citizen or a person of Indian origin, who normally resides outside India, comes on a visit to India during the previous year.	
HUF	Management is wholly or partly situated in India	Karta satisfies all conditions of sec. 6(6)
Company		
a) Indian Co.	Always resident	Not applicable
b) Other Co.	Place of effective management is in India	
Firm	Management is wholly or partly situated in India	
AOP		
BOI		
Other person		

Place of effective management

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.' Circular 6/2017 dated 24-01-2017 provides that 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 (ABOI).

Particulars	POEM
Company is engaged in active business outside India	
- If the majority meetings of the board of directors of the company are held outside India	Outside India
- If Board of directors of the company are standing aside and not exercising their powers of management and such powers are being exercised by either the holding company or any other person (s) resident in India	In India
Company is not engaged in active business outside India then following are required to be ascertained:	
1. The person(s) who actually make the key management and commercial decision for conduct of the company's business as a whole	
2. Place where these decisions are in fact being made	
If such place is in India	In India

Taxpoint

- ◆ A company shall be said to be engaged in "active business outside India" if
 - a) the passive income is not more than 50% of its total income; and
 - b) the passive income is less than 50% of its total assets are situated in India; and
 - c) the passive income is less than 50% of total number of employees are situated in India or are resident in India; and
 - d) the payroll expenses incurred on such employees is 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 company or public financial institution) or rental income;

Clarification related to guidelines for establishing 'Place of Effective Management' (PoEM) in India [Circular 25/2017 dated 23-10-2017]

Guiding Principles for determination of POEM of a company were issued on 24th January, 2017 vide Circular No. 06 of 2017. Further, vide Circular No. 08 of 2017 dated 23rd February, 2017, it has been clarified that the POEM provisions shall not apply to a company having turnover or gross receipts of ₹ 50 crore or less in a financial year.

The stakeholders have been raised concern that as per the extant guidelines, POEM may be triggered in cases of certain multinational companies with regional headquarter structure merely on the ground that certain employees having multi-country responsibility or oversight over the operations in other countries of the region are working from India, and consequently, their income from operations outside India may be taxed in India.

In this regard, it may be mentioned that Para 7 of the guidelines provides that the place of effective management in case of a company engaged in active business outside India (ABOI) shall be presumed to be outside India if the majority meetings of the board of directors (BOD) of the company are held outside India.

However, Para 7.1 of the guidelines provides that if on the basis of facts and circumstances it is established that the Board of directors of the company are standing aside and not exercising their powers of management and such powers are being exercised by either the holding company or any other person(s) resident in India, then the POEM shall be considered to be in India.

It has also been provided that for this purpose, merely because the 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.

In view of the above, it is clarified 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 clarified 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.

Clarification on applicability of section 9(1)(i) relating to indirect transfer in case of redemption of share or interest outside India [Circular No. 28/2017, dated 07-11-2017]

As per sec. 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through 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 situate in India, shall be deemed to accrue or arise in India.

Explanation 5 to section 9(1)(i) provides that 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.

Concerns were raised by investment funds, including private equity funds and venture capital funds that on account of the extant indirect transfer provisions in the Act, non-resident investment funds investing in India, which are set up as multi-tier investment structures, suffer multiple taxation of the same income at the time of subsequent redemption or buyback. Such taxability arises firstly at the level of the fund in India on its short term capital gain / business income and then at every upper level of investment in the fund chain on subsequent redemption or buyback.



Vide Finance Act, 2017, Category I and Category II FPIs have already been exempted from indirect transfer provisions of the Act through insertion of proviso to Explanation 5 to section 9(1)(i) of the Act, with effect from 01.04.2015.

There could be situations in multi-tiered investment structures, where interest or share held indirectly by a non-resident in an Investment Fund or a Venture Capital Company or a Venture Capital Fund (hereinafter referred to as 'specified funds'), is redeemed in an upstream entity outside India in consequence of transfer of shares or securities held in India by the specified funds, the income of which have been subject to tax in India. In such cases, application of indirect transfer provisions on redemption of share or interest in the upstream entity may lead to multiple taxation of the same income. In respect of Category I and Category II FPIs though, such multiple taxation will not take place on account of the insertion of proviso to Explanation 5 to section 9(1)(i) of the Act, vide Finance Act, 2017.

The CBDT has received representations to exclude investors above the level of the direct investor who is already chargeable to tax in India on such income from the ambit of indirect transfer provisions of the Act.

In order to address this concern, the CBDT has 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.

Foreign company said to be resident in India [Sec. 115JH]

Where,

- i. a foreign company is said to be resident in India in any previous year; and
- ii. such foreign company has not been resident in India in any of the previous years preceding the said previous year,

then, the provisions relating to the computation of total income, treatment of unabsorbed depreciation, set off or carry forward and set off of losses, collection and recovery and special provisions relating to avoidance of tax shall apply with such exceptions, modifications and adaptations as may be specified in notification¹ issued by the Government for the said previous year.

Consequences when such company fails to comply with the conditions

- ◆ Where, in a previous year, any benefit, exemption or relief has been claimed and granted to the foreign company and, subsequently, there is failure to comply with any of the conditions specified in the notification, then,:
 - i. such benefit, exemption or relief shall be deemed to have been wrongly allowed;
 - ii. the Assessing Officer may, notwithstanding anything contained in this Act, 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 did not apply; and
 - iii. the provisions of sec. 154 shall, so far as may be, apply thereto and the period of 4 years specified therein being reckoned from the end of the previous year in which the failure to comply with the conditions takes place.

¹ Notification No. 29/2018 dated 22/06/2018

Other Point

- Where the determination regarding foreign company to be resident in India has been made in the assessment proceedings relevant to any previous year, then the provisions shall also apply in respect of any other previous year, succeeding such 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.

2.1 COMPUTATION OF INCOME ON PRESUMPTIVE BASIS

Shipping Business in the case of Non-residents [Sec. 44B]

Applicable to	All non-resident assessee
Condition	Assessee must be engaged in the business of operation of ships.
Estimated income	Income taxable under the head "Profits & gains of business or profession" from such business shall be estimated at 7.5% of the amount being aggregate of the following: - The amount 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 shipped at any port in India; and - The amount 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.
Notes: The amount paid or payable or received or deemed to be received, as the case may be, shall also include demurrage charges or handling charges or any other amount of similar nature.	

Special procedure for Shipping Business of Non-residents [Sec. 172]

Applicable to

The section is applicable 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, livestock, mail or goods shipped at a port in India.

Deemed Income

Where such a ship carries passengers, livestock, mail or goods shipped at a port in India, 7 1/2% of the amount paid or payable on account of such carriage to the owner or the charterer or to any person on his behalf, 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.

Computation of Tax

- Before the departure from any port in India of any such ship, the master of the ship shall 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 his behalf, on account of the carriage of all passengers, livestock, mail or goods shipped at that port since the last arrival of the ship thereat.
- However, where the AO is satisfied that it is not possible for the master of the ship to furnish such return before the departure of the ship from the port and provided the master of the ship has made satisfactory arrangements for the filing of the return and payment of the tax by any other person on his behalf, the Assessing Officer may, if the return is filed within 30 days of the departure of the ship, deem the filing of the return by the person so authorised by the master as sufficient compliance.



- On receipt of the return, the Assessing Officer shall assess such income and determine the sum payable as tax thereon at the rate or rates in force applicable to the total income of a company which has not made the arrangements referred to in sec. 194 (i.e. foreign company) and such sum shall be payable by the master of the ship.
- For this purpose, the Assessing Officer may call for such accounts or documents as he may require.
- No order assessing the income and determining the sum of tax payable thereon shall be made after the expiry of 9 months from the end of the financial year in which the return is furnished.

Other Provisions

- Option to claim that assessment shall be made:** The owner or charterer of a ship has 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 be made of his total income of the previous year and the tax payable on the basis thereof be determined in accordance with the other provisions of this Act. If he so claims, any payment made u/s 172 shall be treated as advance tax and the difference between the sum so paid and the amount of tax found payable by him on such assessment shall be paid by him or refunded to him, as the case may be [Sec. 172(7)]
- The ship which leaves the Indian port and only casually visits the Indian port is covered by sec. 172 and those who do regular shipping business are covered by sec. 44B [V.M. Salgaocar & Brother Ltd. -vs.- Deputy Controller [1991] 187 ITR 381 (Kar.)]

Profits & Gains in connection with the Business of Exploration, etc. of Mineral Oils [Sec. 44BB]

Applicable to	Non-resident assessee
Conditions	Assessee must be engaged in the business of - - Providing services or facilities in connection with; or - Supplying plant¹ and machinery on hire, used or to be used in, – the prospecting for, or extraction or production of, mineral oils². ¹ Plant includes ships, aircraft, vehicles, drilling units, scientific apparatus and equipment, used for the purpose of the said business ² Mineral oil includes petroleum and natural gas.
Estimated income	A sum equal to 10% of the aggregate of the following amount shall be deemed to be the profits and gains of such business chargeable to tax - - The amount paid or payable (whether in or out of India) to the assessee (or to any person on his behalf) on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils in India; and - The amount received or deemed to be received in India by or on behalf of the assessee on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils outside India.
Assessee may claim lower profit	An assessee may claim lower profits and gains if he keeps and maintains books of account as per sec. 44AA and gets his accounts audited and furnishes the report u/s 44AB and thereupon the Assessing Officer shall proceed to make an assessment of the total income of the assessee u/s 143(3) & determine the sum payable by, or refundable to, the assessee

Profits and Gains of the Business of Operation of Aircraft [Sec. 44BBA]

Applicable to	All non-resident assessee.
Condition	Assessee must be engaged in the business of operation of aircraft.
Estimated income	Income of such business shall be estimated at 5% of the aggregate of the following - • The amount 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 • The amount 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.

ILLUSTRATION 1

USA Airlines incorporated as a company in USA operates its flights to India and vice versa during the year 2018-19 and collects charges of ₹ 150 lakh for carriage of passengers and cargo out of which ₹ 90 lakh were received in US Dollars for the passenger fare booked from New York to Mumbai. The total expenses for the year on operation of such flights were ₹ 195 lakh. Income chargeable to tax of the foreign airlines may please be computed.

Solution

Computation of income of USA Airlines

Particulars	Fare booked from Mumbai to New York whether paid in India or outside India	Fare booked from New York to Mumbai	
		If paid in India (or deemed to be received in India)	If paid outside India
Fare	60 lakh [₹ 150 - 90]	90 lakh	90 lakh
Taxable Income @ 5% of the above	3,00,000	4,50,000	-

Profits and Gains of Foreign Companies engaged in the Business of Civil Construction, etc. in certain Turn-key Power Projects [Sec. 44BBB]

Applicable to	A foreign company
Condition	Assessee must be engaged in the business of - • civil construction; or • 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. Approval issued by the Department of Power in the Ministry of Energy shall be deemed to be the approval of the Central Government for this section.
Estimated income	Income of such business shall be estimated at 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.
Assessee may claim lower profit	An assessee may claim lower profits and gains if he keeps and maintain books of account as per sec. 44AA and gets his accounts audited and furnishes the report u/s 44AB and thereupon the Assessing Officer shall proceed to make an assessment of the total income of the assessee u/s 143(3) and determine the sum payable by, or refundable to, the assessee.

**Special Provision for Computing Income by way of Royalties, etc. in case of Non-resident [Sec. 44DA]**

Applicable to	A non-resident (not being a company) or a foreign company
Conditions	1. Assessee has earned income by way of royalty or fees for technical services received from the Government or an Indian concern in pursuance of an agreement made with the Government or the Indian concern; 2. Assessee carries on business in India through a permanent establishment situated therein, or performs professional services from a fixed place of profession situated therein; and 3. Right, property or contract in respect of which royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed place of profession, as the case may be.
Agreement date	After 31/3/2003
Tax Treatment	Income shall be computed under the head "Profits and gains of business or profession" in accordance with the provisions of this Act:
Deduction not permissible	No deduction shall be allowed in respect of - • any expenditure or allowance which is not wholly and exclusively incurred for the business of such permanent establishment or fixed place of profession in India; or • amounts paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to its head office or to any of its other offices.
Note: Assessee shall keep and maintain books of account and other documents as per sec. 44AA and get his accounts audited u/s 44AB and furnish along with the return of income, the report of such audit in Form 3CE duly signed and verified by chartered accountant.	

Deduction of Head Office Expenditure in the case of Non-residents [Sec. 44C]

In case of a non-resident assessee, head office expenditure shall not be allowed (in computing the income chargeable under the head "Profits and gains of business or profession") in excess of the higher of the following amount

- (i) an amount equal to 5% of the adjusted total income; or
- (ii) 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.

Other Points

- ◆ Adjusted total income means the total income without giving effect to:
 - a) Head-office expenditure u/s 44C; or
 - b) Unabsorbed depreciation u/s 32(2); or
 - c) The first proviso to sec. 36(1)(ix) i.e. capital expenditure on family planning; or
 - d) Any loss carried forward u/s 72 or 73 or 74 or 74A; or
 - e) The deductions under Chapter VIA;
- ◆ Where the adjusted total income of the assessee is a loss, then (i) shall be computed at the rate of 5% of the average adjusted total income of the assessee.
- ◆ Average adjusted total income means average of adjusted total income of 3 assessment years immediately preceding the relevant assessment year. However, where the total income of the assessee is assessable only for last 2 or 1 year(s), then average of last 2 or 1 year(s) shall be considered.

- ♦ Head office expenditure means 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 purposes of the business or profession;
 - (b) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profits 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) travelling 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 administration as may be prescribed.

2.2 CAPITAL GAIN ON TRANSFER OF SHARES / DEBENTURES BY A NON-RESIDENT [FIRST PROVISO TO SEC. 48 AND RULE 115A]

Applicable on

A non-resident assessee (not being an assessee covered u/s 115AC and 115AD)

Nature of asset

Capital assets whether long-term or short term being shares in, or debentures of an Indian company acquired by utilizing foreign currency

Taxpoint:

- The provision shall also be applicable in respect of capital gains accruing or arising on transfer of shares in, or debentures of, an Indian company, acquired through reinvestment.
- The asset may be a short-term or long-term capital asset.
- The above provision is not applicable to units of UTI and Mutual Funds.

Procedure

Capital gain on transfer of above asset shall be computed as under:

- Cost of acquisition, expenditure on transfer and the sale consideration shall be converted into the same foreign currency as was initially utilized in the purchase of the shares or debentures; and
- Capital gains (computed in such foreign currency) shall be reconverted into Indian currency.

Taxpoint:

- Benefit of indexation shall not be available in case of above transfer.
- The method of computation is mandatory and not optional.
- Capital gain shall be determined as under:

Step	Conversion of	Particulars	Conversion rate
1	Sale consideration	Find sale consideration in Indian currency and convert it into foreign currency	At average exchange rate ¹ on the date of transfer



2	Expenditure on transfer	Find expenditure on transfer in Indian currency and convert it into foreign currency	At average exchange rate on the date of transfer (not on the date when expenditure was incurred)
3	Cost of acquisition	Find cost of acquisition in Indian currency and convert it into foreign currency	At average exchange rate on the date of acquisition.
4	Capital gain in foreign currency	Step 1 – Step 2 – Step 3	Not applicable
5	Taxable Capital gain	Capital gain so calculated (in step 4) will be reconverted into Indian currency	At buying rate ² on the date of transfer

1. **Average exchange rate:** It is the average of the telegraphic transfer buying rate and telegraphic transfer selling rate.

2. **Buying Rate:** It is telegraphic transfer buying rate of such currency.

Telegraphic transfer buying/selling rate in relation to a foreign currency is a rate of exchange adopted by the State Bank of India for purchasing/selling such currency where such currency is made available by that bank through telegraphic transfer.

ILLUSTRATION 2

Anthony, a non-resident Indian, acquired 1,000 shares in A Ltd. (an Indian Company) for ₹ 20,000 by utilizing foreign currency (\$) on 18/08/2018. On 16/09/2018, Anthony sold such shares for ₹ 45,000 and utilized the proceeds in acquisition of 500 shares of B Ltd. (an Indian Company) after paying expenditure on transfer on 13/8/2018 ₹ 5,000. Compute capital gain liability in the previous year 2018-19.

Date	\$ Buying rate	US \$ Selling rate
18/08/2018	45	46
13/08/2018	48	50
16/09/2018	46	48

Solution

Since the assessee is a non-resident and shares of an Indian company were acquired by utilizing foreign currency, hence, first proviso to sec. 48 and Rule 115A shall be applicable on above transactions.

Computation of capital gain for the A.Y. 2019-20

Particulars	Working	Rate applied	Amount	Amount
Sale consideration	₹ 45,000/₹ 47	Av. rate as on 16/09/2018		\$957.4
Less: Expenditure on transfer	₹ 5,000/₹ 47	Av. rate as on 16/09/2018		\$106.4
Net Sale consideration				\$851.0
Less: Cost of acquisition	₹ 20,000/₹ 45.5	Av rate as on 18/08/2018	\$439.6	
Less: Cost of improvement			Nil	\$439.6
Short term Capital Gain				\$411.4
Short term capital gain	\$411.4 × ₹ 46	Buying rate as on 16/09/2018		₹ 18,924

Special Tax Rate for Long Term Capital Gain in Some Cases [Sec. 112(1)(c)]

Applicable on

Non-resident (not being a company) or a foreign company

Conditions to be satisfied

1. Long-term capital gains shall be arise from the transfer of a capital asset, being unlisted securities or shares of a company in which the public are substantially interested.
2. Capital gain in respect of such asset shall be computed without giving effect to the
 - first proviso to sec. 48 (computation of capital gain in foreign currency) and
 - second proviso to sec. 48 (index benefit).

Special Tax Rate

Such long term capital gain shall be taxable @ 10% (+ surcharge and cess, as applicable).

Special Provisions in relation to certain income of Non-residents [Sec. 115A to Sec.115AC]

Following table enumerated the provisions relating to sec.115A to 115AC

Sec. Particulars	115A(1)(a)	115A(1)(b)	115AB	115AC
Applicable on	Non-resident	Non-resident	Overseas financial organization [§]	Non-resident
Income covered	a) Dividends (other than covered u/s 115-O); or b) Interest received from notified infrastructure bonds or Govt. or an Indian concern on money borrowed in foreign currency; or c) Interest of the nature and extent referred to in sec. 194LC /194LD/194LBA(2)	Royalty or fees for technical services (other than income covered u/s 44DA) received as per agreement entered with Government or an Indian concern* on or after 1-4-1976	Long-term capital gains arising from the transfer of units of UTI or mutual fund specified u/s 10(23D) purchased in foreign currency	a) Interest on notified foreign currency bonds of Indian / public sector company b) Dividend (other than covered u/s 115-O) on GDR c) LTCG arising on transfer of such bonds or Global Depository Receipts (GDR)
Special tax rate	5% (infra bonds or referred to in sec. 194LC or 194LD or 194LBA) / 20% (other cases)	10%	10%	10%
Allowability of expenditure u/s 28 to 44C & sec. 57	No	No	Not Applicable	No

* Where such agreement is with an Indian concern, the agreement is approved by the Central Government or where it relates to a matter included in the industrial policy, for the time being in force, of the Government of India, the agreement is in accordance with that policy



Deduction under Chapter VIA	Not available	Available	Not available	Not available
Index benefit	Not Applicable	Not Applicable	Not Available	Not Available
Requirement to furnish return[#]	No	Yes	Yes	No

[#] If total income consists of such income only and tax has been deducted from such income

^{\$}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 u/s 10(23D) and such arrangement is approved by the Securities and Exchange Board of India.

Special Provisions in relation to certain Income of Non-residents [Sec. 115ACA to Sec.115BBD]

Following table enumerated the provisions relating to sec.115ACA to 115BBD

Sec. Particulars	115ACA	115AD	115BBA(1)(a)	115BBA(1)(b)	115BBD
Applicable on	Resident individual	Foreign Institutional Investor	Non-resident sportsman or entertainer being foreign citizen	Non-resident sports association	Indian Company
Income covered	a) Dividend (other than covered u/s 115-O) on GDR\$ of an Indian company engaged in specified knowledge based industry or service* issued as ESOP b) Long-term capital gains on transfer of such GDR	a) Income on securities (other than unit referred to in sec. 115AB) b) STCG or LTCG on transfer of such securities	Income by way of: a) participation in India in any game or sport; or b) advertisement; or c) contribution of articles relating to any game or sport in India in newspapers, magazines or journals. In case of entertainer, any income received or receivable from his performance in India, Taxpoint: Match Referee is not considered as sportsmen.	Any amount guaranteed to be paid or payable to such association for any game or sport played in India	Dividend [excluding dividend covered u/s 2(22)(e)] from 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.
Special tax rate	10%	STCG u/s 111A 15% Other STCG 30% LTCG 10% Other Income 20%	20%	20%	15%

Sec. Particulars	115ACA	115AD	115BBA(1)(a)	115BBA(1)(b)	115BBD
Allowability of expenditure u/s 28 to 44C & sec. 57	No	No	No	No	No
Deduction u/ch VIA	Not available	Not available	Not available	Not available	No
Index benefit	Not Available	Not Available	Not Applicable	Not Applicable	Not Applicable
Requirement to furnish return[#]	Yes	Yes	No	No	Yes
Others	Assessee must be an employee of such company or its subsidiary		Winning from lottery, cross-word puzzles etc. is taxable @ 30% u/s 115BB		

@ In case of long-term capital asset referred to in section 112A, income-tax @ 10% shall be calculated on such income exceeding ₹ 1 lakh.

Specified knowledge based industry or service means:

- a. information technology software;
- b. information technology service;
- c. entertainment service;
- d. pharmaceutical industry;
- e. bio-technology industry; and
- f. any other specified industry or service

[§]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:

- (i) ordinary shares of issuing company, being a company listed on a recognised stock exchange in India; or
- (ii) foreign currency convertible bonds of issuing company

Special Provision in case of Non-resident Indian [Sec.115C to 115-I]

Applicable on

Non-resident Indians deriving –

- (a) Income from investment in foreign exchange asset; or
- (b) Long-term capital gain on foreign exchange asset.

Taxpoint

- ♦ Foreign exchange asset means any specified asset, which the assessee has acquired or purchased with, or subscribed to, in convertible foreign exchange.
- ♦ Specified asset means any of the following –
 - Shares in Indian company;
 - Debenture issued by an Indian company which is not a private company;
 - Deposit with an Indian company, which is not a private company;
 - Any security of the Central Government; or
 - Any notified asset.



- ◆ Investment income means any income (other than dividend referred in sec. 115-O) derived from a foreign exchange asset.
- ◆ Long-term capital gain means 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.
- ◆ Non-resident Indian means an individual, being a citizen of India or a person of Indian origin who is not a resident.

Special Provision [Sec. 115D]

1. No deduction in respect of any expenditure or allowance is allowed under any provision of this Act in computing the investment income.
2. No deduction shall be allowed to the assessee u/s 80C to 80U

Tax on Investment Income and Long-term Capital Gain [Sec. 115E]

<u>Nature of income</u>	<u>Rate of tax</u>
Income from investment	20%
Long term capital gain	10%

Exempted Capital Gain [Sec. 115F]

Applicable to

Non-resident Indian (i.e. an individual being a citizen of India or a person of Indian origin who is a non-resident)

Conditions

1. Assessee has transferred any of the following long term capital asset, acquired in convertible foreign exchange:
 - Shares in an Indian company; or
 - Debentures of an Indian public limited company; or
 - Deposits with an Indian public limited company; or
 - Central Government securities.(hereinafter referred to as original asset)
2. Within 6 months of transfer of original asset, the taxpayer has invested the whole or any part of net consideration in any of the following assets (hereinafter referred to as new asset)
 - a) Shares in an Indian company; or
 - b) Debentures of an Indian public limited company; or
 - c) Deposit with an Indian public limited company; or
 - d) Central Government securities; or
 - e) National Savings Certificate VI and VII issues.

Amount of exemption

Exemption is available to the minimum of the following –

- Long term capital gain; or
- $\frac{\text{Long term capital gain} \times \text{Amount invested in the new asset}}{\text{Net sale consideration on transfer of original asset}}$

Withdrawal of exemption

When the new asset acquired by the assessee is transferred or converted into money within 3 years from the date of its acquisition, the capital gains exempted earlier shall be revoked.

On revocation of exemption, benefit availed earlier under this section shall be taxed as long-term capital gain in the previous year in which such new asset is transferred or converted into money.

Note: Sec. 115F is optional in nature and not mandatory, i.e. an assessee may or may not opt for sec. 115F by giving a declaration in return of income to this effect. [Sec. 115-I]

Return of Income not to be Filed in certain cases [Sec. 115G]

It is not necessary to file return if during the previous year there is no other income and tax has been deducted at source

Applicability of Provisions after Becoming Resident [Sec. 115H]

Where a person become assessable as resident in India in any subsequent previous year, he may assessed as above provisions for that income provided he file a declaration in writing along with his return of income of subsequent year in this regard.

Non-applicability of Provisions [Sec. 115I]

An assessee may elect not to be governed by this provision for any assessment year by furnishing return of income for that assessment year u/s 139 declaring therein that the provision of this chapter shall not apply on him for that assessment year and if he does so, the provisions of this chapter shall not apply on him.

Conversion of an Indian branch of Foreign Company into Subsidiary Indian Company [Sec. 115JG]

Where a foreign company is engaged in the business of banking in India through its branch situated in India and such branch is converted into a subsidiary company thereof, being an Indian company (hereafter referred to as an Indian subsidiary company) in accordance with the scheme framed by the Reserve Bank of India (and subject to the conditions as may be notified by the Central Government), then,

- (a) The capital gains arising from such conversion shall not be chargeable to tax in the assessment year relevant to the previous year in which such conversion takes place.
- (b) The provisions of this Act relating to treatment 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 and the computation of income in the case of the foreign company and the Indian subsidiary company shall apply with such exceptions, modifications and adaptations as may be specified in that notification.

Consequence of failure to Comply with any of the Conditions

In case of failure to comply with any of the conditions specified in the scheme or in the notification, all the provisions of this Act shall apply to the foreign company and the said Indian subsidiary company without aforesaid benefit, exemption or relief.

Consequence of failure to Comply with any of the conditions after Claiming Benefit

Where, in a previous year, any benefit, exemption or relief has been claimed and granted to the foreign company or the Indian subsidiary company and, subsequently, there is failure to comply with any of the conditions specified in the scheme or in the notification, then:

- (a) Such benefit, exemption or relief shall be deemed to have been wrongly allowed;



- (b) The Assessing Officer may, notwithstanding anything contained in this Act, re-compute the total income of the assessee for the said previous year and make the necessary amendment; and
- (c) The provisions of sec. 154 shall, so far as may be, apply thereto and the period of 4 years specified in that section being reckoned from the end of the previous year in which the failure to comply with the condition takes place.

Submission of Statement by a Non-resident having Liaison Office [Sec.285]

Every person, being a non-resident having a liaison office in India set up in accordance with the guidelines issued by the Reserve Bank of India under the Foreign Exchange Management Act, 1999, shall, in respect of its activities in a financial year, prepare and deliver to the Assessing Officer having jurisdiction, within 60 days from the end of such financial year, a statement in such form (Form 49C) and containing such particulars as may be prescribed.

Furnishing of report in respect of international group [Sec. 286]

- ◆ Every constituent entity resident in India, shall, if it is constituent of an international group, the parent entity of which is not resident in India, notify the prescribed income-tax authority (herein referred to as prescribed authority) in the form and manner, on or before such date, as may be prescribed:
 - a) whether it is the alternate reporting entity of the international group; or
 - b) the details of the parent entity or the alternate reporting entity, if any, of the international group, and the country or territory of which the said entities are resident. [Sec. 286(1)]
- ◆ Every parent entity or the alternate reporting entity, resident in India, shall, for every reporting accounting year, in respect of the international group of which it is a constituent, furnish a report, to the prescribed authority within a period of 12 months from the end of the said reporting accounting year, in the form and manner as may be prescribed [Sec. 286(2)]
- ◆ The report in respect of an international group shall include:
 - a. the aggregate information in respect of the amount of revenue, profit or loss before income-tax, amount of income-tax paid, amount of income-tax accrued, stated capital, accumulated earnings, number of employees and tangible assets not being cash or cash equivalents, with regard to each country or territory in which the group operates;
 - b. the details of each constituent entity of the group including the country or territory in which such constituent entity is incorporated or organised or established and the country or territory where it is resident;
 - c. the nature and details of the main business activity or activities of each constituent entity; and
 - d. any other information as may be prescribed.
- ◆ A constituent entity of an international group, resident in India, other than the entity referred to sec. 286(2), shall furnish the report, in respect of the international group for a reporting accounting year within prescribed period, if the parent entity is resident of a country or territory,—
 - a. where the parent entity is not obligated to file such report;
 - b. with which India does not have an agreement providing for exchange of such report; or
 - c. there has been a systemic failure of the country or territory and the said failure has been intimated by the prescribed authority to such constituent entity.
- ◆ However, if there are more than one such constituent entities of the group, resident in India, the report shall be furnished by any one constituent entity, if,—
 - a) the international group has designated such entity to furnish such report on behalf of all the constituent entities resident in India; and
 - b) the information has been conveyed in writing on behalf of the group to the prescribed authority.

- ♦ If, an alternate reporting entity of the international group has furnished such report with the tax authority of the country or territory in which such entity is resident, on or before the date specified by that country or territory and the following conditions are satisfied then separate report is not required to be furnished:
 - a. the report is required to be furnished under the law for the time being in force in the said country or territory;
 - b. the said country or territory has entered into an agreement with India providing for exchange of the said report;
 - c. the prescribed authority has not conveyed any systemic failure in respect of the said country or territory to any constituent entity of the group that is resident in India;
 - d. the said country or territory has been informed in writing by the constituent entity that it is the alternate reporting entity on behalf of the international group; and
 - e. the prescribed authority has been informed by such entity.
- ♦ The prescribed authority may, for the purposes of determining the accuracy of the report furnished by any reporting entity, by issue of a notice in writing, require the entity to produce such information and document as may be specified in the notice within 30 days of the date of receipt of the notice.
- ♦ The prescribed authority may, on an application made by such entity, extend the period of thirty days by a further period not exceeding 30 days.
- ♦ The provisions of this section shall not apply in respect of an international group for an accounting year, if the total consolidated group revenue, as reflected in the consolidated financial statement for the accounting year preceding such accounting year does not exceed prescribed amount.

- "Accounting Year" means:
 - a. a previous year, in a case where the parent entity or alternate reporting entity is resident in India; or
 - b. 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, in any other case.
- "Agreement" means a combination of all of the following agreements:
 - i. an agreement entered into u/s 90 or u/s 90A; and
 - ii. an agreement for exchange of the report referred to in sec. 286(2) and notified by the Central Government.
- "Alternate Reporting Entity" means any constituent entity of the international group that has been designated by such group, in the place of the parent entity, to furnish the report in the country or territory in which the said constituent entity is resident on behalf of such group.
- "Constituent Entity" means:
 - 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 materiality; or
 - iii. any permanent establishment of any separate business entity of the international group included in (i) or (ii) [supra], if such business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting or internal management control purposes;
- "Group" 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;
- "Consolidated Financial Statement" means 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.
- "International Group" means any group that includes,—
 - i. two or more enterprises which are resident of different countries or territories;
 - 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;
- "Parent Entity" means 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 (i) or (ii) [supra], that includes the separate financial statement of the first mentioned constituent entity;
- "Reporting Accounting Year" means the accounting year in respect of which the financial and operational results are required to be reflected in the report
- "Reporting Entity" means the constituent entity including the parent entity or the alternate reporting entity, that is required to furnish a report.
- "Systemic Failure" with respect to a country or territory means that the country or territory has an agreement with India providing for exchange of such report, 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.

WITHHOLDING TAX FOR NON-RESIDENT

2.3 TDS ON PAYMENT TO NON-RESIDENT SPORTSMAN OR SPORTS ASSOCIATIONS [SEC. 194E]

Who is responsible to deduct tax: Any person who is responsible to pay the following income –

Payee	Income by way of
Sportsman (including an athlete) or an entertainer being non-resident foreign citizen	1. Participation in India in any game (excluding card game or gambling) or sport
	2. Advertising
	3. Contribution of articles relating to any game or sports in any newspaper, magazine or journal.
Sports association being non-resident	Any game (other than card game) or sports organised in India

Rate of TDS: 20% (+ Surcharge + Health & Education Cess)

When tax shall be deducted: At the time of payment or crediting the party whichever is earlier.

2.4 TDS ON INTEREST FROM INFRASTRUCTURE DEBT FUND [SEC. 194LB]

Who is responsible to deduct tax: Any person responsible for paying income by way of interest by an infrastructure debt fund referred to in sec. 10(47) to a non-resident or a foreign company.

When tax shall be deducted: At the time of payment or crediting the payee, whichever is earlier.

Rate of TDS: 5% (+ SC + HEC)

2.5 TDS ON CERTAIN INCOME FROM UNITS OF A BUSINESS TRUST [SEC. 194LBA]

Who is responsible to deduct tax: Any business trust distributing income referred to in sec. 115UA [being of the nature referred to in sec. 10(23FC) or 10(23FCA)] to its unit holder

When tax shall be deducted: At the time of payment or crediting the payee, whichever is earlier.

Rate of TDS:

Payee	Rate of TDS	
	Payment referred to in sec. 10(23FC)	Payment referred to in sec. 10(23FCA)
If payment is made to a resident unit holder	10%	10%
If payment is made to a unit holder being non-resident (not being a company)	5%	30% + SC + HEC
If payment is made to a unit holder being a foreign company	5%	40% + SC + HEC

2.6 TDS ON INCOME OF UNITS OF INVESTMENT FUND [SEC. 194LBB]

Who is responsible to deduct tax: The person responsible for making the payment of any income, other than that proportion of income which is of the same nature as income referred to in sec. 10(23FBB), to a unit holder in respect of units of an investment fund specified in clause (a) of the Explanation 1 to sec. 115UB

When tax shall be deducted: At the time of payment or crediting the payee, whichever is earlier.

Rate of TDS:

Payee	Rate of TDS
Resident	10%
Non-resident (not being a company)	30%
Foreign Company	40%

Note: Where the payee is a non-resident (not being a company) or a foreign company, deduction shall not be made in respect of any income that is not chargeable to tax.

**Exemption or relaxation from the provision**

When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax [Refer sec. 197]

2.7 TDS ON INCOME FROM INVESTMENT IN SECURITIZATION FUND [SEC. 194LBC]

Who is responsible to deduct tax: The person responsible for making the payment to an investor in respect of an investment in a securitisation trust, being referred to in sec. 115TCA

When tax shall be deducted: At the time of payment or crediting the payee, whichever is earlier.

Rate of TDS:

Payee	Rate of TDS
Resident	
- Individual or HUF	25%
- Other resident	30%
Non-Resident	
- Foreign Company	40%
- Other than foreign company	30%

Exemption or relaxation from the provision

When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax [Refer sec. 197]

2.8 TDS ON INTEREST TO NON-RESIDENT [SEC. 194LC]

Who is responsible to deduct tax: Any Indian company or a business trust⁴ responsible for paying income by way of interest to a non-resident or a foreign company. Such interest is payable in respect of monies borrowed by such company at any time on or after 01/07/2012 but before 01/07/2020 in foreign currency, from a source outside India:

- (a) under a loan agreement; or
- (b) by way of issue of long-term bonds including long term infrastructure bonds,
- (c) by way of issue of rupee denominated bond before the 1st day of July, 2020

as approved by the Central Government

When tax shall be deducted: At the time of payment or crediting the payee, whichever is earlier.

Rate of TDS: 5% (+ SC + HEC)

Note: W.e.f. 01-06-2013, the provisions of section 206AA (i.e. rate of TDS will be 20% in absence of PAN) shall not apply in respect of payment of interest, on long-term bonds including long term infrastructure bonds (being referred to in sec. 194LC) to a non-resident, not being a company, or to a foreign company

2.9 INCOME BY WAY OF INTEREST ON CERTAIN BONDS, GOVT. SECURITIES [SEC. 194LD]

Who is responsible to deduct tax: Any person who is responsible for paying interest (at the rate notified by the Central Government) to a person being a Foreign Institutional Investor or a Qualified Foreign Investor². Such interest is payable at any time on or after 01/06/2013 but before 01/06/2020 in respect of investment made by the payee in:

- (i) a rupee denominated bond of an Indian company ; or
- (ii) a Government security

When tax shall be deducted: At the time of payment or crediting the payee, whichever is earlier.

Rate of TDS: 5% (+ SC + HEC)

2.10 TDS ON OTHER SUMS PAYABLE TO NON-RESIDENT [SEC. 195]

Who is responsible to deduct tax: Any person (resident or non-resident³) responsible for paying any sum chargeable under this Act (excluding income chargeable under the head "Salaries") to a non-resident.

When tax shall be deducted: At the time of payment or crediting the payee, whichever is earlier.

Rate of TDS: At the rate in force during the financial year

Exemption or relaxation from the provision

When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax [Refer sec. 197]

Note: In case, payer is a Government or Public sector bank or a financial institution [within the meaning of 10(23D)], tax shall be deducted only at the time of payment.

Other Points

Provision for furnishing information: The person responsible for paying to a non-resident, not being a company, or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall furnish the information relating to payment of such sum, in such form and manner, as may be prescribed.

If a person fails to furnish such information or furnishes inaccurate information, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of ₹ 1,00,000/- [Sec. 271-I]

Application to the Assessing Officer: The Board may notify a class of persons or cases, where the person responsible for paying to a non-resident, any sum, whether or not chargeable under the provisions of this Act, shall make an application to the Assessing Officer to determine, by general or special order, the appropriate proportion of sum chargeable, and upon such determination, tax shall be deducted on that proportion of the sum which is so chargeable.

2.11 TDS ON INCOME FROM UNITS [SEC. 196B]

Who is responsible to deduct tax: Any person responsible for paying any income in respect of units referred to in sec.

² "Qualified Foreign Investor" shall have the meaning assigned to it in the Circular No. Cir/IMD/DF/14/2011, dated the 9th August, 2011, as amended from time to time, issued by the Securities and Exchange Board of India, under section 11 of the Securities and Exchange Board of India Act, 1992

³ whether or not such non-resident person has: (i) a residence or place of business or business connection in India; or (ii) any other presence in any manner whatsoever in India



115AB or by way of long-term capital gains arising from the transfer of such units to an Offshore Fund.

When tax shall be deducted: At the time of payment or crediting the payee, whichever is earlier.

Rate of TDS: 10% + Surcharge + Health & Education Cess

Note: Since income on units is exempted from 1-4-2003, hence, the section is applicable only in the case of long term capital gain arising on transfer of such units.

2.12 TDS ON INCOME FROM FOREIGN CURRENCY BONDS OR GDR [SEC. 196C]

Who is responsible to deduct tax: Any person responsible for paying any income by way of interest or dividends in respect of bonds or Global Depository Receipts referred to in section 115AC or by way of long-term capital gains arising from the transfer of such bonds or Global Depository Receipts to a non-resident

When tax shall be deducted: At the time of payment or crediting the payee, whichever is earlier.

Rate of TDS: 10% + Surcharge + Health & Education Cess

Note: Tax shall not be deducted in respect of any dividends referred to in section 115-O.

2.13 TDS ON INCOME OF FII FROM SECURITIES [SEC. 196D]

Who is responsible to deduct tax: Any person responsible for paying any income in respect of securities referred to in section 115AD (1)(a) to Foreign Institutional Investor.

When tax shall be deducted: At the time of payment or crediting the payee, whichever is earlier.

Rate of TDS: 20% + Surcharge + Health & Education Cess

Notes

Tax shall not be deducted from any capital gains arising from the transfer of securities referred to in section 115AD, payable to a Foreign Institutional Investor. However, Tax shall not be deducted in respect of any dividends referred to in section 115-O.

RECOVERY OF TAX

As per section 160, agent of the non-resident, including a person who is treated as an agent u/s 163 is considered as a representative assessee in respect of the income of a non-resident specified in sec. 9(1).

As per sec. 161, every representative assessee, as regards the income in respect of which he is a representative assessee, shall be subject to the same duties, responsibilities and liabilities as if the income were income received by or accruing to or in favour of him beneficially, and shall be liable to assessment in his own name in respect of that income; but any such assessment shall be deemed to be made upon him in his representative capacity only, and the tax shall, subject to the other provisions contained in this Chapter, be levied upon and recovered from him in like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him.

Agent of a Non-resident [Sec. 163]

Where the person liable to tax under this Act resides outside India, then tax may be levied upon and recovered from

his agent. The agent shall be deemed to be the assessee in respect of such tax. The Assessing Officer may serve a notice on the persons for his intention of treating him as the agent of non resident. No person shall be treated as the agent of a non-resident unless he has had an opportunity of being heard by the Assessing Officer as to his liability to be treated as such.

Who may be treated as an Agent

"Agent", in relation to a non-resident, includes any person in India:

- (a) who is employed by or on behalf of the non-resident; or
- (b) who has any business connection with the non-resident; or
- (c) from or through whom the non-resident is in receipt of any income, whether directly or indirectly; or
- (d) who is the trustee of the non-resident;

and includes also any other person who, whether a resident or non-resident, has acquired by means of a transfer, a capital asset in India.

Exception

A broker in India who, in respect of any transactions, does not deal directly with or on behalf of a non-resident principal but deals with or through a non-resident broker shall not be deemed to be an agent under this section in respect of such transactions, if the following conditions are fulfilled:

- (i) the transactions are carried on in the ordinary course of business through the first-mentioned broker; and
- (ii) the non-resident broker is carrying on such transactions in the ordinary course of his business and not as a principal.

Taxpoint

- An agent shall be entitled to -
 - a) recover any sum paid by him from the person on whose behalf it is paid; or
 - b) to retain out of any moneys that may be in his possession; or
 - c) to retain out of any moneys that may come to him in his capacity as such agent
- Any agent or any person, who apprehends that he may be assessed as an agent, may retain (equal to estimated liability) out of any money payable by him to the person residing outside India on whose behalf he is liable to pay tax (hereinafter in this section referred to as the principal).
- However, where there is any disagreement between the principal and such agent or person, regarding amount to be so retained, such agent or person may secure from the Assessing Officer a certificate stating the amount to be so retained pending final settlement of the liability.
- The amount recoverable from such agent or person at the time of final settlement shall not exceed the amount specified in such certificate, except to the extent to which such agent or person may at such time have in his hands additional assets of the principal.

Recovery of tax in respect of non-resident from his assets [Sec. 173]

Where the person entitled to the income referred to in sec. 9(1)(i) 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 and any arrears of tax may also be recovered from any assets of the non-resident which are, or may at any time come, within India.

Recovery of tax in pursuance of agreements with foreign countries [Sec. 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 has property in a country outside India (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), forward to the Board a certificate drawn up by him u/s 222 and the Board may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

ILLUSTRATION 3

Smart (a non resident) has computed his tax liability as under –

Particulars	Details	Amount
Income from business A		2,80,000
Long term capital gain	10,000	
Less: Income from business B u/s 71	(10,000)	Nil
Income from other sources		30,000
Gross Total Income		3,10,000
Less: Deduction u/s 80CCC to 80U		-
Total Income		3,10,000
Tax liability (after rebated u/s 87A)		520

Comment on the above computation.

Solution

Computation made by Smart is incorrect, as because first intra head set-off shall be made, thereafter inter head set-off can be made. The correct computation is shown below -

Computation of total income and tax liability of Smart for the A.Y. 2019-20

Particulars	Details	Amount
Profits & Gains of Business or Profession		
Income from business A	2,80,000	
Income from business B u/s 70	(10,000)	2,70,000
Capital Gains		
Long term capital gain		10,000
Income from other sources		30,000
Gross Total Income		3,10,000
Less: Deduction u/s 80CCC to 80U		-
Taxable Income		3,10,000
Tax liability $\{[\text{₹ } 10,000 \times 20\% + (\text{₹ } 3,00,000 - \text{₹ } 2,50,000) \times 5\%] \times 104\%$		4,680

In case of non-resident individual, rebate u/s 87A is not available.

ILLUSTRATION 4

Mr. Crown, a non-resident, gives you the following information for the year ended 31-3-2019

Interest on Government securities (gross)

21,000

NON RESIDENT

Dividend on shares of foreign companies received aboard	52,000
Income from units of Unit Trust of India (gross)	10,000
Interest from deposits in Indian companies (gross)	30,000
Income from horse races in India	20,000

He has donated a sum of ₹ 10,000 to Municipal Corporation of Delhi for promotion of family planning. He has paid ₹ 2,000 by cheque to New India Assurance Co. for mediclaim for himself. He has also spent ₹ 16,000 on medical treatment of his minor son who is physically handicapped.

Compute total income of Mr. Crown for the assessment year 2019-20.

Solution

Computation of Total Income of Mr. Crown, a non-resident, for the A.Y.2019-20

Particulars	Working	Amount	Amount
Income from other sources			
Dividend from			
Foreign company	Non-resident	Nil	
UTI	Exempted u/s 10(35)	Nil	
Interest from			
Government securities		21,000	
Indian company deposits		30,000	51,000
Casual income			
Winning from horse races			20,000
Gross Total Income			71,000
Less: Deduction			
U/s 80D (Medical insurance)		2,000	
U/s 80DD (Handicapped son)	Non-resident	Nil	
U/s 80G (Donation)	Note	6,900	8,900
Total Income			62,100

Note: Computation of Deduction u/s 80G

Computation of Adjusted GTI:

Adj. GTI = GTI – Deduction u/s 80CCC to 80U other than 80G

$$= ₹ 71,000 - ₹ 2,000 = ₹ 69,000$$

Qualifying amount for donation = 10% of Adjusted GTI = 10% of ₹ 69,000 = ₹ 6,900

Deduction: In case of donation to Municipal Corporation for family planning, rate of deduction is 100% of qualifying amount. Hence, deduction u/s 80G shall be ₹ 6,900 (being 100% of ₹ 6,900).

ILLUSTRATION 5

Roger, a foreign national, furnishes the following data for the previous year ended 31st March, 2019:



- (i) Royalty from Indian concern under an agreement made on 15-09-1996 approved by the Central Government ₹ 3,00,000.
- (ii) Expenditure as per section 28 to 44C for earning such income ₹ 2,00,000.
- (iii) Interest from an Indian company on money lent in foreign currency ₹ 11,00,000.
- (iv) Expenditure on collection of above interest ₹ 90,000.
- (v) Gross sale of business in India ₹ 30,00,000.
- (vi) Expenditure as per sections 28 to 44C for above business ₹ 28,00,000.
- (vii) Donation to Prime Minister National Relief Fund ₹ 6,00,000.

Determine the total income of Roger for the assessment year 2019-20.

Solution

Computation of Total income of Roger for the A.Y.2019-20

Particulars	Amount	Amount	Amount
Profits and gains of business or profession			
Sale	30,00,000		
Less: Expenditure	28,00,000	2,00,000	
Royalty income	3,00,000		
Less: Expenditure (Not allowed u/s 115A)	Nil	3,00,000	5,00,000
Income from other sources			
Interest income		11,00,000	
Less: Expenses (Not allowed u/s 115A)		Nil	11,00,000
Gross Total Income			16,00,000
Less: Deduction u/s 80G (Note 2)			5,00,000
Total Income			11,00,000

Note:

- a. As per sec. 115A, no expenses shall be allowed from royalty and interest income.
- b. As per sec. 115A, no deduction under chapter VIA shall be allowed from interest on money lent in foreign currency.

ILLUSTRATION 6

The total income of a non-resident Indian includes:

- Investment income (net) ₹ 50,000
- Long term capital gain ₹ 25,000
- Other income ₹ 2,65,000

What will be the tax payable by him in respect of assessment year 2019-20 on the above income under chapter XIIA (special provisions relating to certain income of non-residents) of the I.T. Act, 1961?

Solution

Since the assessee is non-resident hence income shall be taxable as per provision of sec. 115E as under –

Particulars	Income	Rate	Tax liability
Investment income (Net)	50,000	20%	10,000
Long term capital gain	25,000	10%	2,500
Other income	2,65,000	$[(2,50,000 \times \text{Nil}) + (15,000 \times 5\%)]$	750
Tax before surcharge			13,250
Add: Health & Education cess @ 4%			530
Tax liability (Rounded off)			13,780

ILLUSTRATION 7

Mr. Q, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts in the course of the business of operation of aircraft during the previous year:

- ₹ 2 crores in India on account of carriage of passengers from Chennai.
- ₹ 1 crore in India on account of carriage of goods from Chennai.
- ₹ 3 crores in India on account of carriage of passengers from Singapore.
- ₹ 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 was ₹ 6.75 crores.

Compute income chargeable to tax of the foreign airlines

Solution

Computation of income of Mr. Q for the A.Y. 2019-20

Particulars	Amount
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
Total	7,00,00,000
Total Income (as per sec. 44BBA being 5% of above)	35,00,000

ILLUSTRATION 8

The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2019 was a loss of ₹ 50 lacs after charge of head office expenses of ₹ 100 lacs allocated to the branch. Compute income of the branch for the assessment year 2019-20.

Solution

Computation of income of the branch for the A.Y. 2019-20

Particulars	Amount	Amount
Net Income for the year ended on 31-03-2019		(50,00,000)
Add: Head office expenses (to be considered separately)		1,00,00,000



Adjusted Total Income		50,00,000
Less: Head office expenses allowable u/s 44C being lower of the following:		
- 5% of ₹ 50,00,000	2,50,000	
- Actual Expenses	1,00,00,000	2,50,000
Total Income		47,50,000

ILLUSTRATION 9

Roger Federer, a tennis professional and a non-Indian citizen participated in India in a tennis Tournament and won the prize money of ₹ 15 lakh. He contributed articles on the tournament in a local newspaper for which he was paid ₹ 1 lakh. He was also paid ₹ 4 lakh 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 ₹ 1,30,000 towards his travel cost to India. He was a non-resident for tax purposes in India. What would be his tax liability in India for A.Y. 2019-20. Is he required to file his return of income u/s 139(1).

Solution

U/s 115BBA, where a sportsman who is not a citizen of India receives any income by way of i) participating in any game in India; or ii) advertisement; or iii) contributing articles relating to any game or sport in India in newspapers, magazines or journals, then such income shall be chargeable to tax @ 20% + cess @ 4% on the tax.

Accordingly, his income for the A.Y. 2019-20 are as under:

Particulars	Amount
Tennis tournament prize	15,00,000
Amount received on contributing articles in the newspaper	1,00,000
Amount received on advertisement	4,00,000
Total Income	20,00,000
Tax on above [₹ 20,00,000 × 20% × 104%]	4,16,000

Notes

- While computing income, no deduction in respect of any expenditure or allowance shall be allowed
- It shall not be necessary for the assessee to furnish return of his income if:
 - his total income consisted only of income referred to in sec. 115BBA; and
 - the tax deductible at source has been deducted from such income

ILLUSTRATION 10

Compute the income-tax in the following cases :

- Royalty of ₹ 10 lakh received by a foreign company from an Indian concern in pursuance of an agreement approved by the Central Government in the previous year 2018-19.
- ₹ 10 lakh long-term capital gains received by an overseas financial organisation on transfer of unit purchased in foreign currency.

Solution

NON RESIDENT

(a) As per Section 115A(i)(b), the rate of income tax applicable on royalty is 10%.

Therefore, Income tax = 10% of ₹ 10,00,000 = ₹ 1,00,000

Health & Education cess = 4% of ₹ 1,00,000 = ₹ 4,000

Total tax payable = ₹ 1,00,000 + ₹ 4,000 = ₹ 1,04,000

(b) Long term Capital Gain = ₹ 10,00,000

Income-tax u/s 115AB = 10% of ₹ 10,00,000 = ₹ 1,00,000

Health & Education cess = 4% of ₹ 1,00,000 = ₹ 4,000

Total tax payable = ₹ 1,00,000 + ₹ 4,000 = ₹ 1,04,000

However if the units are equity oriented fund then the Long term capital gains on the same shall be exempt u/s 10(38)

ILLUSTRATION 11

A non-resident foreign company has a permanent establishment (PE) in India, in respect of which royalty ₹ 101 lakh was earned from an Indian company in pursuance of an agreement dated 10th June, 2015 (expenditure incurred on PE in India ₹ 12,37,600). Compute the gross tax liability of foreign company ignoring TDS/advance tax for the assessment year 2019-20, assuming that there is no other income of the company for the year.

Solution

Computation of Total Income and Tax Liability

Particulars	Amount
Royalty covered u/s 44DA	1,01,00,000
Less: Expenses	12,37,600
Income	88,62,400
Tax on above [104% {₹ 88,62,400 × 40%} [Rounded off]	36,86,760



STUDY NOTE : 3

RETURN OF INCOME



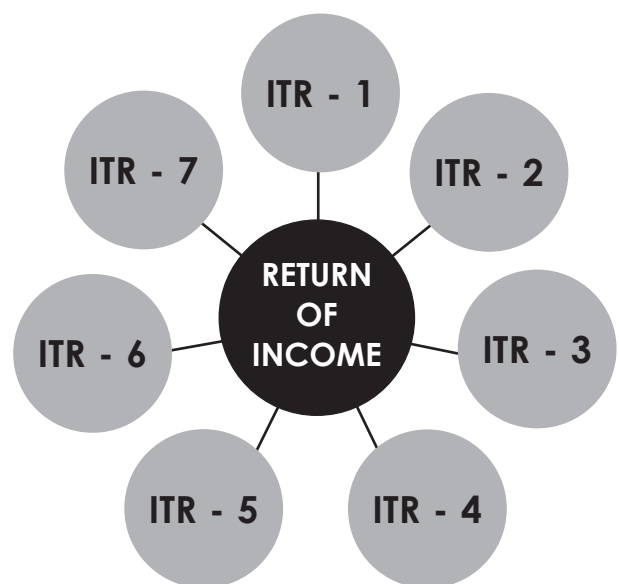
This Study Note includes:

- 3.1 Introduction
- 3.2 Forms – Return of income
- 3.3 Mode of furnishing Income-tax Return
- 3.4 Time limit for filing return of income [Explanation 2 to Sec. 139(1)]
- 3.5 Fee for default in furnishing return of income [Sec. 234F]
- 3.6 When a return of loss should be filed [Sec. 139(3)]
- 3.7 Belated Return [Sec. 139(4)]
- 3.8 Return of income of Charitable Trust [Sec. 139(4A)]
- 3.9 Return of income of Political Party [Sec. 139(4B)]
- 3.10 Return of income of scientific research association, etc. [Sec. 139(4C)]
- 3.11 Return of income by a University/ College etc. [Sec. 139(4D)]
- 3.12 Return of income of a Business Trust [Sec. 139(4E)]
- 3.13 Return of income of Investment Fund [Sec. 139(4F)]
- 3.14 Revised Return [Sec. 139(5)]
- 3.15 Defective Return [Sec. 139(9)]
- 3.16 Verification of Return [Sec. 140]
- 3.17 Quoting of Aadhaar number [Sec. 139AA]

3.1 INTRODUCTION

Every person:

- a) being a company or a firm; or
- b) being a person other than a company or a firm, 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 exceeded the maximum amount which is not chargeable to income-tax, shall, 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 – [Sec. 139(1)]





Compulsory filing of return

Any person, being resident other than not ordinarily resident, shall furnish, a return, within due date, in respect of his income or loss for the person, being resident other than not ordinarily resident, shall furnish, a return, within due date, in respect of his income or loss for the previous year irrespective of the fact that his total income does not exceed basic exemption limit or does not have any taxable income, if he:

- (i) holds, as a beneficial owner or otherwise, any asset (including any financial interest in any entity) located outside India or has signing authority in any account located outside India; or
- (ii) is a beneficiary of any asset (including any financial interest in any entity) located outside India.

Exception: An individual, being a beneficiary of any asset (including any financial interest in any entity) located outside India where, income, if any, arising from such asset is includible in the income of the person referred above in accordance with the provisions of this Act.

- "Beneficial owner" in respect of an asset means 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" in respect of an asset means 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.

3.2 FORMS – RETURN OF INCOME

Rule 12 provides following Form for filing return of income for different assessee:

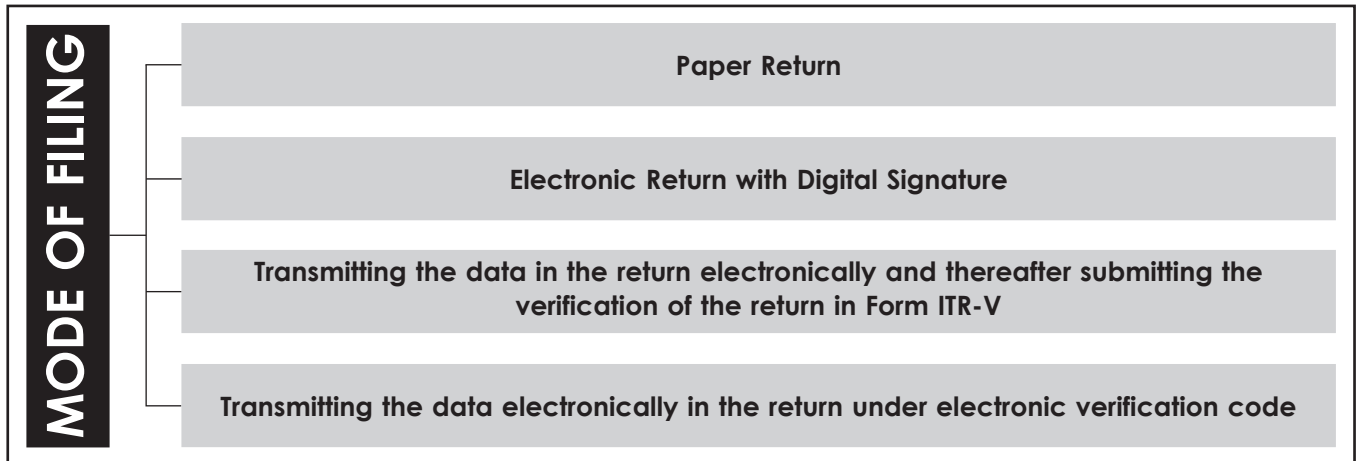
ITR - 1 (Sahaj)	For Individuals having Income from Salaries, one house property (does not have any brought forward loss), other sources [Interest (does not have any loss under the head) etc. but except winnings from lottery or income from race horses] and having total income upto ₹ 50 lakh
ITR - 2	For Individuals and HUFs not carrying out business or profession under any proprietorship
ITR - 3	For individuals and HUFs having income from a proprietary business or profession
ITR - 4 (Sugam)	For presumptive income from Business & Profession
ITR - 5	For person other than (i) Individual; (ii) HUF; (iii) Company; & (iv) Person filing Form ITR-7
ITR - 6	For Companies other than companies claiming exemption u/s 11
ITR - 7	For persons including companies required to furnish return u/s 139(4A) or 139(4B) or 139(4C) or 139(4D) or 139(4F)
ITR - V	Income Tax Return Verification Form [Where the data of the aforesaid Return of Income has transmitted electronically without digital signature]

Taxpoint:

- Form ITR 1 or ITR 4 cannot be used by a person who:
 - a) is an ordinarily resident and has,—
 - i. assets (including financial interest in any entity) located outside India; or
 - ii. signing authority in any account located outside India; or
 - iii. income from any source outside India
 - b) has claimed any relief of tax u/s 90 or 90A or deduction of tax u/s 91

- c) has agricultural income, exceeding ₹ 5,000;
- d) has income taxable u/s 115BBDA; or
- e) has income of the nature referred to in sec. 115BBE.

3.3 MODE OF FURNISHING INCOME-TAX RETURN



The table enumerates mode of filing of return of income:

Person	Condition	Mode
Company	-	Electronically with digital sign
Political Party	-	
Firm or LLP or Individual or HUF	Audit u/s 44AB required	
Resident Individual (other than not-ordinarily resident) or a resident HUF (other than not-ordinarily resident)	If he/it has: (a) assets (including financial interest in any entity) located outside India; or (b) signing authority in any account located outside India.	Electronically with or without digital sign
Any person	Claiming any relief u/s 90 or 90A or 91	
Individual or HUF	Where total income assessable during the previous year of a person: a. being an individual of the age of 80 years or more at any time during the previous year; or b. whose income does not exceed ₹ 5 lakh and no refund is claimed in the return of income, and who furnishes the return in Form No. ITR-1 or Form No. ITR-4	Any of the given mode
Any other case		Any mode other than paper mode

**Steps for e-filing of Return (with offline utility)**

Step 1	Register with http://incometaxindiaefiling.gov.in. For registration, one requires following: - Name of the assessee; - PAN of the assessee; - Date of birth (in case of person other than individual, date of incorporation) - Mobile Number - Email ID - Password of your choice After successful registration, remember the login credentials: • User ID: PAN of the assessee (the ID is not case sensitive) • Password: As provided • Date of birth / incorporation
Step 2	Download appropriate form utility of return of income (or else one can fill the appropriate form online after login). For this, Go to the 'Downloads' located below the login button -> Click 'Offline Utilities' -> Click 'Income Tax Return Preparation Utilities'
Step 3	Select the type of 'ITR' form depending on the types of income you have received in the financial year for which the return is to be filed ⇒ Click 'Download' link available under 'Excel Utility' or 'Java Utility' column
Step 4	Extract the download ZIP file ⇒ Open the extracted ZIP file. • For Excel File - Click 'Import Personal / Tax Details from XML', located at right side of the 'Income Details' tab. The side buttons (like validate, Next, Calculate Tax, etc.) of the excel file will work only if 'Macros' and 'ActiveX' function of the Excel workbook is enabled.
Step 5	Attach the 'Pre-filled XML' file which has been downloaded. For Pre-filled XML file: a) Login to 'e-Filing' Portal b) Go to the 'My Account' menu located at upper-left side of the page -> Click 'Download Pre-filled XML' c) Select the 'Assessment Year' and 'ITR Form Name' from the dropdown list d) Click 'Continue' ⇒ Choose the type of details ⇒ Click 'Confirm' ⇒ Click 'Download XML'
Step 6	Attach the downloaded 'Pre-fill XML' file to populate the relevant details.
Step 7	Enter all the Mandatory Fields ⇒ Validate all the sheets ⇒ Calculate Tax
Step 8	Click 'Generate XML'
Step 9	Click 'Save XML' button to save the XML file at your desktop
Step 10	After saving the generated XML, Upload the XML file at e-Filing Website. For this follow these steps: a) Login to 'e-Filing' Portal b) Go to the 'e-File' menu located at upper-left side of the page ⇒ Click 'Income Tax Return' c) Select the 'Assessment Year', 'ITR Form Name' from the dropdown list d) Select the 'Submission Mode' as 'Upload XML' from the dropdown list e) Choose any one of the following option to verify the Income Tax Return: • Digital Signature Certificate (DSC). If you do not have DSC • Aadhaar OTP • EVC using Prevalidate Bank Account Details • EVC using Prevalidate Demat Account Details

	• Already generated EVC through My Account ⇒ Generate EVC Option or Bank ATM. Validity of such EVC is 72 hours from the time of generation • Don't Want to e-verify this Income Tax Return and would like to send signed ITR-V to Bengaluru f) Click 'Continue' g) Attach the XML file at option 'Attach the ITR XML file h) Taxpayer will get an option to enter OTP for e-verifying the ITR, if an EVC or Aadhaar OTP option is chosen. Or To attach DSC, if DSC option is chosen to e-verify the ITR.
Step 11	After successful submission, ITD will process your ITR and send an email confirmation stating the same

Steps for e-filing of Return Form 1 and Form 4 (online)

Step 1	Logon to 'e-Filing' Portal
Step 2	Go to the ' e-File ' menu located at upper-left side of the page ⇒ Click ' Income Tax Return '
Step 3	Select the ' Assessment Year ', ' ITR Form Name ' from the dropdown list
Step 4	Select the ' Submission Mode ' as ' Prepare and Submit Online ' from the dropdown list
Step 5	Choose any one of the following option to verify the Income Tax Return: • Digital Signature Certificate (DSC). If you do not have DSC • Aadhaar OTP • EVC using Prevalidate Bank Account Details • EVC using Prevalidate Demat Account Details • Already generated EVC through My Account ⇒ Generate EVC Option or Bank ATM. Validity of such EVC is 72 hours from the time of generation • Don't want to e-verify this Income Tax Return and would like to send signed ITR-V to Bengaluru Click 'Continue'
Step 6	Read the instructions ⇒ Fill in Required details While filling the details in ITR, under category 'Return Filed' Note: Before submitting the data, kindly save the data you have entered by clicking on 'Save as Draft' to recheck any mistakes.
Step 7	Click ' Preview and Submit ' button to preview your ITR from before submitting it.
Step 8	Click 'Submit' Taxpayer will get an option to enter OTP for e-verifying the ITR, if an EVC or Aadhaar OTP option is chosen or To attach DSC, if DSC option is chosen to e-verify the ITR. After successful submission, ITD will process your ITR and send an email confirmation stating the same.

26AS Statement

The following details (on yearly basis) have been provided in 26AS statement:

- Advance tax, Self-Assessment Tax and Regular Assessment Tax paid by the assessee
- Tax paid through Tax Deducted at Source (TDS) or TCS on behalf of the assessee
- Refund issued by the Department to the assessee
- Information received from various agencies on high value transaction carried by the assessee.

**Steps are required to follow to view or download 26AS statement:**

Step 1	Logon to the ' e-Filing ' Portal
Step 2	Go to the ' My Account ' menu located at upper-left side of the page ⇒ Click ' View Form 26 AS (Tax Credit) ', User is redirected to TDS-CPC Portal
Step 3	View the disclaimer ⇒ Click ' Confirm ' ⇒ Agree the acceptance of usage ⇒ Click ' Proceed '
Step 4	Click ' View Tax Credit (Form 26AS) '
Step 5	Select the ' Assessment Year ' and ' View type ' (HTML, Text or PDF)
Step 6	Click ' View / Download '

One can also view the 26AS statement from his banking portal.

Functionalities available at e-Filing Portal

Few of the functionalities available at e-filing portal are as follow:

- View Form 26AS
- Tax Credit mismatch
- e-Verify Return
- Add / Disengage CA or e-Return Intermediary
- Filing of Returns
- Filing of return in response of notice u/s 139(9)
- Aadhar linking
- Filing of appeal to CIT(Appeals)
- Refund reissue request
- Profile updation
- View (with download facility) e-Filed Return / Form
- Download pre-filled XML
- Generate EVC
- Add / Register as Representative
- Filing of Rectification
- Status of refund issue or status of demand
- e-Proceedings
- Registration or updation of Digital Sign
- Validation of Bank Account or Demat Account

3.4 TIME LIMIT FOR FILING RETURN OF INCOME [EXPLANATION 2 TO SEC. 139(1)]

A return should be filed on or before the following due date (of respective assessment year):

Assessee	Due date
• Where the assessee is required to furnish a report in Form 3CEB u/s 92E pertaining to international transaction(s)	30 th November
• Where the assessee is a company not having international transaction(s)	30 th September
• Any other assessee	
– Where accounts of the assessee are required to be audited under any law	30 th September
– Where the assessee is a working partner in a firm and the accounts of the firm are required to be audited under any law	30 th September
– In any other case	31 st July

3.5 FEE FOR DEFAULT IN FURNISHING RETURN OF INCOME [SEC. 234F]

Where a person required to furnish a return of income u/s 139, fails to do so within the due date, he shall pay fee of:

Case	Fee
Total income does not exceed ₹ 5 lakh	₹ 1,000
Total income exceeds ₹ 5 lakhs	
- If the return is furnished on or before 31 st December of the assessment year	₹ 5,000
- In any other case	₹ 10,000

3.6 WHEN A RETURN OF LOSS SHOULD BE FILED [SEC. 139(3)]

An assessee, other than few, is not compulsorily required to furnish return of loss. However, the following losses cannot be carried forward if the return of loss is not submitted within the time allowed u/s 139(1) -

- Business loss (speculative or otherwise);
- Capital loss;
- Loss from the activity of owning and maintaining race horses
- Loss from business specified u/s 35AD

Notes

- Loss declared in belated return cannot be carried forward. However, set-off of losses of current year is not prohibited while computing the total income, even if the return of loss is filed after the due date.
- Delay in filing the return of loss may be condoned in certain cases
- Unabsorbed depreciation u/s 32 and loss under the head "Income from house property" can be carried forward even if the loss return is filed after the due date u/s 139(1).
- Although the loss of the current year cannot be carried forward unless the return of loss is submitted before the due date but the loss of earlier years can be carried forward if the return of loss of that year was submitted within the due date.

3.7 BELATED RETURN [SEC. 139(4)]

If an assessee fails to file return within the time limit allowed u/s 139(1) or within the time allowed under a notice issued u/s 142(1), he can file a belated return.

Time limit: Assessee may file such return -

- before the end of the relevant assessment year; or
- before the completion of assessment (u/s 144),
 - whichever is earlier.

However, if an assessee files a belated return, he would be liable to fee u/s 234F and interest u/s 234A.



3.8 RETURN OF INCOME OF CHARITABLE TRUST [SEC. 139(4A)]

Every person who is in receipt of –

- income from property held under the trust or other legal obligation wholly or partly for charitable or religious purpose; or
- income by way of voluntary contribution on behalf of such trust or institution,

and if such income before allowing exemption u/s 11 or 12 exceeds the maximum amount which is not chargeable to tax, must file a return before the due date as per sec.139(1).

Penalty: Where an assessee fails to file return of income under this section, within the time limit, it shall be liable to pay a penalty of ₹ 100 per day during which such failure continues [Sec. 272A(2)].

3.9 RETURN OF INCOME OF POLITICAL PARTY [SEC. 139(4B)]

The chief executive officer (whether such chief executive officer is known as Secretary or by any other designation) of any political party is required to furnish a return in respect of income of such political party, if the amount of gross total income before allowing exemption u/s 13A exceeds the maximum amount not chargeable to tax.

3.10 RETURN OF INCOME OF SCIENTIFIC RESEARCH ASSOCIATION, ETC. [SEC. 139(4C)]

Every -

- Research Association referred to in sec. 10(21);
- News agency referred to in sec. 10(22B);
- Association or institution referred to in sec. 10(23A) or sec. 10(23B);
- Specified Employee Welfare Fund referred to in sec. 10(23AAA);
- Any university or other educational institution referred to in sec. 10(23C)(iiiad) or (iiiab);
- Any hospital or other medical institution referred to in sec. 10(23C)(iiiiae) or (iiiac);
- Fund or institution referred to in sec. 10(23C)(iv);
- Trust or institution referred to in sec. 10(23C)(v);
- Any university or other educational institution referred to in sec. 10(23C)(vi);
- Any hospital or other medical institution referred to in sec. 10(23C)(via);
- Mutual Fund referred to in sec. 10(23D);
- Securitisation trust referred to in sec. 10(23DA);
- Investor Protection Fund referred to in sec. 10(23EC) or sec. 10(23ED);
- Core Settlement Guarantee Fund referred to in sec. 10(23EE);
- Venture Capital Company or Venture Capital Fund referred to in sec. 10(23FB);

- Trade union or an association of such union referred to in sec. 10(24);
- Body or authority or Board or Trust or Commission referred to in sec. 10(46) or 10(29A);
- Infrastructure debt fund referred to in sec. 10(47),

must file a return, if the total income without giving effect to the provisions of sec. 10, exceeds the maximum amount which is not chargeable to income-tax.

Penalty: Where an assessee fails to file return of income under this section, within the time limit, it shall be liable to pay a penalty of ₹ 100 per day during which such failure continues [Sec. 272A(2)].

3.11 RETURN OF INCOME BY A UNIVERSITY/ COLLEGE ETC. [SEC. 139(4D)]

Every University, college or other institutions referred to in sec. 35(1)(ii) or (iii) is required to furnish a return in respect of income or loss irrespective of size of income or loss.

3.12 RETURN OF INCOME OF A BUSINESS TRUST [SEC. 139(4E)]

Every business trust, which is not required to furnish return of income or loss under any other provisions of this section, shall furnish the return of its income in respect of its income or loss in every previous year and all the provisions of this Act shall, so far as may be, apply if it were a return required to be furnished u/s 139(1).

3.13 RETURN OF INCOME OF INVESTMENT FUND [SEC. 139(4F)]

Every investment fund referred to in sec. 115UB, which is not required to furnish return of income or loss under any other provisions of this section, shall furnish the return of income in respect of its income or loss in every previous year and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished u/s 139(1)

3.14 REVISED RETURN [SEC. 139(5)]

If an assessee discovers any omission or wrong statement (bonafide in nature) in the return filed, he can revise his return u/s 139(5).

Time limit: Assessee may file the revised return -

- before the end of the relevant assessment year; or
- before completion of regular assessment,

- whichever is earlier.

Notes

- a) **Replacement of original return:** Once a revised return is filed, it replaces the earlier return. This signifies that the revised return should be complete in itself and not merely an accessory to the original return.



- b) **Revision of revised return:** A revised return can again be revised i.e. a second revised return can be filed u/s 139(5) for correcting any omission or wrong statement made in the first revised return within specified time.
- c) **Revision of belated return:** A belated return u/s 139(4) can be revised.
- d) **Revision of loss return:** A loss return can be revised
- e) Return filed pursuant to notice u/s 142(1) cannot be revised.

3.15 DEFECTIVE RETURN [SEC. 139(9)]

When a return is termed defective - A return of income is said to be defective where all the following conditions are not fulfilled:

- The return is furnished without paying self-assessment tax along with interest, if any.
- The annexure, statements and columns in the return of income have been duly filled in.
- The return is accompanied by the following documents -
 - a. a statement showing the computation of tax liability;
 - b. the audit report u/s 44AB (where the report has been submitted prior to the furnishing of return, a copy of audit report together with proof of furnishing the report);
 - c. the proof of tax deducted or collected at source, advance tax paid and tax paid on self-assessment;
 - d. where regular books of account are maintained by the assessee:
 - i. copies of Manufacturing A/c, Trading A/c, Profit and Loss A/c or Income and Expenditure A/c or any other similar account and Balance Sheet;
 - ii. in the case of -
 - A proprietary business or profession - the personal account of the proprietor;
 - A firm, AOP or BOI - personal account of the partners or members; or
 - A partner or member of the firm, AOP or BOI - his personal account in the firm, association of persons or body of individuals;where regular books of account are not maintained by the assessee -
 - e. where regular books of account are not maintained by the assessee:
 - i. a statement indicating the amount of turnover or gross receipts, gross profit, expenses and net profit of the business or profession and the basis on which such amount have been computed; and
 - ii. the amount of sundry debtors, sundry creditors, stock and cash balance as at the end of the previous year.
 - f. where the accounts of the assessee have been audited, copies of the audited Profit and Loss A/c, Balance Sheet and a copy of the Auditor's report;
 - g. Cost audit report u/s 233B of the Companies Act, 1956 (if any).

Effect: Where the Assessing Officer considers that the return of income furnished by the taxpayer is defective, he may intimate the defect to the taxpayer and give him an opportunity to rectify the defect(s).

Time limit for rectification: The assessee must rectify the error within a period of 15 days from the date of intimation (served on the assessee) or within such extended time as allowed by the Assessing Officer. Where the taxpayer rectifies the defect after the expiry of the period of 15 days or such extended period but before the assessment is completed, the Assessing Officer can condone such delay.

Consequence when defect is not rectified: If defect is not rectified within the time limit, the Assessing Officer will treat the return as an invalid return and provisions of the Act will apply as if the taxpayer had failed to furnish the return at all.

Note: Currently, the assessee is required to furnish paper-less return. i.e., no documents, proof or report (other than some specified report required to be furnished electronically) is required to be attached with return of income. In this regard, return of income shall not be considered as defective return. However, the assessee should retain these documents, proof or report with himself. If called for by the income-tax authority during any proceeding, it shall be incumbent upon the assessee to furnish/produce the same.

3.16 VERIFICATION OF RETURN [SEC. 140]

The return of income is required to be verified:

Assessee	Case	Verified by
Individual	In general	Individual himself
	Where the individual concerned is absent from India	Individual himself or by the duly authorized person of such individual
	Where the individual is mentally incapacitated	Guardian of such individual or any other person competent to act on his behalf
	Where by any other reason it is not possible for the individual to verify the return.	Any person duly authorised by him
	Note: When return is verified by any authorised person in that case the return should be accompanied with power of attorney.	
HUF	In general	Karta
	Where the 'karta' is absent from India or is mentally incapacitated	Any adult member of the family.
Firm	In general	Managing partner
	If due to any reason it is not possible for managing partner to verify or where there is no managing partner	Any adult partner
Limited liability partnership	In general	Designated partner
	If due to any unavoidable reason such designated partner is not able to verify the return, or where there is no designated partner as such	Any partner
Local authority	Principal Officer	
Political party	Chief Executive Officer	
Company	In general	Managing Director (MD)
	If due to any reason it is not possible for MD to verify or where there is no MD	Any director



	Where an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under Insolvency and Bankruptcy Code, 2016	Insolvency professional appointed by such Adjudicating Authority
	Non-resident company	A person holding a valid power of attorney. Copy of such power of attorney must be attached with the return.
	Company in process of winding up	Liquidator of the company
	Where the management of the company has been taken over by the Central or State Government.	Principal officer
Any other association	Any member or principal officer	
Any other person	Such person or any other person competent to act on its behalf.	

3.17 QUOTING OF AADHAAR NUMBER [SEC. 139AA]

Every person who is eligible to obtain Aadhaar number shall quote Aadhaar number:

- in the application form for allotment of permanent account number;
- in the return of income:

Note:

- Where the person does not possess the Aadhaar Number, the Enrolment ID of Aadhaar application form issued to him at the time of enrolment shall be quoted.
- Every person who has been allotted PAN before 01-07-2017 and who is eligible to obtain Aadhaar number, shall intimate his Aadhaar number to such authority on or before specified date. In case of failure to intimate the Aadhaar number, the PAN allotted to the person shall be deemed to be invalid.
- The provisions of this section shall not apply to notified persons or State

STUDY NOTE : 4

ASSESSMENT PROCEDURE



This Study Note includes:

- 4.1 Self-Assessment [Sec. 140A]
- 4.2 Intimation or Assessment by Income tax department
- 4.3 Inquiry before assessment
- 4.4 Intimation / Assessment by Assessing Officer
- 4.5 Intimation [Sec. 143(1)]
- 4.6 Scrutiny Assessment u/s 143(3)
- 4.7 New Scheme for Scrutiny [Sec. 143(3A) to (3C)]
- 4.8 Best Judgment Assessment [Sec. 144]
- 4.9 Power of Joint Commissioner to issue directions in certain cases [Sec. 144A]
- 4.10 Reference to Dispute Resolution Panel [Sec. 144C]
- 4.11 Income Escaping Assessment [Sec. 147]
- 4.12 Period excluded from time limit for completion of assessment [Expl. 1 to sec. 153]
- 4.13 Rectification of Mistake [Sec.154]
- 4.14 Demand Notice [Sec.156]

Assessment means to assess the income of the assessee i.e. to decide the income and tax liability of the assessee on the basis of return filed, information gathered or to the best of judgment of income tax department. It begins with self-assessment i.e. assessment by the assessee himself.

4.1 SELF-ASSESSMENT [SEC. 140A]

In self-assessment, assessee itself is responsible to determine its taxable income, tax liability and to pay tax accordingly. Provision of sec. 140A is as follows -

- a) Where any tax is payable (after deducting relief, rebate, advance payment of tax or tax deducted or collected at source or MAT or AMT credit, if any) on the basis of return furnished the assessee is required to pay such tax before filing the return.

Taxpoint: A return furnished without paying self-assessment tax & interest, if any, shall be treated as defective return.

- b) If any interest is payable for delayed filing of return (u/s 234A) or default in payment of advance tax (u/s 234B) or for deferment of advance tax (u/s 234C) or fee (u/s 234F) is payable for filing return after due date, then such interest or fee should be paid along with self-assessment tax.

Note: While calculating above interest for the purpose of self-assessment, tax on the total income declared in the return shall be considered.



- c) Where the amount paid by the assessee falls short of the aggregate of tax, interest and fee, the amount so paid shall first be adjusted towards fee and thereafter towards interest payable and the balance, if any, shall be adjusted towards tax payable.
- d) After assessment, any amount paid under this section shall be deemed to have been paid towards such assessment.
- e) If an assessee fails to pay whole or any part of such tax or interest or both in accordance with the provisions of sec. 140A, he shall be deemed to be an assessee in default.

4.2 INTIMATION OR ASSESSMENT BY INCOME TAX DEPARTMENT

After submission of return or on non-submission of return by the assessee, assessment is made by the Income tax department. The Assessing Officer can assess the income of the assessee in any of the following manner:

1. **Intimation u/s 143(1);**
2. **Scrutiny Assessment u/s 143(3);**
3. **Best Judgment Assessment u/s 144;**
4. **Income Escaping Assessment u/s 147**

For making assessment, the Assessing Officer can make an inquiry. Provision relating to inquiry before assessment are as under:

4.3 INQUIRY BEFORE ASSESSMENT

1. **Issue of notice to the assessee [Sec. 142(1)]**
 - to submit a return [Sec. 142(1)(i)]
 - to produce accounts, documents etc. [Sec. 142(1)(ii) & (iii)]
2. **Making inquiry [Sec. 142(2)]**
3. **Giving direction to get books of account audited [Sec. 142(2A) to (2D)]**
4. **Opportunity of being heard [Sec. 142(3)]**
5. **Estimate by Valuation Officer in certain cases [Sec. 142A]**

Issue of notice to the assessee [Sec. 142(1)]

For the purpose of making assessment, the Assessing Officer may serve a notice on any person -

- who has submitted a return u/s 139; or
- in whose case the time allowed u/s 139(1) for furnishing the return has expired.

Such notice may relate to any of the following matter -

1. **Notice to submit a return [Sec. 142(1)(i)]:** If the assessee has not submitted a return of income within specified time, the Assessing Officer may require him to submit a return in the prescribed form on or before the date specified in the notice.

Taxpoint: In case assessee has not furnished the return of income, it is not mandatory for the Assessing Officer to issue notice u/s 142(1)(i) if he wishes to make best judgment assessment.

2. **Notice to produce accounts, documents etc. [Sec. 142(1)(ii)]:** The Assessing Officer may ask the assessee to produce such documents or accounts as he may require.

Exception: Assessing Officer shall not require the production of any accounts pertaining to a period more than 3 years prior to the previous year.

3. **Notice to furnish information [Sec. 142(1)(iii)]:** Assessing Officer may require the assessee to furnish in writing information in such form and on such points or matters as he may require (including a statement of all assets and liabilities of the assessee, whether included in the accounts or not). However, prior approval of the Joint Commissioner shall be obtained before requiring the assessee to furnish a statement of all assets and liabilities not included in the accounts.

Taxpoint: Notice u/s 142(1)(i) can be served only if return has not been submitted where as notice u/s 142(1)(ii) & (iii) can be served whether return has been furnished or not.

Making inquiry [Sec. 142(2)]

For the purpose of obtaining full information in respect of the income (or loss) of any person, the Assessing Officer may make such inquiry, as he considers necessary.

Taxpoint: U/s 142(1) Assessing Officer collects information from the assessee, however u/s 142(2) Assessing Officer has the power to collect information from any source.

Giving direction to get books of account audited [Sec. 142(2A) to (2D)]

The Assessing Officer (after giving reasonable opportunity to the assessee) may direct the assessee to get his accounts audited if he is of the opinion that it is necessary to do so 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 specialised nature of business activity of the assessee; and
- interest of revenue.

Such direction can be issued even if the accounts of the assessee have already been audited u/s 44AB or any other law for the time being in force

Notes

- a. Such direction can be issued only with the prior approval of the Principle Chief Commissioner / Principle Commissioner / Chief Commissioner / Commissioner.
- b. The Principle Chief Commissioner / Principle Commissioner / Chief Commissioner / Commissioner nominates such auditor.
- c. Such order can be issued at any stage of the proceedings before the Assessing Officer. However, no such order shall be issued after the completion of assessment/reassessment.

Time Limit for audit report: The audit report shall be furnished by the assessee within the period specified by the Assessing Officer. The Assessing Officer has power to extend such period on an application made by the assessee or suo motu. However, the aggregate period (fixed originally and extended) shall not exceed 180 days from the date on which such direction is received by the assessee.

Form of audit report: The chartered accountant shall submit the report in Form 6B to the assessee. Thereafter such report is to be submitted by the assessee to the Assessing Officer within such period as allowed by the Assessing Officer.

Audit fees: The audit fees and audit expenditure shall be determined by the Principle Chief Commissioner / Principle Commissioner / Chief Commissioner / Commissioner (which shall be final) and paid by the Central Government.



Consequences of failure to get books of account audited: In case assessee fails to get books of account audited, it -

- will be liable to Best Judgment Assessment u/s 144; and
- attracts penalty and prosecution.

Note: Penalty etc. are attracted only if there is a default by the assessee. If accountant nominated by the Commissioner refuses to audit the accounts, the assessee cannot be held responsible

Opportunity of being heard [Sec. 142(3)]

The assessee must be given an opportunity of being heard in respect of any material gathered on the basis of any inquiry u/s 142(2) or any audit u/s 142(2A) and is proposed to be utilised for the purpose of the assessment.

Note: Sec. 142(3) shall not be applicable in case of assessment u/s 144.

Estimation by Valuation Officer in certain cases [Sec. 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 a copy of report to him.
 - "Valuation Officer" has the same meaning as in clause (r) of section 2 of the Wealth-tax Act, 1957
- ♦ 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.
- ♦ The Valuation Officer, on a reference made, shall, for the purpose of estimating the value of the asset, property or investment, have all the powers that he has under section 38A of the Wealth-tax Act, 1957.
- ♦ The Valuation Officer shall, estimate the value of the asset, property or investment after taking into account such evidence as the assessee may produce and any other evidence in his possession gathered, after giving an opportunity of being heard to the assessee.
- ♦ The Valuation Officer may estimate the value of the asset, property or investment to the best of his judgment, if the assessee does not co-operate or comply with his directions.
- ♦ The Valuation Officer shall send a copy of the report of the estimate made to the Assessing Officer and the assessee, within a period of 6 months from the end of the month in which a reference is made.
- ♦ The Assessing Officer may, on receipt of the report from the Valuation Officer, and after giving the assessee an opportunity of being heard, take into account such report in making the assessment or reassessment.

4.4 INTIMATION / ASSESSMENT BY ASSESSING OFFICER

The Assessing Officer makes the following order:

Intimation [Sec. 143(1)]

On the basis of return filed; or

Regular assessment

- On the basis of further evidence gathered by him [Scrutiny Assessment u/s 143(3)]
- On the basis of best of his judgement [Best Judgement Assessment u/s 144]

4.5 INTIMATION [SEC. 143(1)]

Where a return has been made u/s 139 or in response to a notice u/s 142(1), such return shall be processed in the following manner, namely:—

- a. the total income or loss shall be computed after making the following adjustment:
 - i. any arithmetical error in the return;
 - ii. an incorrect claim, if such incorrect claim is apparent from any information in the return;
 - iii. disallowance of loss claimed, if return of the previous year for which set off of loss is claimed was furnished after the due date;
 - 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 u/s 10AA, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID or 80-IE, if the return is furnished after the due date; or

Such adjustments shall not be made unless an intimation is given to the assessee of such adjustments either in writing or in electronic mode. The response received from the assessee, if any, shall be considered before making any adjustment, and in a case where no response is received within 30 days of the issue of such intimation, such adjustments shall be made.

- b. the tax, interest and fee, if any, shall be computed on the total income computed above;
- c. the sum payable by (or the amount of refund due to), the assessee shall be determined after adjustment of the tax, interest and fee, if any, by any TDS, TCS, advance tax paid, any relief, tax paid on self-assessment and any amount paid otherwise by way of tax, interest or fee;
- 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, the assessee; and
- e. the amount of refund due to the assessee in pursuance of the determination shall be granted to the assessee.
- f. 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 or interest or fee is payable by, or no refund is due to, him.

Time limit for intimation: No intimation shall be sent after the expiry of 1 year from the end of the financial year in which the return is made. The period of limitation will run from the date of filing of latest revised return.

Notes

- An incorrect claim apparent from any information in the return shall mean a 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 the information required to be furnished under this Act to substantiate such entry has not been so furnished; 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;
- The acknowledgment of the return shall be deemed to be intimation where either no sum is payable by the assessee or no refund is due to him.
- In case, where refund becomes due to the assessee u/s 143(1) and the Assessing Officer is of the opinion, having regard to the fact that a notice has been issued u/s 143(2) in respect of such return, that the grant of the refund is



likely to adversely affect the revenue, he may, for reasons to be recorded in writing and with the previous approval of the Principal Commissioner or Commissioner, as the case may be, withhold the refund up to the date on which the assessment is made [Sec. 241A]

4.6 SCRUTINY ASSESSMENT U/S 143(3)

Where the Assessing Officer or the prescribed income-tax authority (here-in-after collectively referred to as 'Assessing Officer') considers it necessary to ensure that the assessee has not -

- understated his income; or
- declared excessive loss; or
- under paid the tax,

he can make a scrutiny in this regard and gather such information and evidence as he deems fit. And on the basis of such information and evidence so collected, he shall pass an assessment order. Such order shall be treated as regular assessment order.

Conditions for scrutiny assessment

- A return has been furnished u/s 139 or in response to a notice u/s 142(1); and
- Assessing Officer considers it necessary or expedient to ensure that the assessee has not understated his income, declared excessive loss or under-paid the tax.

Procedure

Notice for scrutiny [Sec. 143(2)]

Assessing Officer shall serve on the assessee a notice requiring the assessee, on a date specified in the notice, to produce, or cause to be produced, any evidence on which assessee may rely, in support of the return.

Time limit of notice

No notice shall be served on the assessee after the expiry of 6 months from the end of the financial year in which the return is furnished.

Order

After collecting such information and hearing such evidence as the assessee produces in response to the notice u/s 143(2) and after taking into account all relevant materials, which the Assessing Officer has gathered;

The Assessing Officer shall, by an order in writing, make an assessment of the 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.

Time limit for completion of scrutiny assessment

Assessment u/s 143(3) should be completed within 12 months from the end of the relevant assessment year..

Special procedure in case of research association etc. [Proviso to Sec. 143(3)]

Applicable to

- Research association referred in sec. 10(21);

- News agency referred in sec. 10(22B);
 - Association or institution referred in sec. 10(23A);
 - institution referred in sec. 10(23B);
 - fund or institution referred in sec. 10(23C)(iv);
 - trust or institution referred in sec. 10(23C)(v);
 - any university or other educational institution referred in sec. 10(23C)(vi);
 - any hospital or other medical institution referred in sec. 10(23C)(via)
 - any university or college u/s 35(1)(ii) or (iii)
- which is required to furnish the return of income u/s 139(4C) or (4D)

Assessment Order

An order for assessment of such assessee shall be made after giving effect to the provisions of sec. 10. However in the following case assessment of such assessee shall be made without giving effect to the provisions of sec. 10—

- a. The Assessing Officer has intimated the Central Government or the prescribed authority about contravention made by above assessee of respective provision of sec. 10 on the basis of which exemption has been granted; and
- b. Approval granted to such assessee has been withdrawn or rescinded by such authority.

Note: No effect shall be given by the Assessing Officer to the provisions of sec. 10(23C) in the case of a trust or institution for a previous year, if the provisions of the first proviso to sec. 2(15) become applicable in the case of such person in such previous year, whether or not the approval granted to such trust or institution or notification issued in respect of such trust or institution has been withdrawn or rescinded.

4.7 NEW SCHEME FOR SCRUTINY [SEC. 143(3A) TO (3C)]

- ♦ The Central Government may make a scheme for the purposes of making assessment of total income or loss of the assessee u/s 143(3) so as to impart greater efficiency, transparency and 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 Central Government may, for the purpose of giving effect to the scheme, direct (within 31-03-2020) that any of the provisions of this Act relating to assessment of total income or loss shall not apply or shall apply with such exceptions, modifications and adaptations.
- ♦ Every notification issued shall, as soon as may be after the notification is issued, be laid before each House of Parliament.

4.8 BEST JUDGMENT ASSESSMENT [SEC. 144]

Under this section, assessment shall be made by the Assessing Officer to the best of his judgment after considering all relevant materials which he has gathered.



Assessing Officer cannot reduce the tax liability of the assessee by assessment under this section.

Taxpoint: A refund cannot be granted u/s 144.

Situation in which it is applicable: In the following situations assessment shall be made under this section -

- If the person fails to file the return u/s 139(1), 139(4) or 139(5); or
- If the person fails to comply with the terms of notice u/s 142(1); or
- If the person fails to comply with the directions u/s 142(2A) requiring him to get his accounts audited; or
- If the person fails to comply with the terms of notice u/s 143(2), requiring his presence or production of evidence and documents.

Note: In any of the given situation, the Assessing Officer is under an obligation to make an assessment under this section. In other words, Best judgment assessment is not the discretionary power of the Assessing Officer but mandatory in nature.

Opportunity of being heard

The assessment u/s 144 can only be made after giving the assessee a reasonable opportunity of being heard. Such opportunity shall be given by serving a "Show cause notice" calling upon the assessee to show cause(s), on a date and time specified in the notice, why the assessment should not be completed to the best of judgment of the Assessing Officer.

Exception: Such opportunity need not be given, where notice u/s 142(1) has already been issued.

Time limit for completion of assessment [Sec. 153(1)]

12 months from the end of relevant assessment year

Other points

Non-maintenance of proper accounts: As per sec. 145(3), if the Assessing Officer is not satisfied with the correctness or the completeness of the accounts of the assessee or if no regular method of accountancy or accounting standards [as notified by the Central Government u/s 145(2)] is followed by the assessee, the Assessing Officer may make an assessment in the manner provided u/s 144.

4.9 POWER OF JOINT COMMISSIONER TO ISSUE DIRECTIONS IN CERTAIN CASES [SEC. 144A]

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
- Having regard to the nature of the case or the amount involved or for any other reason,
- issue such directions as he thinks fit for the guidance of the Assessing Officer to enable him to complete the assessment and such directions shall be binding on the Assessing Officer.

Note: Directions, which are prejudicial to the assessee, shall not be issued without giving the assessee an opportunity of being heard. However, direction of investigation shall not be deemed to be a direction prejudicial to the assessee.

4.10 REFERENCE TO DISPUTE RESOLUTION PANEL [SEC. 144C]

The dispute resolution mechanism presently in place is time consuming and finality in high demand cases is attained

only after a long drawn litigation till Supreme Court. Flow of foreign investment is extremely sensitive to prolonged uncertainty in tax related matter. Therefore, the Income-tax Act is amended to provide for an alternate dispute resolution mechanism which will facilitate expeditious resolution of disputes in a fast track basis. The provision relating to alternate dispute resolution mechanism are as under:

1. The Assessing Officer shall, in the first instance, forward a draft of the proposed order of assessment (hereafter in this section referred to as the draft order) to the eligible assessee[#] if he proposes to make 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 the variation referred to arises as a consequence of the order of the Transfer Pricing Officer passed u/s 92CA(3); and
 - (ii) Any foreign company
2. On receipt of the draft order, the eligible assessee shall, within 30 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 3 Commissioners of Income-tax constituted by the Board for this purpose.

3. The Assessing Officer shall complete the assessment on the basis of the draft order, if:
 - (a) The assessee intimates to the Assessing Officer the acceptance of the variation; or
 - (b) No objections are received within 30 days as specified above.

Time limit for passing of order: The Assessing Officer shall pass such order within 1 month from the end of the month in which,—

- (i) The acceptance is received; or
- (ii) The period of filing of objections (i.e. 30 days) expires.

The time limit is irrespective of time limit given u/s 153 (or 153B) for passing an assessment order.

4. 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.
5. The Dispute Resolution Panel shall issue the directions, for guidance of the Assessing Officer, after considering the following:
 - 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 it; and
 - g. Result of any enquiry made by it.
6. The Dispute Resolution Panel may, before issuing any 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.



7. The Panel may confirm, reduce or enhance the variations proposed in the draft order so, however, that it shall not set aside any proposed variation or issue any direction for further enquiry and passing of the assessment order.
8. If the members of the Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.
9. Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer.
10. No direction shall be issued unless an opportunity of being heard is given to the assessee and the Assessing Officer on such directions which are prejudicial to the interest of the assessee or the interest of the revenue, respectively.
11. No direction shall be issued after 9 months (irrespective of any limitation given u/s 153) from the end of the month in which the draft order is forwarded to the eligible assessee.
12. Upon receipt of the directions, the Assessing Officer shall, in conformity with the directions, complete, the assessment without providing any further opportunity of being heard to the assessee, within 1 month from the end of the month in which the direction is received.
13. The provisions of this section shall not apply to any assessment or reassessment order passed by the Assessing Officer with the prior approval of the Principal Commissioner or Commissioner as provided in sec. 144BA
14. The Board may make rules for the efficient functioning of the Dispute Resolution Panel and expeditious disposal of the objections filed by the eligible assessee.

4.11 INCOME ESCAPING ASSESSMENT [SEC. 147]

The Assessing Officer may assess or reassess an income, if he has reason to believe[#] that such income though chargeable to tax has escaped assessment^{\$} for any assessment year.

Taxpoint: A reassessment proceeding may end without creating a tax liability.

^{\$} Income chargeable to tax has escaped assessment

Following shall deem to be the cases where income chargeable to tax has escaped assessment -

1. Where no return of income has been furnished by the assessee although his total income (or the total income of any other person in respect of which he is assessable under this Act) exceeded the maximum amount which is not chargeable to tax;
2. Where a return of income has been furnished by the assessee but no assessment has been made and 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;
3. Where the assessee has failed to furnish a report in respect of any international transaction which he was so required u/s 92E;
4. Where an assessment has been made, but—
 - income chargeable to tax has been under-assessed; or
 - such income has been assessed at too low a rate; or
 - such income has been subject to excessive relief under this Act; or
 - excessive loss or depreciation allowance or any other allowance under this Act has been computed.
5. Where a return of income has not been furnished by the assessee or a return of income has been furnished by him and on the basis of information or document received from the prescribed income-tax authority, u/s 133C(2), it is

noticed by the Assessing Officer that the income of the assessee exceeds the maximum amount not chargeable to tax, or as the case may be, the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return.

6. Where a person is found to have any asset (including financial interest in any entity) located outside India.

Reason to believe escapement: Sec. 147 can be applied only on 'reason to believe' that income chargeable to tax has escaped assessment. It cannot be applied merely on suspicion, gossip or rumour. There must be nexus between material and belief. Furthermore, before issuing any notice for assessment or reassessment, Assessing Officer must record the reasons for doing so.

Treatment of new information subsequently found

Once an assessment has been reopened, any income -

- which has escaped assessment; and
- which comes to the notice of the Assessing Officer subsequently,

may also be included in the assessment in the course of the proceedings of this section.

Taxpoint: The Assessing Officer may include other income irrespective of the fact that such issues have not been included in the reasons recorded u/s 148.

When can a reassessment proceeding be dropped [Sec. 152(2)]

Where an assessment is reopened u/s 147 and the assessee -

- a) has not opposed any part of the original assessment order for that year either u/s 246 to 248 or u/s 264; and
 - b) shows that he had been assessed on an amount or to a sum not lower than what he would be rightly liable for even if the income alleged to have escaped assessment had been taken into account, or the assessment or computation had been properly made.
- then the proceedings u/s 147 shall be dropped.

Rate of taxation [Sec. 152(1)]

If an assessment/reassessment is made u/s 147, then tax shall be chargeable at the rates at which it would have been charged had the income not escaped assessment.

Issue of notice [Sec. 148]

Before making the assessment u/s 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.

Note: Notice u/s 148 cannot be issued during pendency of assessment proceedings

Time limit for notice [Sec. 149]

Notice u/s 148 can be issued subject to the following time limit—

Time limit for issue of notice	Size of escaped income	Person authorised to issue notice
Where assessment has already been completed u/s 143(3) or 147		
Upto 4 years from the end of the relevant assessment year	Any amount	Any Assessing Officer with the permission of Joint Commissioner.



Beyond 4 years and upto 6 years from the end of relevant assessment year.	₹ 1,00,000 or more	Assessing Officer after approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.
Where assessment has not been completed u/s 143(3) or 147		
Upto 4 years from the end of relevant assessment year.	Any amount	Any Assessing Officer with the permission of Joint Commissioner.
Beyond 4 years and upto 6 years from the end of relevant assessment year.	₹ 1,00,000 or more	Assessing Officer after approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.
If the person on whom a notice u/s 148 is to be served, is a person treated as the agent of a non-resident u/s 163		
Up to 6 years from the end of relevant assessment year.	Escaped income is of any amount	Assessing Officer
Taxpoint: The above time limit is for issuance of notice and not for service of notice. If the notice is issued within the above time limit but served to the assessee after the above time limit, shall be a valid notice.		

Exceptions to the above time limit

- Where an assessment u/s 143(3) or 147 has been made for the relevant assessment year, no action shall be taken under this section after the expiry of 4 years from the end of relevant assessment year, unless any income chargeable to tax has escaped assessment by reason of failure on the part of the assessee -

- to file a return u/s 139 or in response to a notice issued u/s 142(1) or u/s 148; or
- to disclose fully and truly all material facts necessary for his assessment for that assessment year.

Note:

- The aforesaid exception is not applicable where any income in relation to any asset (including financial interest in any entity) located outside India, chargeable to tax, has escaped assessment for any assessment year
 - Production before the Assessing Officer of books of account or other evidence from which material evidence could, with due diligence, have been discovered by the Assessing Officer will not necessarily amount to disclosure within the meaning of the foregoing proviso.
- Where the income in relation to any asset (including financial interest in any entity) located outside India, chargeable to tax, has escaped assessment, notice shall be issued upto 16 years from the end of the relevant assessment year,
 - As per sec. 150(1), the notice u/s 148 may be issued at any time for the purpose of making assessment or reassessment in consequence of or to give effect to any findings or directions contained in an order passed by -
 - any authority in any proceedings under this Act by way of appeal, reference or revision; or
 - a court in any proceeding under any other law.

Exception

The provisions shall not apply in any case where any such assessment (reassessment or recomputation) relates to an assessment year in respect of which an assessment (reassessment or recomputation) could not have been made at the time the order which was the subject-matter of the appeal, reference or revision, as the case may be, was made by reason of aforesaid time-limitation.

General Notes

- The mere fact that the case of the assessee was accepted as correct in the original assessment for an assessment

- year does not preclude the Assessing Officer from reopening that assessment on the basis of his findings of fact from fresh materials obtained in the course of assessment for the next assessment year
2. An opinion of the auditor regarding application or interpretation of law is not information and as such reassessment based on opinion of auditor is invalid.
 3. Facts pointed out by the audit report (which were not known to the ITO when he made the original assessment) constitute information u/s 147 and hence ITO can reopen the assessment proceedings
 4. In the course of reassessment proceeding u/s 147, the Assessing Officer was not competent to make fishing enquiries on concluded matters
 5. Reassessment cannot be done on matters concluded by an order u/s 154, 155, 260, 262 or 263.
 6. It is settled law that unless the return of income already filed is disposed of, notice for reassessment cannot be issued.

Time limit for completion of assessment u/s 147

No order of assessment, reassessment shall be made u/s 147 after the expiry of 9¹ months from the end of the financial year in which notice u/s 148 was served

4.12 PERIOD EXCLUDED FROM TIME LIMIT FOR COMPLETION OF ASSESSMENT [EXPL. 1 TO SEC. 153]

In computing the time limitation for completion of assessment, following period shall be excluded —

1. 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 sec. 129; or
2. Period during which the assessment proceeding is stayed by an order or injunction of a court; or
3. Period commencing from the date on which the Assessing Officer intimates under proviso to sec. 143(3) to the Central Government or the prescribed authority, the contravention of the provisions of sec. 10(21) or (22B) or (23A) or (23B) or (23C)(iv) or (23C)(v) or (23C)(vi) or (23C)(via), and ending with the date on which the copy of the order withdrawing the approval or rescinding the notification, as the case may be, under those clauses is received by the Assessing Officer;
4. Period commencing from the date on which the Assessing Officer directs the assessee to get his accounts audited u/s 142(2A) and ending with the last date on which the assessee is required to furnish a report of such audit (where such direction is challenged before a court, ending with the date on which the order setting aside such direction is received by the Commissioner); or
5. Period commencing from the date on which the Assessing Officer makes a reference to the Valuation Officer u/s 142A and ending with the date on which the report of the Valuation Officer is received by the Assessing Officer; or
6. In a case, where an application made before the Settlement Commission u/s 245C is rejected, the period commencing from the date on which such application is made and ending with the date on which the rejection order is received by the Principal Commissioner or Commissioner; or
7. Period commencing from the date on which an application is made before the Authority for Advance Rulings u/s 245Q and ending with the date on which the order rejecting the application is received by the Principal Commissioner or Commissioner; or

¹ Where the notice u/s 148 is served on or after 01-04-2019, no order of assessment, reassessment shall be made u/s 147 after the expiry of 12 months from the end of the financial year in which notice u/s 148 was served.



8. Period commencing from the date on which an application is made before the Authority for Advance Rulings u/s 245Q and ending with the date on which the order of the advance ruling pronounced by the authority is received by the Principal Commissioner or Commissioner; or
9. Period (maximum period of 1 year) commencing from the date on which a reference (or first reference, if many references are made) for exchange of information is made by an authority competent under an agreement referred to in sec. 90 / 90A and ending with the date on which the information so requested is last received by the Principal Commissioner or Commissioner; or
10. Period commencing from the date on which a reference for declaration of an arrangement to be impermissible avoidance arrangement is received by the Principal Commissioner or Commissioner u/s 144BA(1) and ending on the date on which a direction u/s 144BA (3) or (6) or an order u/s 144BA(5) is received by the Assessing Officer

Note: However, where immediately after the exclusion of the aforesaid time or period, the period available to the Assessing Officer for making an assessment, is less than 60 days, such remaining period shall be extended to 60 days.

Taxpoint

- Where the period available to the Transfer Pricing Officer is extended to 60 days [as per proviso to sec. 92CA(3A)] and the period of limitation available to the Assessing Officer for making an order of assessment (reassessment or recomputation) is less than 60 days, such remaining period shall also be extended to 60 days.
- Where a proceeding before the Settlement Commission abates u/s 245HA, the period of limitation available to the Assessing Officer for making an order of assessment (reassessment or recomputation) shall, after the exclusion of the period u/s 245HA(4), deemed to have been extended to 1 year

Summary of time limit for various purposes [Sec. 153]

Particulars	Section	Time limit
Intimation of summary assessment	143(1)	Must be send within 1 year from the end of financial year in which return of income is filed.
Issuance of notice for scrutiny assessment	143(2)	Must be served within 6 months from the end of the financial year in which return of income is filed.
Completion of Scrutiny assessment u/s 143(3) Completion of Best judgment assessment u/s 144	153(1)	Assessment must be completed within 18 months (from A.Y. 2019-20: 12 months) from the end of the relevant assessment year.
Issuance of notice for Income escaping assessment u/s 147	149	Notice must be issued within 6 years (maximum; 6years, in some cases 16 years) from the end of the relevant assessment year.
Completion of Income escaping assessment u/s 147	153(2)	Assessment must be completed within 9 months from the end of the financial year in which notice for such assessment u/s 148 was served.

Fresh Assessment [Sec. 153(3)]

An order of fresh assessment in pursuance of an order u/s 254, 263 or 264 may be made for setting aside or canceling an assessment.

Time limit for making fresh assessment -

In case of the order passed	Time limit
U/s 254	Within 9* months from the end of the financial year in which such order is received by the Principal Chief Commissioner or Principal Commissioner or Chief Commissioner or Commissioner.
U/s 263 or 264	Within 9** months from the end of the financial year in which such order is passed by the Principal Commissioner or Commissioner.

Note: Where an order is cancelled, then fresh assessment shall be made under the same section [like 143(3) or 144] in which the original assessment was passed. .

4.13 RECTIFICATION OF MISTAKE [SEC.154]

An income-tax authority, is empowered (suo moto or on application by assessee) to -

- rectify any mistake apparent in an order passed by him; or
- amend any intimation issued u/s 143(1) or deemed intimation
- amend any intimation issued u/s 200A(1) or 206CB(1).

Taxpoint: Such order of rectification must be passed in writing.

Time limit for Rectification [Sec. 154(7)]

Within 4 years from the end of the financial year in which the order sought to be amended was passed.

However, in respect of an application made by the assessee or deductor or collector, the authority shall, within a period of 6 months from the end of the month in which the application is received by it, pass an order -

- making the amendment; or
- refusing to allow the claim.

Opportunity of being heard [Sec. 154(3)]: If such rectification order is prejudicial to the assessee or deductor or collector, an opportunity of being heard must be given to the assessee, before passing such order.

Taxpoint

- Where any such amendment has the effect of reducing the assessment or otherwise reducing the liability of the assessee or the deductor or collector, the Assessing Officer shall make any refund which may be due to such assessee or the deductor or collector.
- Where any such amendment has the effect of enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee or the deductor or collector, the Assessing Officer shall serve on the assessee or the deductor or collector, as the case may be a notice of demand in the prescribed form specifying the sum payable, and such notice of demand shall be deemed to be issued u/s 156.
- Mistake apparent from record may be a mistake of fact or mistake of law.

* Where such order is received on or after 01-04-2019: Within 12 months

** Where such order is passed on or after 01-04-2019: Within 12 months



4.14 DEMAND NOTICE [SEC.156]

On completion of assessment, a demand notice is served for additional demand raised in the assessment.

Time limit for payment of tax: The assessee should make the payment of amount demanded within 30 days of service of notice [Sec. 220(1)] Where the Assessing Officer has any reason to believe that it will be detrimental to revenue if the full period of 30 days is allowed, then he may with the previous approval of the Joint Commissioner direct that the sum specified in the notice of demand shall be paid within such time as may be specified by him in the notice.

Interest on delay in payment: If the payment is not made within 30 days (or time allowed in the notice), interest shall be payable @ 1% for every month (or part thereof) of the delay [Sec. 220(2)]

An assessee in default shall be liable to a penalty of an amount not exceeding the amount of tax in arrears. [Sec. 221(1)]

Note: Where any sum is determined to be payable by the assessee or by the deductor or collector u/s 143(1) or 200A(1) or 206CB(1), the intimation under those sections shall be deemed to be a notice of demand for the purposes of this section.

STUDY NOTE : 5

INTEREST



This Study Note includes:

- 5.1 Interest for failure to deduct and pay tax at source [Sec. 201(1A)]
- 5.2 Interest for failure to collect and pay tax at source [Sec. 206C(7)]
- 5.3 Interest for default in furnishing return of income [Sec. 234A]
- 5.4 Interest for default in paying advance tax [Sec. 234B]
- 5.5 For deferment of Advance Tax [Sec. 234C]
- 5.6 Interest for excess refund granted to the assessee [Sec. 234D]
- 5.7 Fee for defaults in furnishing statements [Sec. 234E]
- 5.8 Fee for default in furnishing return of income [Sec. 234F]
- 5.9 Interest for failure to pay tax according to demand notice [Sec. 220(2)]
- 5.10 Waiver or reduction of interest u/s 234A, 234B & 234C
- 5.11 Interest payable to the assessee

Interest payable by the assessee

1. For failure to deduct and pay tax at source [Sec. 201(1A)]
2. For failure to collect and pay tax at source [Sec. 206C(7)]
3. For default in furnishing return of income [Sec. 234A]
4. For default in paying advance tax [Sec. 234B]
5. For deferment of advance tax [Sec. 234C]
6. For excess refund granted to the assessee [Sec. 234D]
7. For failure to pay tax according to demand notice [Sec. 220(2)]

Interest receivable by the assessee

Interest receivable by the assessee on refund [Sec. 244A]

Important notes regarding calculation of interest

Following points are to be noted regarding calculation of interest, whether such interest is receivable from or payable to the Central Government (Rule 119A):

1. Rounding off the amount on which interest is to be calculated

Amount on which such interest is calculated will be rounded off to the multiple of 100 by ignoring any fraction of 100. E.g., amount on which interest is to be calculated is ₹ 240 or ₹ 290, then it is to be rounded off to ₹ 200 by ignoring fraction of ₹ 40 or ₹ 90.

2. Rounding off the period for which interest is to be calculated

- When interest is calculated on monthly basis, any fraction of the month shall be taken as full month. E.g., Interest is to be calculated from 1st August to 5th December, then interest shall be calculated for 5 months.
- When interest is calculated on annual basis, any fraction of the month shall be ignored.

**5.1 INTEREST FOR FAILURE TO DEDUCT AND PAY TAX AT SOURCE [SEC. 201(1A)]**

Condition: Where a person, responsible for deducting tax at source, fails to -

- (a) deduct tax at source; or
- (b) deposit such tax after deducting the same.

Amount on which interest is to be charged: On the amount of such tax.

Rate of Interest:

Period	Rate of Interest
From the date on which such tax was deductible to the date on which such tax is deducted	Simple interest @ 1% per month or part thereof
From the date on which such tax was deducted to the date on which such tax is actually paid	Simple interest @ 1.50% per month or part thereof

Period: From the date on which such tax was deductible to the date on which such tax is actually paid.

Note: In case any person fails to deduct such tax on the sum paid or payable to a resident but is not deemed to be an assessee in default (as per first proviso to sec. 201(1)), the interest shall be payable from the date on which such tax was deductible to the date of furnishing of return of income by such resident.

5.2 INTEREST FOR FAILURE TO COLLECT AND PAY TAX AT SOURCE [SEC. 206C(7)]

Condition: Where a person, responsible for collecting tax at source, fails to -

- (a) collect tax at source; or
- (b) deposit such tax after collecting the same.

Amount on which interest is to be charged: On the amount of such tax

Rate of Interest: Simple interest @ 1% per month or part thereof

Period: From the date on which such tax was collectible to the date on which such tax is actually paid.

Note: Any person (other than seller of bullion or jewellery), responsible for collecting tax, fails to collect such tax on the amount received or receivable from a buyer or licensee or lessee but is not deemed to be an assessee in default (as per First proviso of sec. 206C(6A)), the interest shall be payable from the date on which such tax was collectible to the date of furnishing of return of income by such buyer or licensee or lessee.

5.3 INTEREST FOR DEFAULT IN FURNISHING RETURN OF INCOME [SEC. 234A]

Condition: Where a person, who is required to furnish return of income -

- a) fails to furnish a return; or
- b) furnishes it after the due date specified u/s 139(1).

Amount on which interest is to be charged: On the amount of tax determined u/s 143(1) or on regular assessment as reduced by advance tax paid and tax deducted or collected at source, if any.

INTEREST

In other words, interest is to be calculated on the following amount:

Particulars	Amount	Amount
Tax determined u/s 143(1) or on Regular assessment*		***
Less: Advance Tax paid	***	
Relief u/s 90 or 90A or 91	***	
Credit allowed u/s 115JAA / 115JD (MAT or AMT Credit)	***	
Tax deducted/collected at source	***	***
Amount for interest calculation		***

* Regular Assessment means assessment u/s 143(3)/144/147 (first time)/153A(first time).

Rate of Interest: Simple interest @ 1% per month or part thereof

Period: For every month or part of a month commencing from the day immediately following the due date for furnishing return for the relevant assessment year and ending on -

- Where the return is furnished after due date : Date of furnishing return
- Where the return is not furnished at all : Date of completion of assessment u/s 144

Notes

1. For the purpose of self-assessment u/s 140A, interest shall be calculated on tax liability as declared in the return by the assessee.
2. As interest liability u/s 234A is different, in case of assessment by assessee himself (i.e. self- assessment) and assessment made by income tax authority (i.e. assessment u/s 143(1) or regular assessment), therefore, interest paid u/s 234A at the time of self-assessment shall be reduced from final interest liability u/s 234A.
3. Interest shall not be charged where delay in filing return is due to strike in income-tax department
4. The liability u/s 234A, 234B & 234C is automatic and the question of granting opportunity of being heard does not arise
5. Demand notice for interest u/s 234A, 234B & 234C shall not be issued unless assessment order contains such levy
6. **Reassessment:** Where -
 - a) a return of income is required to be furnished due to notice u/s 148 or 153A (second and subsequent time); &
 - b) assessee fails to furnish such return within time allowed under that section or fails to furnish return of income at all,

- then, assessee shall be liable to pay simple interest @ 1% for every month or part thereof.

Amount on which interest is to be charged: On the amount by which tax on total income as per sec.147, exceeds the tax on the total income determined on the basis of earlier assessment

Period: Commencing on the day immediately following the expiry of the time allowed under that notice and ending on -

- Where the return is furnished after the expiry of : Date of furnishing return time allowed
- Where the return is not furnished at all : Date of completion of reassessment u/s 147 or 153A

7. **Adjustment in interest:** Where tax payable is reduced or increased by an order u/s 154, 155, 245D, 250, 254, 260, 262, 263 & 264, the amount of interest shall be reduced or increased accordingly.



ILLUSTRATION 1

Calculate interest u/s 234A in the following cases –

Name of the assessee	A	A Ltd.	B
Due date of furnishing return	31st July	30th September	31st July
Date of filing return	4th December	30th January	Not filed
Date of completion of assessment	1st March	15th April	15th February
Income as per return	₹ 5,80,000	₹ 5,00,000	--
Assessed Income	₹ 6,10,000	₹ 5,50,000	₹ 12,00,000
Advance tax paid	₹ 10,000	₹ 25,000	₹ 80,000
Tax deducted at source	₹ 10,000	₹ 15,000	₹ 80,000
Tax paid along with return	₹ 6,000	₹ 1,50,000	--

Also state interest payable u/s 234A for the purpose of sec.140A. Ignore interest under any other section.

Solution

Computation of interest u/s 234A

Particulars	Code	A	A Ltd.	B
Period of default	A [#]	5 months (Aug. to Dec.)	4 months (Oct. to Jan.)	7 months (Aug. to Feb.)
Assessed Income	B	6,10,000	5,50,000	12,00,000
Tax rate	C	Slab-rate	30%	Slab rate
Tax liability before surcharge	D=B×C	34,500	1,65,000	1,72,500
Rate of Surcharge	E	Nil	Nil	Nil
Surcharge	F=D×E	Nil	Nil	Nil
Tax and surcharge payable	G=D+F	34,500	1,65,000	1,72,500
Health & Education cess	H=G×4%	1,380	6,600	6,900
Tax liability on assessed income	I=G+H	35,880	1,71,600	1,79,400
Less: Advance tax paid & tax deducted at source	J	20,000	40,000	1,60,000
Shortfall	K=I-J	15,880	1,31,600	19,400
Rounded off	L	15,800	1,31,600	19,400
Interest (1% × A × L)		795	5,264	1,358

Note: Tax paid along with return shall not be reduced while computing interest u/s 234A

Computation of interest u/s 234A for the purpose of sec.140A

Name of the assessee	Code	A	A Ltd.
Period of default	A [#]	5 month (Aug. to Dec.)	4 months (Oct. to Jan.)
Returned Income	B	5,80,000	5,00,000
Tax rate	C	Slab-rate	30%

Tax liability before surcharge	$D = B \times C$	28,500	1,50,000
Rate of Surcharge	E	Nil	Nil
Surcharge	$F = D \times E$	Nil	Nil
Tax & surcharge on above	$G = D + F$	28,500	1,50,000
Health & Education cess	$H = G \times 4\%$	1,140	6,000
Tax liability on assessed income	$I = G + H$	29,640	1,56,000
Less: Advance tax paid & tax deducted at source	J	20,000	40,000
Shortfall	$K = I - J$	9,640	1,16,000
Rounded off	L	9,600	1,16,000
Interest ($1\% \times A \times L$)		480	4,640

It is to be noted that when interest is calculated on monthly basis, any fraction of the month shall be taken as full month.

Note: In case of B, return has not been filed, hence interest payable u/s 234A at the time of self-assessment cannot be computed.

5.4 INTEREST FOR DEFAULT IN PAYING ADVANCE TAX [SEC. 234B]

Condition: Where a person, who is required to pay advance tax, fails to pay -

- (a) advance tax at all; or
- (b) 90% of assessed tax as advance tax.

Amount on which interest is to be charged –

Particulars	Interest
Where no tax is paid u/s 140A	Assessed tax [#] – Advance tax paid
Where tax is paid u/s 140A	
Period upto the date on which tax as per self-assessment is paid	Assessed tax – Advance tax paid
Period after the date on which the tax as per self assessment is paid	Assessed Tax – Advance tax paid - Tax paid on Self Assessment*
[#] Assessed tax means tax determined u/s 143(1) or Regular assessment as reduced by - Tax deducted or collected at source; - Relief allowed u/s 90 or 90A or 91; - Credit allowed u/s 115JAA or 115JD (MAT or AMT Credit)	
[*] Where amount paid under self-assessment falls short of tax and interest calculated as per self-assessment, then amount paid shall be first adjusted towards interest and balance, if any, shall be adjusted towards tax payable.	

Rate of interest: Simple interest @ 1% per month or part thereof

Period: For every month or part of a month commencing from 1st day of April of the relevant assessment year and ending on the date of determination of tax u/s 143(1) or on regular assessment.

**Notes**

- For the purpose of self-assessment u/s 140A, interest shall be calculated on tax as per income shown in the return.
- As interest liability u/s 234B is different in case of assessment by assessee himself (i.e. self-assessment) and assessment made by income tax authority (i.e. assessment u/s 143(1), regular assessment), therefore interest paid u/s 234B at the time of self-assessment shall be reduced from final interest liability u/s 234A.
- Reassessment:** Where as a result of an order of reassessment or recomputation u/s 147 or 153A, the amount on which interest is payable is increased, the assessee shall be liable to pay simple interest @ 1% for every month or part thereof.

Amount on which interest is to be charged: Such interest shall be payable on the amount by which tax on total income exceeds the tax on total income determined on the basis of earlier assessment.

Period -

Commencing on : 1st day of the relevant assessment year

Ending on : Date of the reassessment or recomputation u/s 147 or 153A.

- Adjustment in interest:** Where tax payable is reduced or increased by an order u/s 154, 155, 245D, 250, 254, 260, 262, 263 & 264, the amount of interest shall be reduced or increased accordingly.

ILLUSTRATION 2

A firm furnished its return of income on 30th June, 2019 showing income of ₹ 1,00,000. The return shows other particulars as follows -

Advance tax ₹ 20,000

TDS ₹ 1,000

The AO passed the assessment order enhancing income by ₹ 5,000 on 29-3-2020. Compute interest u/s 234B.

Solution

Computation of interest u/s 234B

Particulars	Amount
Assessed Income	1,05,000
Tax liability before surcharge [₹ 1,05,000 * 30%]	31,500
Add: Health & Education cess @ 4%	1,260
Tax and cess payable	32,760
Less: Tax deducted at source	1,000
Assessed tax	31,760
90% of above	28,584
Advance tax paid	20,000
Since advance tax paid by the firm is less than 90% of assessed tax, sec. 234B is applicable	
Shortfall (Assessed tax less Advance tax paid)	11,760
Rounded off	11,700
Period of default [From April 2019 to March 2020]	12 months
Interest u/s 234B (1% x ₹ 11,700 x 12)	1,404

ILLUSTRATION 3

How shall your answer differ if the assessee pays ₹ 10,200 as self assessment tax along with return. Ignore interest u/s 234C.

Solution

Computation of interest u/s 234B

Particulars	As per	
	Assessed income	Returned income
Income	1,05,000	1,00,000
Tax on above (including cess)	32,760	31,200
Less: TDS and Advance tax	21,000	21,000
Shortfall for the period April' 2019 to June' 2019	11,760	10,200
Rounded off (a)	11,700	10,200
Period of default (b) [From April '2019 to June '2019]	3 months	3 months
Interest u/s 234B (1% x a x b)	351	306
Shortfall for the period July' 2019 to March' 2020	1,806	
(₹ 11,700 – ₹ 9,894 as paid u/s 140A) [Note]	1,800	
Rounded off (c)	9 months	
Period of default (d) [From July' 2019 to March' 2020]	162	
Interest u/s 234B (1% x c x d)		

Note

Since, shortfall till June 2019 is ₹ 11,760 and thereafter assessee has paid ₹ 9,894 [i.e. ₹ 10,200 (amount paid u/s 140A) – ₹ 306 (interest u/s 234B for the purpose of sec.140A)], hence interest shall be calculated on the following -

For the period April' 19 to June' 19 - On ₹ 11,760

For the period July' 19 to March' 20 - On ₹ 1,806

Statement showing interest payable u/s 234B

Particulars	Amount
For the period April to June	351
For the period July to March	162
	513
Less: Interest paid on self assessment	306
Interest payable	207

5.5 FOR DEFERMENT OF ADVANCE TAX [SEC. 234C]

Condition: Payment of advance tax is to be made as per the schedule (mentioned in the chapter "Advance Tax"). In case assessee fails to pay the amount or pays lesser amount as required by the schedule, then assessee will have to pay interest u/s 234C for such deferment.

**Amount on which interest is payable:**

Specified % of tax* on the total income declared in the return filed by the assessee	***
Less: Tax deducted/collected at source	***
Less: Amount of advance tax paid on or before the due date of payment as per the advance tax payment schedule.	***
Less: Relief allowed u/s 90 or 90A or 91	***
Less: Credit allowed u/s 115JAA or 115JD (MAT or AMT Credit)	***
Amount on which interest shall be calculated	***

* Specified % of tax for calculation of interest under this section

Assessee	Due date of installment (of previous year)	Minimum amount payable
An eligible assessee in respect of an eligible business referred to in sec. 44AD or 44ADA	On or before March 15	100% of advance tax liability
Other Assessee	On or before June 15	Upto 15% of advance tax liability
	On or before September 15	Upto 45% of advance tax liability
	On or before December 15	Upto 75% of advance tax liability
	On or before March 15	Upto 100% of advance tax liability

Notes

- Where an assessee has paid 12% or more of tax as advance tax on or before June 15, then no interest u/s 234C is payable.
- Where an assessee has paid 36% or more of tax as advance tax on or before September 15, then no interest u/s 234C is payable.

Rate of interest: Simple interest @ 1% per month or part thereof

Period: 3 months (1 month for last instalment)

Other Points

No interest will be levied in respect of any shortfall in the payment of advance tax due on the returned income, if -

- The shortfall is on account of under-estimation or failure to estimate the amount of:
 - capital gains; or
 - income of the nature referred to in section 2(24)(ix) [i.e. lottery, cross-word, etc.];
 - 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; or
 - income of the nature referred to in sec. 115BBDA (i.e., dividend in excess of specified limit)
- The assessee has paid the whole of the amount of tax payable in respect of such income as part of the remaining installment(s) of advance tax which were due or where no installment is due, by March 31 of the previous year.

ILLUSTRATION 4

A firm made the following payments of advance tax during the financial year 2018-19:

	₹ in lakh
September 15, 2018	7.00
December 15, 2018	7.75
March 15, 2019	10.75
	25.50

The return of income is filed on 31-7-2019 showing -

Business income	₹ 80 lakh
Long term capital gain taxable @ 20% (as on 1-12-2018)	₹ 10 lakh

Compute interest payable u/s 234C.

Solution

Computation of tax liability for A.Y. 2019-20

₹ in lakh

Particulars	Business income	Long term capital gain
Income	80.00	10.00
Tax rate	30%	20%
Tax liability before cess	24.00	2.00
Add: Health & Education cess	0.96	0.08
Tax liability including cess	24.96	2.08

Computation of interest payable u/s 234C

Particulars	Installment of Advance tax			
	15/6/2018	15/9/2018	15/12/2018	15/3/2019
Rate of Advance tax	15%	45%	75%	100%
Amount payable (24,96,000 x 15%)	3,74,400			
(24,96,000 x 45%)		11,23,200		
[(24,96,000 + 2,08,000) x 75%]			20,28,000	
[(24,96,000 + 2,08,000) x 100%]				27,04,000
Less: Amount paid till date	Nil	7,00,000	14,75,000	25,50,000
Shortfall	3,74,400	4,23,200	5,53,000	1,54,000
Rounded off (a)	3,74,400	4,23,200	5,53,000	1,54,000
Period of default (b)	3 months	3 months	3 months	1 month
Interest (1% x a x b)	₹ 11,232	₹ 12,696	₹ 16,590	₹ 1,540
Total interest payable u/s 234C	₹ 42,058			



ILLUSTRATION 5

A Ltd. made the following payments of advance tax during the financial year 2018-19 :

	₹ in lakh		₹ in lakh
June 15, 2018	3.70	September 15, 2018	3.50
December 15, 2018	10.25	March 18, 2019	8.80

The return of income is filed on 31-7-2019 showing -

Business income	₹ 80 lakh
Long term capital gain taxable @ 20% (as on 1-12-2018)	₹ 10 lakh

Compute interest payable u/s 234C.

Solution

Computation of tax liability for A.Y. 2019-20

(₹ in lakh)

Particulars	Business income	Long term capital gain
Income	80.00	10.00
Tax rate	30%	20%
Tax liability before surcharge	24.00	2.00
Add: Surcharge	Nil	Nil
Tax liability after surcharge	24.00	2.00
Add: Education cess	0.96	0.08
Tax liability after surcharge and cess	24.96	2.08

Computation of interest payable u/s 234C

Particulars	Installment of Advance tax			
	15/6/2018	15/9/2018	15/12/2018	15/3/2019
Rate of Advance tax	15%	45%	75%	100%
Amount payable (24,96,000 x 15%)	3,74,400			
(24,96,000 x 45%)		11,23,200		
[(24,96,000 + 2,08,000) x 75%]			20,28,000	
[(24,96,000 + 2,08,000) x 100%]				27,04,000
Less: Amount paid till date	3,70,000	7,20,000	17,45,000	17,45,000 ³
Shortfall	Nil	4,03,200	2,83,000	9,59,000
Rounded off (a)	Nil	4,03,200	2,83,000	9,59,000
Period of default (b)	--	3 months	3 months	1 month
Interest (1% x a x b)	--	₹ 12,096	₹ 8,490	₹ 9,590
Total interest payable u/s 234C		₹ 30,176		

- Since assessee has paid at least 12% of tax (i.e. ₹ 2,99,520) on or before 15th June, 2018, hence no interest u/s 234C shall be levied.

2. Since assessee fails to pay 36% of tax (i.e. ₹ 8,98,560) on or before 15th September, 2018, hence interest u/s 234C shall be levied. It is to be noted that interest shall be payable considering 45% of tax.
3. As payment has not been made within due date, hence advance tax paid on 18-03-2019 has not been considered.

5.6 INTEREST FOR EXCESS REFUND GRANTED TO THE ASSESSEE [SEC. 234D]

Condition: Where any refund is granted to the assessee u/s 143(1) and –

- a) no refund is due on regular assessment; or
- b) the amount refunded exceeds the amount refundable on regular assessment;

Rate of interest: Simple interest @ $\frac{1}{2}\%$ for every month or part of the month

Amount on which interest is to be charged: On the whole or excess amount refunded

Period: From the date of grant of refund to the date of such regular assessment

Adjustment in interest: Where amount of refund is reduced or increased by an order u/s 154, 155, 245D, 250, 254, 260, 262, 263 & 264, the amount of interest shall be reduced or increased accordingly.

5.7 FEE FOR DEFAULTS IN FURNISHING STATEMENTS [SEC. 234E]

Condition: Where a person fails to deliver a quarterly TDS / TCS return within the prescribed time.

Amount of Fee: ₹ 200 for every day during which the failure continues subject to maximum of amount of TDS / TCS

Note:

- The fee shall be paid before delivering a statement.
- The fee is in addition to other consequences of non-delivering such return

5.8 FEE FOR DEFAULT IN FURNISHING RETURN OF INCOME [SEC. 234F]

Where a person required to furnish a return of income u/s 139, fails to do so within the due date, he shall pay fee of:

Case	Fee
Total income does not exceed ₹ 5 lakh	₹ 1,000
Total income exceeds ₹ 5 lakh	
- If the return is furnished on or before 31st December of the assessment year	₹ 5,000
- In any other case	₹ 10,000

5.9 INTEREST FOR FAILURE TO PAY TAX ACCORDING TO DEMAND NOTICE [SEC. 220(2)]

Any amount specified as payable in a notice of demand u/s 156 should be paid within 30 days (or lesser period as specified by the Assessing Officer with prior approval of Joint Commissioner) of the service of the notice.



Condition: Any person fails to pay such amount within such time

Rate of interest: Simple interest @ 1% for every month or part thereof.

Amount on which interest is to be charged: On the amount specified in the notice of demand.

Period: Interest shall be charged for a period commencing from the day immediately after the expiry of 30 days (or specified period¹) and ending on the day on which such amount is paid.

Note

1. Where the Assessing Office has any reason to believe that it will be detrimental to revenue if the full period of 30 days is allowed, then he may with the previous approval of the Joint Commissioner direct that the sum specified in the notice of demand shall be paid within such time as may be specified by him in the notice. In such case interest shall be calculated for a period commencing from the period specified in the notice.
2. Where interest is charged u/s 201(1A) on the amount of tax specified in the intimation issued u/s 200A(1) for any period, then, no interest shall be charged under this section on the same amount for the same period. Similarly, where interest is charged u/s 206C(7) on the amount of tax specified in the intimation issued u/s 206CB(1) for any period, then, no interest shall be charged under this section on the same amount for the same period.
3. Adjustment in interest: Where amount of refund is reduced or increased by an order u/s 154, 155, 250, 254, 260, 262, 264 & 245D, the amount of interest shall be reduced or increased accordingly.
4. 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 the appeal by the last appellate authority or disposal of the proceedings, as the case may be.

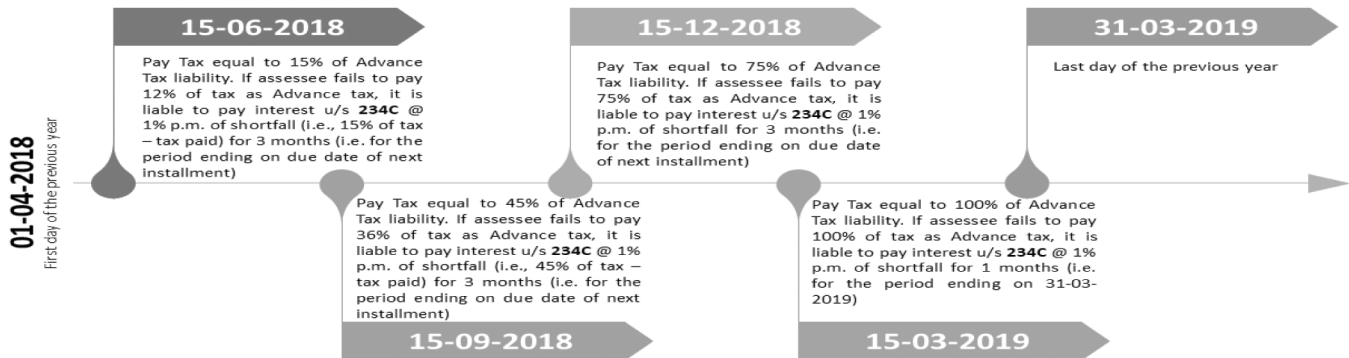
Summary of Interest payable

Dates	Interest liability of an assessee		
01-04-2018	First day of the Previous Year		
15-06-2018	Pay Tax equal to 15% of Advance Tax liability. If assessee fails to pay 12% of tax as Advance tax, it is liable to pay interest u/s 234C @ 1% p.m. of shortfall (i.e., 15% of tax – tax paid) for 3 months (i.e. for the period ending on due date of next installment)		
15-09-2018	Pay Tax equal to 45% of Advance Tax liability. If assessee fails to pay 36% of tax as Advance tax, it is liable to pay interest u/s 234C @ 1% p.m. of shortfall (i.e., 45% of tax – tax paid) for 3 months (i.e. for the period ending on due date of next installment)		
15-12-2018	Pay Tax equal to 75% of Advance Tax liability. If assessee fails to pay 75% of tax as Advance tax, it is liable to pay interest u/s 234C @ 1% p.m. of shortfall for 3 months (i.e. for the period ending on due date of next installment)		
15-03-2019	Pay Tax equal to 100% of Advance Tax liability. If assessee fails to pay 100% of tax as Advance tax, it is liable to pay interest u/s 234C @ 1% p.m. of shortfall for 1 months (i.e. for the period ending on 31-03-2019)		
31-03-2019	Last day of the Previous Year		
01-04-2019	First day of Asst. Year	If assessee fails to pay 90% of assessed tax within 31-03-2019, it is liable to pay interest u/s 234B @ 1% p.m. of shortfall from 01-04-2019 to date of completion of assessment.	
31-07-2019 / 30-09-2019 / 30-11-2019	Due Date of furnishing return ¹ . If assessee fails to furnish its return of income within this date, it is liable for payment of interest u/s 234A @ 1% p.m. of shortfall (i.e. Assessed tax less TDS, Advance Tax and other Relief) from day after this date to date of furnishing return (upto completion of assessment, if return is not furnished at all)		

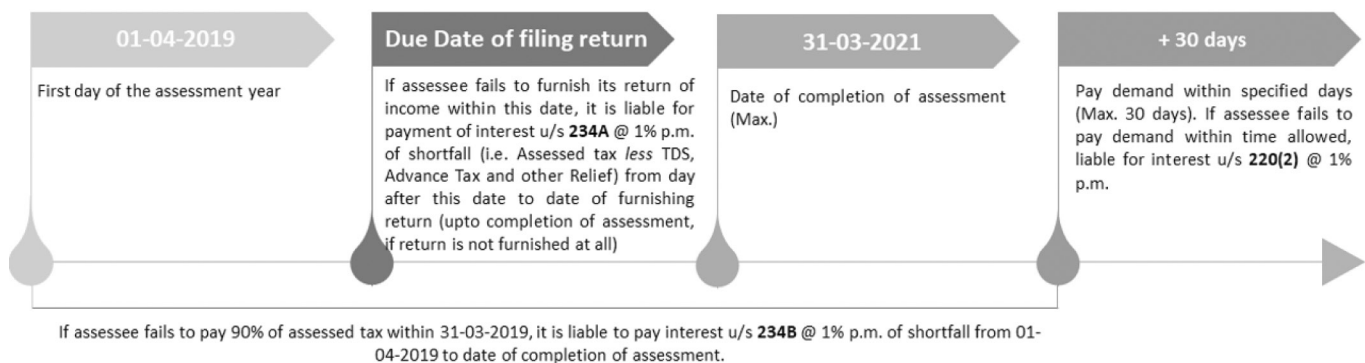
¹ In some cases, 30th November

31-03-2021	Date of completion of assessment (Max.)
	Pay demand within specified days (Max. 30 days)
	If assessee fails to pay demand within time allowed, liable for interest u/s 220(2) @ 1% p.m.

Summary of Interest payable



Interest payable for the period after previous year



5.10 WAIVER OR REDUCTION OF INTEREST U/S 234A, 234B & 234C

- The Chief Commissioners and the Directors-General (Investigation) is empowered to reduce or waive penal interest u/s 234A, 234B and 234C in the following circumstances* -
 - Where, in the course of search and seizure operation, books of account have been taken over by the Department and were not available to the taxpayers to prepare his return of income.
 - Where, in the course of search and seizure operation, cash had been seized, which was not permitted to be adjusted against arrears of tax or payment of advance tax installments falling due after the date of the search.
 - Any income other than capital gains which was received or accrued after the date of first or subsequent installment of advance tax, which was neither anticipated nor contemplated by the taxpayer and on which advance tax was paid by the taxpayer after the receipt of such income.
 - Where, as a result of any retrospective amendment of law or the decisions of the Supreme Court after the end of the relevant previous year, certain receipts, which were earlier treated as exempted income, now become taxable.



- e) Where return of income is filed voluntarily without detection by the Income tax Department and due to circumstances beyond control of the taxpayer such return of income was not filed within the stipulated time-limit or advance tax was not paid at the relevant time.

* The above circumstances are indicative only.

2. The Chief Commissioner of Income Tax/Director-General are empowered to waive or reduce interest u/s 234A, 234B and 234C on income which accrues or arises for any previous year due to the operation of any order of a Court, statutory authority or of the Government (other than an order of assessment, appeal reference or revision passed under the provisions of the Income tax Act) passed after the close of the said previous year [Order F. No. 212/495/92-ITA-II dt. 2-5-1994]

Notes

- a) Board can grant relief u/s 234A, 234B or 234C
- b) Settlement Commission does not have the power to waive or reduce interest u/s 234A or 234B or 234C
- c) Waiver of interest can be considered only if the return of income is filed voluntarily without detection by the Assessing Officer.

5.11 INTEREST PAYABLE TO THE ASSESSEE

Interest on refund [Sec. 244A]

An assessee who is entitled to get refund shall also be entitled to interest on such refund. Provision relating to interest is enumerated below -

Rate of interest: Simple interest @ $\frac{1}{2}\%$ per month or part thereof

Period for calculation of interest

Case	Period
1. Refund is out of TDS or TCS or Advance tax (Note 1)	
– Where return of income is furnished within due date	From first day of relevant assessment year to the date on which such refund is granted.
– Where return is after due date	From the date of furnishing return to the date on which such refund is granted.
2. Refund is out of self-assessment tax (Note 1)	From the date of furnishing return or payment of tax, whichever is later to the date on which such refund is granted.
3. Refund due to any other reason	From date of payment of such tax to the date on which such refund is granted.
4. Refund due to excess payment of TDS by deductor	From the date on which claim for refund is made (however, where refund arise on account of giving effect to an order u/s 250 or 254 or 260 or 262, from date of payment of tax) to the date on which refund is granted.

Notes

1. **Interest on refund due to TDS or TCS:** In case (1) and (2), no interest on refund shall be allowed if the amount of refund is less than 10% of the tax determined u/s 143(1) or on regular assessment.

- 2. Interest on Refund arising out of giving effect to an order:** In a case where a refund arises as a result of giving effect to an order u/s 250 or 254 or 260 or 262 or 263 or 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 (as aforesaid), an additional interest on such amount of refund calculated at the rate of 3% p.a., for the period beginning from the date following the date of expiry of the time allowed u/s 153(5) [i.e., 3 months from the end of the month in which appellate order is received by the CIT) to the date on which the refund is granted
- 3. Taxability of refund and interest on refund:** It is to be noted that refund of tax itself is not taxable. However, interest received on delayed refund is taxable under the head "Income from other sources".
- 4. Adjustment in interest:** Where tax payable is reduced or enhanced by an order u/s 143(3), 144, 147, 154, 155, 250, 254, 260, 262, 263, 264 & 245D(4), the amount of interest shall be reduced or enhanced accordingly.
- 5. Delay in refund due to reason attributable to the assessee:** Where the refund are delayed for the reason attributable to the assessee (or deductor), the period of delay so attributable to him shall be excluded from the period for which interest is payable. Further, where any question arises as to the period to be excluded, it shall be decided by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner whose decision shall be final.



STUDY NOTE : 6

SURVEY, SEARCH AND SEIZURE



This Study Note includes:

- 6.1 Power regarding discovery, production of evidence, etc. [Sec. 131]
- 6.2 Search and Seizure [Sec. 132]
- 6.3 Powers to requisition books of account, assets, etc. [Sec. 132A]
- 6.4 Application of seized or requisitioned assets [Sec. 132B]
- 6.5 Release of asset [First Proviso to sec. 132B]
- 6.6 Power to call for information [Sec. 133]
- 6.7 Power of Survey [Sec. 133A]
- 6.8 Power to collect certain information [Sec. 133B] (Door to door survey)
- 6.9 Power to call for information by prescribed income-tax authority [Sec. 133C]
- 6.10 Power to inspect registers of companies [Sec. 134]
- 6.11 Power of certain authorities [Sec. 135]
- 6.12 Proceedings before income-tax authorities to be judicial proceedings [Sec.136]
- 6.13 Disclosure of information in respect of assessee [Sec. 138]
- 6.14 Assessment in case of Search or requisition [Sec. 153A]
- 6.15 Assessment of income of any other person [Sec. 153C]
- 6.16 Time limit for completion of assessment [Sec. 153B]

6.1 POWER REGARDING DISCOVERY, PRODUCTION OF EVIDENCE, ETC. [SEC. 131]

Power of income tax authority while trying a suit

The income-tax authority [being Assessing Officer, Deputy Commissioner (Appeals), Joint Commissioner, Commissioner (Appeal), Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner and the Dispute Resolution Panel] 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 —

- 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 other documents; and
- d) Issuing commissions

**Power before initiating search and seizure u/s 132 [Sec. 131(1A)]**

The income-tax authority [being Principal Director-General or Director-General or Principal Director or Director or Joint-Director or Assistant Director or Deputy Director or any authorized officer referred u/s 132(1)] before taking any action u/s 132, can exercise above power if he 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 and for the purposes of making any enquiry or investigation relating thereto, it shall be competent for him to exercise above powers.

Taxpoint:

- Above action can be taken even though no proceedings with respect to such person is pending before any income-tax authority.
- In case inquiry (even no proceedings are pending) or investigation is related to an agreement referred to in sec. 90 or 90A, such power can be exercised by any notified income-tax authority (not below the rank of Assistant Commissioner) [Sec. 131(2)]

Power to impound or retain books [Sec. 131(3)]

Any income tax authority [referred in sec. 131(1) or (1A) or (2)] may impound and retain in its custody any books of account or other documents produced before it in any proceedings under this Act. However, an Assessing Officer or an Assistant Director or Deputy Director shall **not** -

- a) Impound any books of account or other documents without recording his reasons for doing so; or
- b) Retain in his custody any such books or documents for a period exceeding 15 days (exclusive of holidays) without obtaining (prior) approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Principal Commissioner or Commissioner or Principal Director or Director.

6.2 SEARCH AND SEIZURE [SEC. 132]**Who can authorize (i.e., issue search warrants) proceedings u/s 132**

Sec.132 empowers 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 to authorize proceedings under this section.

Taxpoint: Proceeding means any proceeding in respect of any year, 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 which may be commenced after such date in respect of any year.

Circumstances when search can be conducted

Any authority (mentioned above) can direct proceedings u/s 132 against the following person where he has **reason to believe** (in consequence of information in his possession, which is something more than mere rumor or gossip) that:

Person	Circumstances
Any person to whom a summons u/s 131(1) or a notice u/s 142(1) was issued to produce any books of account or other documents	Such person has omitted or failed to do so
Any person to whom a summons or notice as aforesaid has been or might be issued	Such person will fail to do so

Any person is in possession of any money, bullion, jewellery or other valuable article or thing	Such money, bullion, jewellery or other valuable article or thing represents either wholly or partly undisclosed income or undisclosed property

Taxpoint: 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.

Who can conduct search

Income tax authority, having power to initiate search u/s 132, can authorise its subordinate(s) (not below the rank of Income tax officer) to conduct search. Following subordinates can be authorised -

Authorized Officer who can conduct search	Authorized from
Additional Director or Additional Commissioner or Joint Director, Joint Commissioner, Assistant Director, Deputy Director, Assistant Commissioner, Deputy Commissioner or Income tax officer	Principal Director General or Director General or Principal Director or Director or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner
Assistant Director, Deputy Director, Assistant Commissioner, Deputy Commissioner or Income tax officer	Additional Director or Additional Commissioner or Joint Director or Joint Commissioner (on the basis of authorization from above authority and being empowered by the Board)

Power of authorized officer

While conducting search, authorized officer has following powers -

- a. **Enter and search any building, etc.:** Enter and search any building, place, vessel, vehicle or aircraft where he has reason to suspect that such books of account, other documents, money, bullion, jewellery or other valuable article or thing are kept.
- b. **Break open the lock of any door, etc.:** Break open the lock of any door, box, locker, safe, almirah or other receptacle, where the keys thereof are not available.
- c. **Search person:** Search any person who -
 - has got out of; or
 - is about to get into; or
 - is in,
 the building, place, vessel, vehicle or aircraft if the authorised officer has reason to suspect that such person has secreted about his person any books of account, other documents, money, bullion, jewellery or other valuable article or thing.
- d. **Require any person to facilitate the authorised officer:** Require any person who is found to be in possession or control of any books of account or other documents maintained in the form of electronic record, to afford the authorised officer the necessary facility to inspect such books of account or other documents.
- e. **Seizure:** Seize any such books of account, other documents, money, bullion, jewellery or other valuable article or thing found as a result of such search.
- f. **Place marks of identification:** Place marks of identification on any books of account or other documents or make extracts or copies therefrom.
- g. **Make inventory:** Make a note or an inventory of any such money, bullion, jewellery or other valuable article or thing.
- h. **Examine on oath:** Examine on oath any person who is found to be in possession or control of any books of account,



documents, money, bullion, jewellery or other valuable article or thing. Any statement made by such person during such examination may thereafter be used as evidence in any proceeding.

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 connected with any proceeding under Act

Taxpoint

♦ No seizure of stock in trade

Bullion, jewellery or other valuable article or thing, being stock-in-trade of the business, shall not be seized but the authorized officer shall make a note or inventory of such stock-in-trade.

♦ Extension of jurisdictional area

- Where any building, place, vessel, vehicle or aircraft is within the area of jurisdiction of any Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, but such authority has no jurisdiction over such person; and
- Such authority has reason to believe that any delay in getting the authorisation from the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner having jurisdiction over such person may be prejudicial to the interests of the revenue,

- then it shall be competent for him to exercise the above powers.

Handing over of seized assets to the Assessing Officer having jurisdiction: Any asset or document so seized shall be handed over to the Assessing Officer having jurisdiction over such person within a period of 60 days from the date on which the last of the authorizations for search was executed. Thereafter, such Assessing Officer exercises all other powers.

♦ Extension of Authorisation [Sec. 132(1A)]

- Where a search for any books of account, other document, money, bullion, jewellery or other valuable article or thing is authorized; and
- Other Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner in consequence of information in his possession, has reason to suspect that such document or asset is kept in any other building, place, vessel, vehicle or air craft not mentioned in the authorization,

- then such other Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner can authorize the officer to search such other building, place, vessel, vehicle or air craft.

Taxpoint: 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.

♦ Deemed or constructive Seizure [Second Proviso to Sec. 132(1)]

Conditions

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 reason of its -

- volume, weight or other physical characteristics; or
- being of a dangerous nature.

Procedure

The authorised officer may serve an order on -

- the owner; or
- the person who is in immediate possession or control of any valuable article or things,

- that he shall not remove, part with or otherwise deal with such article or thing without the prior permission of such authorised officer.

Effect

Such action of the authorised officer shall be deemed to be seizure of such article or thing.

Notes

- a) No such order can be passed for any article or thing, being stock-in-trade.
- b) Though such order can also be passed for reasons other than those mentioned above, but in that case, the order shall not be deemed to be seizure of such article or things and it shall not be in force for a period exceeding 60 days from the date of the order [Sec. 132(3) & (8A)]

◆ Provisional Attachment

- ▶ Where
 - a. during the course of the search or seizure; or
 - b. within a period of 60 days from the date on which the last of the authorisations for search was executed, the authorised officer may attach provisionally any property belonging to the assessee and for the said purpose, the provisions of the Second Schedule shall, mutatis mutandis, apply.
- ▶ Such attachment shall be subject to following conditions:
 - a) The authorised officer is satisfied that for the purpose of protecting the interest of revenue, it is necessary to do so.
 - b) The reasons for such provisional attachment should be recorded in writing
 - c) Previous approval (in writing) of the Principal Director General or Director General or the Principal Director or Director has taken.
- ▶ Every provisional attachment shall cease to have effect after the expiry of 6 months from the date of such order.
- ▶ The authorised officer may make a reference to a Valuation Officer referred to in sec. 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.

Authorisation and assessment in case of search or requisition [Sec. 292CC]

- ◆ It shall not be necessary to issue an authorisation u/s 132 or make a requisition u/s 132A separately in the name of each person.
- ◆ Where an authorisation u/s 132 has been issued or requisition u/s 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 authorisation 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.
- ◆ Though authorisation u/s 132 or requisition u/s 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 authorisation or requisition.

Time limit for retention [Sec. 132(8)]

The books of account or other documents seized or deemed seized shall not be retained by the authorised officer for a period exceeding 30 days from the date of the order of assessment u/s 153A.



Exception

It can be retained for more than 30 days on fulfilment of the following conditions -

1. The reasons for retaining the same are recorded in writing; and
2. The (prior) approval of the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director for such retention is obtained.

Taxpoint

a) Maximum retention

The aforesaid authorities shall not authorise the retention of the books of account and other documents for a period exceeding 30 days after all the proceedings in respect of the years for which the books of account or other documents are relevant, are completed.

b) Power of the Board to pass an order [Sec. 132(10)]

- Where a person is legally entitled to the books of account or other documents seized;
- Such person objects for any reason to the approval given by the authorities; and
- Such person makes 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.
 - then the Board may, after giving the applicant an opportunity of being heard, pass such orders as it thinks fit.

Presumption in case of search [Sec. 132(4A)]

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 search, it may be presumed that -

- Such books of account, other documents, money, bullion, jewellery or other valuable article or thing belongs to such person;
- The contents of such books of account and other documents are true;
- 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, are in that person's handwriting; and
- In the case of a document stamped, executed or attested, it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.

Other Provisions

1. **Help from Government officers [Sec. 132(2)]:** It shall be the duty of every police officer or of any officer of the Central Government or of both officer to assist authorised officer to invoke his power.
2. **Right to make copies or take extract [Sec. 132(9)]:** The person from whose custody books of account or other documents are seized may make copies thereof or take extracts therefrom. Such right can be exercised 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.
3. **Power of Board to make rules [Sec 132(14)]:** The Board may make rules in relation to any search or seizure providing the procedure to be followed by the authorised officer -
 - i) for obtaining ingress (i.e. right to enter) into any building, place, vessel, vehicle or aircraft to be searched where free ingress thereto is not available;

- ii) for ensuring safe custody of any books of account or other documents or assets seized.
4. The provisions of the Code of Criminal Procedure, 1973 relating to searches and seizure shall apply, so far as may be, to search and seizure [Sec. 132(13)].

6.3 POWERS TO REQUISITION BOOKS OF ACCOUNT, ASSETS, ETC. [SEC. 132A]

Circumstances when power u/s 132A can be invoked

Where income-tax authority (being Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner) in consequence of information in his possession, has **reason to believe** that -

- a) Any person to whom a summon u/s 131(1) or a notice u/s 142(1) was issued to produce any books of account or other documents -
 1. Has omitted or failed to produce such books of account or other documents; and
 2. 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 (hereinafter referred as other authority)
- 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 summon or notice has been issued will not produce such books of account or other documents on its returning by other authority
- c) Any assets taken into custody by any officer or authority under any other law for the time being in force is undisclosed (wholly or partly).

Who can requisition books

Requisitioning Officer who can require books, etc.	Authorised from
Additional Director, Additional Commissioner, Joint Director, Joint Commissioner, Assistant Director, Deputy Director, Assistant Commissioner, Deputy Commissioner or Income tax officer	Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner

Power of Requisitioning Officer

The requisitioning officer can make a requisition for delivery of books of account, etc., to such other authority. Such other authority shall deliver the books of account, other documents or assets to the requisitioning officer when such officer or authority is of the opinion that it is no longer necessary to retain the same in his or its custody. For instance, any books of account seized by an officer under Customs Act can be requisitioned by income-tax authority to deliver such books of account.

On the requisition, other authority delivers books of account, etc. to the requisitioning officer. Such books of account, documents, etc. shall be deemed as seized u/s 132(1).

Taxpoint

- ♦ 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.
- ♦ A bank draft when presented for clearing by the customer to the bank cannot be said to have been taken into custody by the bank to attract the applicability of section 132A. Resultantly, the warrant of authorisation



requisitioning the same by the competent authority is totally without jurisdiction [Samta Construction Co. -vs.- Pawan Kumar Sharma]

6.4 APPLICATION OF SEIZED OR REQUISITIONED ASSETS [SEC. 132B]

The seized assets may be adjusted with:

- a) The amount of any **existing liability** under -
 - i) The Income-tax Act, 1961;
 - ii) The Wealth-tax Act, 1957 (now abolished);
 - The existing liability does not include advance tax payable.
- b) The amount of liability determined on completion of the assessment u/s 153A;
- c) The amount of liability determined on completion of the assessment of the year relevant to the previous year in which search is initiated or requisition is made;
(including any penalty levied or interest payable in connection with such assessment); and
- d) The amount in respect of which such person is in default or is deemed to be in default or the amount of liability arising on an application made before the Settlement Commission.

6.5 RELEASE OF ASSET [FIRST PROVISO TO SEC. 132B]

Condition for release of asset

Where the following conditions are satisfied, the amount of any existing liability may be recovered out of such asset and the remaining portion of the asset may be released to the person from whose custody the assets were seized -

1. 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 asset;
2. The nature and source of acquisition of such asset is explained to the satisfaction of the Assessing Officer; and
3. The Assessing Officer obtains the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

Time limit for release of asset

Asset or any portion thereof shall be released within a period of 120 days from the date on which the last of the authorisations for search u/s 132 or for requisition u/s 132A, as the case may be, was executed.

No seized asset shall be retained by the Department during pendency of appeal filed by Revenue [Naresh Kumar Kohali -vs.- CIT (P&H)]

Order of assets to be applied for discharging liability

The above liability shall be discharged by applying the seized asset in the following order -

- a) Money;
- b) Asset other than money (as laid down in the Third Schedule).

It is to be noted that the assessee shall be discharged of the liability to the extent of the money and asset so applied. However, Assessing Officer shall not be precluded from the recovery of above liabilities by any other mode.

Discharge of excess money

After discharging all liabilities if any assets or proceeds thereof left, then it shall be returned to the persons from whose custody such assets were seized.

Interest payable to the assessee

Where the aggregate amount of money (either seized or realized through sale of assets) seized exceeds the aggregate of the amount required to meet the liabilities, Government shall pay simple interest at the rate of $\frac{1}{2}\%$ p.m. The interest shall be payable from the date immediately following the expiry of the period of 120 days (from the date on which the last of the authorisations for search u/s 132 or requisition u/s 132A was executed) to the date of completion of the assessment u/s 153A.

6.6 POWER TO CALL FOR INFORMATION [SEC. 133]

The income-tax authority [being Assessing Officer, Deputy Commissioner (Appeals), Joint Commissioner or Commissioner (Appeals)] may -

1. Require any firm to furnish him with a return of the names and addresses of the partners of the firm and their respective shares;
2. Require any Hindu undivided family to furnish him with a return of the names and addresses of the manager and the members of the family;
3. Require any person whom he has reason to believe to be a trustee, guardian or agent, to furnish him with a return of the names of the persons for or of whom he is a trustee, guardian or agent, and of their addresses;
4. Require any assessee to furnish 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 Rs.1000, together with particulars of all such payments made;
5. Require any dealer, broker or agent or any person concerned in the management of a stock or commodity exchange to furnish a statement of the names and addresses of all persons -
 - a) to whom he or the exchange has paid any sum in connection with the transfer of assets; or
 - b) on whose behalf or from whom he or the exchange has received any such sum,
- together with particulars of all such payments and receipts;
6. Require any person, including a banking company or any officer thereof, to furnish information in relation to such points or matters, or to furnish statements of accounts and affairs,

- which will be useful for, or relevant to, any enquiry or proceeding under this Act.

Taxpoint

- Where no proceeding is pending, the power u/s 133 shall not be exercised by any income-tax authority below the rank of Principal Director or Director or Principal Commissioner or Commissioner, other than the Joint Director or Deputy Director or Assistant Director, without the prior approval of the Principal Director or Director or the Principal Commissioner or Commissioner.
- It is to be noted that power referred in point (6) above may also be exercised by the Principal Director General or 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.



6.7 POWER OF SURVEY [SEC. 133A]

Who can survey

The income-tax authority being Principal Commissioner or Commissioner, a Joint Commissioner, a Principal Director or Director, a Joint Director, an Assistant Director or a Deputy Director or an Assessing Officer or a Tax Recovery Officer or Inspector (in some circumstances) has right to survey.

However, no action shall be taken by an Assistant Director or a Deputy Director or an Assessing Officer or a Tax Recovery Officer or an Inspector of Income-tax without obtaining the approval of the Joint Director or the Joint Commissioner

Jurisdiction of Income-Tax Authority for conducting survey

An income-tax authority may conduct survey at -

- Any place within the limits of the area assigned to him; or
- Any place occupied by any person in respect of whom he exercises jurisdiction; or
- 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,

- where a business or profession or an activity for charitable purpose is carried on.

Power of Income Tax Authority

While conducting survey, income tax authority may exercise following power –

1. Enter in such place of business;
2. Require any proprietor, trustee, employee or any other person who may at that time and place be attending or helping in, the carrying on of such business or profession or such activity for charitable purpose -
 - 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;
 - Inspector is also considered as income-tax authority for this purpose.
 - b) To afford him the necessary facility to check or verify the cash, stock or other valuable article or thing 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 this Act.
3. Place marks of identification on the books of account or other documents inspected by him and make extracts or copies therefrom;
 - Inspector is also considered as income-tax authority for this purpose.
4. Impound and retain in his custody any books of account or other documents inspected by him;
5. Make an inventory of any cash, stock or other valuable article or thing checked or verified by him;
6. Record the statement of any person, which may be useful for, or relevant to, any proceeding under this Act.

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.

Taxpoint

- (i) **Deemed place of business or profession or activity for charitable purpose is carried on:** Where the person carrying on the business or profession or activity for charitable purpose states that any of his books of account or other documents or any part of his cash or stock or other valuable article or thing relating to his business or profession or activity for charitable purpose are kept, then survey shall also be conducted at that place.
- (ii) In case where survey is for the purpose of verifying that tax has been deducted or collected at source as per relevant provisions of the Act, in that case the income-tax authority cannot take exercise power mentioned in point 4 and 5 (above).

Restriction on Income-tax Authority

An income-tax authority shall not -

- Impound any books of account or other documents without recording his reasons for doing so; or
- Retain in his custody any books of account or other documents for a period exceeding 15 days (exclusive of holidays) without obtaining the approval of the Principal Chief Commissioner or the Chief Commissioner or the Principal Director General or the Director General or the Principal Commissioner or the Commissioner or the Principal Director or the Director thereof, as the case may be;
- Remove or cause to be removed any cash, stock or other valuable article or thing.
- The place of business or profession cannot be sealed under survey – [Shyam Jewellers -vs.- CIT (All)]

Time for survey

An income-tax authority may **enter** into -

Place where business or profession is carried on	During the business hours
In case of deemed place of business or profession	Only after sunrise and before sunset

Survey of certain expenditure [Sec. 133A(5)]

- The income tax authority (including Inspector), having regard to the nature and scale of expenditure incurred by an assessee, in connection with any function, ceremony or event, is of the opinion that it is necessary or expedient to do so, he may, at any time after such function, ceremony or event, require -
 - Assessee, who incurred such expenditure; or
 - Any person, who is likely to possess information in respect of such expenditure,
 - to furnish such information as he may require as to any matter which may be useful for, or relevant to, any proceeding under this Act.
- He may record the statements of the assessee or any other person in this regard and such recorded statement may thereafter be used as evidence in any proceeding under this Act.

Effect of non co-operation or non-compliance

If a person does not co-operate or comply during survey, the income-tax authority shall have all the powers u/s 131(1) for enforcing compliance with the requirement made.

6.8 POWER TO COLLECT CERTAIN INFORMATION [SEC. 133B] (DOOR TO DOOR SURVEY)

The income-tax authority (being Joint Commissioner, Assistant Director, Deputy Director, Assessing Officer, authorised



Inspector) may, for the purpose of collecting any information, which may be useful for, or relevant to the purposes of this Act:

- a) Enter into —
 - Any building or place within the limits of the area assigned to such authority; or
 - Any building or place occupied by any person in respect of whom he exercises jurisdiction,
 - where a business or profession is carried on.
- b) Require any proprietor, employee or any other person who may at that time and place be attending or helping in such business or profession to furnish such information as may be prescribed

Time for Entrance

An Income-tax authority may enter into such place only during the hours at which such place is open for the conduct of business or profession.

Restriction on Income-tax Authority

An income-tax authority shall not remove any books of account or other documents, cash, stock or other valuable article or thing.

6.9 POWER TO CALL FOR INFORMATION BY PRESCRIBED INCOME-TAX AUTHORITY [SEC. 133C]

- ♦ The prescribed income-tax authority (being Principal Director General or Director General or Principal Director or Director) may, for the purposes of verification of information in its possession relating to any person, issue a notice to such person requiring him, on or before a date to be specified therein, to furnish information or documents verified in the manner specified therein, which may be useful for, or relevant to, any inquiry or proceeding under this Act.
- ♦ Where any information or document has been received in response to a notice, the income-tax authority may process such information or document and make available the outcome of such processing to the Assessing Officer.
- ♦ The Board 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.

6.10 POWER TO INSPECT REGISTERS OF COMPANIES [SEC. 134]

The Income tax authority [being Assessing Officer, Deputy Commissioner (Appeals), Joint Commissioner, Commissioner (Appeals) or any other authorized person] may inspect and take copies of any register of the members, debenture-holders or mortgagees of any company or of any entry in such register.

6.11 POWER OF CERTAIN AUTHORITIES [SEC. 135]

The Income tax authorities (being Principal Director General or Director General or Principal Director or Director, the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner and the Joint Commissioner) shall be competent to make any enquiry under this Act, and for this purpose shall have all the powers that an Assessing Officer has under this Act in relation to the making of enquiries.

6.12 PROCEEDINGS BEFORE INCOME-TAX AUTHORITIES TO BE JUDICIAL PROCEEDINGS [SEC.136]

Any proceeding under this Act before an income-tax authority shall be deemed to be a judicial proceeding within the meaning of sec. 193, 196 and 228 of the Indian Penal Code, 1860 and every income-tax authority shall be deemed to be a Civil Court for the purposes of sec. 195, but not for the purposes of Chapter XXVI of the Code of Criminal Procedure, 1973.

6.13 DISCLOSURE OF INFORMATION IN RESPECT OF ASSESSEE [SEC. 138]

To the authority of other law

The Board or any authorized income-tax authority may furnish necessary information received or obtained by them to the officer, authority or body under any law (hereinafter referred as other authority) for enabling other authority to perform his duty. Such other authority shall be the officer, authority or body under any law -

- a) relating to the imposition of any tax, duty or cess, or to dealings in foreign exchange as defined in sec. 2(n) of the Foreign Exchange Management Act, 1999; or
- b) as the Central Government may, if in its opinion it is necessary so to do in the public interest, specify by notification in the Official Gazette.

To any other person

Where a person makes an application to the authority (being Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner) for any information relating to any assessee received or obtained by any income-tax authority in the performance of his functions under this Act, then the such authority may (if he is satisfied that it is in the public interest so to do) furnish such information. His decision in this behalf shall be final and shall not be called in question in any court.

Restriction on disclosure of information

The Central Government may (having regard to the practices and usages customary or any other relevant factors) direct that no information or document shall be furnished or produced by a public servant in respect of such matters relating to such class of assessee or except to such authorities as may be specified in the order.

6.14 ASSESSMENT IN CASE OF SEARCH OR REQUISITION [SEC. 153A]

Where a search is initiated u/s 132 or books of account, other documents or any assets are requisitioned u/s 132A, the following provision shall be followed:

- Save as otherwise provided in sec. 153A, 153B, 153C and 153D all other provisions shall apply to the assessment made under this section also.

Procedure

Notice

The Assessing Officer shall issue notice to such person requiring him to furnish the return of income:

- a. in respect of each assessment year falling within 6 assessment years immediately preceding the assessment year relevant to the previous year in which such search is conducted or requisition is made; and



b. for the relevant assessment year or years

- ▶ 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 6 assessment years but not later than 10 assessment years from the end of the assessment year relevant to the previous year in which search is conducted or requisition is made.
- ▶ 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 asset, which has escaped assessment amounts to or is likely to amount to Rs. 50 lakh or more in the relevant assessment year or in aggregate in the relevant assessment years;
 - *Asset shall include immovable property being land or building or both, shares and securities, loans and advances, deposits in bank account.*
 - b) The income referred above or part thereof has escaped assessment for such year or years; and
 - c) The search u/s 132 is initiated or requisition u/s 132A is made on or after 01-04-2017

Time limit for furnishing such return

Such return should be furnished in prescribed Form within such time, as may be specified in the notice.

Assessment of income in respect of each assessment year

Assessing Officer shall assess or re-assess the total income of each of 6 assessment years and for the relevant assessment year or years.

Treatment of pending assessment

Where any assessment or reassessment relating to any assessment year(s) falling in the said period is pending on the date of initiation of the search u/s 132 or requisition u/s 132A, the same shall abate.

- ▶ If any proceeding initiated or any order of assessment or reassessment made has been annulled in appeal or any other legal proceeding, then, the assessment or reassessment relating to any assessment year which has abated, shall stand revived with effect from the date of receipt of the order of such annulment by the Principal Commissioner or Commissioner.
- ▶ Such revival shall cease to have effect, if such order of annulment is set aside.

Rate of tax

Tax rate shall be levied at the rate(s) as applicable to the respective year falling in the said period.

6.15 ASSESSMENT OF INCOME OF ANY OTHER PERSON [SEC. 153C]

- ◆ Where the Assessing Officer is satisfied that -
 - any money, bullion, jewellery or other valuable article or thing seized or requisitioned, belongs to; or
 - any books of account or documents, seized or requisitioned, pertains or pertain to, or any information contained therein, relates to,
- a person other than the person against whom such search or requisition is made,

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; and
- Such Assessing Officer shall proceed against each such other person and issue notice and assess or reassess income of such other person in accordance with the provisions of sec. 153A.

Taxpoint

- ♦ If Assessing Officer 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 6 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 as referred to in sec. 153A
- ♦ For the purpose of abatement of proceedings, the reference to the date of initiation of the search u/s 132 or making of requisition u/s 132A 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 jurisdiction over such other person. [Proviso to sec. 153C(1)]
- ♦ Where books of account or documents or assets seized or requisitioned 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 u/s 132 or requisition is made u/s 132A and in respect of such assessment year:
 - (a) no return of income has been furnished by such other person and no notice u/s 142(1) has been issued to him, or
 - (b) a return of income has been furnished by such other person but no notice u/s 143(2) has been served and limitation of serving the notice u/s 143(2) has expired, or
 - (c) assessment or reassessment, if any, has been made,

before the date of receiving the 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 of such assessment year in the manner provided in section 153A. [Sec. 153C(2)]

6.16 TIME LIMIT FOR COMPLETION OF ASSESSMENT [SEC. 153B]

Assessment Year	Time Limit
1. Each assessment year falling within 6 assessment years immediately preceding the assessment year relevant to the previous year in which such search is conducted or requisition is made	Within a period of 21 months from the end of the financial year, in which the last of the authorisations for search u/s 132 or for requisition u/s 132A was executed#.
2. For relevant assessment year or years	In the case where the last of the authorisations for search u/s 132 or for requisition u/s 132A was executed during the financial year 2018-19: Within a period of 18 months from the end of the financial year, in which the last of the authorisations for search u/s 132 or for requisition u/s 132A was executed
3. Assessment year relevant to the previous year in which search is conducted u/s 132 or requisition is made u/s 132A	In the case where the last of the authorisations for search u/s 132 or for requisition u/s 132A was executed on or after 01-04-2019: Within a period of 12 months from the end of the financial year, in which the last of the authorisations for search u/s 132 or for requisition u/s 132A was executed



# The authorisation shall be deemed to have been executed—	
In the case of 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;
In the case of requisition u/s 132A	On the actual receipt of the books of account or other documents or assets by the Authorised Officer.

Taxpoint

- ◆ In case of other person referred to in section 153C, the period of limitation for making the assessment or reassessment shall be
 - a. The period as referred above; or
 - b. 18 months, in the case where the last of the authorisations for search u/s 132 or for requisition u/s 132A was executed during F.Y. 2018-19 (12 months: in the case where the last of the authorisations for search u/s 132 or for requisition u/s 132A was executed on or after 01-04-2019) from the end of the financial year in which books of account or documents or assets seized or requisitioned are handed over u/s 153C to the Assessing Officer having jurisdiction over such other person,
- whichever is later. [Proviso to sec. 153B]

- ◆ Wherever reference has been given to Transfer Pricing Officer u/s 92CA, time limit in all cases shall be increased by 12 months.

- ◆ **Computation of limitation period**

In computing the above period of limitation, following period shall be excluded —

- a) 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 sec. 129; or
- b) Period during which the assessment proceeding is stayed by an order or injunction of a court; or
- c) Period commencing from the date on which the Assessing Officer directs the assessee to get his accounts audited u/s 142(2A) and ending with

Where such order is challenged before a court	The date on which the order setting aside such direction is received by the Principal Commissioner or Commissioner
In any other case	The last date on which the assessee is required to furnish a report of such audit

- d) Period commencing from the date on which the Assessing Officer makes a reference to the Valuation Officer u/s 142A and ending with the date on which the report of the Valuation Officer is received by the Assessing Officer; or
- e) In case, where an application made before the Income-tax Settlement Commission u/s 245C is rejected, the period commencing from the date on which such application is made and ending with the date on which the rejection order is received by the Principal Commissioner or Commissioner; or
- f) Period commencing from the date on which an application is made before the Authority for Advance Rulings u/s 245Q and ending with the date on which the order rejecting the application is received by the Principal Commissioner or Commissioner u/s 254R; or
- g) Period commencing from the date on which an application is made before the Authority for Advance Ruling u/s 245Q and ending with the date on which the advance ruling pronounced by it is received by the Principal Commissioner or Commissioner u/s 245R.
- h) Period commencing from the date of annulment of a proceeding or order of assessment or reassessment

u/s 153A, till the date of the receipt of the order setting aside the order of such annulment, by the Principal Commissioner or Commissioner; or

- i) Period (maximum period of 1 year) commencing from the date on which a reference (or first reference, if many references are made) for exchange of information is made by an authority competent under an agreement referred to in sec. 90 / 90A and ending with the date on which the information so requested is last received by the Principal Commissioner or Commissioner
- ii) Period commencing from the date on which a reference for declaration of an arrangement to be impermissible avoidance arrangement is received by the Principal Commissioner or Commissioner u/s 144BA(1) and ending on the date on which a direction u/s 144BA (3) or (6) or an order u/s 144BA(5) is received by the Assessing Officer

Note: If after immediate exclusion of the aforesaid period, the period available to the Assessing Officer for making an order of assessment or reassessment is less than 60 days, then such remaining period shall be extended to 60 days.

Taxpoint

- Where the period available to the Transfer Pricing Officer is extended to 60 days [as per proviso to sec. 92CA(3A)] and the period of limitation available to the Assessing Officer for making an order of assessment (reassessment or recomputation) is less than 60 days, such remaining period shall also be extended to 60 days.
- Where a proceeding before the Settlement Commission abates u/s 245HA, the period of limitation available to the Assessing Officer for making an order of assessment (reassessment or recomputation) shall, after the exclusion of the period u/s 245HA(4), deemed to have been extended to 1 year.

Prior approval necessary for assessment in cases of search or requisition [Sec. 153D]

No order of assessment or reassessment (in case of search or requisition) shall be passed by an Assessing Officer below the rank of Joint Commissioner except with the prior approval of the Joint Commissioner.

However, assessment or reassessment order may be passed by the Assessing Officer with the prior approval of the Principal Commissioner or Commissioner u/s 144BA.



STUDY NOTE : 7

COLLECTION, RECOVERY & REFUND



This Study Note includes:

- 7.1 Demand Notice [Sec. 156] & Provisions relating thereto [Sec. 220]
- 7.2 Penalty payable when tax in default [Sec. 221]
- 7.3 Certificate to Tax Recovery Officer [Sec. 222]
- 7.4 Tax Recovery Officer by whom recovery is to be effected [Sec. 223]
- 7.5 Validity of certificate and cancellation or amendment thereof [Sec. 224]
- 7.6 Stay of proceedings [Sec. 225]
- 7.7 Other modes of recovery [Sec. 226]
- 7.8 Recovery through State Government [Sec. 227]
- 7.9 Recovery of tax in pursuance of agreements with foreign countries [Sec. 228A]
- 7.10 Recovery of penalties, fine, interest and other sums [Sec. 229]
- 7.11 Tax clearance certificate [Sec. 230]
- 7.12 Recovery by suit or under other law not affected [Sec. 232]
- 7.13 Provisional attachment to protect revenue in certain cases [Sec. 281B]
- 7.14 Certain transfers to be void [Sec. 281]
- 7.15 Service of notice generally [Sec. 282]
- 7.16 Authentication of notices and other documents [Sec. 282A]
- 7.17 Return of income, etc., not to be invalid on certain grounds [Sec. 292B]
- 7.18 Notice deemed to be valid in certain circumstances [Sec. 292BB]
- 7.19 Refund Meaning [Sec. 237]
- 7.20 Who can claim refund
- 7.21 Form and Time limit for claiming refund [Sec. 239]
- 7.22 Refund on Appeal, etc. [Sec. 240]
- 7.23 Correctness of assessment not to be questioned [Sec. 242]
- 7.24 Interest on refund [Sec. 244A]
- 7.25 Set-off of refund against tax remaining payable [Sec. 245]
- 7.26 Withholding of refund in certain cases [Sec. 241A]



COLLECTION & RECOVERY

7.1 DEMAND NOTICE [SEC. 156] & PROVISIONS RELATING THERETO [SEE. 220]

On completion of assessment (or intimation generated after processing of TDS statement), a demand notice [in Form 7] is served for additional demand raised in the assessment.

Time limit for payment of tax: The assessee should make the payment of amount demanded within 30 days of service of notice [Sec. 220(1)] Where the Assessing Officer has any reason to believe that it will be detrimental to revenue if the full period of 30 days is allowed, then he may with the previous approval of the Joint Commissioner direct that the sum specified in the notice of demand shall be paid within such time as may be specified by him in the notice.

Extension of time limit: On an application made by the assessee before the expiry of due date, the Assessing Officer may extend the time for payment or allow payment by installments, subject to such conditions as he may think fit to impose in the circumstances of the case.

Interest on delay in payment: If the payment is not made within 30 days (or time allowed in the notice), interest shall be payable @ 1% for every month (or part thereof) of the delay [Sec. 220(2)]

Taxpoint: Where interest is charged u/s 201(1A) on the amount of tax specified in the intimation issued u/s 200A(1) for any period, then, no interest shall be charged under this section on the same amount for the same period. Similarly, where interest is charged u/s 206C(7) on the amount of tax specified in the intimation issued u/s 206CB(1) for any period, then, no interest shall be charged under this section on the same amount for the same period.

Waiver or reduction of interest [Sec.220(2A)]: The Chief Commissioner or Commissioner may reduce or waive the amount of interest paid or payable by an assessee u/s 220(2), if he satisfied that:

- a) payment of such amount has caused or would cause genuine hardship to the assessee;
- b) default in the payment of the amount on which interest has been paid or was payable under the said sub-section was due to circumstances beyond the control of the assessee; and
- c) the assessee has co-operated in any inquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

The order accepting or rejecting the application of the assessee, either in full or in part, shall be passed within a period of 12 months from the end of the month in which the application is received. 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.

Assessee in default [Sec.220(4)]: If the amount is not paid within the time (or extended time) at the place and to the person mentioned in the said notice the assessee shall be deemed to be in default. Further, if, in a case where payment by installments is allowed, the assessee commits default in paying any one of the installments within the time, the assessee shall be deemed to be in default as to the whole of the amount then outstanding, and the other installment or installments shall be deemed to have been due on the same date as the installment actually in default.

Exception: In the following circumstances, the assessee may not be considered as an assessee in default:

- a) Where an assessee has presented an appeal u/s 246A, the Assessing Officer may, in his discretion and subject to such conditions as he may think fit to impose in the circumstances of the case, treat the assessee as not being in default in respect of the amount in dispute in the appeal, even though the time for payment has expired, as long as such appeal remains undisposed of.
- b) Where an assessee has been assessed in respect of income arising outside India in a country, the laws of which

prohibit or restrict the remittance of money to India, the Assessing Officer shall not treat the assessee as in default in respect of that part of the tax which is due in respect of that amount of his income which, by reason of such prohibition or restriction, cannot be brought into India, and shall continue to treat the assessee as not in default in respect of such part of the tax until the prohibition or restriction is removed.

For this purpose, income shall be deemed to have been brought into India if it has been utilised or could have been utilised for the purposes of any expenditure actually incurred by the assessee outside India or if the income, whether capitalised or not, has been brought into India in any form.

7.2 PENALTY PAYABLE WHEN TAX IN DEFAULT [SEC. 221]

When an assessee is in default or is deemed to be in default in making a payment of tax, he shall, in addition to the amount of the arrears and the amount of interest payable u/s 220(2), be liable, by way of penalty, to pay such amount as the Assessing Officer may direct, and in the case of a continuing default, such further amount or amounts as the Assessing Officer may, from time to time, direct, so, however, that the total amount of penalty does not exceed the amount of tax in arrears.

Notes:

- a) The assessee shall be given a reasonable opportunity of being heard.
- b) Where the assessee proves to the satisfaction of the Assessing Officer that the default was for good and sufficient reasons, no penalty shall be levied under this section.
- c) An assessee shall not cease to be liable to any penalty merely by reason of the fact that before the levy of such penalty he has paid the tax.
- d) Where as a result 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.

7.3 CERTIFICATE TO TAX RECOVERY OFFICER [SEC. 222]

- ♦ When an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may draw up under his signature a statement in the prescribed form (Form 57) specifying the amount of arrears due from the assessee (such statement being hereafter referred to as "certificate") and shall proceed to recover from such assessee the amount specified in the certificate by one or more of the modes mentioned below (in accordance with the rules laid down in the Second Schedule)
 - a. attachment and sale of the assessee's movable property;
 - b. attachment and sale of the assessee's immovable property;
 - c. arrest of the assessee and his detention in prison;
 - d. appointing a receiver for the management of the assessee's movable and immovable properties.
- ♦ The assessee's movable or immovable property shall include any property which has been transferred, directly or indirectly after 31-5-1973, 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, or stands in the name of, any of the persons aforesaid.



If the movable or immovable property was transferred to his minor child or his son's minor child, it shall, even after the date of attainment of majority by such minor child or son's minor child, as the case may be, continue to be included in the assessee's movable or immovable property for recovering any arrears due from the assessee.

- ◆ No step in execution of a certificate shall be taken until the period of 15 days has elapsed since the date of the service of the notice. However, if the Tax Recovery Officer is satisfied that the defaulter is likely to conceal, remove or dispose of his property, he may at any time direct, for reasons to be recorded in writing, an attachment of such property.

Further, if the defaulter whose property has been so attached furnishes security to the satisfaction of the Tax Recovery Officer, such attachment shall be cancelled from the date on which such security is accepted by the Tax Recovery Officer.

- ◆ Arrear amount includes:
 - (a) interest upon the amount of tax or penalty or other sum to which the certificate relates as is payable in accordance with sec. 220(2); and
 - (b) all charges incurred in respect of:
 - (i) the service of notice and of warrants and other processes; &
 - (ii) all other proceedings taken for realising the arrears
- ◆ The proceeds shall be disposed of in the following manner:
 - (a) they shall first be adjusted towards the amount due under the certificate in execution of which the assets were realised and the costs incurred in the course of such execution;
 - (b) if there remains a balance, the same shall be utilised for satisfaction of any other amount recoverable from the assessee under this Act which may be due on the date on which the assets were realised; &
 - (c) the balance, if any, remaining after above adjustments shall be paid to the defaulter.
- ◆ The order of Tax Recovery Officer relating to the execution or discharge etc. shall be final.
However, a suit may be brought in a civil court upon the ground of fraud.
- ◆ If at any time after the certificate is drawn up by the Tax Recovery Officer the defaulter dies, the proceedings (except arrest and detention) may be continued against the legal representative of the defaulter.
- ◆ An appeal from any original order passed by the Tax Recovery Officer shall lie to the Chief Commissioner or Commissioner. Such appeal must be presented within 30 days from the date of the order appealed against. Pending the decision of any appeal, execution of the certificate may be stayed if the appellate authority so directs, but not otherwise.

7.4 TAX RECOVERY OFFICER BY WHOM RECOVERY IS TO BE EFFECTED [SEC. 223]

- ◆ The Tax Recovery Officer competent to take action u/s 222 shall be:
 - (a) the Tax Recovery Officer within whose jurisdiction the assessee carries on his business or profession or within whose jurisdiction the principal place of his business or profession is situate; or
 - (b) the Tax Recovery Officer within whose jurisdiction the assessee resides or any movable or immovable property of the assessee is situate,

the jurisdiction for this purpose being the jurisdiction assigned to the Tax Recovery Officer under the orders or

directions issued by the Board, or by the Chief Commissioner or Commissioner who is authorised in this behalf by the Board in pursuance of sec. 120.

- ◆ Where an assessee has property within the jurisdiction of more than one Tax Recovery Officer and the Tax Recovery Officer by whom the certificate is drawn up:
 - (a) is not able to recover the entire amount by sale of the property, movable or immovable within his jurisdiction; or
 - (b) is of the opinion that, for the purpose of expediting or securing the recovery of the whole or any part of the amount, it is necessary so to do,

he may send the certificate or, where only a part of the amount is to be recovered, a copy of the certificate certified in the prescribed manner and specifying the amount to be recovered to a Tax Recovery Officer within whose jurisdiction the assessee resides or has property and, thereupon, that Tax Recovery Officer shall also proceed to recover the amount as if the certificate or copy thereof had been drawn up by him.

7.5 VALIDITY OF CERTIFICATE AND CANCELLATION OR AMENDMENT THEREOF [SEC. 224]

It shall not be open to the assessee to dispute the correctness of any certificate drawn up by the Tax Recovery Officer on any ground whatsoever, but it shall be lawful for the Tax Recovery Officer to cancel the certificate if, for any reason, he thinks it necessary so to do, or to correct any clerical or arithmetical mistake therein.

7.6 STAY OF PROCEEDINGS [SEC. 225]

- ◆ It shall be lawful for the Tax Recovery Officer to grant time for the payment of any tax and when he does so, he shall stay the proceedings for the recovery of such tax until the expiry of the time so granted.
- ◆ Where the order giving rise to a demand of tax for which a certificate has been drawn up is modified in appeal or other proceeding under this Act, and, as a consequence thereof, the demand is reduced but the order is the subject-matter of further proceeding under this Act, the Tax Recovery Officer shall stay the recovery of such part of the amount specified in the certificate as pertains to the said reduction for the period for which the appeal or other proceeding remains pending.
- ◆ When the order which was the subject-matter of such appeal or other proceeding has become final and conclusive, TRO shall amend the certificate or cancel it.

7.7 OTHER MODES OF RECOVERY [SEC. 226]

- ◆ Whether or not certificate has been drawn up u/s 222, the Assessing Officer may recover the tax by any one or more of the modes provided in this section.
- ◆ Attachment of salary: If any assessee is in receipt of any income chargeable under the head "Salaries", the Assessing Officer or Tax Recovery Officer may require any person paying the same (i.e., the employer) to deduct from any payment subsequent to the date of such requisition, any arrears of tax due from such assessee. The employer shall comply with any such requisition and shall pay the sum so deducted to the credit of the Central Government or as the Board directs:



- ♦ Garnishee order: The Assessing Officer or Tax Recovery Officer may by notice in writing require, any person from whom money is due or any person holds or may subsequently hold money for or on account of the assessee, to pay to the Assessing Officer or Tax Recovery Officer so much of the money (subject to maximum of amount payable to assessee) as is sufficient to pay the amount due by the assessee.

If the person to whom a notice is sent fails to make payment in pursuance thereof to the Assessing Officer or Tax Recovery Officer, he shall be deemed to be an assessee in default in respect of the amount specified in the notice and further proceedings may be taken against him for the realisation of the amount as if it were an arrear of tax due from him, in the manner provided in sec. 222 to 225.

Any person discharging any liability to the assessee after receipt of a notice shall be personally liable to the Assessing Officer or Tax Recovery Officer to the extent of his own liability to the assessee so discharged or to the extent of the assessee's liability for any sum due under this Act, whichever is less.

A copy of the notice shall be forwarded to the assessee at his last address known to the Assessing Officer or Tax Recovery Officer.

Where a person to whom a notice is sent objects to it by a statement on oath that the sum demanded or any part thereof is not due to the assessee or that he does not hold any money for or on account of the assessee, then, nothing shall be deemed to require such person to pay any such sum or part thereof. But if it is discovered that such statement was false in any material particular, such person shall be personally liable to the Assessing Officer or Tax Recovery Officer to the extent of his own liability to the assessee on the date of the notice, or to the extent of the assessee's liability for any sum due under this Act, whichever is less.

- ♦ The Assessing Officer or Tax Recovery Officer may apply to the court in whose custody there is money belonging to the assessee for payment to him of the entire amount of such money, or, if it is more than the tax due, an amount sufficient to discharge the tax.
- ♦ The Assessing Officer or Tax Recovery Officer may, if authorised by the Chief Commissioner or Commissioner by general or special order, recover any arrears of tax due from an assessee by distraint and sale of his movable property in the manner laid down in the Third Schedule.

7.8 RECOVERY THROUGH STATE GOVERNMENT [SEE. 227]

The recovery of tax in any area has been entrusted to a State Government, the State Government may recover any arrears of tax in the same manner as the municipal tax or local rate is recovered.

7.9 RECOVERY OF TAX IN PURSUANCE OF AGREEMENTS WITH FOREIGN COUNTRIES [SEC. 228A]

- ♦ Where an agreement is entered into by the Central Government with the Government of any country outside India for recovery of income-tax under this Act and the corresponding law in force in that country and the Government of that country or any authority under that Government which is specified in this behalf in such agreement sends to the Board a certificate for the recovery of any tax due under such corresponding law from a person having any property in India, the Board may forward such certificate to any Tax Recovery Officer within whose jurisdiction such property is situated and thereupon such Tax Recovery Officer shall:

(a) 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 u/s 222; and

- (b) remit any sum so recovered by him to the Board after deducting his expenses in connection with the recovery proceedings.
- ◆ 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 has property in a country outside India (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), forward to the Board a certificate drawn up by him u/s 222 and the Board may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

7.10 RECOVERY OF PENALTIES, FINE, INTEREST AND OTHER SUMS [SEC. 229]

Any sum imposed by way of interest, fine, penalty, or any other sum payable under the provisions of this Act, shall be recoverable in the manner provided for the recovery of arrears of tax.

7.11 TAX CLEARANCE CERTIFICATE [SEC. 230]

Person not domiciled in India

- ◆ No person,—
 - (a) who is not domiciled in India;
 - (b) who has come to India in connection with business, profession or employment; and
 - (c) 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:
 - (i) an undertaking in the prescribed form [Form 30A] from his employer; or
 - (ii) through whom such person is in receipt of the income,to the effect that tax payable by such person who is not domiciled in India shall be paid by the employer or the payer, and the prescribed authority shall, on receipt of the undertaking, immediately give to such person a no objection certificate [Form 30B], for leaving India.
- ◆ The aforesaid provision is not applicable 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

Person domiciled in India

- ◆ Every person, who is domiciled in India at the time of his departure from India, shall furnish, in the prescribed form [Form 30C] to the income-tax authority or such other prescribed authority.
 - (a) the permanent account number allotted to him u/s 139A
 - However, where permanent account number has not 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 this Act, such person shall furnish a certificate in the prescribed form.
 - (b) the purpose of his visit outside India;



(c) the estimated period of his stay outside India:

- ◆ No person:
 - (i) who is domiciled in India at the time of his departure; and
 - (ii) in respect of whom circumstances exist which, in the opinion of an income-tax authority render it necessary for such person to obtain a certificate under this section,

shall leave the territory of India by land, sea or air unless he obtains a certificate from the income-tax authority stating that he has no liabilities under direct tax, or 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.

→ No such order shall be made unless such income tax authority records the reasons therefor and obtains the prior approval of the Principal Chief Commissioner or Chief Commissioner of Income-tax.

Liability of the carrier

- ◆ If the owner or charterer of any ship or aircraft carrying persons from any place in the territory of India to any place outside India allows any of the aforesaid person to travel by such ship or aircraft without first satisfying himself 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 amount of tax, if any, payable by such person as the Assessing Officer may, determine.
- ◆ In respect of any sum payable by the owner or charterer of any ship or aircraft, the owner or charterer, as the case may be, shall be deemed to be an assessee in default for such sum, and such sum shall be recoverable from him as if it were an arrear of tax.
 - 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..

7.12 RECOVERY BY SUIT OR UNDER OTHER LAW NOT AFFECTED [SEC. 232]

The several modes of recovery specified in this Chapter shall not affect in any way:

- (a) any other law for the time being in force relating to the recovery of debts due to Government; or
- (b) the right of the Government to institute a suit for the recovery of the arrears due from the assessee;

and it shall be lawful for the Assessing Officer or the Government, as the case may be, to have recourse to any such law or suit, notwithstanding that the tax due is being recovered from the assessee by any mode specified in this Chapter.

7.13 PROVISIONAL ATTACHMENT TO PROTECT REVENUE IN CERTAIN CASES [SEC. 281B]

- ◆ Where, during the pendency of any proceeding for the assessment or reassessment, the Assessing Officer is of the opinion that for the purpose of protecting the interests of the revenue it is necessary so to do, he may, with the previous approval of the Chief Commissioner, Commissioner, Director General or Director, by order in writing, attach provisionally any property belonging to the assessee in the manner provided in the Second Schedule.
- ◆ Every such provisional attachment shall cease to have effect after the expiry of a period of 6 months from the date of such order.

However, Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director may, for reasons to be recorded in writing, extend the aforesaid period by such further period or periods as he thinks fit, so, however, that the total period of extension shall not in any case exceed 2 years or 60 days after the date of order of assessment or reassessment, whichever is later.

- ◆ Where the assessee furnishes a guarantee from a scheduled bank for an amount not less than the fair market value of the property provisionally attached, the Assessing Officer shall, by an order in writing, revoke such attachment. However, where the Assessing Officer is satisfied that a guarantee from a scheduled bank for an amount lower than the fair market value of the property is sufficient to protect the interests of the revenue, he may accept such guarantee and revoke the attachment.
- ◆ The Assessing Officer may, for the purposes of determining the value of the property provisionally attached, make a reference to the Valuation Officer referred to in sec. 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 Assessing Officer within a period of 30 days from the date of receipt of such reference.
- ◆ An order revoking the provisional attachment shall be made:
 - within 45 days from the date of receipt of the guarantee, where a reference to the Valuation Officer has been made; or
 - within 15 days from the date of receipt of guarantee in any other case.
- ◆ Where a notice of demand specifying a sum payable is served upon the assessee and the assessee fails to pay that sum within the time specified in the notice of demand, the Assessing Officer may invoke the guarantee furnished, wholly or in part, to recover the amount.
- ◆ The Assessing Officer shall, in the interests of the revenue, invoke the bank guarantee, if the assessee fails to renew the guarantee, or fails to furnish a new guarantee from a scheduled bank for an equal amount, 15 days before the expiry of the guarantee.
- ◆ The amount realised by invoking the guarantee shall be adjusted against the existing demand which is payable by the assessee and the balance amount, if any, shall be deposited in the Personal Deposit Account of the Principal Commissioner or Commissioner in the branch of the 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 situate.
- ◆ Where the Assessing Officer is satisfied that the guarantee is not required anymore to protect the interests of the revenue, he shall release that guarantee forthwith.

7.14 CERTAIN TRANSFERS TO BE VOID [SEC. 281]

- ◆ Where, during the pendency of any proceeding under this Act or after the completion thereof, but before the service of notice by TRO, any assessee creates a charge on or parts with the possession (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 charge or transfer shall be void as against any claim in respect of any tax or any other sum payable by the assessee as a result of the completion of the said proceeding or otherwise.
- ◆ Assets means land, building, machinery, plant, shares, securities and fixed deposits in banks, to the extent to which any of the assets aforesaid does not form part of the stock-in-trade of the business of the assessee.
- ◆ However, such charge or transfer shall not be void if it is made:



- (i) for adequate consideration and without notice of the pendency of such proceeding or without notice of such tax or other sum payable by the assessee; or
 - (ii) with the previous permission of the Assessing Officer.
- ◆ This section applies to cases where the amount of tax or other sum payable or likely to be payable exceeds ₹ 5,000 and the assets charged or transferred exceed ₹ 10,000 in value..

7.15 SERVICE OF NOTICE GENERALLY [SEC. 282]

The service of a notice or summon or requisition or order or any other communication under this Act (hereafter in this section referred to as "communication") may be made by delivering or transmitting a copy thereof, to the person therein named:

- a) by post or by such courier services as may be approved by the Board; or
- b) in such manner as provided under the Code of Civil Procedure, 1908 for the purposes of service of summons; or
- c) by e-mail; or
- d) by any other means of transmission of documents as provided by rules made by the Board in this behalf.

7.16 AUTHENTICATION OF NOTICES AND OTHER DOCUMENTS [SEC. 282A]

- ◆ Where the Act requires a notice or other document to be issued by any income-tax authority, such notice or other document shall be signed and issued in paper form or communicated in electronic form by that authority in accordance with such procedure as may be prescribed.
- ◆ Every notice or other document 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.

7.17 RETURN OF INCOME, ETC., NOT TO BE INVALID ON CERTAIN GROUNDS [SEC. 292B]

No return of income, assessment, notice, summons or other proceeding, furnished or made or issued or taken or purported to have been furnished or made or issued or taken in pursuance of any of the provisions of this Act shall be invalid merely by reason of any mistake, defect or omission in such return of income, assessment, notice, summons or other proceeding if such return of income, assessment, notice, summons or other proceeding is in substance and effect in conformity with or according to the intent and purpose of this Act.

7.18 NOTICE DEEMED TO BE VALID IN CERTAIN CIRCUMSTANCES [SEC. 292BB]

Where an assessee has appeared in any proceeding or co-operated in any inquiry relating to an assessment or

reassessment, it shall be deemed that any notice, which is required to be served upon him, has been duly served upon him in time in accordance with the provisions of this Act and such assessee shall be precluded from taking any objection in any proceeding or inquiry under this Act 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, aforesaid provision is not applicable, where the assessee has raised such objection before the completion of such assessment or reassessment.

REFUND

7.19 REFUND MEANING [SEC. 237]

Where the tax paid by the assessee[#] is in excess of his tax liability, then such assessee shall be entitled to receive back such excess amount, called refund.

As per sec.237, if any person satisfies the Assessing Officer that the amount of tax paid by him (or on his behalf) for any assessment year, exceeds the amount with which he is chargeable under this Act, then he shall be entitled to a refund of such excess amount.

[#] Tax paid by the assessee includes the following -

1. Advance tax;
2. Tax deducted at source (TDS);
3. Tax collected at source (TCS);
4. Self assessment tax; and
5. Tax paid on demand

7.20 WHO CAN CLAIM REFUND

Following person can claim refund -

1. A person who has paid tax more than the amount for which he is chargeable under this Act [Sec. 237];
2. Where the income of one person is included in the total income of other person, such other person is entitled to claim refund on tax paid on such income [Sec. 238(1)]
3. Where due to death, incapacity, insolvency, liquidation or any other cause, a person is unable to claim or receive any refund due to him, his legal representative, trustee, guardian or receiver, as the case may be, can claim and receive such refund for the benefit of such person or his estate [Sec. 238(2)]

**7.21 FORM AND TIME LIMIT FOR CLAIMING REFUND [SEC. 239]**

Form: A claim for refund should be made in Form 30. Such form should be verified in the prescribed manner and shall be accompanied by the return of income except in cases where return had already been filed.

Time limit: Refund shall be claimed within 1 year from the end of relevant assessment year [Sec. 239]

7.22 REFUND ON APPEAL, ETC. [SEC. 240]

Where any refund becomes due as a result of any order passed in appeal or other proceedings, the Assessing Officer shall refund the amount to the assessee **suomoto** i.e. without any claim being made by the assessee in this behalf. Such refund shall become due on –

Case	When refund becomes due
Where an assessment is set aside or cancelled and an order of fresh assessment is directed to be made	The refund shall become due on completion of such fresh assessment and amount of refund shall be decided as per the fresh assessment.
Where the assessment is annulled	The refund shall become due when such assessment is annulled. The refund shall be only of the amount of the tax paid in excess of tax as per return.

7.23 CORRECTNESS OF ASSESSMENT NOT TO BE QUESTIONED [SEC. 242]

In a claim of refund, it shall not be open to the assessee to question the correctness of any assessment or other matter decided which has become final and conclusive or ask for a review of the same, and the assessee shall not be entitled to any relief on such claim except refund of tax wrongly paid or paid in excess.

7.24 INTEREST ON REFUND [SEC. 244A]

Refer Chapter Interest

7.25 SET-OFF OF REFUND AGAINST TAX REMAINING PAYABLE [SEC. 245]

If a refund is due to an assessee, it can be set-off against the sum payable under this Act. However, tax authorities must give a written intimation to the assessee before such set-off.

Notes

- a. Refund relevant to an assessment year cannot be set-off against tax of another assessment year.

- b. Arrear tax cannot be adjusted against refund on the request of the assessee.
- c. Refund due to assessee cannot be set off against demand outstanding from any other assessee.

7.26 WITHHOLDING OF REFUND IN CERTAIN CASES [SEC. 241A]

If the following conditions are fulfilled, the Assessing Officer, may, for reasons to be recorded in writing and with the previous approval of the Principal Commissioner or Commissioner, withhold the refund due to the assessee u/s 143(1) up to the date on which the assessment u/s 143(3) is made:

- a. Refund of any amount becomes due to the assessee u/s 143(1);
- b. The Assessing Officer is of the opinion, having regard to the fact that a notice has been issued u/s 143(2) [i.e., notice for scrutiny assessment u/s 143(3)] in respect of such return; and
- c. The Assessing Officer is of the opinion that the grant of the refund is likely to adversely affect the revenue.

Payment of interest on refund u/s 244A of excess TDS deposited u/s 195 [Circular 11/2016 dated 26-04-2016]

- ♦ The procedure for refund of tax deducted at source u/s 195, to the person deducting the tax is delineated in CBDT Circular No. 7/2007 dated 23-10-2007. Circular No. 7/2007 states that no interest u/s 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 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 Hon'ble Supreme Court of India in the case of 'Tata Chemical Limited', 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 Government, there being no express statutory provision for payment of interest on the refund of excess amount / tax collected by the Revenue, cannot shrug off its apparent obligation to reimburse the deductors lawful monies with the accrued interest for the period of undue retention of such monies. 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 resident deductor is entitled for the refund of tax deposited u/s 195, then it has to be refunded with interest u/s 244A, from the date of payment of such tax.



STUDY NOTE : 8

APPEALS, RECTIFICATION, REVISION, SETTLEMENT COMMISSION



This Study Note includes:

- 8.1 Appeals
- 8.2 Appeals to Commissioner of Income Tax (Appeals) [CIT (A)] [Sec. 246A to 250]
- 8.3 Appeals to Income Tax Appellate Tribunal (ITAT) [Sec. 252 to 255]
- 8.4 Appeal to High Court [Sec. 260A]
- 8.5 Appeal to the Supreme Court [Sec. 261]
- 8.6 Special provision for avoiding repetitive appeals [Sec. 158A]
- 8.7 Procedure when in an appeal by revenue an identical question of law is pending before Supreme Court [Sec. 158AA]
- 8.8 Revision of order prejudicial to the revenue [Sec. 263]
- 8.9 Revision of Order not Prejudicial to Revenue [Sec. 264]
- 8.10 A comparative study of revision u/s sec. 263 & revision u/s sec. 264
- 8.11 Settlement Commission [Sec. 245B]
- 8.12 Jurisdiction and powers of Settlement Commission [Sec. 245BA]
- 8.13 Application for Settlement of Cases [Sec. 245C & Rule 44C]
- 8.14 Procedure on Receipt of an Application [Sec. 245D]
- 8.15 Power of Settlement Commission
- 8.16 Abatement of Proceeding [Sec. 245HA]
- 8.17 Credit for Tax paid in case of Abatement of Proceedings [Sec. 245 HAA]
- 8.18 Order of Settlement to be Conclusive [Sec. 245-1]
- 8.19 Recovery of Sums due under Order of Settlement [Sec. 245]
- 8.20 Restriction on Subsequent Application for Settlement in certain cases [Sec. 245K]

One Law Dictionary defines 'appeal' as the act of asking a higher authority to change a decision of a lower authority. Right to appeal under income tax law is a creation of statute and not an inherent right. Appeal can be filed only against orders listed in the Income Tax Act and not any order.

Initially, following course of action are available in the Income-tax Act:

ASSESSEE

Rectification u/s 154

Appeals to CIT (Appeals)

Revision u/s 264

DEPARTMENT

Rectification u/s 154

Revision u/s 263

Reassessment u/s 147

**8.1 APPEALS****Appellate Authorities in Income-tax Act**

Appeal	Appellate authority	Against which order	Appellant
1 st	Commissioner (Appeals)	Against specified order of the Assessing Officer	Assessee only
2 nd	Income Tax Appellate Tribunal (ITAT)	Against the order of Commissioner (Appeals)	Assessee or the Commissioner (or Principal Commissioner) of Income tax.
3 rd	High Court	Against the order of ITAT (the case must involve substantial question of law)	
Final	Supreme Court	Against the order of High Court	

8.2 APPEALS TO COMMISSIONER OF INCOME TAX (APPEALS) [CIT (A)] [SEC. 246A TO 250]

Aggrieved tax payer can file appeal before the Commissioner (Appeals) having, jurisdiction over the tax payer. Designation of the Commissioner (Appeals), with whom appeal is to be filed is also mentioned in the notice of demand issued by the Assessing Officer u/s 156.

Provision regarding appeal to the Commissioner (Appeal) are enumerated below:

Appealable Orders	1. U/s 246A - Order passed by a Joint Commissioner u/s 115VP(3)(ii); - Order against the assessee, where the assessee denies his liability to be assessed under this Act; - Intimation u/s 143(1) or 143(1B) or 200A(1) or 206CB(1) or Order of assessment u/s 143(3) [Scrutiny assessment] [except an order passed in pursuance of directions of the Dispute Resolution Panel or an order referred to in sec. 144BA(12)] or u/s 144 [Best judgment assessment] in respect of income assessed or tax determined or loss computed or residential status; - Order of assessment, reassessment or recomputation u/s 147 [(except an order passed in pursuance of directions of the Dispute Resolution Panel or an order referred to in sec. 144BA(12)), 150 & 153A [except an order passed in pursuance of directions of the Dispute Resolution Panel or an order referred to in sec. 144BA(12)]; - Order u/s 154 (Rectification of Mistake) or u/s 155 (other amendments) having the effect of enhancing the assessment or reducing a refund or an order refusing to allow the claim made by the assessee [except where it is in respect of an order referred to in sec. 144BA(12)] - Order of assessment or reassessment u/s 92CD(3) - Order u/s 163 treating assessee as an agent of a non-resident; - Order u/s 170 relating to assessment on succession; - Order u/s 171 refusing to recognize partition of an HUF; - Order u/s 201 or 206C(6A) for default of provisions of TDS/TCS; - Order u/s 237 relating to refunds; - Order relating to Penalty; - Order imposing penalty under chapter XXI;

	- An order of penalty imposed under chapter XXI or an order of imposing or enhancing penalty u/s 275(1A) - Any order made by an Assessing Officer other than a Joint Commissioner, as the Board may direct. 2. U/s 248 Where under an agreement or other arrangement – - the tax deductible u/s 195 on any income (other than interest) is to be borne by the person by whom the income is payable; & - 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 Notes: a) Even when reassessment proceedings have been initiated u/s 147, an appeal can still be filed against the original assessment order passed u/s 143(3) b) Assessee has the right to appeal against an order of the Assessing Officer which is passed while giving effect to the decision of the appellate authority.	
Time limit for filing appeal	Appeal should be filed within 30 days from -	
	Where the appeal is u/s 248	The date of payment of the tax
	Where the appeal relates to any assessment or penalty	The date of service of notice of demand relating to the assessment or penalty
	In any other case	The date on which intimation of the order, sought to be appealed against, is served.
	Period to be excluded [Sec.268] While calculating the above time limit, following period shall be excluded - a) The day on which order complained of was served; and b) Time required for obtaining a copy of the order, where a copy of the order was not furnished with notice of demand. c) Where an application has been made u/s 270AA (seeking immunity from penalty and prosecution), the period beginning from the date on which the application is made, to the date on which the order rejecting the application is served on the assessee	
Delay in filing appeal	The Commissioner (Appeals) may admit belated application on sufficient cause being shown. Note: It is statutory obligation of the appellate authority (where an application for condonation is filed) to consider whether sufficient cause was shown by the appellant	
Form of appeal	Form 35 (Mode of filing depends i.e., electronically or in paper form, on mode of filing return of income of the assessee)	
Documents to be submitted	- Order against which appeal is made - Statement of facts - Grounds of appeal - Notice of demand (in Original) - Challan	
Verification of Form	Form & grounds of appeal must be verified by the person authorised to verify the return of income u/s 140	



Payment of tax before filing of appeal	If a return has been filed – Tax as per the return should be paid. If no return has been filed – The assessee should pay an amount equal to the advance tax which was payable by him. However, CIT(A) may, for any good and sufficient reason (recorded in writing), accept the appeal without payment of such advance tax. Power of Assessing Officer: As per sec. 220(6), where an assessee has presented an appeal u/s 246A, Assessing Officer may treat the assessee as not being in default in respect of the amount in dispute in the appeal. It may be applied - • at the discretion of the Assessing Officer; • subject to such conditions as Assessing Officer may think fit to impose; • even though the time for payment has expired; • as long as such appeal remains undisposed of. Where assessee has not made an application u/s 220(6) or his application u/s 220(6) has been rejected, he can approach the appellate authority for stay order against collection						
Fee	Where assessed income as computed by the Assessing Officer is - <table> <tr> <td>• Up to ₹ 1,00,000</td><td>– ₹ 250</td></tr> <tr> <td>• Exceeds ₹ 1,00,000 but does not exceed ₹ 2,00,000</td><td>– ₹ 500</td></tr> <tr> <td>• Exceeds ₹ 2,00,000</td><td>– ₹ 1,000</td></tr> </table> Where the subject matter of appeal is not covered in above cases – ₹ 250	• Up to ₹ 1,00,000	– ₹ 250	• Exceeds ₹ 1,00,000 but does not exceed ₹ 2,00,000	– ₹ 500	• Exceeds ₹ 2,00,000	– ₹ 1,000
• Up to ₹ 1,00,000	– ₹ 250						
• Exceeds ₹ 1,00,000 but does not exceed ₹ 2,00,000	– ₹ 500						
• Exceeds ₹ 2,00,000	– ₹ 1,000						
Procedure	1. Fixation of Day & Place: The Commissioner (Appeals) shall fix a day and place for the hearing of the appeal, and shall give notice of the same to the appellant and to the Assessing Officer against whose order the appeal is preferred. 2. Hearing: The appellant (either in person or by an authorised representative) and the Assessing Officer (either in person or by an authorised representative) shall have the right to be heard at the hearing of the appeal. Taxpoint: Where the assessee does not insist on a personal hearing the appeal may be decided on the basis of written submission made by him. [Letter No. 277/7/84 of November, 1985] 3. Adjournment: The Commissioner (Appeals) shall have the power to adjourn the hearing of the appeal from time to time. 4. Inquiry: The Commissioner (Appeals) may, before disposing of any appeal, make such further inquiry as he thinks fit, or may direct the Assessing Officer to make further inquiry and report the result of the same to the Commissioner (Appeals). 5. Order: Commissioner (Appeals) must dispose of the appeal by passing an order which shall - • be in writing; • mention the points for determination; • mention the decision thereon; and • mention the reason for the decision. 6. Communication of Order: The Commissioner (Appeals) shall communicate the order passed by him to the assessee and to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner. Note: If during pendency of an appeal, provision of any law has changed with retrospective effect, then such changed law shall be applicable on such appeal too. Law amended retrospectively would be a good law for applicability during the pendency of the appeal						

New grounds during hearing	The Commissioner (Appeals) may, at the hearing of an appeal, allow the appellant to go into any ground of appeal not specified in the 'grounds of appeal', if he is satisfied that the omission of that ground from the Form of appeal was not wilful or unreasonable.	
Time limit for disposal of appeal	Within one year from the end of financial year in which appeal is filed (if possible).	
Production of additional evidence	Appellate authority has the power to accept additional evidence (after recording reason for its admission in writing) and may make further enquiry at his discretion before disposing of the appeal In the following circumstances additional evidence shall be admitted by the Commissioner (Appeals): - Where the Assessing Officer has refused to admit evidence which ought to have been admitted; or - Where appellant was prevented by sufficient cause from producing before the Assessing Officer any evidence, which is related to any ground of appeal; or - Where the appellant was prevented by sufficient cause from producing the evidence, which he was called upon to produce by the Assessing Officer; or - Where the Assessing Officer has made an order (appealed against) without giving sufficient opportunity to the appellant to produce evidence relevant to any ground of appeal. Taxpoint: Before taking into account the additional evidence filed, Commissioner (Appeals) is to provide reasonable opportunity to the Assessing Officer for examining the additional evidence or the witness as well as to produce evidences to rebut additional evidences filed by the tax payer.	
Powers of Commissioner (Appeals) u/s 251	1. Against an order of assessment	To confirm, reduce, enhance or annul the assessment
	2. Against an order imposing a penalty	To confirm or cancel such order or vary it so as either to enhance or to reduce the penalty;
	3. Against the order of assessment in respect of which the proceeding before the Settlement Commission abates u/s 245HA	To confirm, reduce, enhance or annul the assessment after taking into consideration all the material and other information produced by the assessee before, or the results of the inquiry held or evidence recorded by, the Settlement Commission, in the course of the proceeding before it and such other material as may be brought on his record
	4. Relating to any other case	To pass such orders as he thinks fit.
	Notes: - The Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, notwithstanding that such matter was not raised before the Commissioner (Appeals) by the appellant. - Commissioner (Appeals) shall not enhance an assessment or a penalty or reduce the amount of refund unless the appellant has had a reasonable opportunity of showing cause against such enhancement or reduction. - An assessment order, which is void ab initio cannot become a valid order simply by virtue of the fact that it has been confirmed by an appellate authority.	



Withdrawal of appeal	Appeal once filed cannot be withdrawn.

8.3 APPEALS TO INCOME TAX APPELLATE TRIBUNAL (ITAT) [SEC. 252 TO 255]

Appeal against an order of Commissioner (Appeals) lies with the Income Tax Appellate Tribunal (ITAT). Both tax payer and the Assessing Officer can file appeal before the Appellate Tribunal. Several Benches of the Appellate Tribunal constituted all over India by the Central Government and it functions under the Ministry of Law. It consists of as many judicial and accountant members as the Central Government thinks fit to exercise the powers and discharge the functions conferred on the Appellate Tribunal by this Act.

Qualification of members

Member	Qualification
Judicial	• He has held a post of Judicial Officer in the territory of India for at least 10 years; or • He has been served as a member of the Indian Legal Service in Grade II post or any higher post for at least 3 years; or • He has been an advocate for at least 10 years.
Accountant	• He has practiced as a Chartered Accountant for at least 10 years; or • He has practiced as a registered accountant for at least 10 years; or • He has practiced partly as a registered accountant and partly as a Chartered Accountant for at least 10 years; or • He has been a member of the Indian Income-tax Service, Group A and has held the post of the Additional Commissioner of Income tax or any equivalent or higher post for at least 3 years.

President of the ITAT

- ♦ The Central Government shall appoint:
 - a. 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
 - b. one of the Vice-Presidents of the Appellate Tribunal,
 - to be the President thereof.
- ♦ The Central Government may appoint one or more members of the Appellate Tribunal to be the Vice-President(s) 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.

Appealable Orders and Procedure of Appeal

Appealable Orders	A. Appeal by assessee 1. An order passed by a Commissioner (Appeals) u/s 154, 250, 270A, 271, 271A, 271J or 272A; or 2. An order passed by a Principal Commissioner or Commissioner u/s 12AA [registration of trust], 80G(5)(vi), 263 [revision order], 154, 270A or 271 or 272A; or 3. An order passed by an Assessing Officer u/s 143(3) or 147 or 153A or 153C in pursuance of

	the directions of the Dispute Resolution Panel or with the the approval of the Commissioner (or Principal Commissioner) as referred to in sec. 144BA(12) or an order passed u/s 154 or 155 in respect of such order. 4. An order passed by an Assessing Officer u/s 115VZC(1) 5. An order passed by the prescribed authority u/s 10(23C)(iv) or (v) or (vi) or (via) 6. An order passed by Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Principal Director or Director u/s 272A [penalty]. B. Appeal by the Principal Commissioner or Commissioner The Principal Commissioner or Commissioner may direct the Assessing Officer to appeal against the order passed by the Commissioner (Appeals) u/s 154 or 250 [The Board has directed that the appeal shall be filed by the department only if tax effect exceeds ₹ 20,00,000, subject to certain exceptions]										
Time limit for filing appeal	Within 60 days. The period shall start from the date on which order sought to be appealed is communicated to the assessee or Commissioner.										
Delay in filing appeal	Tribunal may admit belated application on sufficient cause being shown.										
Withdrawal of appeal	An assessee cannot withdraw an appeal filed to Tribunal										
Form	Form 36										
Documents to be submitted and number of copies thereof	- Memorandum of Appeal - Order appealed against (including one certified copy) - Order of Assessing Officer - Grounds of appeal before first appellate authority - Statement of facts filed before first appellate authority - In case, appeal against order levying penalty, relevant order										
Fee payable by assessee	Where assessed income as computed by the Assessing Officer is - <table> <tr> <td>• Upto ₹ 1,00,000</td><td>— ₹ 500</td></tr> <tr> <td>• Exceeds ₹ 1,00,000 but does not exceed ₹ 2,00,000</td><td>— ₹ 1,500</td></tr> <tr> <td>• Exceeds ₹ 2,00,000</td><td>— 1% of Assessed income [Max. ₹ 10,000]</td></tr> <tr> <td>Stay petition</td><td>— ₹ 500</td></tr> <tr> <td>Any other case</td><td>— ₹ 500</td></tr> </table>	• Upto ₹ 1,00,000	— ₹ 500	• Exceeds ₹ 1,00,000 but does not exceed ₹ 2,00,000	— ₹ 1,500	• Exceeds ₹ 2,00,000	— 1% of Assessed income [Max. ₹ 10,000]	Stay petition	— ₹ 500	Any other case	— ₹ 500
• Upto ₹ 1,00,000	— ₹ 500										
• Exceeds ₹ 1,00,000 but does not exceed ₹ 2,00,000	— ₹ 1,500										
• Exceeds ₹ 2,00,000	— 1% of Assessed income [Max. ₹ 10,000]										
Stay petition	— ₹ 500										
Any other case	— ₹ 500										
Fee payable by CIT	No fees shall be payable in case of appeal by Commissioner										
Verification of Form	Form 36 and grounds of appeal should be verified by the person authorized to verify the return of income u/s 140 [Rule 47]										
Cross objection	Assessing Officer or the assessee, as the case may be, on receipt of notice that an appeal against the order of the Commissioner (Appeals) has been filed by the other party, may file a memorandum of cross objection with the Tribunal										
Time limit for filing of cross-objections	Within 30 days of receipt of notice that appeal has been filed by the other party. However, Tribunal may admit belated memorandum of cross objection on sufficient cause being shown.										
Form for filing of cross-objections	Form 36A										



Fee for cross objection	Nil
Order of tribunal	The Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders as it thinks fit. Tribunal must record its reasons for its decisions. Order should set out all facts and contentions. Communication of order: Tribunal shall send a copy of the order passed by it to the assessee and to the Principal Commissioner or Commissioner. Notes: - Decision of Tribunal on matter involving question of fact is final. However, one can file a writ petition. - A decision of the tribunal, when passed in appeal, is final not only for the assessee but also for the tribunal itself. - The assessee cannot seek to reopen and reargue the whole matter. i.e. order of Tribunal cannot be reviewed by Tribunal. - On a question of fact determined by ITAT, a writ petition can be filed to the High Court challenging the fact finding process adopted by the ITAT. If the High Court is satisfied that the fact finding process was not correct, then it will quash the order passed by the ITAT and direct the ITAT to do the fact finding in the proper manner and/or as per the direction of the High Court. If the writ petition is dismissed by the High Court then the assessee can file a Special Leave Petition to the Apex Court challenging the fact finding process of the ITAT. If the Apex Court is satisfied that the fact finding process was incorrect then the Apex Court quash the order passed by the ITAT and direct the ITAT to do the fact finding in the proper manner and/or as per the direction of the Apex Court.
Rectification of mistake (Miscellaneous Application)	- The Tribunal may, at any time within 6 months from the end of the month in which the order was passed, with a view to rectify any mistake apparent from the record, amend any order passed by it. - Mistake may be brought to the notice of the Tribunal by the assessee or the Assessing Officer. - Where assessee applies for any rectification, it shall be accompanied by a fee of ₹ 50. - An amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee, shall not be made unless the Appellate Tribunal has given notice to the assessee of its intention to do so and has allowed the assessee a reasonable opportunity of being heard. - It is to be noted that income tax authority [including CIT(A)] can rectify order u/s 154, however in that case: - Assessee is not required to pay any fee; and - Time limit is 4 years from the end of the financial year in which the order sought to be rectified was passed.
Additional grounds which may be taken in appeal	Tribunal has discretionary power to refuse additional ground to be raised. Tribunal may permit the assessee to urge grounds of appeal not mentioned in the memorandum of appeal



Additional evidence	The parties to the appeal are not entitled to produce additional evidence of any kind, either oral or documentary before the Tribunal. However, if the Tribunal requires production of any document, examination of any witness or filing of any affidavit to enable it to pass orders, it may allow such document to be produced, witness to be examined, affidavit to be filed and such evidence to be adduced.
Paper Book	The appellant or the respondent, as the case may be, may submit a paper book in duplicate containing documents or statements or other papers referred to in the assessment or appellate order, which it may wish to rely upon. The paper book duly indexed and page numbered is to be filed at least a day before the hearing of the appeal along-with proof of service of copy of the same on the other side at least a week before. The Bench may in appropriate cases condone the delay and admit the paper book. The Tribunal can also, on its own direct preparation of paper book in triplicate by and at the cost of appellant or the respondent as it may consider necessary for disposal of appeal. Each paper in the paper book is to be certified as true copy by the party filing the same. Additional evidence, if any, should not be part of the paper book and it should be filed separately
Time limit for passing order	Appellate Tribunal, where it is possible, may hear and decide such appeal within a period of 4 years from the end of the financial year in which such appeal is filed. However, the Tribunal may pass an order of stay in any proceedings for a period not exceeding 180 from the date of such order and the Tribunal shall dispose of the appeal within the said period of stay specified in that order. Further where such appeal is not so disposed of within the said period of stay as specified in the order of stay, the Tribunal may, 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, extend the period of stay, or pass an order of stay for a further period or periods as it thinks fit; so, however, 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 and the Tribunal shall dispose of the appeal within the period or periods of stay so extended or allowed Further if such appeal is not so disposed of within the period allowed (original and extended), the order of stay shall stand vacated after the expiry of such period (i.e., 365 days), even if the delay in disposing of the appeal is not attributable to the assessee.
Cost of appeal	Cost of appeal shall be borne by the person as decided by the Tribunal.
Procedure	◆ The powers and functions of the Appellate Tribunal may be exercised and discharged by Benches constituted by the President of the Appellate Tribunal from among the members thereof. ◆ A Bench shall consist of one judicial member and one accountant member. However, in some case, single member bench may be constituted. ◆ The President or any other member of the Appellate Tribunal authorised in this behalf by the Central Government may, sitting singly, dispose of any case which has been allotted to the Bench of which he is a member and which pertains to an assessee whose total income as computed by the Assessing Officer in the case does not exceed ₹ 50 lakh. ◆ The President may, for the disposal of any particular case, constitute a Special Bench consisting of 3 or more members, one of whom shall necessarily be a judicial member and one an accountant member.



- ◆ If the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority. But if the members are equally divided, then the case shall be referred by the President of the Appellate Tribunal for hearing on such point by one or more of the other members of the Appellate Tribunal, and such point shall be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case, including those who first heard it.

8.4 APPEAL TO HIGH COURT [SEC. 260A]

Who can file appeal	Assessee or the Principal Chief Commissioner / Chief Commissioner / Principal Commissioner / Commissioner, being aggrieved by the order of ITAT. Taxpoint: Only order passed by the ITAT (which involves substantial question of law) can be appealed in the High court. [The Board has directed that the appeal shall be filed by the department only if tax effect exceeds ₹ 50,00,000, subject to certain exceptions]
Appealable order	Any order of the Tribunal, if the High Court is satisfied that the case involves a substantial question of law.
Substantial question of law	• The word "substantial" means having substance, essential, real, of sound worth, important or considerable; • The substantial question of law, need not necessarily be a substantial question of law of general importance (i.e. it should be a question of law between the parties); • To be "substantial", a question of law must be debatable, not previously settled by law of the land or a binding precedent, and must have a material bearing on the decision of the case.
Time limit for filing appeal	120 days from the date on which order of the Tribunal is received by the assessee or Principal Chief Commissioner / Chief Commissioner / Principal Commissioner / Commissioner The High Court may admit an appeal after the expiry of said period, if it is satisfied that there was sufficient cause for not filing the same within that period.
Court Fee	The Court fee shall be as specified in relevant law relating to Court fees for filing an appeal to High Court
Manner of appeal	The appeal shall be in form of a memorandum of appeal, precisely stating the substantial question of law involved in the appeal.
Formulation of question of law	• Where the High Court is satisfied that a substantial question of law is involved, it shall formulate the question. • The appeal is to be heard only on the questions formulated. However, the respondents shall, at the hearing of appeal, be allowed to argue that the case does not involve such question.
Hearing of appeal	• The appeal is to be heard by a bench of not less than 2 judges of the High Court. Decision will be in accordance with opinion of the majority of judges.

	Where judges are equally divided in their opinions, the case on the point on which they differ shall be heard by one or more other judges of the High Court.
Hearing of other substantial question of law	The Court has the 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.
Decision	The High Court shall decide the question of law so formulated and deliver such judgment thereon containing the ground on which such decision is founded and may award such cost as it deems fit. The High Court may determine any issue which - - has not been determined by the Tribunal; or - has been wrongly determined by the Tribunal, by reason of a decision on such question of law .
Stay of recovery proceedings	High Court has power to stay proceedings for recovery of demand arising out of the assessment order, pending disposal of appeal.

8.5 APPEAL TO THE SUPREME COURT [SEC. 261]

Who can file appeal	Assessee or the Principal Chief Commissioner / Chief Commissioner / Principal Commissioner / Commissioner aggrieved from the judgment of High Court.. [The Board has directed that the appeal shall be filed by the department only if tax effect exceeds ₹ 1,00,00,000, subject to certain exceptions]
Order against which appeal is possible	Any order passed in the High Court, provided that High Court - is satisfied that the case involves a substantial question of law; and - certifies the case is fit for appeal to the Supreme Court.
If High Court refuses to certify the case	The aggrieved party may make an application to the Supreme Court under Article 136 of the Constitution of India.
Cost of appeal	The costs of the appeal shall be borne by the person as decided by the Supreme Court
Effect of judgment	Where the judgment of the High Court is varied or reversed by the Supreme Court, Tribunal should pass necessary order to dispose the case in conformity with such judgment.

8.6 SPECIAL PROVISION FOR AVOIDING REPETITIVE APPEALS [SEC. 158A]

- ◆ Where an assessee claims (a declaration in the Form 8 and verified in the prescribed manner) that:
 - any question of law arising in his case for an assessment year which is pending before the Assessing Officer or any appellate authority (such case being hereafter in this section referred to as the relevant case) is identical
 - with a question of law arising in his case for another assessment year which is pending before the High Court or the Supreme Court (such case being hereafter in this section referred to as the other case),



- and if the Assessing Officer or the appellate authority, as the case may be, agrees to apply in the relevant case the final decision on the question of law in the other case,
- he shall not raise such question of law in the relevant case in appeal before any appellate authority.
- ◆ The Assessing Officer or the appellate authority, as the case may be, may, by order in writing:
 - i. admit the claim of the assessee if he or it is satisfied that the question of law arising in the relevant case is identical with the question of law in the other case; or
 - ii. reject the claim if he or it is not so satisfied.
- ◆ Such order shall be final and shall not be called in question in any proceeding by way of appeal or revision under this Act.
- ◆ Where a claim is admitted:
 - a. the Assessing Officer or the appellate authority may make an order disposing of the relevant case without awaiting the final decision on the question of law in the other case; and
 - b. the assessee shall not be entitled to raise, in relation to the relevant case, such question of law in appeal.
- ◆ When the decision on the question of law in the other case becomes final, it shall be applied to the relevant case and the Assessing Officer or the appellate authority, shall, if necessary, amend the order conformably to such decision.

8.7 PROCEDURE WHEN IN AN APPEAL BY REVENUE AN IDENTICAL QUESTION OF LAW IS PENDING BEFORE SUPREME COURT [SEC. 158AA]

- ◆ Where the Commissioner or Principal Commissioner is of the opinion that
 - any question of law arising in the case of an assessee for any assessment year (such case being herein referred to as relevant case) is identical with a question of law arising in his case for another assessment year which is pending before the Supreme Court, against the order of the High Court in favour of the assessee (such case being herein referred to as the other case),
 - he may, instead of directing the Assessing Officer to appeal to the Appellate Tribunal, direct the Assessing Officer to make an application to the Appellate Tribunal in the prescribed form within 60 days from the date of receipt of the 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 other case.
- ◆ The Commissioner or Principal Commissioner shall direct the Assessing Officer to make an application 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.
- ◆ Where the order of the Commissioner (Appeals) is not in conformity with the final decision on the question of law in the other case, the Commissioner or Principal Commissioner may direct the Assessing Officer to appeal to the Appellate Tribunal against such order and save as otherwise provided in this section all other provisions of Part B of Chapter XX shall apply accordingly.
- ◆ Aforesaid appeal shall be filed within 60 days from the date on which the order of the Supreme Court in the other case is communicated to the Commissioner or Principal Commissioner.

REVISION

8.8 REVISION OF ORDER PREJUDICIAL TO THE REVENUE [SEC. 263]

Orders which may be revised	Any order passed by the Assessing Officer, which is - - Erroneous; - Prejudicial to the interests of the revenue; and - Passed by an authority subordinate to the Principal Commissioner or Commissioner. Notes - Orders passed by the Assessing Officer includes - - An order of assessment made by the Assistant Commissioner on the basis of the directions issued by the Joint Commissioner u/s 144A; - An order made by the Joint Commissioner as an Assessing Officer. - Even an intimation u/s 143(1) can be revised Taxpoint - Order made by the Assessing Officer after making proper enquiries and considering relevant details and decisions of Supreme Court cannot be said to be erroneous and prejudicial to the interest of the revenue, hence such order cannot be revised. - 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 order is passed allowing any relief without inquiring into the claim; - the order has not been made in accordance with any order, direction or instruction issued by the Board under section 119; or - 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 .
Treatment of an order, which is subject matter of the appeal	Revision u/s 263 of an order, which is subject matter of appeal, cannot be made. Notes - The Principal Commissioner or Commissioner can revise such order (which has been a subject matter of appeal) which had not been considered and decided in such appeal. E.g., From the perusal of the order u/s 143(3) passed by the Assessing Officer following was observed: - Point A: Against the assessee - Point B: In favour of the assessee



	The assessee being aggrieved with point A in the order passed by the Assessing Officer, preferred an appeal to the Commissioner (Appeals). However, the Commissioner wants to revise the order u/s 263 for point B (subject to other conditions being fulfilled). It is possible as doctrine of partial merger of the order is applicable in case of sec. 263. However, the Commissioner cannot revise the order for point A (as the same is subject matter of an appeal) • An order cannot be said to have been made subject of an appeal if the appeal has been disposed of by the appellate authority without passing an order
Procedure to be followed	1. Examination of Records: The Principal Commissioner or Commissioner may call for and examine the records of any proceeding under the Act. If he considers that any order passed by the Assessing Officer is prejudicial to the interest of the revenue, he can revise and rectify the assessment. Record shall include all records relating to any proceeding under this Act available at the time of examination by the Principal Commissioner or Commissioner. This means that any material, which was not available at the time of assessment but available at the time of examination by the Principal Commissioner or Commissioner, shall also be considered for order u/s 263. 2. Inquiry: He must make or cause to be made such inquiry as he deems necessary. 3. Opportunity of being Heard: No revision order shall be passed u/s 263 without giving the assessee an opportunity of being heard. 4. Order: Finally, he may pass such revision order as the circumstances of the case justify including an order enhancing, modifying or cancelling the assessment and directing a fresh assessment.
Time limit for passing revision order	2 years from the end of the financial year in which the order sought to be revised was passed. In computing the above period of limitation following period shall be excluded - • Time taken in giving an opportunity to the assessee of being re-heard u/s 129; & • Any period during which any proceeding under this section is stayed by an order or injunction of any court. Exception: There is no time limit for passing a revision order to give effect to, or in consequence of, an order of the ITAT, the High Court or the Supreme Court.
Appeal against order u/s 263	A revisional order passed by the Principal Commissioner or Commissioner u/s 263 can be appealed to the Tribunal.
Sec.263 vs. sec.154: Principal Commissioner or Commissioner can exercise the power even in a case where the issue is debatable. Revisional power u/s 263 is not comparable with the power of rectification of mistake u/s 154.	

8.9 REVISION OF ORDER NOT PREJUDICIAL TO REVENUE [SEC. 264]

Orders which may be revised	Any order which is - • erroneous; • not covered u/s 263 (i.e. not prejudicial to the interest of the revenue); • passed by an authority subordinate to the Principal Commissioner or Commissioner.



	Taxpoint: No order under this section can be passed which is prejudicial to the assessee. Notes: a) Order which is not appealable before the Commissioner (Appeal) can also be referred to the Commissioner for revision. b) For the purposes of this section, the Deputy Commissioner (Appeals) shall be deemed to be an authority subordinate to the Commissioner.
On whose motion is revision possible	Either on own motion of the Principal Commissioner / Commissioner or on an application by the assessee for revision.
Procedure to be followed	1. Examination of Records: Once revision proceedings have been initiated, the Principal Commissioner or Commissioner may call for and examine the record of any proceeding. 2. Inquiry: He must also make or cause to be made such inquiry as he deems necessary 3. Order: He may pass such revision order as the circumstances of the case justify. However, the order passed should not be prejudicial to the assessee.
Time limit for filing an application	Where revision has been initiated by the assessee, the application must be made within 1 year from the date on which the order in question was communicated to the assessee or the date on which he otherwise came to know of it, whichever is earlier. However, the Principal Commissioner or Commissioner can admit a belated application if the assessee was prevented by sufficient cause from making the application within time. In computing the above period of limitation following time shall be excluded: • The day on which the order complained of was served; and • If the assessee had not received the copy of the order, the time required to obtain copy of such order.
Time limit for passing a revisional order	Where the Principal Commissioner or Commissioner acts on his own motion – Within 1 year from the date of original order Where the application is made by the assessee – Within 1 Year from the end of the financial year in which such application is made. In computing the above period of limitation following period shall be excluded. • Time taken in giving an opportunity to the assessee of being re-heard u/s 129; & • Any period during which any proceeding under this section is stayed by an order or injunction of any court. [Sec. 264(6)] • However, there is no time limit for passing a revision order for giving effect to, or in consequence of, an order of the ITAT, the High Court or the Supreme Court
Orders which cannot be revised	a) Where an order is appealable but no appeal has been made to CIT (Appeals) or to the Tribunal and time within which such appeal can be made, has not expired. Note: Where an appeal lies to the Commissioner (Appeals) or to the Appellate Tribunal and the right of appeal is waived by the assessee, the Principal Commissioner or Commissioner may revise the order even before the expiry of time limit of appeal. b) Where the order has been made the subject of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal. E.g., the assessee has been aggrieved with point A and point B in the order passed by the Assessing Officer. He preferred an appeal to the Commissioner (Appeals) in respect



	of point A and seeks to file revision petition u/s 264 in respect of point B. It is not possible, he cannot file revision petition u/s 264 due to doctrine of total (or complete) merger of the order. He has to choose either way of the course. It is to be noted that for the purpose of sec. 264, doctrine of total merger is applicable, on the other hand, for the purpose of sec. 147, 154 and 263, doctrine of partial merger is applicable. Note The assessment order could not be said to have been made subject matter of appeal, where an appeal was dismissed - a) on the ground that the same was incompetent; or b) as barred by limitation; or .
Fee	₹ 500 where the application for revision is made by the assessee.
Appeal against order u/s 264	A revisional order passed by the Principal Commissioner or Commissioner u/s 264 cannot be appealed to the Tribunal or the High Court. However, a petition for a writ of certiorari under Article 226 is maintainable
Other points	- The assessee cannot claim the right of revision in respect of an earlier year on the basis of finding of the Tribunal for a subsequent year. - An order by the Principal Commissioner or Commissioner declining to interfere shall not be deemed to be an order prejudicial to the assessee.

8.10 A COMPARATIVE STUDY OF REVISION U/S SEC. 263 & REVISION U/S SEC. 264

Basis	Sec. 263	Sec. 264
Which order can be revised	Order, which is prejudicial to the interest of revenue.	Order, which is prejudicial to the interest of assessee.
Proceedings at the motion of	At the own motion of the Pr. Commissioner or commissioner.	At the own motion of the Pr. Commissioner or commissioner or on the application of the assessee.
Scope	Revision is possible of the issues which have not been considered and decided in an appeal, i.e., doctrine of partial merger is applicable	Revision u/s 264 is not possible on any issue if an appeal has been filed, i.e., doctrine of total merger is applicable
Time limit for application	Assessee does not apply	Within 1 year from the date on which the order in question was communicated to the assessee
Time limit for passing a revisional order	2 years from the end of the financial year in which the order sought to be revised was passed.	- Where the Pr. Commissioner or commissioner acts on his own motion: within 1 year from the date of original order. - Where the application is made by the assessee: within 1 year from

		<i>the end of the financial year in which such application is made.</i>
Fee	Not applicable	₹ 500 where the application for revision is made by the assessee.
Appeal against order	Appeal can be filed to the Tribunal	No appeal can be filed.
Beneficial to	Revenue	Assessee

SETTLEMENT COMMISSION

"In the administration of fiscal laws, whose 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 unintended defaulter from making a clean breast of his affairs, but would also unnecessarily strain the investigational resources of the Department in case of doubtful benefit to revenue, while needlessly proliferating litigation and holding up collections. We would, therefore, suggest that there should be a provision in the law for a settlement with the taxpayer at any stage of the proceedings."

Based on the above recommendations of the Wanchoo Committee, the Settlement Commission was set up for settling across the board, tax liabilities in complicated cases with doubtful benefit to revenue and thereby ensure a mechanism to avoid protracted and endless litigation and save avoidable strain on investigational resources of the Income-tax Department.

8.11 SETTLEMENT COMMISSION [SEC. 245B]

Chapter XIXA provides for settlement of cases pending before income-tax authority. For this purpose, the Central Government constituted the 'Settlement Commission'. The Commission shall consist of a Chairman and as many Vice-Chairmen and other members as the Central Government thinks fit. It shall function within the Department of the Central Government dealing with direct taxes.

The members shall 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.

Where a member of the Board is appointed as a member of the Commission, he shall cease to be a member of the Board.

8.12 JURISDICTION AND POWERS OF SETTLEMENT COMMISSION [SEC. 245BA]

- ◆ The jurisdiction, powers and authority of the Settlement Commission may be exercised by Benches thereof.
- ◆ A Bench shall be presided over by the Chairman or a Vice-Chairman and shall consist of 2 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, as the case may be, other Member of another Bench.
- ◆ When one of the persons constituting a Bench (whether such person be the Presiding Officer or other Member of the Bench) is unable to discharge his functions owing to absence, illness or any other cause or in the event of the occurrence of any vacancy either in the office of the Presiding Officer or in the office of one or the other Members of the Bench, the remaining two persons may function as the Bench and if the Presiding Officer of the Bench is not one of the remaining two persons, the senior among the remaining persons shall act as the Presiding Officer of the Bench.
- ◆ If at any stage of the hearing of any such case or matter, it appears to the Presiding Officer that the case is ought to be heard of by a Bench consisting of 3 Members, the case may be referred by the Presiding Officer of such Bench to the Chairman for transfer to such Bench as the Chairman may deem fit.
- ◆ The Chairman may, for the disposal of any particular case, constitute a Special Bench consisting of more than 3 Members.
- ◆ The places at which the principal Bench and the additional Benches shall ordinarily sit shall be such as the Central Government may, by notification in the Official Gazette, specify and the Special Bench shall sit at a place to be fixed by the Chairman.
- ◆ **Transfer of cases:** On the application of the assessee or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner and after notice to them, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Chairman may transfer any case pending before one Bench, for disposal, to another Bench [Sec. 245BC]
- ◆ **Decision by majority:** If the Members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority. But if the Members are equally divided, they shall refer the point to the Chairman who shall either hear the point himself or refer the case for hearing on such point by one or more of the other Members of the Settlement Commission and such point shall be decided according to the opinion of the majority of the Members of the Settlement Commission who have heard the case, including those who first heard it [Sec. 245BD]

8.13 APPLICATION FOR SETTLEMENT OF CASES [SEC. 245C & RULE 44C]

Who can apply	Any assessee
When to apply	At any stage of a Case ¹
Conditions to be satisfied for application	a. The additional amount of income-tax² payable on the income disclosed in the application exceeds specified amount³. b. such tax and the interest thereon, which would have been paid under the provisions of this Act had the income disclosed in the application been declared in the return of income before the Assessing Officer on the date of application, has been paid on or before the date of making the application and the proof of such payment is attached with the application
Submission of application form	A settlement application shall be presented in Form No. 34B (in quintuplicate) by the applicant in person or by his agent, to the Secretary at the headquarters of the Commission at New Delhi or of the Bench within whose jurisdiction his case falls or to any officer authorised in this behalf by the Secretary, or shall be sent by registered post addressed to the Secretary, or to such officer.

	A settlement application sent by post shall be deemed to have been presented on the day on which it is received in the office of the Commission.
Information to be given in the form	Following information are required to be given in application form – • Full and true disclosure of his income which has not been disclosed before the AO; • The manner in which such income has been derived; • The additional amount of income-tax payable on such income; and • Such other particulars as may be prescribed.
Fees	The application should be accompanied by fee of ₹ 500.
Verification of the application	Every application and other document accompanied with such application must be verified by the person who is authorised to verify return of income u/s 140
Intimation to the AO	An assessee shall, on the date on which he makes an application, also intimate the AO in the prescribed manner of having made such application to the Commission

- ¹. Case means any proceeding for assessment, of any person in respect of any assessment year or assessment years which may be pending before an Assessing Officer on the date on which an application is made.

Taxpoint

1. A proceeding for assessment or reassessment or recomputation u/s 147 shall be deemed to have commenced:
 - a. from the date on which a notice u/s 148 is issued for any assessment year;
 - b. from the date of issuance of the notice referred above, for any other assessment year or assessment years for which a notice u/s 148 has not been issued, but such notice could have been issued on such date, if the return of income for the other assessment year or assessment years has been furnished u/s 139 or in response to a notice u/s 142;
2. A proceeding for making fresh assessment in pursuance of an order u/s 254 or sec. 263 or sec. 264, setting aside or cancelling an assessment shall be deemed to have been commenced from the date on which such order, setting aside or cancelling an assessment was passed;
3. A proceeding for assessment or reassessment for any of the assessment years u/s 153A / 153C shall be deemed to have commenced on the date of issue of notice initiating such proceeding and concluded on the date on which the assessment is made;
4. A proceeding for assessment for any assessment year, other than aforesaid proceedings shall be deemed to have commenced from the date on which the return of income for that assessment year is furnished u/s 139 or in response to a notice served u/s 142 and concluded on the date on which the assessment is made; or on the expiry of the time specified for making assessment u/s 153(1), in case where no assessment is made.

2. Additional amount of Income Tax

The additional amount of income-tax payable shall be calculated in accordance with the following provisions –

a. Where the income disclosed in the application relates to only one previous year -

Situation	Income for the purpose	Additional amount of tax
Col. 1	Col. 2	Col. 3
If return of such year has not been filed u/s 139 (whether or not assessment has been made)	Income disclosed in the application	Tax as calculated on income shown in col. 2



If return of such income has been submitted (whether or not assessment has been made)	Income disclosed in the application as well as in the return	Tax as calculated on income shown in col. 2 Less: Tax calculated on the total income returned for that year	**** (**)

b. Where the income disclosed in the application relates to more than one previous year –

- Calculate additional amount of income tax payable (as mentioned above) in respect of each year for which the application has been made.
- The aggregate amount of the additional income tax of each of the years shall be the additional amount of income-tax payable.

3. Specified Amount

Particulars	Amount
Where an application before the Commission is filed in a case where proceedings for assessment or reassessment have been initiated as a result of search or as a result of requisition of books of account or assets, etc.	Additional amount of income tax payable on the income disclosed in application should exceeds ₹ 50 lakh
Where the applicant is related to the aforesaid person and in whose case proceedings have been initiated as a result of search	Additional amount of income tax payable on the income disclosed in application should exceeds ₹ 10 lakh
In any other case	Additional amount of income tax payable on the income disclosed in application should exceeds ₹ 10 lakh

Taxpoint: An application made to the Commission shall not be allowed to be withdrawn by the assessee.

8.14 PROCEDURE ON RECEIPT OF AN APPLICATION [SEC. 245D]

- ◆ **Admission or Rejection of Application:** On receipt of an application, the Settlement Commission shall within 7 days from the date of receipt of the application, issue a notice to the applicant requiring him to explain as to why the application made by him be allowed to be proceeded with, and on hearing the applicant, the Settlement Commission shall, within a period of 14 days from the date of the application, by an order in writing, reject the application or allow the application to be proceeded with.

Taxpoint: Where no order has been passed within the aforesaid period by the Settlement Commission, the application shall be deemed to have been allowed to be proceeded with.

- ◆ **Report from the Commissioner**

- ▶ The Commission shall (in respect of an application which is allowed to be proceeded) within 30 days from the date on which the application was made call for a report from the Principal Commissioner or Commissioner, and the Principal Commissioner or Commissioner shall furnish the report within a period of 30 days of the receipt of communication from the Settlement Commission.
- ▶ On the basis of the report and within a period of 15 days of the receipt of the report, by an order in writing (and after giving an opportunity of being heard), declare the application in question as invalid and shall send the copy of such order to the applicant and the Commissioner.
- ▶ Where the Principal Commissioner or Commissioner has not furnished the report within the aforesaid period, the Settlement Commission shall proceed further in the matter without the report of the Commissioner

♦ Examination of Records and Passing of Order

- ▶ The Commission in respect of an application which has not been declared invalid may call for the records from the Principal Commissioner or Commissioner.
- ▶ After examination of such records, if the Settlement Commission is of the opinion that any further enquiry or investigation in the matter is necessary, it may direct the Principal Commissioner or Commissioner to make such further enquiry or investigation and furnish a report on the matters covered by the application and any other matter relating to the case.
- ▶ The Principal Commissioner or Commissioner shall furnish the report within a period of 90 days of the receipt of communication from the Settlement Commission. Where the Principal Commissioner or Commissioner does not furnish the report within the aforesaid period, the Settlement Commission may proceed to pass an order without such report.
- ▶ After -
 - (a) examination of the records and the report of the Principal Commissioner or Commissioner, if any, received;
 - (b) giving an opportunity to the applicant and to the Principal Commissioner or Commissioner to be heard (either in person or through a representative)
 - (c) and after examining such further evidence as may be placed before it or obtained by it,the Settlement Commission may, in accordance with the provisions of this Act, 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.

♦ Every such order shall provide for -

- (a) The terms of settlement including any demand by way of tax, penalty or interest;
- (b) The manner in which any sum due under the settlement shall be paid;
- (c) All other matters to make the settlement effective; and
- (d) The settlement shall be void if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.

♦ Such order shall be passed within 18 months from the end of the month in which the application was made**♦ Time Limit for Payment of Tax:** Any tax payable in pursuance of order of settlement commission must be paid within 35 days of the receipt of a copy of the order.**♦ Interest on Late Payment of Tax due on Settlement:** Where tax, as settled by the Commission, is not paid within 35 days of the receipt of a copy of the order (whether or not the Commission has extended the time for payment), the assessee shall be liable to pay simple interest @ 1.25% p.m. on the amount remaining unpaid from the date of expiry of the period of 35 days.**♦ Settlement obtained by Fraud, etc.:** The settlement shall be void, if it is subsequently found by the Settlement Commission, that it has been obtained by fraud or misrepresentation of facts.**♦ Consequences where the Settlement becomes Void**

- ▶ Where a settlement becomes void, the proceedings shall be deemed to have been revived from the stage at which the application was allowed to be proceeded with by the Settlement Commission.
- ▶ The income-tax authority concerned may complete such proceedings before the expiry of two years from the end of the financial year in which the settlement became void.



- ♦ **Rectification of Order:** The Settlement Commission may, with a view to rectifying any mistake apparent from the record, amend any order passed by it:

- (a) at any time within a period of 6 months from the end of the month in which the order was passed; or
- (b) at any time within the period of 6 months from the end of the month in which an application for rectification has been made by the Principal Commissioner or the Commissioner or the applicant, as the case may be.

However, no application for rectification shall 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 for settlement is passed by the Settlement Commission.

An amendment which has the effect of modifying the liability of the applicant shall not be made unless the Settlement Commission has given notice to the applicant and the Principal Commissioner or Commissioner of its intention to do so and has allowed the applicant and the Principal Commissioner or Commissioner an opportunity of being heard.

8.15 POWER OF SETTLEMENT COMMISSION

- ♦ **To order Provisional Attachment to protect Revenue [Sec. 245DD]**

- ▶ Where, during the pendency of any proceeding, the Settlement Commission is of the opinion that for the purpose of protecting the interests of the revenue it is necessary to do so, it may, by order, attach provisionally (in the manner provided in the Second Schedule) any property belonging to the applicant.
- ▶ Cessation of Attachment: Every provisional attachment shall cease to have effect after the expiry of a period of 6 months from the date of such order. However, the Commission may, for reasons to be recorded in writing, extend the period by such further period(s) as it thinks fit.

- ♦ **To provide Inspection, etc., of Reports [Sec. 245G]**

- ▶ No person shall be entitled to inspect or obtain copies of, any reports given by any income-tax authority to the Commission. However, on an application, the Commission may furnish copies thereof to any such person on payment of the prescribed fee.
- ▶ For the purpose of enabling assessee to rebut any evidence brought on record against him in any such report, the Settlement Commission shall furnish him with a certified copy of any such report or part thereof relevant for the purpose. For this purpose, assessee needs to make an application and payment of the prescribed fee.

- ♦ **To grant Immunity from Prosecution and Penalty [Sec. 245H]**

- ▶ The Settlement Commission may grant immunity (subject to such conditions as it may think fit to impose for the reasons to be recorded in writing) from –
 - (a) Prosecution for any offence under this Act or under the Wealth Tax Act; and
 - (b) Imposition of any penalty (wholly or partly) under this Act,– with respect to the case covered by it.
- ▶ Such immunity can be granted by the Commission, if the assessee –
 - (a) has co-operated with the Settlement Commission in the proceedings before it;

- (b) has made a full and true disclosure of his income; and
- (c) has made a full and true disclosure of the manner in which such income has been derived.

Taxpoint:

- Such immunity shall not be granted by the Settlement Commission in cases where the proceedings for the prosecution have been instituted before the date of receipt of the application u/s 245C.
- The Settlement Commission does not have the power to reduce or waive interest statutorily payable u/s 234A, 234B and 234C, except to the extent of granting relief under circulars issued by the Board (see chapter 'Interest')
- It has to be noted that waiver or reduction of interest u/s 220(2A) and other provisions is waived or reduced with certain conditions. If these conditions are satisfied, the Commission has the power to direct waiver or reduction
- Interest u/s 234B shall be charged upto date of the order of Settlement Commission u/s 245D(4)

♦ Withdrawal of Immunity Granted

An immunity granted to a person shall stand withdrawn if –

- (1) Such person fails to -
 - (a) Pay any sum specified in the order of settlement within the time allowed by the Settlement Commission; or
 - (b) Comply with any other condition(s) subject to which the immunity was granted.
- (2) Such person had, in the course of the settlement proceedings, concealed any particulars material to the settlement or had given false evidence.

♦ Consequences of Withdrawal of Immunity Granted

On withdrawal of immunity granted the provisions of this Act shall apply as if such immunity had not been granted.

♦ Other Power [Sec. 245F]

- (1) In addition to the powers conferred on the Settlement Commission under this Chapter, it shall have all the powers, which are vested in an income-tax authority under this Act.
- (2) The Commission shall have exclusive jurisdiction from the date on which the application was made. Where an application is rejected or not allowed to be further proceeded or declared invalid, the Commission shall have such exclusive jurisdiction upto the date on which application is rejected, etc.
- (3) The Commission shall have power to regulate its own procedure and the procedure of Benches thereof in all matters or of the discharge of its functions, including the places at which the Benches shall hold their sittings.
- (4) In the absence of any express direction to the contrary by the Settlement Commission, nothing contained in this section shall affect the operation of any other provision of this Act -
 - Requiring the applicant to pay tax on the basis of self-assessment in relation to the matters before the Settlement Commission; and
 - Related to any matters other than those before the Settlement Commission.

Taxpoint: The Settlement Commission shall not have any power to reopen the proceedings. [Sec. 234E]



8.16 ABATEMENT OF PROCEEDING [SEC. 245HA]

- ◆ Where an application has been rejected or not been allowed to be proceeded or declared as invalid or has been allowed but no order has been passed within prescribed time or an order u/s 245D(4) has been passed not providing for the terms of settlement, the proceedings before the Settlement Commission shall abate on the specified date (i.e. the day on which application is rejected or declared invalid or time limit of 18 months expires).
- ◆ Where a proceeding before the Commission abates, the AO before whom the proceeding at the time of making the application was pending, shall dispose of the case in accordance with the provisions of this Act as if no application u/s 245C had been made.
- ◆ The AO shall be entitled to use all the material and other information produced by the assessee before the Commission or the results of the inquiry held or evidence recorded by the Commission in the course of the proceedings before it, as if such material, information, inquiry and evidence had been produced before the AO or held or recorded by him in the course of the proceedings before him.
- ◆ For the purposes of the time-limit u/s 149, 153, 153B, 154, 155, 158BE & 231 and for the purposes of payment of interest u/s 244A, for making the assessment or reassessment, the period commencing on and from the date of the application to the Settlement Commission and ending with specified date shall be excluded.
- ◆ Where a proceeding before the Settlement Commission abates, the period of limitation available u/s 153 to the AO for making an order of assessment shall, after the exclusion of the said period, be not less than 1 year; and where such period of limitation is less than 1 year, it shall be deemed to have been extended to 1 year.

8.17 CREDIT FOR TAX PAID IN CASE OF ABATEMENT OF PROCEEDINGS [SEC. 245 HAA]

Where an application made u/s 245C is rejected or not allowed to be proceeded or declared invalid or an order has not been passed within the time of 18 months, the Assessing Officer shall allow the 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.

8.18 ORDER OF SETTLEMENT TO BE CONCLUSIVE [SEC. 245-1]

Every order of settlement shall be conclusive as to the matter stated therein. Any matter covered by such order shall not be reopened in any proceeding under this Act or under any other law for the time being in force.

Note: An order, which have a mistake apparent from the record, can be rectified by Commission u/s 154.

8.19 RECOVERY OF SUMS DUE UNDER ORDER OF SETTLEMENT [SEC. 245]

Any sum specified in an order of settlement may, subject to such conditions, if any, as may be specified therein, be recovered, and any penalty for default in making payment of such sum may be imposed and recovered in accordance with the provisions of Chapter XVII, by the Assessing Officer having jurisdiction over the person who made the application for settlement.

8.20 RESTRICTION ON SUBSEQUENT APPLICATION FOR SETTLEMENT IN CERTAIN CASES [SEC. 245K]

- ◆ Where —
 - (a) an order of settlement provides for the imposition of a penalty on the person who made the application for settlement, on the ground of concealment of particulars of his income; or
 - (b) after the passing of an order of settlement, such person is convicted of any offence under Chapter XXII in relation to that case; orthen, he or any person related to such person shall not be entitled to apply for settlement in relation to any other matter.
- ◆ Where a person has made an application and if such application has been allowed to be proceeded with, such person (or related person) shall not be subsequently entitled to make an application for settlement. That means, settlement can be made once in life time.
- ◆ Related person with respect to a person means:
 - (i) where such person is an individual, any company in which such person holds more than 50% of the shares or voting rights at any time, or any firm or association of persons or body of individuals in which such person is entitled to more than 50% of the profits at any time, or any Hindu undivided family in which such person is a karta;
 - (ii) where such person is a 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;
 - (iii) where such person is a firm or association of persons or body of individuals, any individual who was entitled to more than 50% of the profits in such firm, association of persons or body of individuals, at any time before the date of application before the Settlement Commission by such person;
 - (iv) where such person is a Hindu undivided family, the karta of that Hindu undivided family



STUDY NOTE : 9

ADVANCE RULING



This Study Note includes:

- 9.1 Introduction
- 9.2 Definitions
- 9.3 Authority for Advance Rulings [Sec. 245-O]
- 9.4 Application for Advance Ruling [Sec. 245-Q]
- 9.5 Procedure on Receipt of Application [Sec. 245R]
- 9.6 Appellate Authority not to Proceed in certain Cases [Sec. 245RR]
- 9.7 Applicability of Advance Ruling [Sec. 245S]
- 9.8 Advance Ruling to be void in certain circumstances [Sec. 245-T]
- 9.9 Powers of the Authority [Sec. 245U]
- 9.10 Procedure of Authority [Sec. 245V]

9.1 INTRODUCTION

In the interest of avoiding needless litigation and promoting better taxpayer relations, a scheme for giving advance rulings was introduced by the Finance Act, 1993. Chapter XIX-B of the Income-tax Act, which deals with advance rulings, came into force with effect from 1-6-1993. Under the scheme the power of giving advance rulings has been entrusted to an independent adjudicatory body. Accordingly, a high level body headed by a retired judge of the Supreme Court has been set-up. This is empowered to issue rulings, which are binding both on the Income-tax Department and the applicant. The procedure prescribed is simple, inexpensive, expeditious and authoritative. 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. It has been defined in section 245N(a) of the Income-tax Act, 1961 as amended from time-to-time.

9.2 DEFINITIONS

Advance Ruling [Sec. 245N(a)]

Advance ruling means:

- (i) 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



- (ii) 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; or
- (iia) 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
- In above cases, such determination shall include the determination of any question of law or of fact specified in the application.
- (iii) 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 of any question of law or of fact relating to such computation of total income specified in the application.
- (iv) 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.

Applicant [Sec. 245N(b)]

Applicant means any person who is:

- a) a non-resident referred to in sub-clause (i) of clause (a) above; or
- b) a resident referred to in sub-clause (ii) of clause (a) above; or
- c) a resident who has undertaken or propose to undertake one or more transactions of value of ₹ 100 crore or more in total [Notification No. 73, dated 28-11-2014]
- d) a public sector company [Notification No. 725, dated 03-08-2000]
- e) a resident or a non-resident referred to in sub-clause (iv) of clause (a) above
- f) an applicant as defined in sec. 28E(c) of the Customs Act, 1962
- g) an applicant as defined in sec. 23A(c) of the Central Excise Act, 1944
- h) an applicant as defined in sec. 96A(b) of the Finance Act, 1994
 - makes an application u/s 245Q(1).

9.3 AUTHORITY FOR ADVANCE RULINGS [SEC. 245-O]

- ♦ The Central Government shall constitute¹ an Authority for giving advance rulings, to be known as "Authority for Advance Rulings".
- ♦ The Authority shall consist of a Chairman and such number of Vice-chairmen, revenue Members and law Members as the Central Government may, by notification, appoint
- ♦ A person shall be qualified for appointment as—
 - (a) Chairman, who has been a Judge of the Supreme Court or the Chief Justice of a High Court or for at least 7 years a Judge of a High Court;

¹ The Authority shall cease to act as an Authority for Advance Rulings for the purposes of Chapter V of the Customs Act, 1962 on and from the date of appointment of the Customs Authority for Advance Rulings u/s 28EA of that Act. On and from the date of appointment of the Customs Authority for Advance Rulings, the Authority shall act as an Appellate Authority, for the purpose of Chapter V of the Customs Act, 1962. The Authority shall not admit any appeal against any ruling or order passed earlier by it in the capacity of the Authority for Advance Rulings in relation to any matter under Chapter V of the Customs Act, 1962 after the date of such appointment of the Customs Authority for Advance Rulings.

- (b) Vice-chairman, who has been Judge of a High Court;
- (c) a revenue Member:
 - i. where the Authority is dealing with an application seeking advance ruling in any matter relating to this Act; the revenue member shall be appointed from the Indian Revenue Service, who is (or is qualified to be), a Member of the Board; or
 - ii. in other case, revenue member shall be appointed from the Indian Customs and Central Excise Service, who is (or is qualified to be), a Member of the Central Board of Excise and Customs,on the date of occurrence of vacancy
- (d) a law Member from the Indian Legal Service, who is (or is qualified to be), an Additional Secretary to the Government of India on the date of occurrence of vacancy.
- ♦ The terms and conditions of service and the salaries and allowances payable to the Members shall be such as may be prescribed.
- ♦ 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 this Act.
- ♦ The powers and functions of the Authority may be discharged by its Benches as may be constituted by the Chairman from amongst the Members thereof.
- ♦ In the event of the occurrence of 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 to fill such vacancy, enters upon his office.
- ♦ In case the Chairman is unable to discharge his functions owing to absence, illness or any other cause, the senior-most Vice-Chairman shall discharge the functions of the Chairman until the date on which the Chairman resumes his duties
- ♦ A Bench shall consist of the Chairman or the Vice-chairman and one revenue Member and one law Member.
- ♦ The Authority shall be located in the National Capital Territory of Delhi and its Benches shall be located at such places as the Central Government may, by notification specify.
- ♦ "Member" means a Member of the Authority and includes the Chairman and Vice-chairman.
- ♦ "Vice-chairman" means the Vice-chairman of the Authority

9.4 APPLICATION FOR ADVANCE RULING [SEC. 245-Q]

- ♦ An applicant desirous of obtaining an advance ruling may make an application stating the question on which the advance ruling is sought in quadruplicate in:
 - (a) in Form No. 34C in respect of a non-resident applicant;
 - (b) in Form No. 34D in respect of a resident applicant seeking advance ruling in relation to a transaction undertaken or proposed to be undertaken by him with a non-resident;
 - (c) in Form No. 34DA in respect of a resident applicant referred to in sec. 245N(b)(iia) falling within any such class or category of person as notified by the Central Government; and
 - (d) in Form No. 34E in respect of a notified resident referred to in sec. 245N(b)(iii)
 - (e) in Form No. 34EA in respect of a applicant referred to in sec. 245N(b)(iiia)and shall be verified in the manner indicated therein.



Taxpoint: From the date of appointment of the Customs Authority for Advance Rulings u/s 28EA of the Customs Act, 1962, no application relating to Customs laws shall be admitted.

- ◆ The application shall be accompanied by a fee of
 - a. ₹ 10,000 or
 - b. such fees as may be prescribed.– whichever is higher
- ◆ An applicant may withdraw an application within 30 days from the date of the application.
- ◆ An application shall be presented by the applicant in person or by an authorised representative to the Secretary or any other officer notified in writing by the Secretary or sent by registered post addressed to the Secretary along with a fee (in the form of a Demand Draft drawn in favour of "Authority for Advance Rulings" payable at New Delhi).
- ◆ An application sent by registered post shall be deemed to have been made on the date on which it is received in the office of the Authority.
- ◆ If the applicant is not hitherto assessed in India, he shall indicate in Annexure I to the application:
 - (a) his head office in any other country,
 - (b) the place where his office and residence is located or is likely to be located in India, and
 - (c) the name and address of his representative in India, if any, authorised to receive notices and papers and act on his behalf.
- ◆ The Secretary may send the application back to the applicant if it is defective in any manner for removing the defects within such time as he may allow. Such application shall be deemed to have been made on the date when it is represented after correction.

9.5 PROCEDURE ON RECEIPT OF APPLICATION [SEC. 245R]

- ◆ On receipt of an application, the Authority shall cause a copy thereof to be forwarded to the Principal Commissioner or Commissioner and, if necessary, call upon him to furnish the relevant records. Where any records have been called for by the Authority, such records shall, as soon as possible, be returned to the Principal Commissioner or Commissioner.
- ◆ The Authority may, after examining the application and the records called for, by order, either allow or reject the application. However, where the question raised in the application -
 - (i) is already pending before any income-tax authority or Appellate Tribunal [except in the case of a resident applicant falling in sec. 245N(b)(iii)] or any court;
 - (ii) involves determination of fair market value of any property;
 - (iii) relates to a transaction or issue which is designed prima facie for the avoidance of income-tax [except in the case of a resident applicant falling in sec. 245N(b)(iii)]– shall be rejected by the authority.
- ◆ The words 'already pending', should be interpreted to mean: 'already pending as on the date of the application' and not with reference to any future date [Monte Harris -vs.- CIT (AAR)]
- ◆ No application shall be rejected unless an opportunity has been given to the applicant of being heard. Further, where the application is rejected, reasons for such rejection shall be given in the order.

- ◆ A copy of every order (allowing or rejecting) shall be sent to the applicant and to the Principal Commissioner or Commissioner.
- ◆ Where an application is allowed, the Authority shall, after examining such further material as may be placed before it by the applicant or obtained by the Authority, pronounce its advance ruling on the question specified in the application.
- ◆ On a request received from the applicant, the Authority shall, before pronouncing its advance ruling, provide an opportunity to the applicant of being heard, either in person or through a duly authorised representative.
- ◆ The Authority shall pronounce its advance ruling in writing within 6 months of the receipt of application.
- ◆ A copy of the advance ruling pronounced by the authority, duly signed by the Members and certified in the prescribed manner shall be sent to the applicant and to the Principal Commissioner or Commissioner, as soon as may be, after such pronouncement.

9.6 APPELLATE AUTHORITY NOT TO PROCEED IN CERTAIN CASES [SEC. 245RR]

No Income-tax Authority or the Appellate Tribunal shall proceed to decide any issue in respect to which an application has been made by an applicant, being a resident, u/s 245Q.

9.7 APPLICABILITY OF ADVANCE RULING [SEC. 245S]

- ◆ The advance ruling pronounced by the Authority u/s 245R shall be binding only:
 - (a) on the applicant who had sought it;
 - (b) in respect of the transaction in relation to which the ruling had been sought; and
 - (c) on the Principal Commissioner or Commissioner, and the income-tax authorities subordinate to him, in respect of the applicant and the said transaction.
- ◆ The advance ruling shall be binding as aforesaid unless there is a change in law or facts on the basis of which the advance ruling has been pronounced.

9.8 ADVANCE RULING TO BE VOID IN CERTAIN CIRCUMSTANCES [SEC. 245-T]

- ◆ Where the Authority finds, on a representation made to it by the Principal Commissioner or Commissioner or otherwise, that an advance ruling pronounced by it has been obtained by the applicant by fraud or misrepresentation of facts, it may, by order, declare such ruling to be void ab initio and thereupon all the provisions of this Act shall apply to the applicant as if such advance ruling had never been made.
- ◆ A copy of such order shall be sent to the applicant and the Principal Commissioner or Commissioner.

9.9 POWERS OF THE AUTHORITY [SEC. 245U]

The Authority shall, for the purpose of exercising its powers, have all the powers of a civil court under the Code of Civil Procedure, 1908 as are referred to in section 131 of this Act.



9.10 PROCEDURE OF AUTHORITY [SEC. 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 this Act.

STUDY NOTE : 10

PENALTIES AND PROSECUTION



This Study Note includes:

- 10.1 Penalties
- 10.2 Penalty for under-reporting and misreporting of income [Sec. 270A]
- 10.3 Immunity from imposition of penalty, etc. [Sec. 270AA]
- 10.4 Power to Reduce or Waive Penalty, etc., in certain cases [Sec. 273A]
- 10.5 Power of Principal Commissioner or Commissioner to Grant Immunity from Penalty [Sec. 273AA]
- 10.6 Penalty not to be Imposed in certain cases [Sec. 273B]
- 10.7 Procedure [Sec. 274]
- 10.8 Bar of limitation for imposing penalties [Sec. 275]
- 10.9 When Assessee becomes Liable for Prosecution
- 10.10 Power of Commissioner to Grant Immunity from Prosecution [Sec. 273AB]

10.1 PENALTIES

Penalty is imposed on an assessee for violating the different provisions of the Act. The provisions of penalty are tabulated below:

Section	Nature of default	Penalty	
		Minimum	Maximum
221(1)	Failure in making the payment of tax, interest or any demand within the prescribed time limit	Amount decided by the Assessing Officer	Tax or interest or both in arrears
140A(3)	Failure to pay whole or any part of income tax and/or interest as per sec.140A(1)		
270A	Penalty for under-reporting and misreporting of income (Discussed later on in details)	50% of the tax on under-reported income	200% of the tax on misreported income
271A	Failure to comply with sec. 44AA i.e. to keep or maintain books of account, documents, etc.	₹ 25,000	
271AA(1)	Failure to keep and maintain, information and documents for international transactions or specified domestic transaction or fails to report such transaction	2% of the value of each international transaction or specified domestic transaction	
271AA(2)	Fails to furnish the information and the document as required u/s 92D(4)	₹ 5,00,000	



271AAB(1A)	Undisclosed income in case of search initiated on or after 15-12-2016 However, if the assessee: a) in the course of the search, in a statement u/s 132(4), admits the undisclosed income and specifies the manner in which such income has been derived. b) substantiates the manner in which the undisclosed income was derived; and c) on or before the specified date: A. pays the tax, together with interest in respect of the undisclosed income; and B. furnishes the return of income for the specified previous year declaring such undisclosed income therein	60% of the undisclosed income of the specified previous year	
		30% of the undisclosed income of the specified previous year	
271AAC	Where the income determined includes any income referred to in sec. 68, 69, 69A, 69B, 69C or 69D for any previous year	10% of tax payable u/s 115BBE No penalty shall be levied if such income has been included by the assessee in the return of income furnished u/s 139 and the tax thereon (as per sec. 115BBE) has been paid on or before the end of the relevant previous year.	
271B	Failure to comply with sec. 44AB i.e. to get accounts audited or to furnish such audit report.	½% of the total sales or turnover or gross receipts	₹ 1,50,000
271BA	Failure to furnish report from an accountant as per sec.92E	₹ 1,00,000	
271C	Failure to deduct part or whole of tax u/s 192 to 196C	Amount of tax failed to deduct	
	Failure to pay tax on dividends u/s 115-O or under second proviso to sec. 194B	Amount of tax failed to pay	
271CA	Failure to collect tax at source	Amount of tax failed to collect	
271D	Taking or accepting any loan or deposit or specified sum in contravention of the provisions of sec.269SS	Amount of the loan or deposit or specified sum so taken/accepted	
271DA	Receives any sum in contravention of sec. 269ST	Amount equal to such receipt	
271E	Repayment of any loan or deposit or specified advance in contravention of the provisions of sec.269T	Amount of loan or deposit or specified advance so repaid.	
271FA	Failure to furnish a statement of financial transaction or reportable account as required u/s 285BA(1) within the prescribed time limit	₹ 500 for every day during which the failure continues	
Proviso to sec. 271FA	Failure to furnish the statement of financial transaction or reportable account as within the period specified in the notice issued u/s 285BA(5)	₹ 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 expires	
271FAA	Person referred to in sec. 285BA(1)(k) provides inaccurate information in the 'statement of financial transaction or reportable account'	₹ 50,000	

271FAB	Fails to furnish information or document as required u/s 9A(5) within the prescribed time limit	₹ 5,00,000	
271G	Failure to furnish information or documents as required u/s 92D(3)	2% of the value of the international transaction or specified domestic transaction.	
271GA	Failure to furnish information or documents as required u/s 285A	2% of the value of the transaction, if such transaction had the effect of directly or indirectly transferring the right of management or control in relation to the Indian concern; In other case: ₹ 5,00,000	
271GB(1)	Failure by any reporting entity to furnish the report referred to in sec. 286(2) in respect of a reporting accounting year	► Failure does not exceed one month: ₹ 5,000 per day ► Failure continues beyond the period of one month: ₹ 15,000 per day ► Failure continues after an order of penalty has been served on the entity: ₹ 50,000 per day from the date of service of such order	
271GB(2)	Failure by any reporting entity to produce the information and documents within the period specified u/s 286(6)	► ₹ 5,000 per day ► Failure continues after an order of penalty has been served on the entity: ₹ 50,000 per day from the date of service of such order	
271GB(4)	Reporting entity provides inaccurate information in the report referred to in sec. 286(2)	₹ 5,00,000 Penalty shall be levied if: a) the entity has knowledge of the inaccuracy at the time of furnishing the report but fails to inform the prescribed authority; or b) the entity discovers the inaccuracy after the report is furnished and fails to inform the prescribed authority and furnish correct report within a period of 15 days of such discovery; or c) the entity furnishes inaccurate information or document in response to the notice issued u/s 286(6).	
271H ¹	Failure to furnish TDS / TCS Return or furnishing inaccurate details in these Return	₹ 10,000	₹ 1,00,000
271-I	Fails to furnish information, or furnishes inaccurate information as required u/s 195(6)	₹ 1,00,000	

¹ No penalty u/s 271H shall be levied if the person proves that after paying TDS / TCS along with the fee u/s 234E and interest, if any, to the credit of the Central Government, he had delivered the statement before the expiry of 1 year from the time prescribed for delivering such statement.



271J	Furnishing incorrect information in reports or certificates by an accountant or merchant banker or registered valuer	₹ 10,000 for each report Penalty is leviable by the AO or the Commissioner (Appeals) who in the course of any proceedings finds that such report has incorrect information
272A(1)(a)	Failure to answer any question (related to assessment) of an income-tax authority	₹ 10,000 for each default
272A(1)(b)	Refuse to sign any statement made by the assessee in course of income tax proceedings	
272A(1)(c)	Failure to comply with summons u/s 131(1) to attend office or to give evidence or to produce books of account or other documents, at certain place & time	
272A(1)(d)	Fails to comply with a notice u/s 142(1) or 143(2) or fails to comply with a direction issued u/s 142(2A) [Penalty shall be levied by such authority]	
272A(2)(a)	Failure to comply with a notice issued u/s 94(6)	A sum of ₹ 100, for every day during which the failure continues: However, the amount of penalty for failures in relation to a declaration mentioned in sec. 197A, a certificate as required by sec. 203 and returns or statement u/s 200 or 206 and 206C shall not exceed the amount of tax deductible or collectible.
272A(2)(b)	Failure to give notice of discontinuance of his business or profession as required u/s 176(3)	
272A(2)(c)	Failure to furnish in due time any of the returns, statements or particulars mentioned in section 133, 206, 206C or 285B	
272A(2)(d)	Failure to allow inspection of any register u/s 134 or of any entry in such register or to allow copies of such register or of any entry therein to be taken	
272A(2)(e)	Failure to furnish the return of income which he is required to furnish u/s 139(4A) or (4C) within time allowed and in the manner required.	
272A(2)(f)	Failure to deliver or cause to be delivered in due time a copy of the declaration mentioned in sec. 197A	
272A(2)(g)	Failure to furnish a certificate u/s 203 or 206C	
272A(2)(h)	Failure to deduct and pay tax u/s 226(2)	
272A(2)(i)	Failure to furnish a statement u/s 192(2C)	
272A(2)(j)	Failure to deliver a copy of declaration referred u/s 206C(1A) within due time	
272A(2)(l)	Failure to deliver or cause to be delivered the quarterly return within the time prescribed u/s 206A(1)	
272A(2)(m)	Failure to deliver a statement within the time prescribed u/s 200(2A) or 206C(3A)	
272AA	Failure to comply with the provisions of sec. 133B	Maximum up to ₹ 1,000
272B	Failure to comply with the provisions of sec. 139A	₹ 10,000
272BB(1A)	Failure to quote Tax deduction or collection number	₹ 10,000
272BBB	Failure to comply with the provisions of sec. 206CA	₹ 10,000

Notes:

1) Specified previous year means previous year:

- (i) which has ended before the date of search, but the date of filing the return of income u/s 139(1) for such year has not expired before the date of search and the assessee has not furnished the return of income for the previous year before the said date; or
- (ii) in which search was conducted.

2) As per sec. 274(2), in the following cases, penalty can be imposed only with the prior approval of the Joint Commissioner:

Where penalty is imposed by the Income-tax Officer	Exceeds ₹ 10,000
Where penalty is imposed by the Assistant Commissioner or Deputy Commissioner	Exceeds ₹ 20,000

10.2 PENALTY FOR UNDER-REPORTING AND MISREPORTING OF INCOME [SEC. 270A]

The

- Assessing Officer; or
- Commissioner (Appeals); or
- Principal Commissioner or Commissioner

may, during the course of any proceedings under this Act, direct that any person who has under-reported his income shall be liable to pay a penalty in addition to tax, if any, on the under-reported income.

Taxpoint

- Penalty proceedings must be initiated before completion of the assessment or appeal order or revision order, as the case may be.
- Penalty order is different from assessment order. Aggrieved with the penalty order passed by the Assessing Officer, the assessee is required to file separate appeal to the Commissioner (Appeals) or separate revision petition u/s 264 or separate rectification petition u/s 154. Further, appeal can be filed with the Tribunal against the penalty order passed by the Commissioner (Appeals) or Principal Commissioner or Commissioner.
- Tribunal cannot impose penalty
- Penalty shall be imposed by the respective income-tax authority on addition made by them. E.g., on addition being made by the Assessing Officer, Commissioner (Appeals) cannot levy penalty. Even the Assessing Officer fails to levy penalty on such addition, Commissioner (Appeals) cannot levy penalty on such addition made by the Assessing Officer. In CIT -vs.- Shadiram Balmukund, the Apex court has held that the Assessing officer can levy penalty on the additions made by him and not on the additions made by Commissioner (Appeals). Similarly, Commissioner (Appeals) can levy penalty on the additions made by him and not on the additions made by the Assessing Officer.

Quantum of penalty [Sec. 270A(7) & (8)]

- **50%** of the amount of tax payable on under-reported income [Sec. 270A(7)]
- **200%** of the amount of tax payable on under-reported income, where under-reported income is in consequence of any misreporting thereof by any person - [Sec. 270A(8)]

Cases of under-reporting of income [Sec. 270A(2)]

A person shall be considered to have under-reported his income, if:

- the income assessed is greater than the income determined in the return processed u/s 143(1)(a);
- the income assessed is greater than the maximum amount not chargeable to tax, where no return of income has been furnished;
- the income reassessed is greater than the income assessed or reassessed immediately before such reassessment;
- the amount of deemed total income assessed or reassessed u/s 115JB or 115JC is greater than the deemed total income determined in the return processed u/s 143(1)(a);
- the amount of deemed total income assessed u/s 115JB or 115JC is greater than the maximum amount not chargeable to tax, where no return of income has been filed;
- the amount of deemed total income reassessed u/s 115JB or 115JC is greater than the deemed total income assessed or reassessed immediately before such reassessment;
- the income assessed or reassessed has the effect of reducing the loss or converting such loss into income.

Computation of amount of under-reported income [Sec. 270A(3)]

The amount of under-reported income shall be:

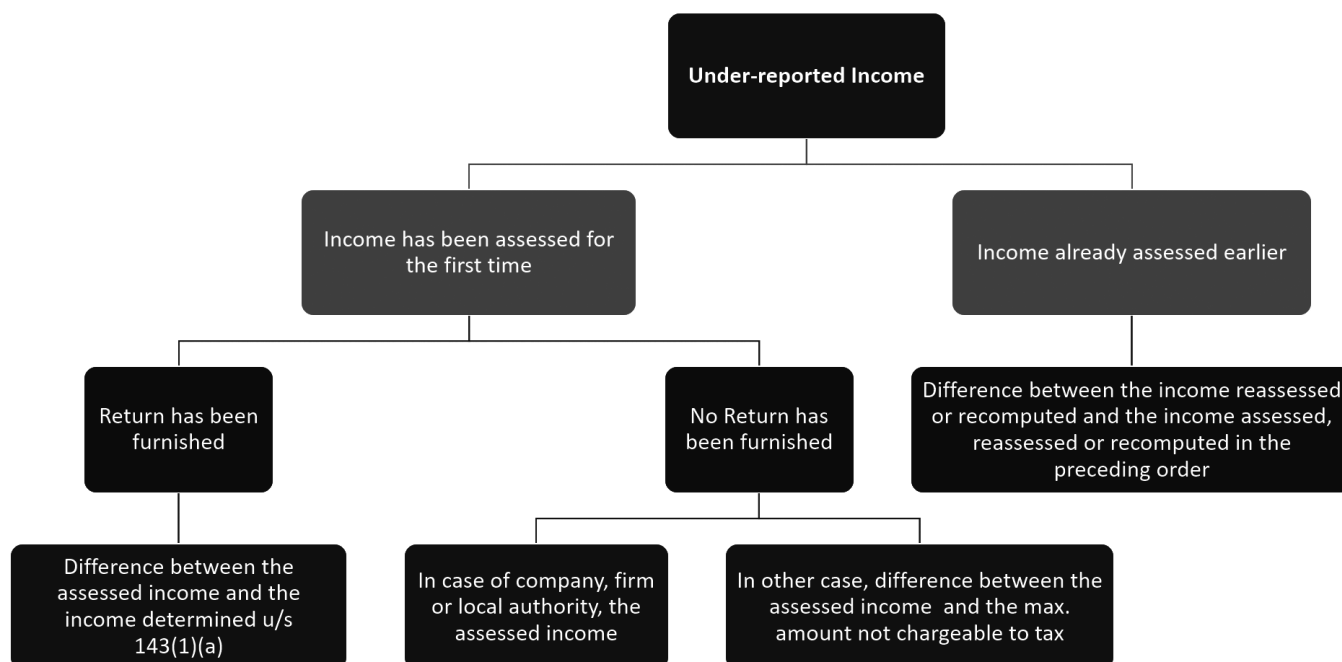
- in a case where income has been assessed for the first time:

▶ If return has been furnished	Assessed Income – Income determined u/s 143(1)(a)
▶ If return has not been furnished	<i>In case of company, firm or local authority:</i> Assessed Income <i>Other persons:</i> Assessed Income – Basis Exemption Limit

- in a case where income has been assessed for the first time:

Income reassessed or recomputed - Income assessed, reassessed or recomputed in a preceding order

- ▶ **Preceding order** means an order immediately preceding the order during the course of which the penalty has been initiated.



- ♦ in a case where under-reported income arises out of determination of deemed total income in accordance with sec. 115JB or 115JC, the amount of total under-reported income shall be determined in accordance with the following formula:

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

Where,

- A = Total income assessed as per the provisions other than the provisions contained in sec. 115JB or 115JC (herein called general provisions)
- B = 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 = Total income assessed u/s 115JB or 115JC
- D = Total income that would have been chargeable had the total income assessed u/s 115JB or 115JC been reduced by the amount of under-reported income.

However, where the amount of under-reported income on any issue is considered both u/s 115JB / 115JC and under general provisions, such amount shall not be reduced from total income assessed while determining the amount under item D.

- ♦ in a case where an assessment or reassessment has the effect of reducing the loss declared in the return or converting that loss into income:

The income or loss assessed or reassessed - Loss claimed

Meaning of under-reported income in a case where source is linked to earlier year [Sec. 270A(4)]

Where:

- the source of any receipt, deposit or investment in any 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 year prior to the assessment year in which such receipt, deposit or investment appears (hereinafter referred to as "preceding year")
- and no penalty was levied for such preceding year,

then, the under-reported income shall include such amount as is sufficient to cover such receipt, deposit or investment.

Taxpoint

- ♦ Such amount shall be deemed to be amount of income under-reported for the preceding year in the following order:
 - a. the preceding year immediately before the year in which the receipt, deposit or investment appears, being the first preceding year; and
 - b. 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.
- ♦ The assessee can explain that the investment or expenditure is made out of additions made during earlier years – *Anantharam Veerasinghaiah & Co. -vs.- CIT (SC)*



Example

- Addition made by the Assessing Officer on estimated basis in the preceding year(s) ₹ 1,00,000
- Penalty levied on the said addition in the preceding year(s) Nil
[Due to provision of sec. 270A(6)(b) or (c)]

- In subsequent assessment year, such addition is explained as source of investment made by the assessee, citing the decision of the Apex court in the case of Anantharam Veerasinghaiah & Co.
- Despite this confession of concealment on the part of the assessee, no penalty was leviable in such cases as the time limit for initiating concealment penalty proceedings in respect of the earlier year in which addition was made would have expired. Moreover, the penalty could also not be imposed in respect of the year in which the deposit was made as there was no concealment in that year, the deposit having been explained as out of an earlier year's income.
- In this type of case, sec. 270A(4) comes into play which states that under-reported income shall include such amount.

Cases not considered as under-reported income [Sec. 270(6)]

The under-reported income shall not include the following:

- a. **Proper Explanation:** The amount of income in respect of which the assessee offers an explanation and the Assessing Officer or the Commissioner (Appeals) or the Commissioner or the Principal Commissioner, as the case may be, is satisfied that the explanation is bona fide and the assessee has disclosed all the material facts to substantiate the explanation offered.
- b. **Estimate by the authority:** 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 Assessing Officer or the Commissioner (Appeals) or the Commissioner or the Principal Commissioner, as the case may be, but the method employed is such that the income cannot properly be deduced therefrom;
- c. **Estimate by the assessee:** 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, has included such amount in the computation of his income and has disclosed all the facts material to the addition or disallowance.
- d. **Arm's length price:** 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 u/s 92D, declared the international transaction under Chapter X, and, disclosed all the material facts relating to the transaction; and
- e. **Undisclosed income in search operation:** The amount of undisclosed income referred u/s 271AAB

Cases of misreporting of income [Sec. 270A(9)]

The cases of misreporting of income shall be the following:

- 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; and
- 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.

Computation of tax payable on under-reported income [Sec. 270A(10)]

The tax payable in respect of the under-reported income shall be:

Where no return of income has been furnished and the income has been assessed for the first time	Tax calculated on the under-reported income as increased by the maximum amount not chargeable to tax as if it were the total income	
Where the total income determined u/s 143(1)(a) or assessed, reassessed or recomputed in a preceding order is a loss	Tax calculated on the under-reported income as if it were the total income	
In any other case	Tax on (Under-reported income + Income determined u/s 143(1)(a) or income assessed, reassessed or recomputed in a preceding order) Less: Tax on Income determined u/s 143(1)(a) or income assessed, reassessed or recomputed in a preceding order	*** (**)

Other Points

- ♦ No double penalty on same amount: 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 – [Sec. 270A(11)].
- ♦ Written order: The penalty shall be imposed, by an order in writing, by the Assessing Officer, the Commissioner (Appeals), the Commissioner or the Principal Commissioner, as the case may be – [Sec. 270A(12)]

ILLUSTRATION 1

Computation of under-reported income assuming income has been assessed for the first time:

Assessee	Return Filed	Income u/s 143(1)(a)	Assessed Income	Under-reported Income	Tax payable on (a)	Tax payable on (b)	Tax payable on (c)	Penalty
		a	b	c = (b – a)	d	e	f = (e – d)	f x 50%
Individual	Yes	6,00,000	10,00,000	4,00,000	33,800	1,17,000	83,200	41,600
Firm	Yes	17,00,000	20,00,000	3,00,000	5,30,400	6,24,000	93,600	46,800
Firm	Yes	(8,00,000)	20,00,000	28,00,000	-	8,73,600	8,73,600	4,36,800
Individual	Yes	(9,00,000)	(3,00,000)	6,00,000	-	33,800	33,800	16,900
Firm	No	N.A.	8,00,000	8,00,000	-	2,49,600	2,49,600	1,24,800
Individual	No	N.A.	7,50,000	5,00,000 [#]	-	65,000	65,000	32,500

[#] Assessed income as reduced by basic exemption

200% of (f) shall be levied as penalty if the case is misreporting of income.

**ILLUSTRATION 2**

Computation of under-reported income assuming income has not been assessed for the first time:

Assessee	Income assessed in the preceding order	Reassessed Income	Under-reported Income
Individual	7,00,000	12,00,000	5,00,000
Company	20,00,000	22,00,000	2,00,000

ILLUSTRATION 3

Compute penalty leviable u/s 270A in case of X Ltd from the following details:

Particulars	Total Income	Tax on Total Income	Book Profit	Tax on Book Profit
Return of income	80,00,000	24,96,000	2,00,00,000	41,17,360
Assessed income	1,20,00,000	40,06,080	2,10,00,000	43,23,228

Solution

Computation of penalty

Particulars		Amount
<u>Under-reported income</u>		
Total income computed by the Assessing Officer	A	1,20,00,000
Total income as per return of income	B	80,00,000
Book profit computed by the Assessing Officer	C	2,10,00,000
Book profit as per return of income	D	2,00,00,000
Under-reported income [(A – B) + (C – D)]		50,00,000
<u>Tax on under-reported income</u>		
Tax on A	P	40,06,080
Tax on B	Q	24,96,000
Tax on C	R	43,23,228
Tax on D	S	41,17,360
Tax on Under-reported income [(P – Q) + (R – S)]		17,15,948
<u>Penalty u/s 270A</u>		
- Minimum (being 50% of T)		8,57,974
- Maximum (being 200% of T)		34,31,896

ILLUSTRATION 4

In the above example, out of addition of ₹ 10 lakh made in the book profit and ₹ 40 lakh made in the total income (under general provisions), ₹ 3,00,000 was made on the same ground. Compute penalty u/s 270A.

Solution

Computation of penalty

Particulars		Amount
Under-reported income		
Total income computed by the Assessing Officer	A	1,20,00,000
Total income as per return of income	B	80,00,000
Book profit computed by the Assessing Officer	C	2,10,00,000
Book profit as per return of income	D	2,03,00,000
Under-reported income [(A – B) + (C – D)]		47,00,000
Tax on under-reported income		
Tax on A	P	40,06,080
Tax on B	Q	24,96,000
Tax on C	R	43,23,228
Tax on D	S	41,79,120
Tax on Under-reported income [(P – Q) + (R – S)]		16,54,188
Penalty u/s 270A		
- Minimum (being 50% of T)		8,27,094
- Maximum (being 200% of T)		33,08,376

10.3 IMMUNITY FROM IMPOSITION OF PENALTY, ETC. [SEC. 270AA]

- ◆ An assessee may make an application to the Assessing Officer to grant immunity from imposition of penalty u/s 270A and initiation of proceedings u/s 276C or 276CC, if he fulfils the following conditions:
 - a. the tax and interest payable as per the order of assessment or reassessment u/s 143(3) or 147, as the case may be, has been paid within the period specified in such notice of demand; and
 - b. no appeal against aforesaid order has been filed.
- ◆ An application shall be made within 1 month from the end of the month in which the said order has been received and shall be made in such form (Form 68) and verified in prescribed manner.
- ◆ The Assessing Officer shall (on fulfilment of the aforesaid conditions) and after the expiry of the period of filing the appeal to the Commissioner (Appeals), grant immunity from imposition of penalty u/s 270A and initiation of proceedings u/s 276C or 276CC, where the proceedings for penalty u/s 270A has not been initiated due to misreporting of income.
- ◆ The Assessing Officer shall, within a period of 1 month from the end of the month in which the application is received, pass an order accepting or rejecting such application after giving an opportunity of being heard to the assessee.
- ◆ The order made by the assessing officer in this regard is final.



- ◆ Where immunity is granted to the assessee, then appeal to Commissioner (Appeals) or an application for revision u/s 264 shall not be admissible against the order of assessment or reassessment.

The CBDT, vide Circular No. 05/2018 dated 16-08-2018, has clarified that an application made by an assessee u/s 270AA seeking immunity, will not bar the assessee from contesting the same issue in any earlier assessment year. The circular also clarifies that the tax authority shall not take an adverse view in penalty proceedings for earlier assessment years under old penalty regime merely because the taxpayer has applied for immunity under the new penalty regime (i.e., section 270AA).

10.4 POWER TO REDUCE OR WAIVE PENALTY, ETC., IN CERTAIN CASES [SEC. 273A]

Power u/s 273A(1)

- ◆ The Principal Commissioner or Commissioner may, in his discretion, whether on his own motion or otherwise reduce or waive the amount of penalty imposed or imposable on a person u/s 270A¹ for concealment of income (not other penalty) if he is satisfied that such person:
 - (a) has, prior to the detection by the Assessing Officer, of the concealment of particulars of income or of the inaccuracy of particulars furnished in respect of such income, voluntarily and in good faith, made full and true disclosure of such particulars;
 - ▶ A person shall be deemed to have made full and true disclosure of his income or of the particulars relating thereto in any case where the excess of income assessed over the income returned is of such a nature as not to attract the provisions of sec. 270A.
 - (b) has, co-operated in any enquiry relating to the assessment of his income; and
 - (c) has either paid or made satisfactory arrangements for the payment of any tax or interest payable in consequence of an order passed under this Act in respect of the relevant assessment year.
- ◆ However, where the amount of income in respect of which the penalty is imposed or imposable for the relevant assessment year, or, where such disclosure relates to more than one assessment year, the aggregate amount of such income for those years, exceeds a sum of ₹ 5,00,000, no order reducing or waiving the penalty shall be made by the Principal Commissioner or Commissioner except with the previous approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General, as the case may be.
- ◆ Where an order of waiver u/s 273A(1) has been made 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. That means such waiver can be done once in life of assessee.

Power u/s 273A(4)

- ◆ The Principal Commissioner or Commissioner may, on an application (not suo motu) made in this behalf by an assessee, and after recording his reasons for so doing, reduce or waive the amount of any penalty payable by the assessee under this Act, or stay or compound any proceeding for the recovery of any such amount, if he is satisfied that—
 - (i) to do otherwise would cause genuine hardship to the assessee, having regard to the circumstances of the case; and

¹ Also covered penalty imposable u/s 271(1)(c)

- (ii) the assessee has co-operated in any inquiry relating to the assessment or any proceeding for the recovery of any amount due from him.
- ◆ Where the amount of any penalty payable under this Act or, where such application relates to more than one penalty, the aggregate amount of such penalties exceeds ₹ 1,00,000, no order reducing or waiving the amount or compounding any proceeding for its recovery shall be made by the Principal Commissioner or Commissioner except with the previous approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General, as the case may be.
- ◆ The order, either accepting or rejecting the application in full or in part, shall be passed within a period of 12 months from the end of the month in which the application is received by the Principal Commissioner or the Commissioner. 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.

Taxpoint:

- ◆ An assessee can claim relief u/s 273A(1) or 273A(4) after claiming relief u/s 273A(4). However, if assessee already claimed relief u/s 273A(1), then no relief u/s 273A(4) or 273A(1) can be granted.
- ◆ Every order made under this section shall be final and shall not be called into question by any court or any other authority.
- ◆ The “genuine hardship” referred to in the provisions of section 273A(4) should exist at the time at which the application under section 273A(4) is made by the assessee before the Commissioner and should so exist even at the time of passing of order under section 273A(4) by the Commissioner. [Circular No. 784, dated 22nd November, 1999]

10.5 POWER OF PRINCIPAL COMMISSIONER OR COMMISSIONER TO GRANT IMMUNITY FROM PENALTY [SEC. 273AA]

1. A person may make an application to the Principal Commissioner or Commissioner for granting immunity from penalty, if —
 - (a) he has made an application for settlement u/s 245C and the proceedings for settlement have abated u/s 245HA; and
 - (b) the penalty proceedings have been initiated under this Act.
2. The application to the Principal Commissioner or Commissioner shall not be made after the imposition of penalty after abatement.
3. The Principal Commissioner or Commissioner may, subject to such conditions as he may think fit to impose, grant to the person immunity from the imposition of any penalty under this Act, if he is satisfied that the person has, after the abatement, co-operated with the income-tax authority in the proceedings before him and has made a full and true disclosure of his income and the manner in which such income has been derived.
4. The order, either accepting or rejecting the application in full or in part, shall be passed within a period of 12 months from the end of the month in which the application is received by the Principal Commissioner or the Commissioner. 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.
5. The immunity granted to a person shall stand withdrawn, if such person fails to comply with any condition subject to which the immunity was granted and thereupon the provisions of this Act shall apply as if such immunity had not been granted.



6. 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, concealed any particulars material to the assessment from the income-tax authority or had given false evidence, and thereupon such person shall become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

10.6 PENALTY NOT TO BE IMPOSED IN CERTAIN CASES [SEC. 273B]

Penalty referred to in sec. 271A, 271AA, 271B, 271BA, 271BB, 271C, 271CA, 271D, 271E, 271FA, 271FAB, 271FB, 271G, 271GA, 271GB, 271H, 271I, 271J, 272A(1)(c), 272A(1)(d), 272A(2), 272AA, 272B, 272BB or 272BBB, shall not be imposable on the person or the assessee, as the case may be, for any failure referred to in the said provisions if he proves that there was reasonable cause for the said failure.

10.7 PROCEDURE [SEC. 274]

- ◆ No order imposing a penalty under this Chapter shall be made unless the assessee has been heard, or has been given a reasonable opportunity of being heard.
- ◆ No order imposing a penalty under this Chapter shall be made:
 - (a) by the Income-tax Officer, where the penalty exceeds ₹ 10,000;
 - (b) by the Assistant Commissioner or Deputy Commissioner, where the penalty exceeds ₹ 20,000, except with the prior approval of the Joint Commissioner.
- ◆ An income-tax authority on making an order under this Chapter imposing a penalty (unless he is himself the Assessing Officer) shall send a copy of such order to the Assessing Officer.

10.8 BAR OF LIMITATION FOR IMPOSING PENALTIES [SEC. 275]

No order imposing a penalty under this Chapter shall be passed after following time limit:

Where the relevant assessment or other order is the subject-matter of an appeal to the Commissioner (Appeals) and the Commissioner (Appeals) passes the order on or after 01-06-2003 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 1 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

Where the relevant assessment or other order is the subject-matter of revision u/s 263 or 264	Penalty order shall not be passed after the expiry of 6 months from the end of the month in which such order of revision is passed
In any other case	Penalty order shall not be passed: - 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 - six months from the end of the month in which action for imposition of penalty is initiated, whichever period expires later

Revision of penalty order [Sec. 275(1A)]

Case:

- Where the relevant assessment or other order is the subject-matter of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal or to the High Court or to the Supreme Court [here-in-after referred to as 'appeal'] or revision u/s 263 or 264
- An order imposing or enhancing or reducing or cancelling penalty or dropping the proceedings for the imposition of penalty is passed before appeal order is received by the Principal Chief Commissioner or Chief Commissioner or the Principal Commissioner or Commissioner or the order of revision is passed,

then

- An order imposing or enhancing or reducing or cancelling 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 appeal and revision
- However, no order of imposing or enhancing or reducing or cancelling penalty or dropping the proceedings for the imposition of penalty shall be passed after the expiry of 6 months from the end of the month in which the appeal order is received by the Principal Chief Commissioner or Chief Commissioner or the Principal Commissioner or Commissioner or the order of revision is passed.
- Further, no penalty order is passed unless the assessee has been heard, or has been given a reasonable opportunity of being heard.

PROSECUTION

10.9 WHEN ASSESSEE BECOMES LIABLE FOR PROSECUTION

The Department is empowered to put on prosecution proceedings for offences committed by taxpayers. Prosecution details are tabulated below:

Section	Nature of offence	Rigorous Imprisonment and Fine	
		Minimum	Maximum
275A	Contravention of any order referred to in the second proviso to sec. 132(1) or (3)		



275B	Failure to comply with provision of sec. 132(1)(iib)	Any period up to 2 years (and fine also)	
276	Removal, concealment, transfer or delivery of property or any interest therein to prevent tax recovery.		
276A	Failure to comply with provision of sec. 178(1)/(3) by liquidator of a company.	Any period up to 2 years	
276B	Failure to pay to the credit of Central Government - tax deducted at source or tax on dividend u/s 115-O or tax payable under second proviso to sec.194B	3 months (with fine)	7 years (with fine)
276BB	Failure to pay to the credit of Central Government tax collected at source u/s 206C		
276C(1)	Attempt to evade tax, penalty or interest chargeable/ imposable, or under-reports income Case I: If amount sought to be evaded exceeds ₹ 25,00,000	6 months (with fine)	7 years (with fine)
	Case II: If such amount involved does not exceed ₹ 25,00,000	3 months (with fine)	2 years (with fine)
276C(2)	Attempt to evade the payment of any tax, penalty or interest.	3 months (with fine)	3 years (with fine)
276CC	Willful failure to file return of income in time u/s 139(1), or in response to notice u/s 142(1) or u/s 148 or u/s 153A provided tax payable by such person (other than company), on the total income determined on regular assessment (as reduced by the advance tax and TDS), exceeds ₹ 3,000		
	Case I: If amount of tax sought to be evaded exceeds ₹ 25,00,000	6 months (with fine)	7 years (with fine)
	Case II: If amount of tax sought to be evaded does not exceed ₹ 25,00,000	3 months (with fine)	2 years (with fine)
276D	Willful failure to produce books of account and documents as required u/s 142(1) or wilful failure to comply with direction u/s 142(2A) to get the accounts audited	Any period up to one year (and with fine)	
277	Makes false statement in any verification or delivers a false account or statement under this Act or rules there under		
	Case I: If amount of tax sought to be evaded exceeds ₹ 25,00,000	6 months (with fine)	7 years (with fine)
	Case II: If amount of tax sought to be evaded does not exceed ₹ 25,00,000	3 months (with fine)	2 years (with fine)
277A	Where any person (hereafter referred to as the first person) wilfully and with intent to enable any other person (hereafter referred to as the second person) to evade any tax or interest or penalty chargeable and		

	impossible under this Act, makes any entry or statement which is false and which the first person either knows to be false or does not believe to be true, in any books of account or other document being useful in any proceedings against the first person or the second person. For establishing the charge, it shall not be necessary to prove that the second person has actually evaded any tax, penalty or interest chargeable or impossible under this Act.	The first person shall be punishable with rigorous imprisonment for 3 months and with fine.	The first person shall be punishable with rigorous imprisonment for 2 years with fine.
278	Abetment or inducement in any manner to another person to make false statement or declaration relating to any income or any fringe benefits chargeable to tax. Case I: Where the amount of tax, penalty or interest which would have been evaded due to such false presentation, exceeds ₹ 25,00,000 Case II: In any other case	6 months (with fine)	7 years (with fine)
278A	Punishment for second and subsequent offences u/s 276B, 276C(1), 276CC, 277 or 278	3 months (with fine)	2 years (with fine)
278B	Where an offence under this Act has been committed by a company - - The company itself; and - Every person who, at the time the offence was committed, was in charge of, and was responsible to the company for the conduct of the business of the company, - shall be deemed to be guilty of the offence Note: Company includes firm, AOP/BOI.	Liable to be proceeded against and punished accordingly. Note: Where the punishment for an offence is imprisonment and fine, then such company shall be punished with fine only.	
278C	Where an offence under this Act has been committed by an HUF, the Karta thereof shall be deemed to be guilty of the offence		
280	Disclosure of any information by public servants in contravention of sec. 138(2)	Upto 6 months (with fine) (With previous sanction of the Central Government)	

Notes:

- (a) No court inferior to that of a Presidency Magistrate of the first class shall try any offence under this Act [Sec. 292]
- (b) Punishment shall not be imposed u/s 276A, 276AB and 276B if the assessee proves that there was reasonable cause for failure [Sec.278AA]
- (c) Prosecution proceeding shall not be instituted u/s 275A, 275B, 276, 276A, 276B, 276BB, 276C, 276CC, 276D, 277, 277A and 278 without previous sanction of the Principal Commissioner or Commissioner or Commissioner (Appeals) or the appropriate authority [Sec. 279]
- (d) A person shall not be proceeded against for an offence u/s 276C or 277 in relation to the assessment for an



assessment year in respect of which the penalty imposed or imposable on him u/s 270A has been reduced or waived u/s 273A. [Sec. 279(1A)]

10.10 POWER OF COMMISSIONER TO GRANT IMMUNITY FROM PROSECUTION [SEC. 273AB]

1. A person may make an application to the Principal Commissioner or Commissioner for granting immunity from prosecution, if he has made an application for settlement u/s 245C and the proceedings for settlement have abated u/s 245HA.
2. The application to the Principal Commissioner or Commissioner shall not be made after institution of the prosecution proceedings after abatement.
3. The Principal Commissioner or Commissioner may, subject to such conditions as he may think fit to impose, grant to the person immunity from prosecution for any offence under this Act, if he is satisfied that the person has, after the abatement, co-operated with the income-tax authority in the proceedings before him and has made a full and true disclosure of his income and the manner in which such income has been derived:
4. The immunity granted to a person shall stand withdrawn, if such person fails to comply with any condition subject to which the immunity was granted and thereupon the provisions of this Act shall apply as if such immunity had not been granted.
5. 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, concealed any particulars material to the assessment from the income-tax authority or had given false evidence, and thereupon such 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.

STUDY NOTE : 11

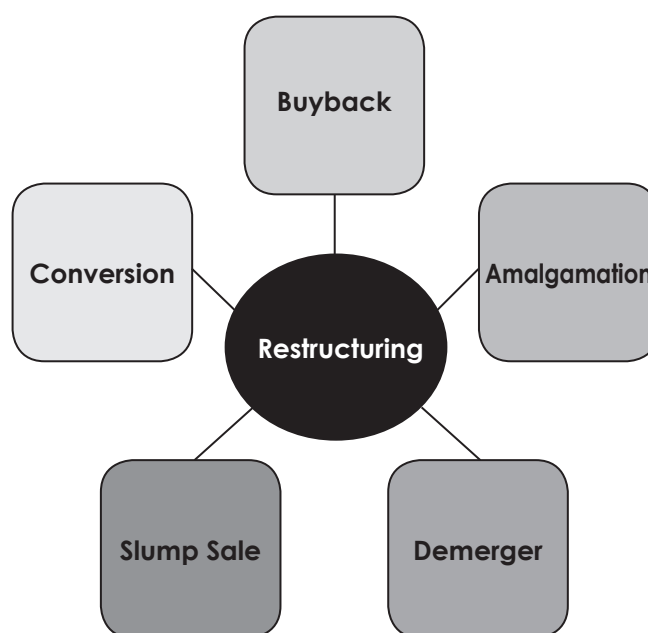
BUSINESS RESTRUCTURING AND REORGANISATION



This Study Note includes:

- 11.1 Amalgamation
- 11.2 Demerger
- 11.3 Slump Sale
- 11.4 Conversion of sole proprietary business or firm into company
- 11.5 Conversion of private limited company or unlisted company into LLP
- 11.6 Capital Gain on buy back of own shares or other specified securities [Sec. 46A]

Restructuring is term used for the act of reorganizing the legal, ownership, operational, or other structures of a company for the purpose of making it more profitable, or better organized for its present needs. Companies are resorting to acquisitions as a means to consolidate and grow rapidly in an ever changing business environment. As a result, there is an increase in the level of restructuring activity in various sectors. Change in ownership or operational structure transaction have tax implication. The purpose of a suitable business strategy for restructuring must increase efficiency, consolidate operations, increase market share, assist in turn around, increase market capitalization and create entry barrier for competitors. Proper tax planning in this regard shall reduce the cost of restructuring in this front. The chapter highlights the various tax aspect in hands of all concerned person.



11.1 AMALGAMATION

Definition [Sec. 2(1B)]

Amalgamation (in relation to companies) means:

- the merger of one or more companies with another company; or
- the merger of two or more companies to form one company;

in such a manner that—

- (a) all assets and liabilities of the amalgamating company or companies immediately before the amalgamation becomes the assets and liabilities of the amalgamated company;
- (b) shareholders (both equity or preference) holding not less than 75% in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by



a nominee for, the amalgamated company or its subsidiary) become shareholders (equity or preference) of the amalgamated company.

- ▶ Number of shares allotted to the shareholders of the amalgamating company by the amalgamated company is not relevant.
- ▶ Where C Ltd. merges with Z Ltd., in a scheme of amalgamation, and immediately before the amalgamation, Z Ltd. holds 20% of the share in C Ltd., the aforesaid mentioned condition will be satisfied if shareholders holding not less than $\frac{3}{4}$ th (in value) of the remaining 80% of the shares in C Ltd., i.e., 60% thereof ($\frac{3}{4} \times 80$), become shareholders of Z Ltd., by virtue of the amalgamation. Where, however, the whole of the share capital of a company is held by another company, the merger of the two companies will qualify as an amalgamation within sec. 2(1B), if the other two conditions are satisfied [Circular 5P, dated 9-10-67]

Exceptions:

Following mergers shall not be treated as amalgamation -

- Merger as a result of acquisition of the property of one company by another company pursuant to the purchase of such property by the other company; or
- Merger as a result of distribution of such property to the other company after the winding up of the first-mentioned company.

Amalgamation & Shareholder of amalgamating company

Effect of amalgamation on a shareholder are as under:

Transfer of shares of amalgamating company	As per sec. 47(vii), any transfer by a shareholder, in a scheme of amalgamation, of share(s) held by him in the amalgamating company is not treated as transfer and hence not liable to capital gain tax, if following conditions are satisfied: i. The transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company; and ii. The amalgamated company is an Indian company.
Cost of shares in amalgamated company	The cost of shares in amalgamating company shall be deemed to be the cost of shares in amalgamated company. [Sec. 49(2)]
Determination of nature of assets	To find whether shares in amalgamated company are long-term or short-term capital asset, the period of holding shall be calculated from the date when shares in the amalgamating company were acquired. [Sec. 2(42A)]
Indexation benefit	Indexation benefit shall be available from the year in which shares of amalgamated company were acquired by the assessee.

Amalgamation & amalgamating company

- ♦ As per sec. 47(vi), any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company is not treated as transfer (hence not liable to capital gain) provided the amalgamated company is an Indian company.
- ♦ If amalgamation does not satisfy condition of sec. 2(1B) and of sec. 47(vi), then exemption is not available.
- ♦ As per sec. 47(viab), any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company, (referred to in the Explanation 5 of sec.9(1)(i)), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company, if:

- a. at least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and
- b. such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated.
- ♦ As per sec. 47(via), any transfer, in a scheme of amalgamation, of a capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company is not treated as transfer (hence not liable to capital gain) provided:
 - a) at least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and
 - b) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated.

Taxpoint

- Such transfer is in a scheme of amalgamation by the amalgamating foreign company to the amalgamated foreign company.
- Transferred asset must be a capital asset being a share or shares held in an Indian company.
- At least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company.
- Such transfer does not attract tax on capital gain in the country, in which the amalgamating company is incorporated.

Amalgamation & amalgamated company

♦ Value of non-depreciable capital assets for the purpose of capital gain

- As per sec. 49(1), where a capital asset became the property of amalgamated (Indian) company in a scheme of amalgamation, the cost of acquisition of the asset to the amalgamated company shall be deemed to be the cost for which the previous owner (i.e., amalgamating company) of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be.
- It is to be noted that where non-depreciable asset was acquired before 1-4-2001, the cost of acquisition can be taken as cost of acquisition or fair market value of the asset as on 1-4-2001, at the option of the assessee.
- In determining the period of holding of such asset, period of holding of previous owner shall also be considered, however, indexation benefit is available from the year of amalgamation.

♦ Value of depreciable asset for the purpose of business income

- Where in any previous year, any block of assets is transferred by the amalgamating company to the amalgamated (Indian) company in a scheme of amalgamation, then, the actual cost of the block of assets in the case of the amalgamated company shall be the written down value of the block of assets as in the case of the amalgamating company for the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said preceding previous year [Exp. 2 to sec. 43(6)]
- Allocation of depreciation in the year of amalgamation: The aggregate deduction, in respect of depreciation allowable to the amalgamating company and the amalgamated company in the case of amalgamation shall not exceed in any previous year the deduction calculated at the prescribed rates as if the amalgamation had not taken place and such deduction shall be apportioned between the amalgamating company and the amalgamated company in the ratio of the number of days for which the assets were used by them.

♦ Value of asset transferred as stock in trade

- Where an asset [not being an asset referred to in sec. 45(2)] which becomes the property of an amalgamated company under a scheme of amalgamation, is sold by the amalgamated company as stock-in-trade of the



business carried on by it, the cost of acquisition of the said asset to the amalgamated company in computing the profits and gains from the sale of such asset shall be the cost of acquisition of the said asset to the amalgamating company, as increased by the cost, if any, of any improvement made thereto, and the expenditure, if any, incurred, wholly and exclusively in connection with such transfer by the amalgamating company [Sec. 43C(1)]

Taxpoint: The provision is applicable where following asset of the amalgamating company is taken over by the amalgamated company as stock-in-trade at revalued price:

- a) Stock-in-trade
 - b) Capital asset converted to stock-in-trade
 - c) Capital asset
- Sec. 43C is also applicable where an asset becomes the property of the assessee on the total or partial partition of HUF or under a gift or will or irrevocable trust.

■ Set-off and carry forward of business loss and unabsorbed depreciation [Sec. 72A]

Applicable

- Where there has been an amalgamation of a company owning:
 - (a) an industrial undertaking; or
 - (b) a ship; or
 - (c) a hotel,- with another company.
- An amalgamation of a banking company with a specified bank.
- One or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business,

Conditions to be satisfied

The accumulated loss shall not be set off or carried forward and the unabsorbed depreciation shall not be allowed in the assessment of the amalgamated company unless:

- (a) The amalgamating company—
 - (i) has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;
 - (ii) has held continuously as on the date of the amalgamation at least $\frac{3}{4}$ th of the book value of fixed assets held by it two years prior to the date of amalgamation.
- (b) The amalgamated company—
 - (i) holds continuously for a minimum period of 5 years from the date of amalgamation at least $\frac{3}{4}$ th of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;
 - (ii) continues the business of the amalgamating company for a minimum period of 5 years from the date of amalgamation;
 - (iii) fulfils such other conditions* as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

* Conditions for carrying forward or set-off of accumulated loss and unabsorbed depreciation allowance in case of amalgamation [Rule 9C]

- (a) The amalgamated company, owning an industrial undertaking of the amalgamating company by way of amalgamation, shall achieve the level of production of at least 50% of the installed capacity (i.e., the capacity of production existing 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.

Provided that the Central Government, on an application made by the amalgamated company, may relax the condition of achieving the level of production or the period during which the same is to be achieved or both in suitable cases having regard to the genuine efforts made by the amalgamated company to attain the prescribed level of production and the circumstances preventing such efforts from achieving the same.

- (b) The amalgamated company shall furnish to the Assessing Officer a certificate in Form No. 62, duly verified by an accountant, with reference to the books of accounts and other documents showing particulars of production, along with the return of income for the assessment year relevant to the previous year during which the prescribed level of production is achieved and for subsequent assessment years relevant to the previous years falling within five years from the date of amalgamation.

Treatment

- The accumulated business (non-speculative) loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.
- In a case where any of the conditions are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.

Deduction of expenses incurred in case of amalgamation or demerger [Sec. 35DD]

Applicable to: An Indian company

Conditions

- Assessee has incurred certain expenditure wholly & exclusively for the purpose of amalgamation or demerger.
- No deduction has been claimed for such expenses under any other section.

Quantum of deduction: 1/5th of expenses so incurred for a period of 5 years commencing from the year in which amalgamation or demerger takes places.

Other Provisions

Capital Expenditure on Scientific Research [Sec. 35(5)]: Provisions of sec. 35 shall apply to the amalgamated company, as it would have been applied to the amalgamating company, if the latter had not transferred such asset.

Telecom or spectrum licence: The amalgamated company or resulting company (being Indian company) as the case may be shall be entitled to claim deduction u/s 35ABB (or sec. 35ABA) for the residual period as if the amalgamating or demerged company had not transferred the licence.

Amortisation of Preliminary Expenses: In case of transfer of undertaking under the scheme of amalgamation or demerger, the amalgamated company or resulting company (being Indian company) shall be entitled to claim deduction u/s 35D for the residual period as if the amalgamation or demerger had not taken place.

Amortisation of expenditure incurred under VRS: In case of transfer of undertaking under the scheme of amalgamation or demerger, the amalgamated company or resulting company (being Indian company) as the case may be, shall be entitled to claim deduction u/s 35DDA for the residual period as if the amalgamation or demerger had not taken place.



11.2 DEMERGER

Definition [Sec. 2 (19AA)]

Demerger (in relation to companies) means the transfer, pursuant to a scheme of arrangement u/s 230 to 232 of the Companies Act, 2013, by a demerged company of its one or more undertakings to any resulting company in such a manner that:

- i. **All assets and liabilities are transferred:** All assets and liabilities of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the assets and liabilities of the resulting company.
- ii. **Transfer at Book value:** Assets and liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at its book-value (without considering revaluation) immediately before the demerger.
Note: Any change in the value of assets consequent to their revaluation shall be ignored.
- iii. **Consideration in shares:** Resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company.
- iv. **Common share-holders:** Shareholders holding not less than 75% in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company.
- v. **Going concern:** Transfer of the undertaking is on a going concern basis.
- vi. **Other specified condition:** The demerger is in accordance with the conditions, if any, notified u/s 72A(5) by the Central Government in this behalf.

Taxpoint

- ♦ Undertaking shall include (i) any part of an undertaking, or (ii) a unit or division of an undertaking or (iii) a business activity taken as a whole, (iv) but does not include individual assets or liabilities or any combination thereof not constituting a business activity.
- ♦ The liabilities referred above, shall include:
 - (a) the liabilities which arise out of the activities or operations of the undertaking;
 - (b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and
 - (c) in cases of general borrowings, so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger, i.e.,

General/multi-purpose borrowings of the demerged company	×	Book value of assets (ignoring revaluation) transferred in the demerger
		Total book value of assets (ignoring revaluation) of the demerged company before demerger

- ♦ The splitting up or the reconstruction of any authority or a body constituted or established under a Central, State or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils such conditions as may be notified by the Central Government.
- ♦ The reconstruction or splitting up of a company, which ceased to be a public sector company as a result of transfer of its shares by the Central Government, into separate companies, shall be deemed to be a demerger, if such reconstruction or splitting up has been made to give effect to any condition attached to the said transfer of shares and also fulfils such other conditions as may be notified by the Central Government.

- ◆ Demerged company means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company[Sec. 2(19AAA)]
- ◆ Resulting company means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger[Sec. 2(41A)]

Demerger and Shareholder of demerged company

As per sec. 47(vid), any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company shall not be treated as transfer if the transfer or issue is made in consideration of demerger of the undertaking.

In case of demerger, the existing shareholder of the demerged company will now hold:

- Shares in resulting company; and
- Shares in demerged company.

and in case the shareholder transfers any of the above shares subsequent to the demerger, the cost of such shares shall be determined as under:

Cost of acquisition of the shares in the resulting company [Sec. 49(2C)]

The cost of acquisition of the shares in the resulting company shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.

Net worth shall mean the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.

Cost of acquisition of the shares in demerged company [Sec. 49(2D)]

The cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived at u/s 49(2C).

Taxpoint:

Cost of shares	Resulting company	$\frac{\text{Cost of acquisition of Original shares} \times \text{Net book value of assets transferred to resulting company}}{\text{Net worth}^{\#} \text{ of the company immediately before such demerger}}$
		[#] Net worth = Paid-up share capital + General reserves (as per books of account of the demerged company immediately before demerger)
	Demerged company (after demerger)	Cost of acquisition of the original shares **** Less: Cost of shares of resulting company (as above) (***) Cost of shares of demerged company ****
Determination of nature of asset	Resulting company	To find whether shares in resulting company are long-term or short term capital asset, the period of holding shall be calculated from date of acquisition of original shares in demerged company (before demerger).
	Demerged company	
Indexation benefit	Resulting company	Indexation benefit shall be available from the year in which shares in resulting company were acquired by the assessee.
	Demerged company	Indexation benefit shall be available from the year in which original shares in demerged company were acquired by the assessee.



ILLUSTRATION 1

Dona purchases 600 equity shares in XY (P) Ltd. on 1-04-2018 @ ₹ 150 each. On 31-12-2018, XY (P) Ltd. is demerged. In the scheme of demerger, division Y was transferred to Y (P) Ltd. (resulting company). On that date balance sheet of XY (P) Ltd. is as follow –

Liabilities	Division		Total	Asset	Division		Total
	X	Y			X	Y	
6,000 E.Shares			6,00,000	Land	-	2,50,000	2,50,000
General Reserve			4,00,000	Plant	1,75,000	1,00,000	2,75,000
Loan (General)			2,00,000	Investment	2,50,000	-	2,50,000
Loan (Specific)	60,000	75,000	1,35,000	Stock	1,95,000	2,30,000	4,25,000
Creditors	25,000	40,000	65,000	Debtors	55,000	45,000	1,00,000
				Cash and Bank	25,000	75,000	1,00,000
			14,00,000				14,00,000

Y (P) Ltd., in consideration of the demerger, issued equity share of ₹ 100 each (at par) to the shareholders of XY (P) Ltd. on proportionate basis. You are required to compute –

- Number of shares of Y (P) Ltd. received by Dona and cost thereof.
- Cost of acquisition of shares held by Dona in XY (P) Ltd. after demerger.
- Capital gain, if Dona sold 200 shares of XY (P) Ltd.@ ₹ 125 & 100 shares of Y(P) Ltd.@ ₹ 110 on 31-03-2019.

Solution

Calculation of number of shares of Y (P) Ltd. received by Dona

Particulars	Amount	Amount
Net asset taken over by Y (P) Ltd		
Assets taken over		
Land		2,50,000
Plant		1,00,000
Stock		2,30,000
Debtors		45,000
Cash and bank		75,000
		7,00,000
Less: Liabilities		
Loan (Specific)	75,000	
Creditors	40,000	
Share of General loan (₹ 2,00,000 x ₹ 7,00,000) / ₹ 14,00,000	1,00,000	2,15,000
Net asset taken over		4,85,000
No. of shares issued by Y (P) Ltd.		4,850 shares
(Consideration of ₹ 4,85,000 was discharged by issuing equity shares of ₹ 100 each)		
% of Dona's holding in XY (P) Ltd. (600 shares, out of 6,000 shares of XY (P) Ltd.)		10%
No. of shares allotted in Y (P) Ltd to Dona (10% of 4,850 shares)		485 Shares

Cost of such shares is –

$$\frac{\text{Cost of acquisition of shares in XY (P) Ltd.} \times \text{Net book value of asset transferred to Y (P) Ltd.}}{\text{Net worth of XY (P) Ltd. immediately before demerger (i.e. Paid up capital + General Reserve)}}$$

$$= \frac{(600 \times ₹ 150) \times ₹ 4,85,000}{₹ 6,00,000 + ₹ 4,00,000} = ₹ 43,650$$

b) Cost of acquisition of shares of XY (P) Ltd. (after demerger) = Original cost of acquisition – Cost of acquisition of shares of Y (P) Ltd. (as computed above)

$$= ₹ 90,000 - ₹ 43,650 = ₹ 46,350$$

Computation of capital gain in the hands of Dona for the A.Y. 2019-20

Particulars	Details	Shares of	
		XY (P) Ltd.	Y (P) Ltd.
Sale Consideration	200 × ₹ 125	25,000	-
	100 × ₹ 110	-	11,000
Less: Expenses on transfer		Nil	Nil
Net Sale Consideration		25,000	11,000
Less: i) Cost of acquisition	[(₹ 46,350 × 200)/600]	15,450	-
	[(₹ 43,650 × 100)/485]	-	9,000
ii) Cost of improvement		Nil	Nil
Short Term Capital Gain		9,550	2,000

Demerger and Demerged company

- ♦ As per sec. 47(vib), any transfer, in a demerger, of a capital asset by the demerged company to the resulting company is not treated as transfer (hence not liable to capital gain) provided the resulting company is an Indian company.
- ♦ As per sec. 47(vic), any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company is not treated as transfer provided:
 - a) the shareholders holding not less than ¾th in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
 - b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

The provisions of the Companies Act shall not apply in case of demergers referred to in this clause.

- ♦ As per sec. 47(vicc), any transfer in a demerger, of a capital asset, being a share of a foreign company (referred to in the Explanation 5 of sec. 9(1)(i)), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged foreign company to the resulting foreign company, if:
 - a) the shareholders, holding not less than ¾th in value of the shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company; and
 - b) such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated.

WDV of depreciable asset in hands of demerged company

Where in any previous year, any asset forming part of a block of assets is transferred by a demerged company to the resulting company, then, the written down value of the block of assets of the demerged company for the immediately preceding previous year shall be reduced by the written down value of the assets transferred to the resulting company pursuant to the demerger [Explanation 2A to Sec. 43(6)]



Demerger and Resulting Company

Actual cost of assets to the resulting company

Where, in a demerger, any capital asset is transferred by the demerged company to the resulting company and the resulting company is an Indian company, the actual cost of the transferred capital asset to the resulting company shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business.

However, such actual cost shall not exceed the written down value of such capital asset in the hands of the demerged company. [Explanation 7A to sec. 43(1)]

WDV of depreciable asset in hands of resulting company

Where in a previous year, any asset forming part of a block of assets is transferred by a demerged company to the resulting company, then, the written down value of the block of assets in the case of the resulting company shall be the written down value of the transferred assets of the demerged company immediately before the demerger [Explanation 2B to Sec. 43(6)]

Allocation of depreciation in the year of demerger

The aggregate deduction, in respect of depreciation allowable to the demerged company and the resulted company in the case of demerger shall not exceed in any previous year the deduction calculated at the prescribed rates as if the demerger had not taken place and such deduction shall be apportioned between the demerged company and the resulting company in the ratio of the number of days for which the assets were used by them.

Set off and carry forward [Sec. 72A]

In the case of a demerger, the accumulated business loss (other than speculation loss) and the allowance for unabsorbed depreciation of the demerged company shall:

- (a) where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company;
- (b) where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

The Central Government may, for the purposes of this Act, by notification in the Official Gazette, specify such conditions as it considers necessary to ensure that the demerger is for genuine business purposes.

11.3 SLUMP SALE

Definition [Sec. 2(42C)]:

It means transfer of undertaking(s) for a lump sum consideration without assigning values to the individual assets of such undertaking(s)

Undertaking shall include any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Computation of capital gain

Full value of consideration	As usual
Cost of Acquisition or Improvement	Net worth [#] of the undertaking
Indexation Benefit	Not available
Nature of gain whether short term or long term	If undertaking is owned and held by the assessee for not more than 36 months, then capital gain shall be deemed to be short-term capital gain otherwise long-term capital gain. Note: Where an undertaking is owned and held by an assessee for more than 36 months immediately preceding the date of its transfer, then it shall be treated as a long-term capital asset. It makes no difference that few of the assets of the undertaking are newly acquired (i.e. for less than 36 months).
Net worth shall be the – Aggregate value of total assets of the undertaking **** Less: Value of liabilities of such undertaking as appearing in the books of account **** Net worth ****	
Notes Effect of revaluation: If any change has been made in the value of assets on account of revaluation of assets etc. then such change in value shall be ignored. The aggregate value of total assets, in case of: - Depreciable assets - WDV of block of assets - Capital assets in respect of which the whole of the expenditure has been allowed as a deduction under section 35AD - Nil - Other assets - Book value of all such assets Treatment of stock: In case of slump sale, no profit under the head 'Profits & gains of business or profession' shall arise even if the stock of the said undertaking is transferred along with other assets. Carry-forward of losses: In case of slump sale, benefit of unabsorbed losses and depreciation of the undertaking transferred shall be available to the transferor company and not to the transferee company. Report of an accountant: The assessee is required to furnish, along with the return of income, a report of a chartered accountant in Form 3CEA indicating the computation of the net worth of the undertaking or division and certifying that the net worth of the undertaking or division has been correctly arrived at in accordance with the provisions of this section.	

Computation of written down value of block of assets in case of slump sale

Particulars	Amount
W.D.V of the block at the beginning of the previous year	***
Add: Purchase during the previous year	***
	Mno
Less: Sale consideration for assets sold (to the maximum of mno)	(****)
	Pqr
Less: WDV (Note) of the asset sold under slump sale	(abc)



[Value of deduction at this stage i.e. abc cannot exceed pqr]	XYZ
Less: Depreciation (as a % on XYZ)	(***)
WDV of the block at the end of year	****

Note: Written down value of the asset sold under slump sale

Particulars	Amount
Original cost of asset sold under slump sale	***
Less: Depreciation (actual) allowed on such asset in respect of any previous year commencing before 1987-88	(***)
Less: Depreciation (notional) that would have been allowable from the previous year 1987-88 onwards as if the asset is only asset in the relevant block.	(***)
Written down value of the asset sold under slump sale	***

ILLUSTRATION 2

M/s AP a wholesale enterprises, has sold one of its undertaking consisting of Machinery A (rate of depreciation 30%), Machinery X (rate of depreciation 15%), Building B (rate of depreciation 10%) for ₹ 15,00,000 on 1/9/2018.

- Machinery A, originally acquired for ₹ 5,00,000 on 1/8/2015
- Machinery X, originally acquired for ₹ 10,00,000, the amount of depreciation allowed on such machinery up to the A.Y. 1988-89 ₹ 2,00,000 and depreciation for A.Y. 1989-90 to 2018-19 (assuming this is the only machinery in the block) is ₹ 7,94,000.
- Building B acquired on 17/7/2018 for ₹ 4,00,000.
- During the year, new machinery Z (15%) purchased for ₹ 5,00,000 on 7/7/2018.

Compute depreciation for the A.Y.2019-20:

- Machinery (rate of depreciation 30%) block [WDV as on 1/4/2018 is ₹ 9,00,000]
- Machinery (rate of depreciation 15%) block [WDV as on 1/4/2018 is ₹ 8,00,000]
- Building (rate of depreciation 10%) block [WDV as on 1/4/2018 is ₹ 5,00,000].

Solution

Computation of depreciation for Block

Particulars	Machinery (30%)	Machinery (15%)	Building (10%)
W.D.V. as on 1/4/2018	9,00,000	8,00,000	5,00,000
Add: Purchase during the year	Nil	5,00,000	4,00,000
	9,00,000	13,00,000	9,00,000
Less: Sale under slump sale (Working)	1,71,500	6,000	4,00,000
	7,28,500	12,94,000	5,00,000
Depreciation	2,18,550	1,94,100	50,000

Working: Written down value of the asset sold under slump sale

Particulars	Machinery A	Machinery X	Building B
Original cost of asset sold under slump sale	5,00,000	10,00,000	4,00,000
Less: Depreciation (actual) allowed on such asset in respect of any previous year commencing before 1987-88	Nil	2,00,000	Nil

Less: Depreciation (notional) that would have been allowable from the previous year 1987-88 onwards as if the asset is only asset in the relevant block.	3,28,500*	7,94,000	Nil
* Depreciation ₹ 1,50,000 (for 2015-16) + ₹ 1,05,000 (for 2016-17) + ₹ 73,500 (for 2017-18)	3,28,500*	7,94,000	Nil
Written down value of the asset sold under slump sale	1,71,500	6,000	4,00,000

11.4 CONVERSION OF SOLE PROPRIETARY BUSINESS OR FIRM INTO COMPANY

Transaction not regarded as transfer for the purpose of capital gain [Sec. 47(xiv)]

Where a sole proprietary concern is succeeded by a company in the business carried on by it as a result of which the sole proprietary concern sells or otherwise transfers any capital asset to the company, the transaction is not regarded as transfer provided following conditions are satisfied:

- All assets and liabilities of the sole proprietary concern relating to the business immediately before the succession become the assets and liabilities of the company;
- Proprietor holds not less than 50% of the total voting power in the company and his shareholding continues to remain as such for a period of 5 years from the date of succession; and
- The sole proprietor 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 company.

Taxpoint

- Transfer must have taken place as a result of succession of the proprietorship concern to a company.
- All assets and liabilities related to the business must have been transferred.
- The whole consideration shall be paid by allotment of shares in the company.
- Proprietor must hold at least 50% of the total voting power of the company.
- Lock in period for above share is 5 years from the date of succession.
- Exemption is available for capital gain on transfer of capital asset and not on transfer of stock in trade. Therefore, if stock is transferred at profits, it will be taxable as business income.

Transaction not regarded as transfer for the purpose of capital gain [Sec. 47(xiii)]

Any transfer of a capital asset, by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, shall not be regarded as transfer provided following conditions are satisfied:

- All assets and liabilities of the firm relating to the business immediately before the succession become the assets and liabilities of the company.
- All the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of succession.
- The partners of the firm do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company; and
- The aggregate of the shareholding in the company of the partners of the firm is not less than 50% of the total voting power in the company and their shareholding continues to be as such for a period of 5 years from the date of succession.

**Taxpoint**

- Transfer must have taken place as a result of succession of the firm to a company.
- All assets and liabilities related to the business must have been transferred.
- All the partners become the shareholders of the company in their capital ratio (as on the date of the succession)
- The whole consideration shall be paid by allotment of shares in the company
- Partners (altogether) must hold atleast 50% of the total voting power of the company
- Lock in period for above share is 5 years from the date of succession.

Withdrawal of exemption u/s 47(xiii)/47(xiv) [Sec. 47A(3)]

On violation of conditions, exemption earlier allowed shall be withdrawn and amount of profits or gains arising from the transfer of such capital asset not charged earlier shall be deemed to be the profits and gains chargeable to tax of the successor company for the previous year in which the requirements of sec. 47(xiii)/(xiv) are violated.

Taxpoint

Withdrawal of exemption	The benefits availed shall be deemed to be the capital gain
Year of taxability	The year in which condition u/s 47(xiii) or (xiv) are violated.
Who will be liable to tax	Successor company
Benefit of indexation	Available up to the year when succession took place.

ILLUSTRATION 3

M/S ABC converted itself into a company as on 31/03/2016. As on date, balance sheet of the firm was as under:

Liabilities	Amount	Assets	Amount
A's Capital	40,000	Machinery (WDV as per IT Act)	1,00,000
B's Capital	1,10,000	Investments (acquired on 14/08/2004)	50,000
C's Capital	50,000	Stock	70,000
Creditors	1,00,000	Debtors	60,000
		Bank	20,000
	3,00,000		3,00,000

Following value was agreed upon on conversion –

Machinery	₹ 1,20,000
Investments	₹ 2,50,000
Stock	₹ 90,000
Debtors	₹ 60,000

The firm fulfilled all the conditions of sec.47(xiii) and partners account are settled by way of issuing equity shares in their capital ratio. However, on 01/04/2018, all partners transferred all of their shares. Show tax treatment.

Solution

As per sec. 47A(3), where any of the conditions laid down in sec. 47(xiii) are not complied with, the gain exempted u/s 47(xiii) shall be charged to tax in the hands of successor company in the previous year in which the requirements of sec. 47(xiii) are violated. One of the conditions stated in sec. 47(xiii) is that the partner of the old firm cannot transfer shares of the successor company till 5 years. In the given case, all partners sold shares of the successor company within 5 years hence earlier exempted gain shall be revoked.

Computation of taxable income in the hands of successor company for the A.Y. 2019-20

Particulars	Investments	Machinery
Sale consideration	2,50,000	1,20,000
Less: Expenses on transfer	Nil	Nil
Net Sale Consideration	2,50,000	1,20,000
Less: Indexed cost of acquisition [$\text{₹ } 50,000 \times 254/113$]	1,12,389	Nil
Less: Cost of acquisition (being WDV)	Nil	1,00,000
Long Term Capital Gain	1,37,611	Nil
Short Term Capital Gain	Nil	20,000
Note: Profit on transfer of stock by firm to company (i.e. ₹ 20,000 being ₹ 90,000 – ₹ 70,000) is taxable as business income of the firm for the A.Y. 2016-17.		

Value of non-depreciable capital assets for the purpose of capital gain

As per sec. 49(1), where a capital asset became the property of the company under transfer referred to in sec. 47(xiii) or 47(xiv), the cost of acquisition of the asset to the company shall be deemed to be the cost for which the previous owner (i.e., erstwhile concern or firm) of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be.

Allocation of depreciation in the year of conversion

Deduction for depreciation shall be apportioned between the proprietary concern (or firm) and the company in the ratio of the number of days for which the assets were used by them.

ILLUSTRATION 4

M/s. QQ Trading Co. a sole proprietary concern, was converted into a company w.e.f 01-09-2018. Before the conversion, the sole proprietary concern had a block of Plant & Machinery (15%), whose WDV as on 1-4-2018 was ₹ 3,00,000. On 1st April itself, a new plant of the same block was purchased for ₹ 1,20,000. After the conversion, the company has purchased the same type of plant on 1-1-2019 for ₹ 1,60,000. Compute the depreciation that would be allocated between the concern & the company.

Solution

Computation of depreciation on plant and machinery if there were no succession

Particulars	Plant & Machinery
W.D.V. as on 1/4/2018	3,00,000
Add: Purchase during the year	1,20,000
	4,20,000
Less: Sale during the year	Nil
	4,20,000
Depreciation @ 15% of ₹ 4,20,000	63,000

Allocation of depreciation between sole proprietary concern and the successor company

The depreciation of ₹ 63,000 is to be allocated in the ratio of number of days the assets were used by the sole proprietary concern and the successor company.



Calculation of allowable depreciation to sole proprietary concern

Particulars	Amount
Ex-sole proprietary:	
Plant & machinery are used by sole proprietary concern from 1/4/2018 to 31/8/2018 i.e. 153 days.	
Depreciation for 153 days ($\text{₹ } 63,000 \times 153/365$)	26,408

Calculation of allowable depreciation to successor company

Particulars	Amount
Plant & machinery of sole proprietary concern used by the successor company from 1/9/2018 to 31/3/2019 i.e. 212 days. Depreciation for such period ($\text{₹ } 63,000 \times 212/365$)	36,592
After conversion	
Depreciation in respect of assets purchased by the successor company on 1/1/2019 is fully allowable in the hands of successor company [50% of 15% on $\text{₹ } 1,60,000$].	12,000
Total depreciation	48,592

ILLUSTRATION 5

M/s S& Co., a sole proprietary concern is converted into a company, Sid Co. Ltd. with effect from November 29, 2018. The written down value of assets as on April 1, 2018 are as follows:

Items	Rate of Depreciation	WDV as on 1 April, 2018
Building	10%	₹ 3,50,000
Furniture	10%	₹ 50,000
Plant & Machinery	15%	₹ 2,00,000

Further, on 15-10-2018, M/s S& Co. purchased a plant for ₹ 1,00,000 (rate of depreciation 15%). After conversion, the company added another plant worth ₹ 50,000 (rate of depreciation 15%). Compute the depreciation available to (i) M/s S& Co. and (ii) Sid Co. Ltd. for the A.Y. 2019-20

Solution

Computation of depreciation on assets if there were no succession

Particulars	Building	Furniture	Plant & Machinery
Rate of depreciation	10%	10%	15%
W.D.V. as on 1/4/2018	3,50,000	50,000	2,00,000
Add: Purchase during the year	Nil	Nil	1,00,000*
	3,50,000	50,000	3,00,000
Less: Sale during the year	Nil	Nil	Nil
	3,50,000	50,000	3,00,000
Depreciation	35,000	5,000	37,500

It is assumed that the assessee is not entitled for additional depreciation.

* Without considering assets acquired after succession.** $[(\text{₹ } 2,00,000 \times 15\%) + (\text{₹ } 1,00,000 \times 15\% \times \frac{1}{2})]$

Allocation of depreciation between sole proprietary concern and the successor company

The depreciation is to be allocated in the ratio of number of days the assets were used by the sole proprietary concern and the successor company.

Calculation of allowable depreciation to sole proprietary concern

Particulars	Amount
Depreciation on assets held as on 01/04/2018	
Assets are used by sole proprietary concern from 1/4/2018 to 28/11/2018 i.e. 242 days, hence depreciation shall be allowed for 242 days	
- Building ($\text{₹ } 35,000 \times 242/365$)	23,205
- Furniture ($\text{₹ } 5,000 \times 242/365$)	3,315
- Plant and Machinery ($\text{₹ } 30,000 \times 242/365$)	19,890
Depreciation on newly acquired assets	
New assets has been used by it from 15/10/2018 to 28/11/2018 i.e. 45 days, hence depreciation shall be allowed for 45 days	
- Plant and Machinery ($\text{₹ } 7,500 \times 45/168$)	2,009
Depreciation allowable u/s 32	48,419

Calculation of allowable depreciation to successor company

Particulars	Amount
Depreciation on assets held by sole-proprietary concern as on 01/04/2018	
Asset of sole proprietary concern used by the successor company from 29/11/2018 to 31/3/2019 i.e. 123 days, hence depreciation shall be allowed for 123 days	
- Building ($\text{₹ } 35,000 \times 123/365$)	11,795
- Furniture ($\text{₹ } 5,000 \times 123/365$)	1,685
- Plant and Machinery ($\text{₹ } 30,000 \times 123/365$)	10,110
Depreciation on assets acquired by sole-proprietary concern during the year	
New asset has been used by it from 29/11/2018 to 31/03/2019 i.e. 123 days, hence depreciation shall be allowed for 123 days	
- Plant and Machinery ($\text{₹ } 7,500 \times 123/168$)	5,491
After conversion	
Depreciation in respect of plant purchased by the successor company is fully allowable in the hands of successor company [50% of 15% on ₹ 50,000].	3,750
Total depreciation	32,831

Carry forward & Set off of losses on conversion of proprietary concern or partnership firm into company [Sec. 72A(6)]

Condition: Where -

- a firm is succeeded by a company fulfilling the conditions laid down in sec. 47(xiii); or
- a proprietary concern is succeeded by a company fulfilling conditions laid down in sec. 47(xiv).

Tax Treatment: The accumulated loss and unabsorbed depreciation of the predecessor firm or the proprietary concern, as the case may be, shall be deemed to be the loss or allowance for depreciation of the successor company for the purpose of previous year in which reorganisation of business was effected.

Taxpoint: Accumulated loss of such firm or concern can be carried forward for further 8 years.

Effect of non compliance of conditions given u/s 47(xiii) and (xiv)

If any of the conditions laid down in the sec. 47(xiii) or (xiv) are not complied with, the set off of loss or allowance



of depreciation made in any previous year by the successor company shall be deemed to be the income of the company and chargeable to tax in the year in which such conditions are violated.

11.5 CONVERSION OF PRIVATE LIMITED COMPANY OR UNLISTED COMPANY INTO LLP

Transaction not regarded as transfer for the purpose of capital gain [Sec. 47(xiiib)]

Any transfer of -

- a. a capital asset or intangible asset by a private company or unlisted public company¹ (hereafter referred to as the company) to a limited liability partnership (LLP); or
- b. a share(s) held in the company by a shareholder as a result of conversion² of the company into a limited liability partnership (LLP)

shall not be regarded as a transfer, if following conditions are satisfied:

- i. All the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the LLP;
- ii. All the shareholders of the company immediately before the conversion become the partners of the LLP and their capital contribution and profit sharing ratio in the LLP are in the same proportion as their shareholding in the company on the date of conversion;
- iii. The shareholders of the company do not receive any consideration or benefit other than by way of share in profit and capital contribution in the LLP;
- iv. The aggregate of the profit sharing ratio of the shareholders of the company in the LLP shall not be less than 50% at any time during the period of 5 years from the date of conversion;
- v. The total sales, turnover or gross receipts in business of the company in any of the 3 previous years preceding the previous year in which the conversion takes place does not exceed ₹ 60 lakh;
- vi. The total value of the assets as appearing in the books of account of the company in any of the 3 previous years preceding the previous year in which the conversion takes place does not exceed ₹ 5 crore; and
- vii. No amount is paid (directly or indirectly) to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of 3 years from the date of conversion.

Withdrawal of exemption u/s 47(xiiib) [Sec. 47A(4)]

On violation of aforesaid conditions, exemption earlier allowed to the company or shareholder shall be withdrawn and amount of profits or gains arising from the transfer of such capital asset or intangible asset or share(s) not charged earlier shall be deemed to be the profits and gains chargeable to tax of the successor LLP or the shareholder (of predecessor company) for the previous year in which the requirements of sec. 47(xiiib) are violated.

Taxpoint

Withdrawal of exemption	The benefits availed shall be treated as deemed income
Year of taxability	The year in which condition u/s 47(xiiib) are violated.
Who will be liable to tax	For exemption available to the company: Successor LLP For exemption available to the shareholder: Such shareholder
Benefit of indexation	Available up to the year when succession took place.

¹ Private company or unlisted public company as per provisions of the Limited Liability Partnership Act, 2008

² Such conversion should be in accordance with the provisions of sec. 56 or 57 of the Limited Liability Partnership Act, 2008

Cost of acquisition of transferred asset in hands of the LLP	If conditions u/s 47(xiiib) are satisfied: Cost of asset in hands of the company If conditions u/s 47(xiiib) are not satisfied: Value at which such asset were transferred to the LLP at the time of conversion
Period of holding in hands of the LLP	In any circumstances, period of holding starts afresh. In other words, holding period of the previous owner cannot be considered.

ILLUSTRATION 6

Balance sheet of Handoo&Handoo (P) Ltd. as on 1/04/2018

Liabilities	Amount	Assets	Amount
Equity Share capital of ₹ 10 each	10,00,000	Land (acquired on 17/05/2007)	10,00,000
Reserves	30,00,000	(Market value ₹ 50,00,000)	
		Building (WDV as per IT Act)	13,00,000
		(Market value ₹ 30,00,000)	
		Machinery (WDV as per IT Act)	6,00,000
		(Market value ₹ 10,00,000)	
		Investments (acquired on 18/08/2001)	4,00,000
		(Market value ₹ 12,00,000)	
		Current Assets (Realizable)	7,00,000
	40,00,000		40,00,000

Additional information

- The company converts itself into limited liability partnership (LLP) [as per conditions mentioned u/s 47(xiiib)] on the date of balance sheet.
- All assets and liabilities of the company was transferred to the LLP. Further, it was also agreed that assets shall be transferred to the LLP at market value.
- Total number of shareholder in the company: 4 (each holding 25% of equity shares capital and acquired at face value on 01-04-2001)
- On 10-12-2018, the LLP has transferred land to Mr. Animesh for a consideration of ₹ 63,00,000.

Discuss tax treatment in hands of company, shareholder and LLP.

Solution

Computation of capital gain for the A.Y. 2019-20 in the hands of Handoo&Handoo (P) Ltd.

Particulars	Land	Building	Machinery	Investment
Full value of consideration	50,00,000	30,00,000	10,00,000	12,00,000
Less: Indexed Cost of Acquisition				
[₹ 10,00,000 x 280 / 129]	21,70,543	-	-	-
[₹ 4,00,000 x 280 / 100]	-	-	-	11,20,000
Less: Cost of Acquisition	-	13,00,000	6,00,000	-



Long Term Capital Gain	28,29,457	-	-	80,000
Short Term Capital Gain	-	17,00,000	4,00,000	-

Note: Entire capital gain is exempt in hands of Handoo&Handoo (P) Ltd., if such conversion fulfills all the conditions given in sec.47(xiiib). However, if such conditions are not fulfilled at the time of conversion, then entire capital gain would be taxable in hands of the company. Further, if later on, such conditions are **violated**, then such capital gain shall be taxable in hands of the **Limited Liability Partnership in the year of such violation**.

Statement showing consideration received by a shareholder of the company

Land	₹ 50,00,000
Building	₹ 30,00,000
Machinery	₹ 10,00,000
Investment	₹ 12,00,000
Current Asset as reduced by corporate dividend tax [₹ 7,00,000 – ₹ 6,16,659#]	₹ 83,341
Total worth available for 1,00,000 shares	₹ 1,02,83,341
To be received by each shareholder (₹ 1,02,83,341 x 25%)	₹ 25,70,835
- Received as Dividend [(₹ 30,00,000 – ₹ 6,16,659) x 25%] or [25% of ₹ 23,83,341]	₹ 5,95,835
- Received against shares	₹ 19,75,000
# (₹ 30,00,000 x 15%/85%) x 112% x 104%	

Computation of capital gain in hands of each Shareholder

Particulars	Amount
Full value of consideration	19,75,000
Less: Indexed Cost of Acquisition [(₹ 10,00,000 x 25%) x 280/ 100]	7,00,000
Long Term Capital Gain	12,75,000
Note: Entire capital gain is exempt in hands of shareholder, if such conversion fulfills all the conditions given in sec.47(xiiib). However, if such conditions are not fulfilled at the time of conversion, then entire capital gain would be taxable in hands of the shareholder. Further, if later on, such conditions are violated , then such capital gain shall be taxable in hands of the shareholder in the year of such violation .	

Computation of capital gain in hands of LLP (Sale of land)

Particulars	Amount
Full value of consideration	63,00,000
Less: Cost of Acquisition	10,00,000
Short Term Capital Gain	53,00,000

Allocation of depreciation in the year of conversion

Deduction for depreciation shall be apportioned between the company and the LLP in the ratio of the number of days for which the assets were used by them.

Carry forward & Set off of losses on conversion into Limited Liability Partnership [Sec. 72A(6A)]

Condition: Where a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to sec.47(xiiib).

Tax Treatment: The accumulated loss and unabsorbed depreciation of the predecessor concern shall be deemed to be the loss or allowance for depreciation of the successor firm for the purpose of previous year in which reorganisation of business was effected.

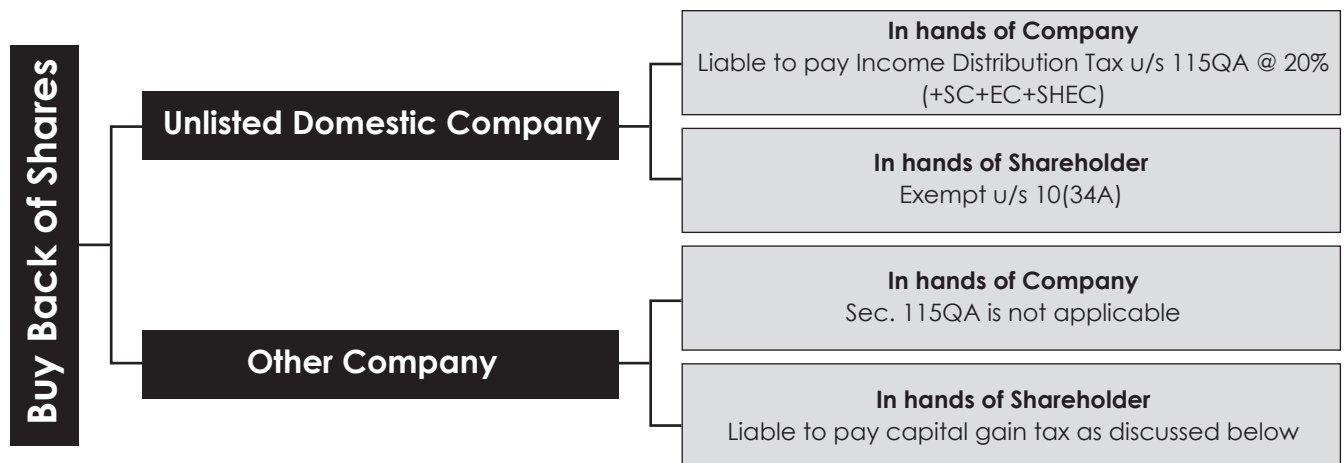
Taxpoint: Accumulated loss of such firm or concern can be carried forward for further 8 years.

Effect of non compliance of conditions given u/s 47(xiiib)

If any of the conditions laid down in the sec. 47(xiiib) are not complied with, the set off of loss or allowance of depreciation made in any previous year by the successor firm shall be deemed to be the income of the firm and chargeable to tax in the year in which such conditions are violated.

11.6 CAPITAL GAIN ON BUY BACK OF OWN SHARES OR OTHER SPECIFIED SECURITIES [SEC. 46A]

Buy back of shares is a transfer for its holder and shall be treated as under:



Sale consideration	Amount received by a shareholder (or a holder of other specified securities) from the company.
Cost of acquisition/Cost of improvement	As usual
Taxable	In the year when such shares or securities are purchased by the company.

ILLUSTRATION 7

Smile Ltd. is a wholly-owned subsidiary company of Happy Ltd., an Indian company. Smile Ltd. owns Plant-A and Plant-B (depreciation rate 40%, depreciated value of the block ₹ 3,00,000 on 1st April, 2018). Plant-B was purchased and put to use on 10th November, 2016 (cost being ₹ 70,000). Plant-B is transferred by Smile Ltd. to Happy Ltd. on 14th December, 2018 for ₹ 20,000. It is put to use by Happy Ltd. on the same day. Happy Ltd. owns Plant-C on 1st April, 2018 (depreciation rate 40%, depreciated value ₹ 60,000). Find out the amount of depreciation in the hands of Smile Ltd. and Happy Ltd. for the assessment year 2019-20.

**Solution**

Depreciation in the hands of Smile Ltd. for the assessment year 2019-20:

Particulars	Amount
Depreciated value of the Plant A and B on 1st April, 2018	3,00,000
<i>Less: Plant B transferred to Happy Ltd</i>	20,000
WDV as on 31 st March, 2019	2,80,000
Depreciation for the block P.Y.2018-19	1,12,000
WDV at the end of the year	1,38,000

Depreciation in the hands of Happy Ltd. for the assessment year 2019-20:

Particulars	Amount
Depreciated value of the block on 1 st April, 2018	60,000
<i>Add: Actual Cost of Plant B acquired from Smile Ltd (See Note)</i>	33,600
WDV as on 31 st March, 2019	93,600
Depreciation on transferred asset [$\text{₹ } 33,600 \times \frac{1}{2} \times 40\%$]	6,720
Other Asset @ 40% of ₹ 60,000	24,000
Total Depreciation	30,720

Note: Actual Cost of Plant B in the hands of Happy Ltd.

Particulars	Amount
Actual Cost of Plant B in the hands of Smile Ltd on Nov 10, 2016	70,000
<i>Less: Depreciation for P.Y 2016-17 (1/2 of 40% of ₹ 70,000)</i>	14,000
Balance on April 1, 2017	56,000
<i>Less: Depreciation for the P.Y.2017-18</i>	22,400
Balance on April 1, 2018	33,600

STUDY NOTE : 12

DIFFERENT ASPECTS OF TAX PLANNING



This Study Note includes:

- 12.1 Introduction
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12.1 INTRODUCTION

"How can I reduce my tax liability?" is the question that goes through every tax payer's mind. Tax liability can be reduced through proper tax planning. The obvious benefit of tax planning is to reduced tax liabilities, which by extension means the individual or the company retaining more money for their own needs. Businesses reducing their tax liability through tax planning can provide better returns to their investors and better wages to their employees. It can also spend the money otherwise payable as tax to increase working capital and thereby improve performance efficiency, or spend more on capital expansion and thereby expand market share.

Individuals applying tax planning will have more disposable income in their hands. Very often, tax planning provides individuals with money to spend for their personal benefit or enjoyment, and failure to apply tax planning may lead to such money paid as tax.

Tax planning also provides an indirect benefit of allowing a sound control over finances. It provides a valuable road map to plan finances in the most optimal manner. It allows streamlining cash outflows, making planned expenditure, and committing to an informed investment decision.

Reducing tax liability is not always a bad or illegal exercise. There are legitimate ways to reduce taxes through proper



tax planning and such methods are always encouraged. But unfortunately, there is also a tendency to reduce tax through illegal methods. They are not accepted practice and can invite problems. There are three methods which are commonly used by the taxpayers to reduce their tax liabilities:

- Tax Planning;
- Tax Avoidance; and
- Tax Evasion

The Apex Court in *McDowell & Co. Ltd. -vs.- CTO* (1985) has observed that "tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay tax honestly without resorting to subterfuges." In deciding whether a transaction is a genuine or colourable device, it is open for the tax authorities to go behind the transaction and examine the "substance" and not merely the "form".

Doctrine of form and substance in the context of tax planning

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:

1. **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. This 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. [*Motor and General Stores (P) Ltd. -vs.- CIT* (1967)]
2. **True legal relation is the crucial element for taxability:** A firm transferred its business assets to a company formed for its purposes. The same business was carried by the company consisting of the erstwhile partners as its shareholders. The Income-tax Officer sought to withdraw the depreciation allowed (the difference between sale price and written-down value) on machinery. Tribunal and High Court has held that there was change only in the form of ownership as persons behind both firm and company were the same. The Apex Court has held that 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 -vs.- B.M. Kharwar* (1969) (SC)]
3. **Substance (i.e. actual nature of expense) is relevant and not the form:** 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.
 - 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. -vs.- CIT* (1967) (SC)].
 - 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. -vs.- CIT* (1955) (SC)]. 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.

- Certain shares were held in the name of others, but the deceased was the real owner of the shares as was found with reference to evidence. The High Court had held that the shares were not includible in the estate of the deceased as they were not in his name. The Supreme Court pointed out that, in substance, the deceased was the owner though only beneficially and upheld the inclusion for estate duty purposes [CED -vs.- Aloke Mitra (1980)].

Formation of Tax Laws

Article 265 of the Constitution of India states that no tax shall be levied or collected except by authority. In Murthy Match Works case, it is stated that:

"It is well established that the modern State, in exercising its sovereign power of taxation, has to deal with complex factors relating to the objects to be taxed, the quantum to be levied, the conditions subject to which the levy has to be made, the social and economic policies which the tax is designed to subserve, and what not."

Though wide latitude is given to the legislature in the matter of levy of taxes, what is needed, firstly, is that the tax statute should be constitutionally valid to pass the muster of Article 14 of the Constitution of India.

Secondly, liability of tax depends upon the charging section. No tax is complete nor a charge can raise under a fiscal statutes unless the subject, the object and the quantum of tax are prescribed. In the case of State of Tamil Nadu -vs.- M K Kandaswami, the Apex Court has held that the essence of tax laws depends upon three inter-related and distinct concepts which are:

- a. Who is *taxable person*;
- b. What is *taxable event*; and
- c. What is *subject matter of taxation*

12.2 TAX EVASION, TAX AVOIDANCE AND TAX PLANNING

Tax evasion is the illegal way to reduce tax liability by deliberately suppressing income or sale or by increasing expenses, etc., which results in reduction of total income of the assessee. Dishonest taxpayers try to reduce their taxes by concealing income, inflation of expenses, submitting misleading information, falsification of accounts and willful violation of the provisions of the Income-tax Act. Such unethical practices often create problems for the tax evaders. Tax department not only imposes huge penalties but also initiate prosecution in such cases. It is illegal, both in script & moral. It is the cancer of modern society and work as a clog in the development of the nation. It is a grave problem in a developing country like ours as it leads to a creation of a 'resource crunch' for developmental activities of the State.

Tax avoidance is an exercise by which the assessee legally takes advantages, with malafide motive, of loopholes in the Act. Tax avoidance is minimizing the incidence of tax by adjusting the affairs in such a manner that although it is within the four corners of the laws, it is done with a purpose to defraud the revenue. It is a practice of dodging or bending the law without breaking it. It is a way to reduce tax liability by applying script of law only. E.g. if A gives gift to his wife, the income from the asset gifted will be clubbed in the hand of A. But to avoid this clubbing provision "A" decides to give gift to B's wife and B reciprocates it by giving gift to A's wife. This is not tax planning but tax avoidance. Most of the amendments are aimed to curb such loopholes.

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".

The Royal Commission on Taxation for Canada has explained the concept of tax avoidance as under:

"Tax Avoidance" will be used to describe 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 of law. It excludes fraud, concealment or other illegal measures.

The line of demarcation between tax avoidance and tax planning is very thin and blurred. There are two thoughts about tax avoidance –

- a) As per first thought it is legal. Such thought is also supported by various judgments of the Supreme Court, some of them are as follows –

Helvering vs. Gregory (1934)

"Anyone may so arrange his affairs that his taxes shall be as low as possible. He is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."

IRC vs. Duke of Westminster (1936)

"Taxpayer is entitled to so arrange his affairs that the tax under the appropriate Act is less than what otherwise it could be."

Inland Revenue Commissioners vs. Fishers Executors (1958)

"The highest in authority, have always recognized that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown, so far he can do so within the law, and that he may legitimately claim the advantage of any express terms or any omissions that he can find in his favour in taxing Act. In doing so, he neither comes under liability, nor incurs blame."

CIT vs. Raman & Co. (1968)

"Avoidance of tax liability by so arranging commercial affairs that the charge of tax is distributed, is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the Income-tax Act."

Smt. C. Kamala vs. CIT (1978)

"It is quite possible that when a transaction is entered into in one form known to law, the amount received under that transaction may attract liability under the Act and if it is entered into in another form which is equally lawful, it may not attract such tax liability. But when the assessee has adopted the latter one, it would not be open to the court to hold him liable for tax."

CWT vs. Arvind Narotham (1988)

"It is true that tax avoidance in an underdeveloped or developing economy should not be encouraged on practical as well as ideological grounds. One would wish..... that one could get the enthusiasm that taxes are the price of civilization and one would like to pay that price to buy civilization. But the question which many ordinary taxpayers 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 ostentation and waste in Government spending are avoided or eschewed, no amount of moral sermons would change people's attitude to tax avoidance."

- b) As per second thought it is not a legal way to reduce tax burden and it should be prohibited.

McDowell & Co. Ltd. vs Commercial Tax Officer (1985)

Supreme Court observed - "we think time has come for us to depart from Westminster principle....tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the honestly without resorting to subterfuges."

CIT vs B.M. Kharwar (1969)

Supreme Court held - "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 to the taxing authorities to unravel the device and to determine the true character of relationship. But the legal effect of a transaction cannot be displaced by probing into substance of the transaction."

Justice O. Chinnappa Reddy of Supreme Court has, while briefing the evil consequences of tax avoidance in Mc.Dowell & Co. Ltd. -vs.- CTO, observed that one such evil consequence is the ethics (or the lack of it) of transferring the burden of tax liability to the shoulders of the guideless, good citizens from those of artful dodgers. As regards the ethics of taxation, he observed:

"We now live in a welfare State whose financial needs, if backed by law, have to be respected and met. We must recognize that there is behind taxation laws as much moral sanction as behind any other welfare legislation and it is a pretence to say that avoidance of taxation is not unethical and that it stands on no less moral plane than honest payment of taxation".

A similar observation was made by Lord Chancellor in Latilla vs. Inland Revenue Commissioner (1943) 011 ITR (E.C) 0078:

"There is, of course no doubt that they are within their legal rights but that is no reason why their efforts, or those of the professional gentlemen who assist them in the matter, should be regarded as a commendable exercise of ingenuity or as a discharge of the duties of the good citizenship. On the contrary, one result of such methods, if they succeed, is of course to increase pro tanto the load of tax on the shoulder of the body of good citizens who do not desire or do not know how to adopt these maneuvers."

12.3 TAX PLANNING

Tax law reflects the complexity of modern life and the multitude of choices and options available to all taxpayers when legitimately seeking to structure their affairs. This necessary offer of options within tax legislation creates the opportunity for choice on the part of the tax payer and means that determining the right amount of tax (but no more) that they seek to pay does necessarily requires the exercise of judgement on occasion. So long as the exercise of that judgement seeks to ensure that the taxpayer makes choices that exercise options clearly allowed by law and that they do not exploit unintended loopholes created between laws then that process of a taxpayer choosing how to structure their affairs is the process of tax planning, which is a legitimate, proper and socially acceptable act.

Thus, tax planning is a systematic evaluation of finances and investments, to reduce the tax burden in a legitimate way. It involves understanding the tax implications of various cash inflows and outflows such as salary composition, property income, home loan, investments, sale or purchase of assets, gifts and interest-bearing deposits, to draw up an appropriate investment strategy that allows realization of financial goals while at the same time reducing tax liability to minimum.



It is a way to reduce tax liability by taking full advantages provided by the Act through various exemptions, deductions, rebates & relief. In other words, it is a way to reduce tax liability by applying script & moral of law. The two basic approaches of tax planning are:

1. **Reducing taxable income:** As a rule, higher the income or profit, higher the tax liability on such income or profit. Gross income is total profits or income from all sources, and taxable income is such gross income less adjustments allowable under various tax laws and other provisions. Such adjustments bases itself on the nature of income and expenditure. Opting for the income or expenditure heads that allows maximum set-offs from the gross income reduces taxable income, and by extension tax liability.
2. **Deferring payment of taxes to the extent possible:** An underestimated dimension of tax planning is timing investments and financial transactions so that the tax liability for such transactions arises at the farthest possible time. While this does not reduce the amount of tax payable, it delays tax outgo, thereby effectively providing interest-free cash on hand. Individuals may not need to resort to such a strategy, but delayed pay-out is valuable for small businesses that very often face cash flow difficulties.

The goal of tax planning is to arrange your financial affairs so as to minimize your taxes. It is the planning so as to attract minimum tax liability or postponement of tax liability for the subsequent period by availing various incentives, concessions, allowance, rebates and relief provided in the Act.

12.4 DISTINGUISH BETWEEN TAX PLANNING, TAX EVASION, TAX AVOIDANCE AND TAX MANAGEMENT

Difference between tax planning, tax avoidance, tax evasion & tax management

Points of distinction	Tax planning	Tax Avoidance	Tax Evasion	Tax Management
Definition	It is a way to reduce tax liability by taking full advantages provided by the Act through various exemptions, deductions, rebates & relief.	It is an exercise by which the assessee legally takes advantage of the loopholes in the Act.	It is the illegal way to reduce tax liability by deliberately suppressing income or sale or by increasing expenses, etc., which results in reduction of total income of the assessee.	It is a procedure to comply with the provisions of the law.
Feature	Tax planning is a practice to follow the provisions of law within the moral framework.	Tax avoidance is a practice of bending the law without breaking it.	Tax evasion is illegal, both in script & moral.	It is implementation or execution part of taxation department of an organisation.
Object	To reduce tax liability by applying script & moral of law.	To reduce the tax liability to the minimum by applying script of law only	To reduce tax liability by applying unfair means.	To comply with the provisions of laws.

Approach	It is futuristic and positive in nature. The planning is made today to avail benefits in future.	It is futuristic but short term in nature, as loophole of the law will be corrected in future by amendments of the law.	It is concerned with past and applied after the liability of tax has arisen. It is done with negative approach to avail benefits by killing the moral of law.	It is a continuous approach, which is concerned with past (rectification, revisions etc.), present (filing of return, etc.) & future (corrective action).
Benefit	Generally, arises in long run.	Generally, arises in short run.	Generally, benefits do not arise but it causes penalty and prosecution.	Penalty, interest & prosecution can be avoided.
Treatment of Law	It uses benefits of the law.	It uses loopholes in the law.	It overrules the law.	It implements the law.
Practice	It is tax saving.	It is tax hedging.	It is tax concealment.	It is tax administration.
Need	It is desirable	It is avoidable	It is objectionable	It is essential.
Morality	It is moral in nature.	It is immoral in nature	It is illegal.	It is duty.

12.5 OBJECTIVES OF TAX PLANNING

Tax planning is an exercise undertaken to minimize tax liability through the best use of all available allowances, deductions, exclusions, exemptions, etc. The objectives of tax planning cannot be regarded as offending any concept of the taxation laws and subjected to reprehension of reducing the inflow of revenue to the Government's coffer, so long as the measures are in conformity with the statute laws and the judicial expositions thereof. The basic objectives of tax planning are:

a. Reduction of Tax liability

Tax law provides multiple choices and options to taxpayers. This necessary offer of options within tax legislation creates the opportunity for choice on the part of the tax payer. However, due to lack of awareness of legal requirements, in many a cases, a taxpayer may suffer heavy taxation. Through proper tax planning and awareness, a tax payer may reduce such heavy tax burden.

b. Minimisation of litigation

In the matter of taxation, the tax payers will try to pay the least tax and on the other hand, the tax administrator will attempt to extract the maximum. This conflict behaviour may results into litigations. However, where proper tax planning is adopted by the tax payer in conformity with the provisions of the taxation laws, the incidence of litigation can be minimised. This saves him from the hardships and inconveniences caused by the unnecessary litigations.

c. Productive investment

A tax payer may reduce heavy tax burden through proper tax planning. Such reduction results into reduction in cash-outflow. In the days of credit squeeze and dear money conditions, even a rupee of tax decently saved



may be taken as an interest-free loan from the Government, which perhaps, an assessee need not repay. Such retained cash can be utilised in other productive venture which also provide additional earning to the taxpayer. That means, proper tax planning is a measure of proper utilisation of available resources which in turn maximise the cash-inflow and minimise the tax burden.

d. Healthy growth of economy

The growth of a nation's economy is synonymous with the growth and prosperity of its citizens. In this context, a saving of earnings by legally sanctioned devices fosters the growth of both, because savings by dubious means lead to generation of black money, the evils of which are obvious. Conversely, tax-planning measures are aimed at generating white money having a free flow and generation without reservations for the overall progress of the nation. Tax planning assumes a great significance in this context.

e. Economic stability

Tax planning results in economic stability by way of:

- (i) productive investments by the tax payers; and
- (ii) harnessing of resources for national projects aimed at general prosperity of the national economy and reaping of benefits even by those not liable to pay tax on their incomes.

12.6 ESSENTIALS OF TAX PLANNING

Following are the essentials of tax planning:

- Uptodate Knowledge of tax laws alongwith circulars, notifications, clarifications and Administrative instructions issued by the CBDT.
- Disclosure of full and true material information
- Avoid sham transactions or make-believe transactions or colourable devices
- Foresight of future development or changes and enterprise's goal.

12.7 TYPES OF TAX PLANNING

The tax planning exercise ranges from devising a model for specific transaction as well as for systematic corporate planning. These are:

- (a) Short-range and long-range tax planning:** Short-range planning refers to planning to achieve some specific or limited objective of particular fiscal year. E.g., an individual assessee whose income is likely to register unusual growth in particular year as compared to the preceding year, may plan to subscribe to the PPF/NSC's within the prescribed limits in order to enjoy substantive tax relief. By investing in such a way, he is not making permanent commitment but is substantially saving in the tax. Long-range planning on the other hand, involves entering into activities, which may not pay-off immediately. E.g., when an assessee transfers his equity shares to his minor son he knows that the Income from the shares will be clubbed with his own income. But clubbing would also cease after his son attains majority.

- (b) Permissive tax planning:** Permissive tax planning is tax planning under the express provisions of tax laws. Tax laws of our country offer many exemptions and incentives.
- (c) Purposive tax planning:** Purposive tax planning is based on the basis of circumvention of the law. The permissive tax planning has the express sanction of the Statute while the purposive tax planning does not carry such sanction. E.g., If an assessee manages his affairs in such a way that his income is taxable in hands of other person without attracting clubbing provision, such a plan would work in favour of the tax payer because it would increase his disposable resources.

12.8 AREAS OF TAX PLANNING

Some of the important areas where planning can be attempted in an organised manner are as under:

- (a)** Form of organisation/ownership pattern;
- (b)** Locational aspects;
- (c)** Nature of business.
- (d)** Tax planning in respect of corporate restructuring;
- (e)** Tax planning in respect of financial management;
- (f)** Tax planning in respect of employees remunerations;
- (g)** Tax planning in respect of specific managerial decisions;
- (h)** Tax planning in respect of Non-Residents

12.9 FORM OF ORGANISATION

A snapshot of features of different forms of business:

Particulars	Form of Business		
	Company	Firm or LLP	Sole proprietorship
Tax rates	Company is liable to pay @ 30% (in some case 25%) + surcharge + cess @ 4%. Further, whatever amount of tax is paid by a company is not deemed to have been paid on behalf of the shareholders. Therefore, no rebate is allowed to shareholders.	Firm is liable to pay @ 30% + surcharge + cess @ 4%. Share of profit distributed to the partner is exempt from tax.	Sole proprietor is liable to tax at slab rate.
Remuneration to owner-director	Remuneration to the persons who are managing the affairs of the company and also owning its shares is allowed	Remuneration to the working partners is allowed. However, such remuneration is subject to sec.40(b)	Remuneration to owner of the business is not an allowable expenditure.



Distribution of income	At the time of distribution of profit to its owner, the company is liable to pay corporate dividend tax u/s 115-O. Such tax is over and above corporate tax payable by the company on its income. However, dividend received by shareholder is exempt u/s 10(34) to some extent	No such tax is required to be paid by this form of business. Further, share of profit distributed to the partner is exempt from tax.	No such tax is required to be paid by this form of business.
Specific business expenditure allowed	Certain expenditure is allowed only in hands of company assessee. E.g., expenditure covered u/s 36(1)(ix) are allowable only in hands of company assessee only.	Apart from sec. 40(b), no other provision contains such restriction.	Expenditure like interest on loan provided to the business by the owner or remuneration to proprietor is not an allowable expenses.
Different assessee	Company is treated as a separate assessee apart from its shareholders	Firm is treated as a separate assessee apart from its partners.	Proprietorship business is not treated as a separate assessee.
Decision making	Any important business matter required to be deal in proper meeting and requires a long procedure. Thus, decision on any important business matter can be delayed	Since partners of the firm meets more frequently, decision on any important business matter cannot be delayed	As owner is the only person to take decisions, thus decision on any important business matter cannot be delayed
Risk taking capacity	Once approved by the governing body, the chance of getting involved in risky activities is comparatively high.	The chance of getting involved in risky activities is very less because every important decision is made with the concurrence of all the partners.	The chance of getting involved in risky activities is depends on the owner's ability to take risk.
Raising of additional capital	Company can raise large capital by way of issuing shares to large number of public ¹ .	Capital can be raised by introducing new partner or by existing partners.	There is personal limitation is raising capital.
Loan-fund	Since the company has perpetual succession, lender is happy to lent money to company form of business.	Money can be raised by way of borrowings easily, in compared to sole-proprietorship business, because of number of partners and their joint and several liability to pay the debts of the firm, the lenders will be more interested in lending.	There is personal limitation in raising capital.
Limited liability	Shareholder is not liable to pay more than his shares amount.	Partners have unlimited liability, subject to certain case.	Proprietor have unlimited liability.
Liability of owner	Owners are not liable for act of governing body.	Partners are liable for act of another partner	N.A.

¹ Not in case of private limited company.

Size of business	In case of public company, there is no such limitation.	Partnership can be formed up to maximum number of 20 partners. Thus, it is not suitable for large scale business.	It is not suitable for large scale business.

12.10 LOCATIONAL ASPECTS

There are certain locations which are given special tax treatment. Some of these are as under:

- Unit located in special economic zone is eligible for exemption u/s 10AA for several numbers of years.
- Enterprise engaged in the development of Special Economic Zone is eligible for deduction u/s 80-IAB.
- New industrial undertaking located in an industrially backward State or district is eligible for deduction u/s 80-IB.
- New industrial undertaking or substantial expansion of an existing undertaking in certain special category States is eligible for deduction u/s 80-IC.
- Profits and gains from business of hotels and convention centres in specified area or a hotel at world heritage site is eligible for deduction u/s 80-ID.
- In respect of certain undertakings in North-Eastern States is eligible for deduction u/s 80-IE.

12.11 NATURE OF BUSINESS

There are certain businesses which are granted special tax treatment. Some of them are as follows:

- Newly established units in special economic zones [Section 10AA].
- Tea Development Account, Coffee Development Account and Rubber Development Account [Section 33AB].
- Site restoration fund [Section 33ABA].
- Specified business eligible for deduction of Capital Expenditure [Section 35AD].
- Special reserve created by a financial corporation under Section 36(1)(viii).
- Special provision for deduction in the case of business for prospecting for mineral oil [Sections 42 and 44BB].
- Special provisions for computing profits and gains of business on presumptive basis [Section 44AD].
- Special provisions in the case of business of plying, hiring or leasing goods carriages [Section 44AE].
- Special provisions in the case of shipping business in the case of non-residents [Section 44B].
- Special provisions in the case of business of operation of aircraft [Section 44BBA].
- Special provisions in the case of certain turnkey power projects [Section 44BBB].
- Special provisions in the case of royalty income of foreign companies [Section 44D].
- Special provisions in case of royalty income of non-residents [Section 44DA].
- Certain income of offshore Banking Units and international Financial Service Centre [Section 80-LA].



- Profit and gains of industrial undertakings or enterprises engaged in infrastructure development, etc.
- Profits and gains of an undertaking or an enterprise engaged in development of Special Economic Zone. [Section 80-IAB].
- Profits and gains from certain industrial undertaking other than infrastructure development undertaking [Section 80-IB].
- Special provisions in respect of certain undertakings or enterprises in certain special category States [Section 80-IC].
- Deduction in respect of profits and gains from business of hotels and convention centres in specified area or a hotel at world heritage site. [Section 80-ID].
- Special provisions in respect of certain undertakings in North-Eastern States. [Section 80-IE].
- Profits and gains from the business of collecting and processing of bio-degradable waste [Section 80JJA].
- Special tax rate under Sections 115A, 115AB, 115AC, 115AD, 115B, 115BB, 115BA and 115D.

12.12 TAX PLANNING RELATING TO CORPORATE RESTRUCTURING

Corporate Restructuring is a process of redesigning one or more aspects of a corporate for achieving certain objectives. The objectives of restructuring may be achieving economies of scale or surviving in an adverse economic climate or restructuring of debt or for any other objectives. Such restructuring can be done through various tools. Some of them are as follow:

- Amalgamation
- Demerger
- Slump sale of business
- Buy back of shares
- Capital Reduction
- Conversion of debentures into shares
- Redemption of preference shares
- Conversion into company
- Conversion of an Indian branch of foreign company into an subsidiary company
- Conversion of company into LLP, etc.

12.13 TAX PLANNING RELATING TO FINANCIAL MANAGEMENT DECISIONS

Fund can be obtained from various sources thus their procurement is always considered as a complex problem by a business organisation. Fund procured from different sources have different characteristics in terms of risk, cost and control. Some of the sources for funds for a business enterprise are:

Equity: The funds raised by the issue of equity shares are the best from the risk point of view for the firm, since there

is no question of repayment of equity capital except when the firm is under liquidation. From the tax point of view, dividends are an appropriation of profit, thus the same is not allowed as an expense under the Income Tax Act.

Debentures: Debentures as a source of funds are comparatively cheaper than the shares because of their tax advantage. The interest the company pays on a debenture is tax deductible.

In this regards, following sections are relevant:

- Amortisation of preliminary expenses [Sec. 35D]
- Interest on borrowed capital [Sec. 36(1)(iii)]
- Actual cost of assets [Sec. 43(1)]
- General Deductions [Sec. 37]
- Depreciation [Sec. 32]
- Tax on distribution of profit [Sec. 115-O]

Capital Structure

The optimum capital structure is a mix of equity capital and debt funds. Following should be considered in this regard:

- a) Interest on debt fund is allowed as deduction as it is a business expenditure. Therefore, it may increase the rate of return on owner's equity.
- b) Dividend on equity fund is not allowed as deduction as it is the appropriation of profit. Further, the company declaring the dividend shall be liable to pay dividend distribution tax.
- c) The cost of raising owner's fund is treated as capital expenditure therefore not allowed as deduction. However, if conditions of sec. 35D is satisfied then such cost can also be amortized.
- d) The cost of raising debt fund is treaded as revenue expenditure.

Lease or Buy

When a person needs an asset for his business purposes, he has to decide whether the asset should be purchased or taken on lease. Following should be considered in this regard:

- a) Lease rental can be claimed as deduction as revenue expenditure. However, depreciation on leases asset is not allowed.
- b) Depreciation on depreciable assets can be claimed as deduction u/s 32.
- c) In case, the asset is purchased from the amount taken on loan, interest paid for the period after the asset is first put to use, the deduction on account of interest shall be claimed as revenue expenditure. However, interest paid for the period before the asset is first put to use shall be capitalized.
- d) Any gain on transfer of capital asset is subject to capital gain. In this regard, it is to be noted that in case of depreciable asset, asset shall be merged in the respective block of asset.

12.14 ORGANISATION TAX PLANNING CELLS

Various organisation have separate tax planning departments to plan their transactions with a view to attract the least incidence of tax. Organisation of such a cell can be justified on the following grounds:



- a. **Complexity and volume of work:** Where the volume of tax work to be handled is large and highly complex, then it is required to appoint a special tax expert along with the required staff.
- b. **Separate Documentation:** Documentation is an indispensable ingredient of tax management. An assessee has to keep reliable, complete and updated documentation for all the relevant tax files so that the documentary evidence can be made available at a short notice whenever it is required. In absence thereof, an assessee may lose a case for want of proper documentary evidence. Not only that the company has to maintain proper account books, records, vouchers, bills, correspondence and agreements, etc. as a part of tax management. In the case of new industrial undertaking it is better to keep separate accounts for the same.
- c. **Data Collection:** The staff concerned with taxation has to collect and keep on collecting data relating to latest circulars, case laws, rules and provisions, and other government notifications to keep abreast of the current developments.
- d. **Integration:** Tax planner should be consulted by all the departments of the company to know the impact of taxation on their decisions. It would be necessary to integrate and properly link all the departments of the company with the tax planning department.
- e. **Constant Monitoring:** In order to obtain the intended tax benefits, persons connected with tax management should ensure compliance of all the pre-requisites, like procedures, rules etc. Besides, there should be constant monitoring, so that all the tax obligations are discharged and penal consequences avoided.
- f. **Developing Tax effective Alternatives:** Tax laws provides various options for entering into a transactions. A tax planner could guide management in taking important decisions, by considering varieties of alternatives and choices.
- g. **Take advantage of variance allowances and deductions:** An expert tax manager has to keep track of the provisions relating to various allowances, deductions, exemptions, and rebates so as to initiate tax planning measures.

ILLUSTRATION 1

Naresh, who is neither a director nor he has substantial interest in any company, is offered an employment by Freewheel Ltd., Mumbai with the following two alternatives:

Particulars	I (₹)	II (₹)
Basic pay	66,000	66,000
Bonus	9,000	9,000
Education allowance for 2 children	30,200	-
Education facility for 2 children in school maintained by employer	-	30,200
Sweeper allowance	10,000	-
Sweeper facility	-	10,000
Entertainment allowance	6,000	-
Club facility	-	6,000
Transport allowance for personal use	1,800 pm	-
Free car (1200 cc) facility for performing journey between office to home and vice versa (car owned by employer)	-	12,000
Medical allowance	18,000	-

Medical bills reimbursement facility	-	18,000
Allowance for gas, electricity and water supply	4,500	-
Free gas, electricity and water supply (bills will be in the name of the employer)	-	4,500
Holiday home allowance	8,000	-
Holiday home facility	-	8,000
Lunch allowance	18,000	-
Free lunch (₹ 70 × 200 days + ₹ 80 × 50 days)	-	18,000
Diwali gift allowance	7,500	-
Gift on Diwali	-	7,500
A rent free unfurnished home – lease rent	14,000	14,000

Which of the two alternatives Naresh should opt for on the assumption that both employer and employee will contribute 10% of salary towards unrecognized provident fund? Interest free loan of ₹ 20,000 will be given to him for purchasing household items.

Solution

As both the options are yielding equivalent facilities, hence the option where tax liability can be minimized is the better choice for the assessee. Accordingly, computation of taxable salary of Naresh under both options are as under

Particulars	Working	Option1		Option2	
		Details (₹)	Amount (₹)	Details (₹)	Amount (₹)
Basic salary			66,000		66,000
Bonus			9,000		9,000
Allowances					
Children education allowance		30,200			
Less: Exemption u/s 10(14) Rule 2BB	100 × 2 × 12	2,400	27,800		
Transport allowance		21,600			
Less: Exemption u/s 10(14)		Nil	21,600		
Holiday home allowance			8,000		
Medical allowance			18,000		
Sweeper allowance			10,000		
Entertainment allowance			6,000		
Lunch allowance			18,000		
Gas, electricity & water allowance			4,500		
Diwali gift allowance			7,500		
Perquisites u/s 17(2)					
Rent free accommodation					



(Being minimum of the following):					
Rent paid by employer		14,000		14,000	
15% of salary*		26,580	14,000	11,250	11,250
Car facility for performing journey between office to home and vice versa	Exempted				Nil
Education facility				30,200	
Less: Exempted				24,000	6,200
Interest free loan exempted up to ₹ 20,000			Nil		Nil
Sweeper facility					10,000
Club facility					6,000
Holiday home facility					8,000
Medical facility					18,000
Gift	7,500 – 5,000				2,500
Gas, electricity & water facility					4,500
Free lunch facility	(20 × 200)+(30 × 50)				5,500
Gross Taxable Salary			2,10,400		1,46,950
Less: Standard Deduction u/s 16(ia)			40,000		40,000
Taxable Salary			1,70,400		1,06,950

* Salary for the purpose of -

Particulars	Rent free accommodation	
	Option 1 (₹)	Option 2 (₹)
Basic	66,000	66,000
Bonus	9,000	9,000
Children education allowance	27,800	-
Transport allowance	21,600	-
Holiday home allowance	8,000	-
Medical allowance	18,000	-
Sweeper Allowance	10,000	-
Entertainment allowance	6,000	-
Lunch allowance	18,000	-
Gas, electricity & water allowance	4,500	-
Diwali gift allowance	7,500	-
Total	1,96,400	75,000

Note: Contribution to URPF is not taxable.

Conclusion: Option 2 is better.

ILLUSTRATION 2

Star Gas Ltd. commenced operations of the business of laying and operating a cross country natural gas pipeline network for distribution of 1st April, 2018. The company incurred capital expenditure of ₹ 1,490 lakh (including cost of financial instrument ₹ 2 lakh) during the period January to March, 2018 exclusively for the above business and capitalized the same in its books of account as on 1st April, 2018.

Further, during the financial year 2018-19, it incurred capital expenditure of ₹ 6,600 lakh (including cost of land ₹ 1,100 lakh) exclusively for the above business. Compute the amount of deduction under section 35AD for the assessment year 2019-20, assuring that the company has fulfilled all the conditions specified in section 35AD

Solution

Computation of the Amount of Deduction under Section 35AD for the Assessment Year 2019-20

Particulars	₹ in lakh
Capital expenditure incurred during the Year (excluding cost of land) [₹ 6,600 lakh – ₹ 1,100 lakh]	5,500
Capital expenditure incurred prior to commencement of business & capitalized (excluding cost of Financial Instrument) [₹ 1,490 lakh – ₹ 2 lakh]	1,488
Total Deduction u/s 35AD	6,988

ILLUSTRATION 3

Lucent Ltd. purchased a machinery on 1st April, 2018 for ₹ 10 crore by availing 70% loan facility from bank. The machine was put to use into effective production on 1st February, 2019. The interest on loan works out to 12% per annum. Advise Lucent Ltd. on the treatment of interest payment made on this loan and depreciation allowable for the previous year 2018-19. You may assume that this is the only machine in its block.

Solution

Computation of Depreciation

Particulars	Amount (₹ in Crore)	Amount (₹ in Crore)
Block: Plant & Machinery (Rate 15%)		
W.D.V. as on 1/4/2018		Nil
Add: Purchase	10	
Interest on loan upto Jan. 2019 (₹ 10 cr × 12% × 10/12)	1	11
		11
Depreciation [₹ 11 cr. × 15% × ½]		0.825

Interest cost from Feb 2019 shall be allowed as deduction u/s 36(1)(iii).

ILLUSTRATION 4

A company wants to raise capital of ₹ 40,00,000 for a project wherefrom earnings before tax would be 30% of the capital employed. The company can raise debt finance @ 12% p.a.



The following three alternatives for raising capital are available for the company :

- (i) ₹ 40,00,000 by equity capital
- (ii) ₹ 20,00,000 by equity capital and ₹ 20,00,000 by loans
- (iii) ₹ 8,00,000 by equity capital and ₹ 32,00,000 by loans.

Assume that the company would distribute the entire amount of profits and dividend. The tax rate is 30% and dividend distribution tax rate is 20%. (Ignore surcharge and cess)

Work out which one of the above three alternatives should the company opt to minimise its tax liability?

Solution

Computation of Tax Benefit in different Alternative

Particulars	Alt – (i) (₹)	Alt – (ii) (₹)	Alt – (iii) (₹)
Equity Capital	40,00,000	20,00,000	8,00,000
12% loans	—	20,00,000	32,00,000
EBIT	12,00,000	12,00,000	12,00,000
Cost to Company			
Interest on loan	—	2,40,000	3,84,000
Net Profit before tax and dividend	12,00,000	9,60,000	8,16,000
Tax Payable @ 30% (A)	3,60,000	2,88,000	2,44,800
Profit after tax	8,40,000	6,72,000	5,71,200
Dividend Distribution Tax @ 20% (B)	1,68,000	1,34,400	1,14,240
Profit after cost of capital	6,72,000	5,37,600	4,56,960
Total tax paid (A +B)	5,28,000	4,22,400	3,59,040

ILLUSTRATION 5

A Ltd. wants to acquire a machine on 1st April, 2018. It will cost ₹ 60 lakh. It is expected to have a useful life of 5 years. Scrap value will be ₹ 10,000. If the machine is purchased through borrowed funds, rate of interest is 11.5% per annum. Loan is repayable at the end of 5 years. If machine is acquired through lease, lease rent would be ₹ 16 lakh per annum.

Profit before depreciation and tax is expected to be ₹ 4.50 crore every year. Depreciation is charged @ 15% on written down value. Besides, additional depreciation is available in the first year. Investment allowance is, however, not available. Average rate of tax may be taken at 32.445%.

A Ltd. seeks your advice whether it should —

- (i) Acquire the machine through own funds or borrowed funds; or
- (ii) Take it on lease.

Present value factor shall be taken @ 10%. At this rate present values of rupee one are — year 1: 0.9091; year 2: 0.8264; year 3: 0.7513; year 4: 0.6830; and year 5: 0.6209.

Solution

In all the scenarios, profit is same, therefore, we can advice on the basis of present value of Outflow and loans.

(I) Purchasing machine through own funds

Particulars	Year					
	0 (₹)	1 (₹)	2 (₹)	3 (₹)	4 (₹)	5 (₹)
Cash Outflow	60,00,000	–	–	–	–	–
Less: Tax Relief on Depreciation @ 32.445%	–	2,92,005	2,48,204	2,10,974	1,79,328	1,52,428
Less: Sale Proceeds of machine	–	–	–	–	–	10,000
Total	60,00,000	2,92,005	2,48,204	2,10,974	1,79,328	1,62,428
Present Value factor @ 10%	1	0.9091	0.8264	0.7513	0.6830	0.6209
Present value cash outflows	60,00,000	2,65,462	2,05,116	1,58,505	1,22,481	1,00,852
Net value of cash inflows less outflows = ₹ 51,47,584						

(II) Acquiring machine on lease

Particulars	Year					
	0 (₹)	1 (₹)	2 (₹)	3 (₹)	4 (₹)	5 (₹)
Cash Outflows on lease rent:	–	16,00,000	16,00,000	16,00,000	16,00,000	16,00,000
Less: Tax Relief on Lease Rent @ 32.445%	–	5,19,120	5,19,120	5,19,120	5,19,120	5,19,120
Net Cash Outflow	–	10,80,880	10,80,880	10,80,880	10,80,880	10,80,880
Discount factor @ 10%	1	0.9091	0.8264	0.7513	0.6830	0.6209
PV of Cash Outflows	–	9,82,628	8,93,239	8,12,065	7,38,241	6,71,118
Net Present Value of Cash Outflows = ₹ 40,97,291						

Conclusion: Cash outflow is least if machine is acquired on lease. Hence, machine shall be acquired on lease.

Working Notes: Calculation of Tax relief on Depreciation and Balancing Allowance

Year	Opening Balance (₹)	Depreciation@ 15% (₹)	Tax Relief @ 32.445% (₹)
1	60,00,000	9,00,000	2,92,005
2	51,00,000	7,65,000	2,48,204
3	43,35,000	6,50,250	2,10,974
4	36,84,750	5,52,713	1,79,328
5	31,32,037	4,69,806	1,52,428
			10,82,939

ILLUSTRATION 6

Virat Ltd. is a widely held company. It is currently considering a major expansion of its production facilities and the following alternative are available:

Particulars	Alt-1	Alt-2	Alt-3
	(₹)	(₹)	(₹)
Share capital	50,00,000	20,00,000	10,00,000
14% Debentures	—	20,00,000	15,00,000
18% Loan from Bank	—	10,00,000	25,00,000

Expected rate of return before tax is 30% (ignore surcharge and cess). Rate of dividend of the company since 1995 has not been less than 22% and date of dividend declaration is 30th June every year. Which alternative should the company opt with reference to tax planning? Dividend tax is payable @ 17.647%

Solution

Before taking the source of finances i.e. Capital or borrowings, the comparison between pre commencement period and post commencement period should be made. The comparison is as follows:

- (a) (i) Dividend is not deductible either for pre commencement period or in the post commencement period in India;
- (ii) Interest is capitalised for pre-commencement period, i.e. added to the cost of project (cost of fixed assets) and depreciation is calculated on capitalised value of assets. For post commencement period, interest is fully deductible.
- (b) (i) Cost of raising finance in form of capital is not deductible as revenue expenditure but amortised u/s 35D of the Act. If such expenditure is incurred after the commencement of the business, Section 35D is applicable provided the expenditure is undertaken for expansion purposes.
- (ii) Cost of borrowing funds in case of pre commencement period is capitalised and in case of post commencement period, it is deductible fully in the year.

The above consideration will go a long way in suggesting the managements of corporate entities to adopt a suitable capital structure and selecting the appropriate financing sources by providing an optimal capital mix for the organization.

Computation of Net Benefit in different Alternative

Particulars	Alt - 1 (₹)	Alt - 2 (₹)	Alt - 3 (₹)
Share Capital	50,00,000	20,00,000	10,00,000
14% Debentures	—	15,00,000	15,00,000
18% loan from Bank	—	25,00,000	25,00,000
EBIT	15,00,000	15,00,000	15,00,000
Cost to Company			
Debt Interest	—	2,80,000	2,10,000
Interest on loan from Bank	—	1,80,000	4,50,000
Net Profit before tax and dividend	15,00,000	10,40,000	8,40,000
Tax Payable @ 30%	4,50,000	3,12,000	2,52,000

Profit after tax	10,50,000	7,28,000	5,88,000
Less: Dividend @ 22%	11,00,000	4,40,000	2,20,000
	(50,000)	2,88,000	3,68,000
Less: Dividend Distribution Tax u/s 115-O	1,94,117	77,647	38,823
Profit after cost of capital	(2,44,117)	2,10,353	3,29,177

Hence, Alt-3 is better.

ILLUSTRATION 7

P Ltd. owns two undertakings. Undertaking-A is eligible for deduction u/s 80-IA and Undertaking-B is not eligible for such deduction. Date of commencement of operation in both the undertaking is 14th September, 2018. The profits earned by both the undertaking are as under:

Previous Year	Undertaking-A (₹ in Lakhs)	Undertaking-B (₹ in Lakhs)
2018-19	(-) 6	(-) 4
2019-20	(-) 4	10
2020-21	5	9
2021-22	8	6
2022-23	9	(-) 3

Calculate total income of P Ltd. for last three assessment years.

Solution

In the given case, the entire loss of the undertaking A has been set-off under Sections 70 & 72 till the A.Y 2021-22

Assessment Year	Unit A	Unit B	GTI	Carried forward losses
2019-20	- 6	- 4	Nil	-10
2020-21	- 4	10	Nil	-4
2021-22	5	9	10	Nil
2022-23	8	6	14	Nil
2023-24	9	- 3	6	Nil

There is no loss brought forward for earlier years for the Assessment Year 2022-23 and subsequent year. However, to compute profit eligible for tax holidays u/s 80-IA, it is assumed that the undertaking is the only unit owned by P. Ltd. Consequently, deduction u/s 80-IA is as under:

Computation of Total Income

Particulars	A.Y. 2021-22	A.Y. 2022-23	A.Y. 2023-24
Profit from Unit A	5	8	9
Add: Profit from Unit B	9	6	-3



Gross Total Income (a)	14	14	6
Less: Deduction u/s 80-IA			
Current year profit of Unit A	5	8	9
Less: Notional B/F loss from earlier years	-10	-5	Nil
Balance	-5	3	9
Deduction U/S 80-IA @ 100% (b)	Nil	3	6 (Restricted to GTI)
Total Income [(a)-(b)]	14	11	Nil

STUDY NOTE : 13

INCOME TAX AUTHORITIES



This Study Note includes:

- 13.1 Income Tax Authorities [Sec. 116]
- 13.2 Appointment of income-tax authorities [Sec. 117]
- 13.3 Central Board of Direct Taxes (CBDT)
- 13.4 Jurisdiction of income-tax authorities [Sec. 120]
- 13.5 Jurisdiction of Assessing Officers [Sec. 124]
- 13.6 Power to transfer cases [Sec. 127]
- 13.7 Succession of income-tax authority [Sec. 129]

13.1 INCOME TAX AUTHORITIES [SEC. 116]

- a) The Central Board of Direct Taxes (CBDT) constituted under the Central Boards of Revenue Act, 1963
- b) Principal Directors General of Income-tax or Principal Chief Commissioners of Income-tax
- c) Directors-General of Income-tax or Chief Commissioners of Income-tax
- d) Principal Directors of Income-tax or Principal Commissioners of Income-tax
- e) Directors of Income-tax or Commissioners of Income-tax or Commissioners of Income-tax (Appeals)
- f) Additional Directors of Income-tax or Additional Commissioners of Income-tax or Additional Commissioners of Income-tax (Appeals)
- g) Joint Directors of Income-tax or Joint Commissioners of Income-tax
- h) Deputy Directors of Income-tax or Deputy Commissioners of Income-tax or Deputy Commissioners of Income-tax (Appeals)
- i) Assistant Directors of Income-tax or Assistant Commissioners of Income-tax
- j) Income-tax Officers
- k) Tax Recovery Officers
- l) Inspectors of Income-tax

Taxpoint

- As per sec. 2(7A), *Assessing Officer* means the Assistant Commissioner or Deputy Commissioner or Assistant Director or Deputy Director or the Income-tax Officer who is vested with the relevant jurisdiction by virtue of directions or orders, and the Additional Commissioner or Additional Director or Joint Commissioner or Joint Director who is



directed to exercise or perform all or any of the powers and functions conferred on, or assigned to, an Assessing Officer under this Act.

- As per sec. 2(9A), *Assistant Commissioner* means a person appointed to be an Assistant Commissioner of Income-tax or a Deputy Commissioner of Income-tax u/s 117(1)
- As per sec. 2(15A), *Chief Commissioner* means a person appointed to be a Chief Commissioner of Income-tax or a Principal Chief Commissioner of Income-tax u/s 117(1)
- As per sec. 2(16), *Commissioner* means a person appointed to be a Commissioner of Income-tax or a Director of Income-tax or a Principal Commissioner of Income-tax or a Principal Director of Income-tax u/s 117(1)
- As per sec. 2(21), *Director General or Director* means a person appointed to be a Director General of Income-tax or a Principal Director General of Income-tax or, as the case may be, a Director of Income-tax or a Principal Director of Income-tax, u/s 117(1), and includes a person appointed to be an Additional Director of Income-tax or a Joint Director of Income-tax or an Assistant Director or Deputy Director of Income-tax
- As per sec. 2(28C), *Joint Commissioner* means a person appointed to be a Joint Commissioner of Income-tax or an Additional Commissioner of Income-tax u/s 117(1).
- As per sec. 2(28D), *Joint Director* means a person appointed to be a Joint Director of Income-tax or an Additional Director of Income-tax u/s 117(1)

13.2 APPOINTMENT OF INCOME-TAX AUTHORITIES [SEC. 117]

- (1) The Central Government may appoint such persons as it thinks fit to be income-tax authorities.
- (2) The Central Government may 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.
- (3) An income-tax authority authorised in this behalf by the Board may appoint such executive or ministerial staff as may be necessary to assist it in the execution of its functions.

All these appointments can be made subject to the rules and orders of the Central Government.

13.3 CENTRAL BOARD OF DIRECT TAXES (CBDT)

The Central Board of Direct Taxes is a statutory authority functioning under the Central Board of Revenue Act, 1963. The officials of the Board in their ex-officio capacity also function as a Division of the Ministry dealing with matters relating to levy and collection of direct taxes.

The Central Board of Revenue as the apex body of the Department, charged with the administration of taxes, came into existence as a result of the Central Board of Revenue Act, 1924. Initially the Board was in charge of both direct and indirect taxes. However, when the administration of taxes became too unwieldy for one Board to handle, the Board was split up into two, namely the Central Board of Direct Taxes and Central Board of Excise and Customs with effect from 1.1.1964. This bifurcation was brought about by constitution of two Boards u/s 3 of the Central Board of Revenue Act, 1963.

The Central Board of Direct Taxes consists of a Chairman and following six Members: -

1. **Chairman**
2. **Member (Income-tax)**
3. **Member (Legislation & Computerisation)**
4. **Member (Personnel & Vigilance)**
5. **Member (Investigation)**
6. **Member (Revenue)**
7. **Member (Audit & Judicial)**

Power of CBDT

1. Instructions to subordinate authorities [Sec. 119(1)]

The Board may, from time to time, issue such orders, instructions and directions to other income-tax authorities as it may deem fit for the proper administration of this Act. Such authorities and all other persons employed in the execution of this Act shall observe and follow such orders, instructions and directions of the Board.

Exception

No such orders, instructions or directions shall be issued—

- 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
- So as to interfere with the discretion of the Commissioner (Appeals) in the exercise of his appellate functions.

However, the Board can issue administrative instructions.

2. Issue General or Special order to subordinates [Sec. 119(2)(a)]

The Board may issue from time to time general or special orders to its subordinate subject to following features:

- (a) If it considers it necessary or expedient to do so, for the purpose of proper and efficient management of the work of assessment and collection of revenue.
- (b) Such order may be issued whether by way of relaxation of any of the provisions of sec. 115P, 115S, 139, 143, 144, 147, 148, 154, 155, 158BFA, 201(1A), 210, 211, 234A, 234B, 234C, 234E, 270A, 271, 271C, 271CA and 273 or otherwise.
- (c) Such orders may be in respect of any class of incomes or class of cases
- (d) Such order must not be prejudicial to the assessee.
- (e) Such order acts as guidelines, principles or procedures to be followed by other income-tax authorities in the work relating to assessment or collection of revenue or the initiation of proceedings for the imposition of penalties;
- (f) Any such order may, if the Board is of the opinion that it is necessary in the public interest so to do, be published and circulated in the prescribed manner for general information.

3. Admit application or claim after expiry of time limit [Sec. 119(2)(b)]

- (a) The Board may, by general or special order, admit an application or claim for any exemption, deduction,



refund or any other relief under this Act after the expiry of the period specified under this Act for making such application or claim.

- (b) Such order can be issued by the Board, if it considers it desirable or expedient to do so, for avoiding genuine hardship in any case or class of cases.
- (c) Such order can be issued to any income-tax authority except Commissioner (Appeals).

4. Relaxation in requirement of the provisions of Chapter IV or Chapter VIA [Sec. 119(2)(c)]

- The Board may, by general or special order, relax any requirement contained in any of the provisions of Chapter IV (Sec.14 to 59) or Chapter VIA (Sec.80A to 80U), where the assessee has failed to comply with any requirement specified in such provision for claiming deduction thereunder.
- Reasons for issuing such order are to be specified therein;
- The Board can issue such order if it considers it desirable or expedient to do so for avoiding genuine hardship in any case or class of cases;
- Such order can be issued subject to the following conditions:
 - a) the default in complying with such requirement was due to circumstances beyond the control of the assessee; and
 - b) the assessee has complied with such requirement before the completion of assessment in relation to the previous year in which such deduction is claimed.

Note: The Central Government shall cause every order issued under this clause to be laid before each House of Parliament.

5. Control over income-tax authorities [Sec. 118]

The Board may, by notification in the Official Gazette, direct that any income-tax authority or authorities specified in the notification shall be subordinate to such other income-tax authority or authorities as may be specified in such notification.

Note

An order, circular, instruction or direction issued u/s 119 cannot override the provisions of the Act.

13.4 JURISDICTION OF INCOME-TAX AUTHORITIES [SEC. 120]

- ◆ Income-tax authorities shall exercise all or any of the powers and perform all or any of the functions assigned to such authorities in accordance with directions of the Board
- ◆ The directions of the Board may authorise any other income-tax authority to issue orders in writing for the exercise of the powers and performance of the functions by any of its subordinate.
- ◆ The Board or other authorised income-tax authority may have regard to any one or more of the following criteria:
 - a) territorial area;
 - b) persons or classes of persons;
 - c) incomes or classes of income; and
 - d) cases or classes of cases.

- ◆ The Board may, by general or special order, and subject to such conditions, restrictions or limitations as may be specified therein:
 - a. authorise any Principal Director General or Director General or Principal Director or Director to perform such functions of any other income-tax authority as may be assigned to him by the Board;
 - b. 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 that the powers and functions assigned to, the Assessing Officer in respect of any specified area or persons or classes of persons or incomes or classes of income or cases or classes of cases, shall be exercised or performed by an Additional Commissioner or an Additional Director or a Joint Commissioner or a Joint Director; and
- ◆ Where it is considered necessary or appropriate for the proper management of the work, jurisdiction with more than one income tax authority in relation to any case may be conferred or assigned.
- ◆ The Board may direct that for the purpose of furnishing of the return of income or the doing of any other act or thing under this Act or any rule made thereunder by any person or class of persons, the income-tax authority exercising and performing the powers and functions in relation to the said person or class of persons shall be such authority as may be specified in the notification.

13.5 JURISDICTION OF ASSESSING OFFICERS [SEC. 124]

1. Where the Assessing Officer has been vested with jurisdiction over any area, within the limits of such area, he shall have jurisdiction:

In respect of any person carrying on a business or profession	If the place at which such person carries on business or profession is situate within the area, or where his business or profession is carried on in more places than one if the principal place of his business or profession is situate within the area
In respect of any other person	Person residing within the area

2. Where a question arises 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 Commissioner or the Principal Commissioner or Commissioner.
3. In case, where the question is one relating to areas within the jurisdiction of different Principal Directors General or Directors General or Principal Chief Commissioners or Chief Commissioners or Principal Commissioners or Commissioners, by the Principal Directors General or Directors General or Principal Chief Commissioners or Chief Commissioners or Principal Commissioners or Commissioners concerned or, if they are not in agreement, 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 notify.
4. No person shall be entitled to call in question the jurisdiction of an Assessing Officer:
 - a. where he has made a return u/s 139(1), after the expiry of 1 month from the date on which he was served with a notice u/s 142(2) or 143(2) or after the completion of the assessment, whichever is earlier.
 - b. where he has made no such return, after the expiry of the time allowed by the notice u/s 142(1) or 148 for the making of the return or by the notice under the first proviso to sec. 144 to show cause why the assessment should not be completed to the best of the judgment of the Assessing Officer, whichever is earlier.



- c. where an action has been taken u/s 132 or 132A, after the expiry of 1 month from the date on which he was served with a notice u/s 153A or 153C or after the completion of the assessment, whichever is earlier.
- 5. Where an assessee calls in question 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 (as given in point 2 and 3) before the assessment is made.
- 6. 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.

13.6 POWER TO TRANSFER CASES [SEC. 127]

- ◆ The Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may transfer any case from one or more Assessing Officers subordinate to him (whether with or without concurrent jurisdiction) to any other Assessing Officer or Assessing Officers (whether with or without concurrent jurisdiction) also subordinate to him.
 - ▲ Such power shall be exercised after:
 - a) giving the assessee a reasonable opportunity of being heard in the matter wherever it is possible to do so.
 - b) recording his reasons for doing so.
- ◆ Where the Assessing Officer or Assessing Officers from whom the case is to be transferred and the Assessing Officer or Assessing Officers to whom the case is to be transferred are not subordinate to the same Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner:
 - a. where the Principal Directors General or Directors General or Principal Chief Commissioners or Chief Commissioners or Principal Commissioners or Commissioners to whom such Assessing Officers are subordinate are in agreement, then the Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner from whose jurisdiction the case is to be transferred may pass the order.
 - ▲ Such power shall be exercised after:
 - a) giving the assessee a reasonable opportunity of being heard in the matter wherever it is possible to do so.
 - b) recording his reasons for doing so.
 - b. where such authorities are not in agreement, the order transferring the case may be passed by the Board or any other notified higher authority
- ◆ No opportunity of being heard to be given to the assessee where the transfer is from any Assessing Officer (whether with or without concurrent jurisdiction) to any other Assessing Officer (whether with or without concurrent jurisdiction) and the offices of all such officers are situated in the same city, locality or place.
- ◆ The transfer of a case may be made at any stage of the proceedings, and shall not render necessary the re-issue of any notice already issued by the Assessing Officer from whom the case is transferred.
 - **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.

13.7 SUCCESSION OF INCOME-TAX AUTHORITY [SEC. 129]

- Whenever in respect of any proceeding under this Act an income-tax authority ceases to exercise jurisdiction and another income tax authority exercises jurisdiction.
- The income-tax authority so succeeding may continue the proceeding from the stage at which the proceeding was left by his predecessor.

Opportunity of being re-heard

The assessee may demand that before -

- Such succeeding authority reopens previous proceeding or any part thereof; or
 - any order of assessment is passed against him,
- he must be given an opportunity of being re-heard.



STUDY NOTE : 14

LIABILITY IN SPECIAL CASES



This Study Note includes:

- 14.1 Equalisation Levy
- 14.2 Tonnage Tax Scheme [Sec. 115V to Sec. 115VZC]
- 14.3 Legal representatives [Sec. 159]
- 14.4 Executors [Sec. 168]
- 14.5 Representative assessee [Sec. 160]
- 14.6 Exceptions to the general rule that income of a Previous Year is taxed in its Assessment Year
- 14.7 Company in liquidation [Sec. 178]
- 14.8 Miscellaneous Provisions

14.1 EQUALISATION LEVY

With the expansion of information and communication technology, the supply and procurement of digital goods and services have undergone exponential expansion everywhere, including India. The digital economy is growing at 10% per year, significantly faster than the global economy as a whole.

Currently 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. From a certain perspective, business in digital domain doesn't seem to occur in any physical location but instead takes place in the nebulous world of "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.

These new business models have created new tax challenges. The typical direct tax issues relating to e-commerce are the difficulties of characterizing the nature of payment and establishing a nexus or link between a taxable transaction, activity and a taxing jurisdiction, the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes. The digital business fundamentally 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.

The Organization for Economic Cooperation and Development (OECD) has recommended, in Base Erosion and Profit Shifting (BEPS) project under Action Plan 1, several options to tackle the direct tax challenges which include modifying the existing Permanent Establishment (PE) rule to include that where 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. It further recommended 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. It also recommended to impose 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.

Considering the potential of new digital economy and the rapidly evolving nature of business operations it is found essential to address the challenges in terms of taxation of such digital transactions as mentioned above. In order to address these challenges, Chapter VIII of the Finance Act, 2016¹, 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 ('PE') in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India. Different provisions thereof are discussed below:

Chargeability [Sec. 165]

Equalisation levy shall be payable @ 6% of the consideration for any specified service received or receivable by a person, being a non-resident from:

- i. a person resident in India and carrying on business or profession; or
 - ii. a non-resident having a permanent establishment in India.
- Specified service means
- a) **online advertisement**,
 - b) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and
 - c) any other notified service – Sec. 164(i)
- 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 – Sec. 164(f)

Taxpoint

These provisions extend to the whole of India except the State of Jammu and Kashmir.

Exception

The equalisation levy shall not be charged, where:

- a) the non-resident providing the specified service has a permanent establishment in India and the specified service is effectively connected with such permanent establishment;
- b) the aggregate amount of consideration for specified service received or receivable in a previous year from resident in India or from a non-resident having a permanent establishment in India, does not exceed ₹ 1,00,000; or
- c) 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.

Collection and recovery of equalisation levy [Sec. 166]

Who is liable to deduct equalisation levy:

Every person, being a resident and carrying on business or profession or a non-resident having a permanent establishment in India (hereafter in this Chapter referred to as assessee) shall deduct the equalisation levy from the amount paid or payable to a non-resident in respect of the specified service

Rate of levy: 6%

Threshold limit: Such deduction shall be made if the aggregate amount of consideration for specified service in a previous year exceeds ₹ 1,00,000.

¹ The equalization levy would come into effect from 01-06-2016 [Notification dated 27-05-2016]

Time limit for depositing the levy to the credit of the Central Government: 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 day of the month immediately following the said calendar month.

Consequences of failure to deduct equalisation levy: Any assessee who fails to deduct the levy shall be (even though not deducted) liable to pay the levy to the credit of the Central Government in accordance with the aforesaid provisions

Furnishing of Statement [Sec. 167]

- ◆ Every assessee shall, within 30th June immediately following the financial year, prepare and deliver to the Assessing Officer (or to any other authority or agency authorised by the Board), a statement in Form 1, verified in such manner and setting forth such particulars as may be prescribed, in respect of all specified services during such financial year.
- ◆ **Revised Statement:** An assessee who has not furnished the statement within aforesaid time or having furnished such statement, notices any omission or wrong particular therein, may furnish a statement or a revised statement, as the case may be, at any time before the expiry of 2 years from the end of the financial year in which the specified service was provided.
- ◆ **Notice by the Assessing Officer:** Where any assessee fails to furnish the statement within 30th June immediately following the financial year, 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 such particulars, within 30 days from the date of service of the notice.

Processing of Statement [Sec. 168]

Statement furnished u/s 167 shall be processed in the following manner:

- 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 the interest against any amount paid u/s 166 or 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 shall be granted to him.

Time limit

No intimation shall be **sent** after the expiry of 1 year from the end of the financial year in which the statement is furnished.

Taxpoint

For the purposes of processing of statements, the Board may make a scheme for centralised processing of such statements to expeditiously determine the tax payable by, or the refund due to, the assessee.

Rectification of mistake [Sec. 169]

- ◆ With a view to rectifying any mistake apparent from the record, the Assessing Officer may amend any intimation issued u/s 168, within **1 year** from the end of the financial year in which the intimation sought to be amended was issued.
- ◆ The Assessing Officer may make an amendment to any intimation either *suo motu* or on any mistake brought to his notice by the assessee.



- ♦ 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.

Interest on Delayed payment of equalisation levy [Sec. 170]

Every assessee, who fails to credit adequate equalisation levy to the account of the Central Government within specified period, shall pay simple interest @ 1% of such levy for every month or part of a month by which such crediting of the tax is delayed.

Penalty

Penalties provisions are as under:

Sec.	Nature of default	Amount of Penalty
171(a)	Fails to deduct the equalisation levy	Equal to the amount of equalisation levy
171(b)	Fails to pay levy, after deduction, to the credit of the Central Government	₹ 100 for every day during which the failure continues subject to maximum of amount failed to pay
172	Failure to furnish statement as required u/s 172	₹ 100 for every day during which the failure continues

- ♦ No penalty shall be imposable:
 1. If the assessee proves to the satisfaction of the Assessing Officer that there was reasonable cause for the said failure.
 2. Without giving reasonable opportunity of being heard to the assessee [Sec. 173].
- ♦ An assessee aggrieved by an order imposing penalty may appeal to the Commissioner of Income-tax (Appeals) within 30 days from the date of receipt of the order in Form 3. It shall be accompanied with fees of ₹ 1,000/-. The provisions relating to appeals are in line with that of the Income-tax Act, 1961. [Sec. 174]
- ♦ Similarly, appeals can be filed before the ITAT against the order of the Commissioner (Appeals) in Form 4 within 60 days from the date on which the order sought to be appealed against is received by the assessee or by the Commissioner. In case appeal before the ITAT is filed by the assessee, it should be accompanied with fees of ₹ 1,000/- [Sec. 175]

Punishment for false statement [Sec. 176]

If a person makes a false statement in any verification or delivers an account or statement, which is false, 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 3 years and with fine.

Taxpoint:

- ▶ An offence punishable above shall be deemed to be non-cognizable.
- ▶ No prosecution shall be instituted against any person for any offence except with the previous sanction of the Chief Commissioner of Income-tax [Sec. 177].

Application of Certain provisions of Income-tax Act [Sec. 178]

The provisions of sec. 120, 131, 133A, 138, 156, Chapter XV and sec. 220 to 227, 229, 232, 260A, 261, 262, 265 to 269,

278B, 280A, 280B, 280C, 280D, 282 and 288 to 293 of the Income-tax Act shall so far as may be, apply in relation to equalisation levy, as they apply in relation to income-tax.

14.2 TONNAGE TAX SCHEME [SEC. 115V TO SEC. 115VZC]

To make the Indian shipping industry more competitive, a tonnage tax scheme for taxation of shipping profits was introduced. Some of the basic features of the tonnage tax scheme are as follows:-

- It is a scheme of presumptive taxation whereby the notional income arising from the operation of a ship is determined based on the tonnage of the ship.
- The notional income is taxed at the normal corporate rate applicable for the year.
- Tax is payable even if there is a loss in an year.
- A company may opt for the scheme and once such option is exercised, there is a lock in period of 10 years. If a company opts out, it is debarred from re-entry for 10 years.
- Since this is a preferential regime of taxation, certain conditions like creation of reserves, training etc. are required to be met.
- A company may be expelled in certain circumstances.

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. Certain types of ships like fishing vessels, pleasure crafts etc. are excluded in terms of sec. 115V-D. The business of operating qualifying ships is to be considered a separate business and separate accounts are to be maintained. Sec. 115VG gives the manner of computation of the daily tonnage income which when multiplied by the number of days the ship operated, will give the annual tonnage income from the ship. A company owning at least 1 ship may charter in ships subject to certain limits for the purpose of operation. Relevant shipping income, which replaces the actual income from the operations, is defined in sec. 115 V-I. Sec. 115VJ gives the treatment of common costs.

A company opting for the scheme is not allowed any set-off of loss nor is any depreciation allowed. However, both loss and depreciation are deemed to have been allowed and notional adjustments are made against the relevant shipping income. Although depreciation is not allowed, it is necessary to bifurcate the qualifying ships and non-qualifying ships at the time a company joins the scheme. Sec. 115VK lays down the method for allocating the written down value amongst qualifying and non-qualifying ships. Any income from transfer of qualifying assets is treated in the same manner as for any other business asset in terms of sec. 115VN.

The profits from the business of operating qualifying ships will not be taken into consideration for the purpose of MAT as per sec. 115V-O.

Sec. 115VP lays down the procedure for the option and the manner of granting approval. Sec. 115VQ lays down that once a company opts for the scheme, the option remains in force for 10 years except in certain circumstances. Sec. 115VS provides for the circumstances in which the tonnage tax company is prohibited from opting for the scheme. Such prohibition is for a period of 10 years. Sec. 115VT, 115VU, 115VS and 115VW lay down the conditions for the applicability of the scheme. In terms of sec. 115VT, a tonnage tax company has to create a reserve of at least 20% of its book profits to be utilized for the purpose of acquisition of new ships. As per sec. 115VU a tonnage tax company has to comply with a minimum training requirement in accordance with the guidelines to be issued by the DG (Shipping). The company will be expelled if the training requirements are not met for 5 consecutive years. Sec. 115VV lays down the limit of 49% for chartering in. In terms of sec. 115VW, maintenance of separate books of account and the audit of the same is compulsory for a company opting for the scheme. Sec. 115VX lays down the details regarding valid certificate which indicates the net tonnage of ships. Sec. 115VY and 115VZ provide for the contingencies of amalgamation and demerger. Sec. 115VZB enjoins upon a company not to abuse the preferential tax regime and sec. 115VZC provides for expulsion of a company in case of abuse



Few of the provisions are discussed here in below:

Computation of profits and gains from the business of operating qualifying ships [Sec. 115VA]

In the case of a company, the income from the business of operating qualifying ships, may, **at its option**, be computed in accordance with the provisions of this Chapter and such income 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".

Taxpoint

♦ Operating ships [Sec. 115VB]

A company shall be regarded as operating a ship if it operates any ship whether owned or chartered by it and includes a case where even a part of the ship has been chartered in by it in an arrangement such as slot charter, space charter or joint charter.

However, a company shall not be regarded as the operator of a ship, which has been chartered out by it on bareboat charter-cum-demise¹ terms or on bareboat charter² terms for a period exceeding 3 years.

- ▶ 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;
- ▶ 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;

♦ Qualifying ship [Sec. 115VD]

A ship is a qualifying ship if:

- a. it is a sea going ship or vessel of 15 net tonnage or more;
 - ▶ Seagoing ship means a ship if it is certified as such by the competent authority of any country.
- b. it is a ship registered under the Merchant Shipping Act, 1958 or a ship registered outside India in respect of which a licence has been issued by the Director-General of Shipping u/s 406 or section 407 of the Merchant Shipping Act, 1958; and
- c. a valid certificate in respect of such ship indicating its net tonnage is in force,—

In nutshell, qualifying ship means a sea-going ship having valid certificate

- but does not include—

- i. Factory ships;
 - ▶ Factory ship includes a vessel providing processing services in respect of processing of the fishing produce.
- ii. Pleasure crafts;
 - ▶ Pleasure craft means a ship of a kind whose primary use is for the purposes of sport or recreation.
- iii. Harbour and river ferries;
- iv. A seagoing ship or vessel if the main purpose for which it is used is the provision of goods or services of a kind normally provided on land;
- v. Off-shore installations;
- vi. Fishing vessels
- vii. a qualifying ship, which is used as a fishing vessel for a period of more than 30 days during a previous year.

Qualifying company [Sec. 115VC]

A company is a qualifying company if:

- (a) it is an Indian company;
- (b) the place of effective management of the company is in India;

Place of effective management of the company means:

- (i) the place where the board of directors of the company or its executive directors, as the case may be, make their decisions; or
- (ii) 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.
- (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.

Manner of computation of income under tonnage tax scheme [Sec. 115VE]

- ♦ A tonnage tax company (means a qualifying company in relation to which tonnage tax option is in force) engaged in the business of operating qualifying ships shall compute the profits from such business under the tonnage tax scheme.
- ♦ The business of operating qualifying ships giving rise to income [referred to in sec. 115V-I(1)] shall be considered as a separate business (hereafter referred to as the tonnage tax business) distinct from all other activities or business carried on by the company.
- ♦ The profits shall be computed separately from the profits and gains from any other business.
- ♦ The tonnage tax scheme shall apply only if an option to that effect is made in accordance with the provisions of section 115VP.
- ♦ Where a company engaged in the business of operating qualifying ships is not covered under the tonnage tax scheme or, has not made an option to that effect, as the case may be, the profits and gains of such company from such business shall be computed in accordance with the other provisions of this Act.

Tonnage income [Sec. 115VF]

The tonnage income shall be computed in accordance with sec. 115VG and the income so computed shall be deemed to be the profits chargeable under the head "Profits and gains of business or profession" and the relevant shipping income referred to in sec. 115V-I(1) shall not be chargeable to tax.

Computation of tonnage income [Sec. 115VG]

The tonnage income of a tonnage tax company for a previous year shall be the aggregate of the tonnage income of each qualifying ship computed in accordance with the following provisions:

- ♦ The tonnage income of each qualifying ship shall be the daily tonnage income of each such ship multiplied by:
 - (a) the number of days in the previous year; or
 - (b) the number of days in part of the previous year in case the ship is operated by the company as a qualifying ship for only part of the previous year.
- ♦ Daily tonnage income of a qualifying ship shall be:

Qualifying ship having net tonnage	Amount of daily tonnage income
Upto 1,000	₹ 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

- ♦ The tonnage shall be rounded off to the nearest multiple of 100 tons and for this purpose
 - ▶ any tonnage consisting of kilograms shall be ignored and thereafter;



- ▶ if such tonnage is not a multiple of 100, then,
 - if the last figure in that amount is 50 tons or more, the tonnage shall be increased to the next higher tonnage which is a multiple of 100; or
 - if the last figure is less than 50 tons the tonnage shall be reduced to the next lower tonnage which is a multiple of 100.
- ♦ No deduction or set off shall be allowed in computing the tonnage income under this Chapter.

Relevant shipping income [Sec. 115V-I]

- ♦ The relevant shipping income of a tonnage tax company means:
 - (i) its profits from core activities;
 - (ii) its profits from incidental activities
- ♦ Where the aggregate of incomes from incidental activities exceeds $\frac{1}{4}\%$ of the turnover from core activities, such excess shall not form part of the relevant shipping income for the purposes of this Chapter and shall be taxable under the other provisions of this Act.
- ♦ The core activities of a tonnage tax company shall be:
 - (i) its activities from operating qualifying ships; and
 - (ii) other ship-related activities mentioned as under:—
 - (A) shipping contracts in respect of—
 - (a) earning from pooling arrangements;
 - ▶ Pooling arrangement means an agreement between two or more persons for providing services through a pool or operating one or more ships and sharing earnings or operating profits on the basis of mutually agreed terms.
 - (b) contracts of affreightment
 - ▶ Contract of affreightment means 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,—
 - (a) on-board or on-shore activities of passenger ships comprising of fares and food and beverages consumed on board;
 - (b) slot charters, space charters, joint charters, feeder services, container box leasing of container shipping.
- ♦ The **incidental activities** shall be the activities which are incidental to the core activities and which may be prescribed for the purpose.
- ♦ Where a tonnage tax company operates any ship, which is not a qualifying ship, the income attributable to operating such non-qualifying ship shall be computed in accordance with the other provisions of this Act.
- ♦ 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 vice versa and the consideration 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, then, the relevant shipping income under this section shall be computed as if the transfer, in either case, had been made at the market value of such goods or services as on that date.
- ♦ Where it appears to the Assessing Officer that, owing to the close connection between the tonnage tax company and any other person, or for any other reason, the course of business between them is so arranged that the business transacted between them produces to the tonnage tax company more than the ordinary profits which might be expected to arise in the tonnage tax business, the Assessing Officer shall, in computing the relevant shipping income of the tonnage tax company for the purposes of this Chapter, take the amount of income as may be reasonably deemed to have been derived therefrom.

- ♦ In case the relevant shipping income of a tonnage tax company is a loss, then, such loss shall be ignored for the purposes of computing tonnage income.

General exclusion of deduction and set off, etc. [Sec. 115VL]

In computing the tonnage income of a tonnage tax company for any previous year (hereafter in this section referred to as the "relevant previous year") in which it is chargeable to tax in accordance with this Chapter:

- ♦ Every loss, allowance or deduction referred to sec. 30 to 43B had been given full effect to for that previous year;
- ♦ No loss referred to in sec. 70(1) or 70(3) [long term capital loss] or 71(1) or 71(2) or 72(1) or 72A(1), in so far as such loss relates to the business of operating qualifying ships of the company, shall be carried forward or set off where such loss relates to any of the previous years when the company is under the tonnage tax scheme;
- ♦ No deduction shall be allowed under Chapter VI-A in relation to the profits and gains from the business of operating qualifying ships; and
- ♦ In computing the depreciation allowance u/s 32, the written down value of any asset used for the purposes of the tonnage tax business shall be computed as if the company has claimed and has been actually allowed the deduction in respect of depreciation for the relevant previous year.

Exclusion of loss [Sec. 115VM]

- ♦ Section 72 shall apply in respect of any losses that have accrued to a company before its option for tonnage tax scheme and which are attributable to its tonnage tax business, as if such losses had been set off against the relevant shipping income in any of the previous years when the company is under the tonnage tax scheme.
- ♦ The losses shall not be available for set off against any income other than relevant shipping income in any previous year beginning on or after the company exercises its option u/s 115VP.

Exclusion from section 115JB [Sec. 115VO]

The book profit or loss derived from the activities of a tonnage tax company, referred to in sec. 115VI(1), shall be excluded from the book profit of the company for the purposes of sec. 115JB. In other words, MAT provisions are not applicable.

14.3 LEGAL REPRESENTATIVES [SEC. 159]

- ♦ Where a person dies, his legal representatives shall be liable to pay any sum which the deceased would have been liable to pay if he had not died, in the like manner and to the same extent as the deceased.
- ♦ The liability of a legal representative is limited to the extent to which the estate is capable of meeting the liability.
- ♦ However, every legal representative shall be personally liable for any tax payable by him in his capacity as legal representative if, while his liability for **tax** remains undischarged, he creates a charge on or disposes of or parts with any assets of the estate of the deceased, which are in, or may come into, his possession, but such liability shall be limited to the value of the asset so charged, disposed of or parted with.
- ♦ For the purpose of making an assessment (including an assessment, reassessment or recomputation u/s 147) of the income of the deceased and for the purpose of levying any sum in the hands of the legal representative in accordance with the above provisions:
 - (a) 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 the stage at which it stood on the date of the death of the deceased;



- (b) any proceeding which could have been taken against the deceased if he had survived, may be taken against the legal representative; and
 - (c) all the provisions of this Act shall apply accordingly.
- ♦ The legal representative of the deceased shall be deemed to be an assessee.

Taxpoint:

- ▶ In the year of death of the assessee, there are two assessment (i) upto date of death, sec. 159 is applicable; (ii) after the date of death, sec. 168 or other sections are applicable.
- ▶ Representative u/s 159 and Executors u/s 168 may be same person.
- ▶ In case of death of the karta of HUF, HUF continues with to exist with changed composition and karta, hence section 159 is not applicable in case of death of karta. However, sec. 159 is applicable on the individual income of the karta.

14.4 EXECUTORS [SEC. 168]

- ♦ The income of the estate of deceased person shall be chargeable to tax in the hands of the executor:
 - (a) if there is only one executor, then, as if the executor were an individual; or
 - (b) if there are more executors than one, then, as if the executors were an association of persons;and for the purposes of this Act, the executor shall be deemed to be resident or non-resident according as the deceased person was a resident or non-resident during the previous year in which his death took place.
- ♦ 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 assessments shall be made on the total income of each completed previous year (or part thereof) as is included in the period from the date of the death to the date of complete distribution to the beneficiaries of the estate according to their several interests.
- ♦ In computing the total income of any previous year, any income of the estate of that previous year distributed to (or applied to the benefit of) any specific legatee of the estate during that previous year shall be excluded; but the income so excluded shall be included in the total income of the previous year of such specific legatee.
- ♦ Executor includes an administrator or other person administering the estate of a deceased person.
- ♦ An executor in respect of tax paid or payable by him shall be recovered by him from the estate or from the beneficiaries [Sec. 169]

14.5 REPRESENTATIVE ASSESSEE [SEC. 160]

Representative assessee means:

In respect of the income	Representative Assessee
(i) of a non-resident specified in Sec. 9(1)	Agent of the non-resident, including a person who is treated as an agent u/s 163
(ii) of a minor, lunatic or idiot	A guardian or manager who is entitled to receive or is in receipt of such income on behalf of such minor, lunatic or idiot.

(iii) which is received by - the Court of Wards; - the Administrator-General; - the Official Trustee; or - any receiver or manager, appointed by or under any order of a court on behalf of or for the benefit of any person.	Such – - Court of Wards; - Administrator-General; - Official Trustee; or - Receiver or Manager
(iv) which is received by trustee [appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise (including any valid wakf deed)] on behalf of or for the benefit of any person	Such trustee or trustees
(v) which is received receives or entitled to receive by trustee (appointed under an oral trust) on behalf of or for the benefit of any person	Such trustee or trustees

Taxpoint: Every representative assessee shall be deemed to be an assessee.

Liability of representative assessee [Sec. 161]

- Every representative assessee shall be subject to the same duties, responsibilities and liabilities as if the income were income received by or accruing to or in favour of him beneficially. Any assessment shall be deemed to be made upon him in his representative capacity only, and the tax shall be levied upon and recovered from him in like manner and to the same extent as it would be leviable upon & recoverable from the person represented by him.
- Where any person is, in respect of any income, assessable in the capacity of a representative assessee, he shall not, in respect of that income, be assessed under any other provision of this Act.
- Further see *Private Trust*

Right of representative assessee to recover tax paid [Sec. 162]

- Every representative assessee who, as such, pays any sum under this Act, shall be entitled to recover the sum so paid from the person on whose behalf it is paid, or to retain out of any moneys that may be in his possession or may come to him in his representative capacity, an amount equal to the sum so paid.
- Any representative assessee who apprehends that he may be assessed as a representative assessee, may retain out of any money payable by him to the person on whose behalf he is liable to pay tax (hereinafter in this section referred to as the principal), a sum equal to his estimated liability.
- In the event of any disagreement between the principal and such 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, and the certificate so obtained shall be his warrant for retaining that amount.
- The amount recoverable from such representative assessee at the time of final settlement shall not exceed the amount specified in such certificate, except to the extent to which such representative assessee may, at such time, have in his hands additional assets of the principal.

Direct assessment or recovery not barred [Sec. 166]

Nothing shall prevent either the direct assessment of the person on whose behalf or for whose benefit income therein referred to is receivable or the recovery from such person of the tax payable in respect of such income.

Remedies against property in cases of representative assessee [Sec. 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, and in as full and ample a manner, whether the demand is raised against the representative assessee or against the beneficiary direct.

14.6 EXCEPTIONS TO THE GENERAL RULE THAT INCOME OF A PREVIOUS YEAR IS TAXED IN ITS ASSESSMENT YEAR

Assessment of persons leaving India [Sec. 174]

- ◆ When it appears to the Assessing Officer that any individual may leave India during the current assessment year or shortly after its expiry **and** that he has no present intention of returning to India, the total income of such individual for the period from the expiry of the previous year for that assessment year up to the probable date of his departure from India shall be chargeable to tax in that assessment year.
- ◆ The total income of each completed previous year or part of any previous year included in such period shall be chargeable to tax at the rate or rates in force in that assessment year, and separate assessments shall be made in respect of each such 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 this Act.
- ◆ For the purpose of making an assessment, the Assessing Officer may serve a notice upon such individual requiring him to furnish, within such time, not being less than 7 days, as may be specified in the notice, a return in the same form and verified in the same manner as a return u/s 142(1)(i), setting forth his total income for each previous year and his estimated total income for any part of the previous year and the provisions of this Act shall, so far as may be, and subject to the provisions of this section, apply as if the notice were a notice issued u/s 142(1)(i).

Assessment of AOP or BOI or artificial juridical person formed for shorter period [Sec. 174A]

- ◆ Where it appears to the Assessing Officer that any AOP or BOI or an artificial juridical person, formed for a particular purpose is likely to be dissolved in the assessment year in which such AOP, etc. was formed or immediately after such assessment year, the total income of such association, etc. for the period from the expiry of the previous year for that assessment year up to the date of its dissolution shall be chargeable to tax in that assessment year.
- ◆ Proceedings (as given in sec. 174 in the case of persons leaving India) shall be applicable.

Assessment of persons likely to transfer property to avoid tax [Sec. 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 any liability under the provisions of this 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
- ◆ Proceedings (as given in sec. 174 in the case of persons leaving India) shall be applicable.

Discontinued business [Sec. 176]

- ◆ Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year for that assessment year up to the date of such discontinuance may, at the **discretion** of the Assessing Officer, be charged to tax in that assessment year.
- ◆ The total income of each completed previous year or part of any previous year included in such period shall be chargeable to tax at the rate or rates in force in that assessment year, and separate assessments shall be made in respect of each such completed previous year or part of any previous year.

- ♦ Any person discontinuing any business or profession shall give to the Assessing Officer notice of such discontinuance within 15 days thereof.
- ♦ Where any business is discontinued in any year, any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt, if such sum would have been included in the total income of the person who carried on the business had such sum been received before such discontinuance. [Sec. 176(3A)]
- ♦ Where any profession is discontinued in any year on account of the cessation of the profession by, or the retirement or death of, the person carrying on the profession, any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt, if such sum would have been included in the total income of the aforesaid person had it been received before such discontinuance. [Sec. 176(4)]
- ♦ Where an assessment is to be made under the provisions of this section, the Assessing Officer may serve on the person whose income is to be assessed or, in the case of a firm, on any person who was a partner of such firm at the time of its discontinuance or, in the case of a company, on the principal officer thereof, a notice containing all or any of the requirements which may be included in a notice u/s 142(1)(i) and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued u/s 142(1)(i).

Association dissolved or business discontinued [Sec. 177]

- ♦ Where any business or profession carried on by an association of persons has been discontinued or where an association of persons is dissolved, the Assessing Officer shall make an assessment of the total income of the association of persons as if no such discontinuance or dissolution had taken place, and all the provisions of this Act, including the provisions relating to the levy of a penalty or any other sum chargeable under any provision of this Act shall apply, so far as may be, to such assessment.
- ♦ If the Assessing Officer or the Commissioner (Appeals) in the course of any proceeding under this Act in respect of any such association of persons is satisfied that the association of persons was guilty of any of the acts specified in Chapter XXI (i.e., penalties), he may impose or direct the imposition of a penalty in accordance with the provisions of that Chapter.
- ♦ Every person who was at the time of such discontinuance or dissolution a member of the association of persons, and the legal representative of any such person who is deceased, shall be jointly and severally liable for the amount of tax, penalty or other sum payable, and all the provisions of this Act, so far as may be, shall apply to any such assessment or imposition of penalty or other sum.
- ♦ Where such discontinuance or dissolution takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against above persons from the stage at which the proceedings stood at the time of such discontinuance or dissolution, and all the provisions of this Act shall, so far as may be, apply accordingly.

14.7 COMPANY IN LIQUIDATION [SEC. 178]

- ♦ 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 the receiver of any assets of a company,(hereinafter referred to as the liquidator) shall, within 30 days after he has become such liquidator, give notice of his appointment as such to the Assessing Officer who is entitled to assess the income of the company.
- ♦ The Assessing Officer shall, after making such inquiries or calling for such information as he may deem fit, notify to the liquidator within 3 months from the date on which he receives notice of the appointment of the liquidator the amount which, in the opinion of the Assessing Officer, would be sufficient to provide for any tax which is then, or is likely thereafter to become, payable by the company.



- ◆ The liquidator:
 - a. shall not, without the leave of the Chief Commissioner or Commissioner, part with any of the assets of the company or the properties in his hands until he has been notified by the Assessing Officer (as above); and
 - b. on being so notified, shall set aside an amount equal to the amount notified and, until he so sets aside such amount, shall not part with any of the assets of the company or the properties in his hands.
- ▶ However, the liquidator can part with for:
 - 1. The purpose of the payment of the tax payable by the company or
 - 2. The purpose of making any payment to secured creditors whose debts are entitled under law to priority of payment over debts due to Government on the date of liquidation or
 - 3. The purpose of meeting such costs and expenses of the winding-up of the company as are in the opinion of the Chief Commissioner or Commissioner reasonable.
- ◆ If the liquidator fails to give the notice or fails to set aside such amount or parts with any of the assets of the company or the properties in his hands in contravention of above provisions, he shall be personally liable for the payment of the tax which the company would be liable to pay.
 - ▶ However, the personal liability of the liquidator shall be restricted to the notified amount.
- ◆ Where there are more liquidators than one, the obligations and liabilities attached to the liquidator under this section shall attach to all the liquidators jointly and severally.
- ◆ The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force except the provisions of the Insolvency and Bankruptcy Code, 2016.

Liability of directors of private company in liquidation [Sec. 179]

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 a director of the private company *at any time during the relevant previous year* shall be jointly and severally liable for the payment of such tax. However, no such director shall be 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.

Taxpoint: Tax Due includes penalty, interest or any other sum payable under the Act

14.8 MISCELLANEOUS PROVISIONS

Mode of taking or accepting certain loans, deposits and specified sum [Sec. 269SS]

No person shall take or accept from any other person (herein referred to as the depositor), any loan or deposit or any specified sum, otherwise than by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account, if:

- a) the amount of such loan or deposit or specified sum or the aggregate amount of such loan, deposit and specified sum; or
- b) on the date of taking or accepting such loan or deposit or specified sum, any loan or deposit or specified sum taken or accepted earlier by such person from the depositor is remaining unpaid (whether repayment has fallen due or not), the amount or the aggregate amount remaining unpaid; or

- c) the amount or the aggregate amount referred to in **(a)** together with the amount or the aggregate amount referred to in **(b)**,

is ₹ 20,000 or more.

Taxpoint

- ▶ Loan or deposit means loan or deposit of money.
- ▶ Specified sum means any sum of money receivable, whether as advance or otherwise, in relation to transfer of an immovable property, whether or not the transfer takes place.

Exception 1

The provisions shall not apply to any loan or deposit or specified sum taken or accepted from, or any loan or deposit or specified sum taken or accepted by:

- a. the Government;
- b. any banking company, post office savings bank or co-operative bank;
- c. any corporation established by a Central, State or Provincial Act;
- d. any Government company as defined in sec. 2(45) of the Companies Act, 2013;
- e. such other notified institution, association or body or class of institutions, associations or bodies.

Taxpoint: The reasons for notifying such institution, etc. should be recorded in writing

Exception 2

The provisions shall not apply to any loan or deposit or specified sum, where both, receiver and giver, are having agricultural income and neither of them has any income chargeable to tax

Penalty [Sec. 271D]

If a person takes or accepts any loan or deposit or specified sum in contravention of the provisions of sec. 269SS, he shall be liable to pay, by way of penalty, a sum equal to the amount of the loan or deposit or specified sum so taken or accepted. Such penalty shall be imposed by the Joint Commissioner.

Mode of undertaking transactions [Sec. 269ST]

No person shall receive an amount of ₹ 2,00,000 or more:

- 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,

otherwise than by an account payee cheque or an account payee bank draft or use of electronic clearing system through a bank account.

Exception

The provisions shall not apply to:

- i. any receipt by:
 - a) Government;
 - b) any banking company, post office savings bank or co-operative bank;
- ii. transactions of the nature referred to in sec. 269SS
- iii. such other persons or class of persons or receipts, which the Central Government may notify.



- ▶ The Central Government vide Notification No. 28/2017 dated 05-04-2017 & 57/2017 dated 03-07-2017 has specified following receipt on which the provision is not applicable:
 - a) 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;
 - b) 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
 - c) 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
 - d) receipt by a company or institution issuing credit cards against bills raised in respect of one or more credit cards;
 - e) receipt which is not includible in the total income u/s 10(17A)
 - f) receipt by any person from any banking company, post office savings bank or co-operative bank;

Clarification vide Circular No. 22/2017 dated 03-07-2017

In respect of receipt in the nature of repayment of loan by Non-Banking Financial Companies (NBFCs) and 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 sec. 269ST(b) and all the instalments paid for a loan shall not be aggregated for the purposes of determining applicability of the provisions sec. 269ST.

Penalty [Sec. 271DA]

If a person receives any sum in contravention of the provisions of sec. 269ST, he shall be liable to pay, by way of penalty, a sum 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.

Taxpoint: Such penalty shall be imposed by the Joint Commissioner.

Mode of repayment of certain loans or deposits [Sec. 269T]

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

- a. the amount of the loan or deposit or specified advance together with the interest, if any, payable thereon, or
- b. the aggregate amount of the loans or deposits held by such person with the branch of the banking company or co-operative bank or, as the case may be, the other company or co-operative society or the firm, or other person either in his own name or jointly with any other person on the date of such repayment together with the interest, if any, payable on such loans or deposits, or
- c. 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 the interest, if any, payable on such specified advances,
 - is ₹ 20,000 or more:

Taxpoint:

- ▶ **Loan or deposit means** any loan or deposit of money which is repayable after notice or repayable after a period and, in the case of a person other than a company, includes loan or deposit of any nature.
- ▶ **Specified advance** means 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.
- ▶ **Where the repayment is by a branch of a banking company or co-operative bank, such repayment may also be**

made by crediting the amount of such loan or deposit to the savings bank account or the current account (if any) with such branch of the person to whom such loan or deposit has to be repaid.

Exception

The provision of this section shall not apply to 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;
- v. such other notified institution, association or body or class of institutions, associations or bodies.

Taxpoint: The reasons for notifying such institution, etc. should be recorded in writing

Penalty [Sec. 271E]

If a person repays any loan or deposit or specified advance referred to in sec. 269T otherwise than in accordance with the provisions of that section, he shall be liable to pay, by way of penalty, a sum equal to the amount of the loan or deposit or specified advance so repaid.

Taxpoint: Such penalty shall be imposed by the Joint Commissioner.

Service of notice when family is disrupted or firm, etc., is dissolved [Sec. 283]

- ♦ After a finding of total partition has been recorded by the Assessing Officer u/s 171 in respect of any Hindu family, notices under this Act in respect of the income of the Hindu family shall be served on the person who was the last manager of the Hindu family, or, if such person is dead, then on all adults who were members of the Hindu family immediately before the partition.
- ♦ Where a firm or other association of persons is dissolved, notices under this Act in respect of the income of the firm or association may be served on any person who was a partner (not being a minor) or member of the association, as the case may be, immediately before its dissolution.

Service of notice in the case of discontinued business [Sec. 284]

Where an assessment is to be made u/s 176, the Assessing Officer may serve on the person whose income is to be assessed, or, in the case of a firm or an association of persons, on any person who was a member of such firm or association at the time of its discontinuance or, in the case of a company, on the principal officer thereof, a notice containing all or any of the requirements which may be included in a notice u/s 139(2), and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued under that section.

Submission of statement by a non-resident having liaison office [Sec. 285]

Every person, being a non-resident having a liaison office in India set up in accordance with the guidelines issued by the Reserve Bank of India under the Foreign Exchange Management Act, 1999, shall, in respect of its activities in a financial year, prepare and deliver to the Assessing Officer having jurisdiction, within 60 days from the end of such financial year, a statement in Form – 49C and containing such particulars as may be prescribed.

Furnishing of information or documents by an Indian concern in certain cases [Sec. 285A]

Where any share of, or interest in, a company or an entity registered or incorporated outside India derives, directly



or indirectly, its value substantially from the assets located in India, as referred to in *Explanation 5* to sec. 9(1)(i) and such company or, as the case may be, entity, holds, directly or indirectly, such assets in India through, or in, an Indian concern, then, such Indian concern shall, for the purposes of determination of any income accruing or arising in India u/s 9(1)(i), furnish within the prescribed period to the prescribed income-tax authority the information or documents, in such manner (Form – 49D), as may be prescribed

Submission of statements by producers of cinematograph films [Sec. 285B]

Any person carrying on the production of a cinematograph film during the whole or any part of any financial year shall, in respect of the period during which such production is carried on by him in such financial year, prepare and deliver to the Assessing Officer, within 30 days from the end of such financial year or within 30 days from the date of the completion of the production of the film, whichever is earlier, a statement in the prescribed form (Form 52A) containing particulars of all payments of over ₹ 50,000 in the aggregate made by him or due from him to each such person as is engaged by him in such production.

Publication of information respecting assessee in certain cases [Sec. 287]

- ♦ If the Central Government is of opinion that it is necessary or expedient in the public interest to publish the names of any assessee and any other particulars relating to any proceedings or prosecutions under this Act in respect of such assessee, it may cause to be published such names and particulars in such manner as it thinks fit.
- ♦ No publication under this section shall be made in relation to any penalty imposed under this Act until the time for presenting an appeal to the Commissioner (Appeals) has expired without an appeal having been presented or 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 the members of the association, as the case may be, may also be published if, in the opinion of the Central Government, the circumstances of the case justify it.

Appearance by registered valuer in certain matters [Sec. 287A]

Any assessee who is entitled 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 when required u/s 131 to attend personally for examination on oath or affirmation, may attend by a registered valuer.

Appearance by authorised representative [Sec. 288]

Any assessee who is entitled or required to attend before any income-tax authority or the Appellate Tribunal in connection with any proceeding under this Act otherwise than when required u/s 131 to attend personally for examination on oath or affirmation, may, subject to the other provisions of this section, attend by an authorised representative.

- Authorised representative means a person authorised by the assessee in writing to appear on his behalf, being:
- i. a person related to the assessee in any manner, or a person regularly employed by the assessee; or
 - ii. any officer of a Scheduled Bank with which the assessee maintains a current account or has other regular dealings; or
 - iii. any legal practitioner who is entitled to practise in any civil court in India; or
 - iv. an accountant; or
 - v. any person who has passed any accountancy examination recognised in this behalf by the Board; or
- The following accountancy examinations are recognised [Rule 50]:



- a. 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.
 - b. Government Diploma in Company Secretaryship awarded by the Department of Company Affairs, under the Ministry of Industrial Development and Company Affairs, New Delhi.
 - c. Final Examination of the Institute of Company Secretaries of India, New Delhi.
 - d. The Final Examination of the Institute of Cost and Works Accountants of India constituted under the Cost and Works Accountants Act, 1959
 - e. The Departmental Examinations conducted by or on behalf of the Central Board of Direct Taxes for Assessing Officers, Class I or Group 'A', Probationers, or for Assessing Officers, Class II or Group 'B', Probationers, or for promotion to the post of Assessing Officers, Class II or Group 'B', as the case may be.
 - f. The Revenue Audit Examination for Section Officers conducted by the Office of the Comptroller and Auditor General of India.]
- vi. any person who has acquired such educational qualifications as the Board may prescribe for this purpose; or
- A degree in Commerce or Law conferred by any of the following Universities are prescribed as educational qualifications [Rule 51]:
- a. Any Indian University
 - b. Rangoon University.
 - c. **English and Welsh Universities:** The Universities of Birmingham, Bristol, Cambridge, Durham, Leeds, Liverpool, London, Manchester, Oxford, Reading, Sheffield and Wales.
 - d. **Scottish Universities:** The Universities of Aberdeen, Edinburgh, Glasgow and St. Andrews.
 - e. **Irish Universities:** The Universities of Dublin (Trinity College), the Queen's University, Belfast and the National University of Dublin.
 - f. Any Pakistan University incorporated by any law for the time being in force.
- 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 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.
- **Accountant** means a chartered accountant as defined in the Chartered Accountants Act, 1949 who holds a valid certificate of practice, but does not include [except for the purposes of representing the assessee]:
- a. in case of an assessee, being a company, the person who is not eligible for appointment as an auditor of the said company in accordance with the provisions of sec. 141(3) of the Companies Act, 2013; or
 - b. in any other case:
 - i. the assessee himself or in case of the assessee, being a firm or association of persons or Hindu undivided family, any partner of the firm, or member of the association or the family;
 - ii. in case of the assessee, being a trust or institution, any person referred to in sec. 13(3)(a), (b), (c) and (cc);
 - iii. the person who is competent to verify the return u/s 139 in accordance with the provisions of sec. 140;
 - iv. any relative of any of aforesaid persons;
 - v. an officer or employee of the assessee;
 - vi. an individual who is a partner, or who is in the employment, of an officer or employee of the assessee;
 - vii. an individual who, or his relative or partner:



- I. is holding any security of, or interest in, the assessee
 - The relative may hold security or interest in the assessee of the face value not exceeding ₹ 1,00,000
- II. is indebted to the assessee
 - ▶ The relative may be indebted to the assessee for an amount not exceeding ₹ 1,00,000;
- III. has given a guarantee or provided any security in connection with the indebtedness of any third person to the assessee.
 - ▶ 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 ₹ 1,00,000;
- viii. a person who, whether directly or indirectly, has business relationship with the assessee of such nature as may be prescribed;
 - **Business relationship** shall be construed as any transaction entered into for a commercial purpose, other than,:
 - a) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
 - b) commercial transactions which are in the ordinary course of business of the company at arm's length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses – [Rule 51A]
- ix. 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.

- ▶ No person shall be qualified to represent an assessee:

Person, who has been	Disqualification for
Dismissed or removed from Government service after 01-04-1938	All times
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 u/s 271(1)(ii) or 272A(1)(d)	Such time as the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may by order determine
An insolvent	The period during which the insolvency continues
Convicted by a court for an offence involving fraud	A period of 10 years from the date of conviction

- ▶ If any person who is a legal practitioner or an accountant is found guilty of misconduct in:
 - a. 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 practise as a legal practitioner or accountant, as the case may be;
 - b. connection with any income-tax proceedings by the Chief Commissioner or Commissioner having requisite jurisdiction may direct that he shall thenceforth be disqualified to represent an assessee
- ▶ Such order or direction shall be subject to the following conditions:
 - 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 1 month of the making of the order or direction, appeal to the Board to have the order or direction cancelled; and

- c. no such order or direction shall take effect until the expiration of 1 month from the making thereof, or, where an appeal has been preferred, until the disposal of the appeal.

► **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) to (e);
- g. any lineal descendant of a brother or sister of either the individual or the spouse of the individual.



STUDY NOTE : 15

INCOME COMPUTATION & DISCLOSURE STANDARDS



.... for the purposes of ascertaining profits and gains, the ordinary principles of commercial accounting should be applied, so long as they do not conflict with any express provision of the relevant statutes.

Croom-Johnson, J

Commissioners of Inland Revenue -vs.- Cock, Russell & Co. Ltd.

This Study Note includes:

- 15.1 Income Computation & Disclosure Standards
- 15.2 ICDS
- 15.3 ICDS I: Accounting Policies
- 15.4 ICDS II: Valuation of Inventories
- 15.5 ICDS III: Construction Contracts
- 15.6 ICDS IV: Revenue Recognition
- 15.7 ICDS V: Tangible Fixed Assets
- 15.8 ICDS VI: Effects of Changes in Foreign Exchange Rates
- 15.9 ICDS VII: Government Grants
- 15.10 ICDS VIII: Securities
- 15.11 ICDS IX: Borrowing Costs
- 15.12 ICDS X: Provisions, Contingent Liabilities and Contingent Assets
- 15.13 Method of accounting in certain cases [Sec. 145A]
- 15.14 Taxation of foreign exchange fluctuation [Sec. 43AA]
- 15.15 Loss as per ICDS [Sec. 36(1)(xviii)]
- 15.16 Computation of income from construction and service contracts [Sec. 43CB]

15.1 INCOME COMPUTATION & DISCLOSURE STANDARDS

In exercise of the powers conferred by sec. 145(2), the Central Government has notified (vide Notification No. 87/2016 dated 29-09-2016) the income computation and disclosure standards (ICDS). The rationale behind issuing ICDS is to lessen the uncertainty of alternative accounting treatment due to flexibility offered by Accounting Standards (AS) & also to reduce litigation that crops up when the stand taken by income-tax authorities is not in alignment with the AS

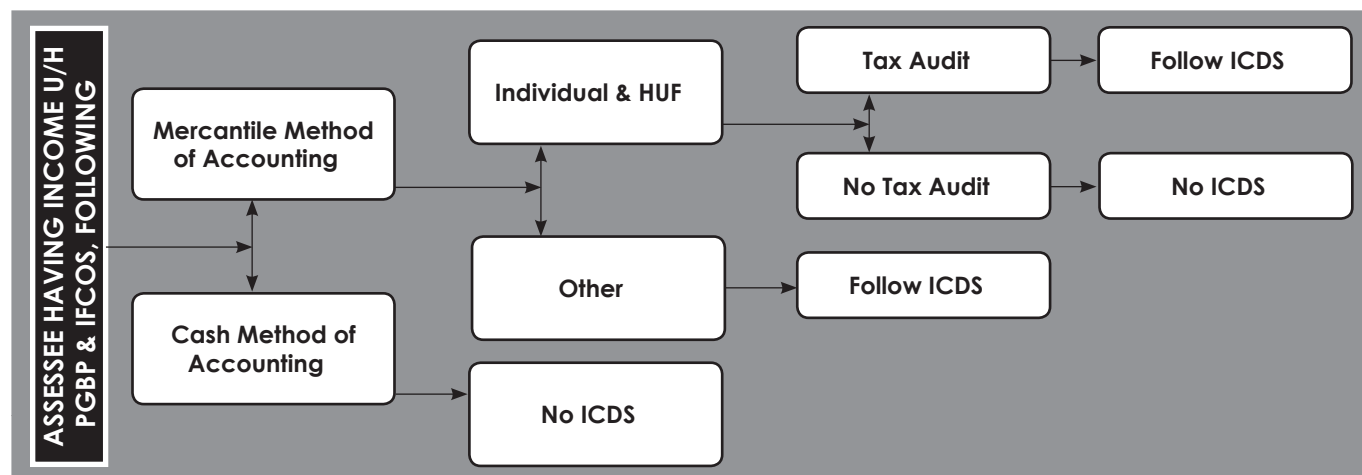
Applicability

The standards are required to be followed:

- by all assessee (other than an individual or a Hindu undivided family who is not required to get his accounts of the previous year audited u/s 44AB)
- who follows the mercantile system of accounting,
- for the purposes of computation of income chargeable to income-tax under the head "Profits and gains of business or profession" or "Income from other sources".

Taxpoint

- The standards are not for the purpose of maintenance of books of account. The standards are for computation of income under aforesaid heads of income only.
- In case of conflict between the provision of the Income-tax Act and ICDS, the provision of the Act shall prevail to that extent.



15.2 ICDS

Following ICDS have been notified:

ICDS	Name of the ICDS	Corresponding	
		AS	Ind-AS
ICDS I	Accounting Policies	1	1 & 8
ICDS II	Valuation of Inventories	2	2
ICDS III	Construction Contracts	7	11
ICDS IV	Revenue Recognition	9	18
ICDS V	Tangible Fixed Assets	10	16
ICDS VI	Effects of change in Foreign Exchange Rates	11	21
ICDS VII	Government Grants	12	20
ICDS VIII	Securities	13	32
ICDS IX	Borrowing Costs	16	23
ICDS X	Contingent Assets	29	37

15.3 ICDS I: ACCOUNTING POLICIES

Accounting Policies

- ◆ 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.

Taxpoint: accounting policies should be such that discloses 'true and fair view' and not —'true and correct'.

- ♦ The treatment and presentation of transactions and events shall be governed by their substance and not merely by the legal form.
- ♦ 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.

Fundamental Accounting Assumptions

- ♦ The fundamental accounting assumptions i.e., Going Concern, Consistency and Accrual are assumed as followed. No specific disclosure is required, if these assumptions are followed, however, if such assumption are not followed, the fact shall be disclosed.

Taxpoint: ICDS does not recognize materiality as an accounting policy

Change in Accounting Policies

- ♦ An accounting policy shall not be changed without reasonable cause.

Taxpoint: The word 'reasonable cause' is not defined in the ICDS

Disclosure of Accounting Policies

- ♦ All significant accounting policies adopted by a person shall be disclosed.
- ♦ Any change in an accounting policy which has a material effect shall be disclosed (with quantum of the effect, if ascertainable). Where such amount is not ascertainable, the fact shall be indicated.
- ♦ Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item.

Comparative study of ICDS with respective AS

Basis of difference	AS 1	ICDS I
Concept of Prudence	Provision is made for all known liabilities and losses on best estimate basis	Marked to market (MTM) loss or an expected loss shall not be recognised unless permitted by any other ICDS
	Anticipated profits are not recognized	ICDS silent on recognition of anticipated profits
Materiality	Materiality should be considered while selecting and applying accounting policy	Concept of Materiality not recognized in ICDS
Change in accounting policy	Change in accounting policy permitted if (a) required by statute; (b) required for compliance of AS; (c) change results in more appropriate presentation of financial statements	Accounting policies shall not be changed without a "reasonable cause"
Disclosure of change in accounting policy	Required in period of change, if impact is not material in current period but material in later periods	Required in period of change and also required in first year in which change has material effect, if impact is not material in current period but material in later periods.



15.4 ICDS II: VALUATION OF INVENTORIES

Scope

- ◆ This Standard shall be applied for valuation of inventories, except
 - i. Work-in-progress arising under 'construction contract'
 - ii. Work-in-progress which is dealt with by other Standard
 - iii. Shares, debentures and other financial instruments held as stock-in-trade¹
 - iv. Producers' inventories of livestock, agriculture and forest products, mineral oils, ores and gases to the extent that they are measured at net realisable value
 - v. Machinery spares, which can be used only in connection with a tangible fixed asset and their use is expected to be irregular²

Measurement

- ◆ Inventories shall be valued at cost, or net realisable value, whichever is lower.
 - *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.
 - 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. The provision is contrary to law settled by the Apex court in the case of Sakti Trading Co.

Cost of Inventories

- ◆ 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.
 - 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
 - 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.
 - 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.
 - **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.
 - 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.
 - In determining the cost of inventories, the following costs shall be excluded
 - 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;

¹ Refer ICDS on Securities

² Refer ICDS on Tangible Fixed Assets

- c. Administrative overheads that do not contribute to bringing the inventories to their present location and condition;
- d. Selling costs.

Cost Formulae

- ♦ The standard recognizes 3 cost formulae viz. (i) Specific Identification Method; (ii) First-in-First-Out Method (FIFO); (iii) Weighted Average Method

Change of Method of Valuation of Inventory

- ♦ The method of valuation of inventories once adopted by a person in any previous year shall not be changed without reasonable cause

Disclosure

- ♦ Following shall be disclosed:
 - a. the accounting policies adopted in measuring inventories including the cost formulae used; and
 - b. the total carrying amount of inventories and its classification appropriate to a person.

Comparative study of ICDS with respective AS

Basis of difference	AS 2	ICDS II
Valuation of service inventory	No specific provision	NA
Opening inventory	No specific provision	→ Value of opening inventory of a business shall be the same as the value of inventory at the end of the immediately preceding financial year → In case of commencement of business, Cost of inventory on the day of commencement of business will be opening inventory
Change in method of inventory valuation	Change permitted if (a) required by statute; (b) required for compliance of AS; (c) change results in more appropriate presentation of financial statements	Method of valuation once adopted shall not be changed without "reasonable cause"
Inventory valuation in case of certain dissolutions	No specific provision	In case of partnership firm, AOP or BOI inventory on the date of dissolution shall be valued at NRV, whether or not business is discontinued

15.5 ICDS III: CONSTRUCTION CONTRACTS

Scope

- ♦ The Standard should be applied in determination of income for a construction contract of a contractor.



- **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.
- ◆ Construction contracts are formulated in a number of ways which are classified as fixed price contracts and cost plus contracts.
 - **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.
 - **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.

Contract Revenue

- ◆ Contract revenue shall be recognised when there is reasonable certainty of its ultimate collection.
- ◆ Contract revenue shall comprise of:
 - a) the initial amount of revenue agreed in the contract, including retentions; and
 - **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.
 - **Progress billings** are amounts billed for work performed on a contract whether or not they have been paid by the customer.
 - 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.

Contract Costs

- ◆ 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 ICDS 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.
- ◆ 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.

Recognition of Contract Revenue and Expenses

- ◆ 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.
- ◆ 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.

Changes in Estimates

- ◆ 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.

Disclosure

- ◆ 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.
- ◆ A person shall disclose the following for contracts in progress at the reporting date:
 - 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.

Comparative study of ICDS with respective AS

Basis of difference	AS 7	ICDS III
Recognition of contract revenue	Contract revenue is required to be recognized if it is possible to reliably measure the outcome of a contract	- The criteria of 'reliable measurement of outcome of contract' omitted - Recognized as per provision of ICDS – III
Retention money	Silent on treatment of accrual of income	Retention money is required to be considered as part of contract revenue and revenue to be recognized on POCM basis
Allowability of losses including probable / expected loss	Losses fully allowable irrespective of commencement, stage of completion and expected profits from other independent contracts	- Losses not allowable unless actually incurred and only on POCM basis - ICDS on accounting policies also does not permit recognition of foreseeable loss
Contract Work in progress recognition	Contract cost which relates to future activity shall be recognized as an asset only if recoverability is probable	Contract cost is to be recognized as an asset
Early stage of contract – Non- recognition of revenue	- Revenue is to be recognized only to the extent of recoverable costs - No profit is to be recognized during early stages of contract	Same as AS, however ICDS objectively defines early stage as not to exceed beyond 25%
Pre- construction incidental income	Contract cost may be reduced by any incidental income that is not included in contract revenue	Contract cost shall be reduced by any incidental income (except interest, dividend and capital gains) that is not included in contract revenue



15.6 ICDS IV: REVENUE RECOGNITION

Scope

- ♦ The Standard deals with the bases for recognition of revenue arising in the course of the ordinary activities of a person from:
 - a) the sale of goods;
 - b) the rendering of services;
 - c) the use by others of the person's resources yielding interest, royalties or dividends.
 - 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.
 - The Standard does not deal with the aspects of revenue recognition which are dealt with by other ICDS.

Sale of Goods

- ♦ Revenue from sales transactions should be recognized when the following conditions are fulfilled -
 - a) 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;
 - b) The seller retains no effective control of the goods transferred to a degree usually associated with ownership;
 - c) There is reasonable certainty of its ultimate collection.

Rendering of Services

- ♦ 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.
- ♦ 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.
- ♦ Revenue from service contracts with duration of not more than 90 days may be recognised when the rendering of services under that contract is completed or substantially completed.

Interest

- ♦ Interest shall accrue on the time basis determined by the amount outstanding and the rate applicable.
- ♦ 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.
- ♦ Discount or premium on debt securities held is treated as though it were accruing over the period to maturity.

Royalty

- ♦ 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.

Dividend

- ♦ Dividends are recognised in accordance with the provisions of the Act

Disclosure

- ♦ Following disclosures shall be made in respect of revenue recognition:
 - a) in a transaction involving sale of goods, 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.

Comparative study of ICDS with respective AS

Basis of difference	AS 9	ICDS IV
Postponement of revenue recognition	Revenue recognition to be postponed if significant uncertainty exists on measurability and collectability of revenue from sale of goods, rendering of services, interest, royalties and dividends	Revenue to be recognized only if there is reasonable certainty of its ultimate collection from sale of goods and rendering of services
Method of revenue recognition for service contracts	- Proportionate completion method or - Completed service contract method	- Mandatory to recognize revenue based on Percentage completion method - ICDS requires application of ICDS III on Construction contracts for recognition of such revenue on mutatis mutandis basis
Disclosure requirement	Disclose circumstances in which revenue recognition has been postponed pending significant uncertainties.	Disclosures for amounts not recognized as revenue due to lack of reasonable certainty of its ultimate collection along with nature of uncertainty

15.7 ICDS V: TANGIBLE FIXED ASSETS

Scope

- ♦ This Income Computation and Disclosure Standard deals with the treatment of tangible fixed assets.
 - **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.
 - 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

- ◆ 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.
- ◆ The cost of a tangible fixed asset may undergo changes subsequent to its acquisition or construction on account of:
 - a. price adjustment, changes in duties or similar factors; or
 - b. exchange fluctuation as specified in ICDS on the effects of changes in foreign exchange rates.
- ◆ 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.
- ◆ The expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, shall be capitalised.

Self-constructed Tangible Fixed Assets

- ◆ In arriving at the actual cost of self-constructed tangible fixed assets, the same principles shall be followed.
- ◆ 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

- ◆ 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.
 - **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
- ◆ 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

- ◆ An Expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is added to the actual cost.
- ◆ 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

- ◆ 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.
- ◆ Where several assets are purchased for a consolidated price, the consideration shall be apportioned to the various assets on a fair basis.

Comparative study of ICDS with respective AS

Basis of difference	AS 10	ICDS V
Applicability	Fixed assets such as land, building, plant and machinery, vehicles, furniture and fittings, goodwill, patents, trademarks and designs, royalties and dividends	Tangible fixed assets being land, building, machinery, plant or furniture
Component of cost	'Cost' of fixed asset comprises its purchase price, non-refundable taxes and any directly attributable cost of bringing the asset to its working condition for its intended use. Trade discount and rebates will be deducted while computing cost.	It has similar definition to AS 10 but words used are 'actual cost' as compared to 'cost' in AS 10
Stand-by equipment and servicing equipment	AS acknowledges capitalization of stand-by equipment and servicing equipment as a normal practice but does not mandate it.	ICDS 'mandates' capitalization of stand-by equipment and servicing equipment
Machinery spares	- It is 'usually' charged to P&L a/c on consumption. - However, if spares are used only in connection with the item of fixed asset with irregular use then it 'may' be appropriate to capitalize	- It 'shall' be charged to P&L a/c on consumption - However, if spares are used only in connection with the item of fixed asset with irregular use then it 'shall' be capitalized
Asset acquired against non-monetary consideration	In case of acquisition of fixed asset in exchange for another asset, shares or other securities issued, cost of asset acquired should be recorded either at (a) fair market value of asset given up/shares or securities issued or (b) fair market value of asset acquired, whichever is more clearly evident	In case of acquisition of a tangible fixed asset in exchange for another asset, shares or other securities issued, actual cost of the tangible fixed asset shall be recorded at fair value of tangible fixed asset acquired
Assets acquired for consolidated price	Consolidated price to be apportioned to various assets on a fair basis as determined by competent valuers	Consolidated price shall be apportioned to various assets on a fair basis
Disclosure requirement	Gross and net book values at beginning and end of year showing additions, deletions and other movements, expenditure incurred in course of construction and revalued amount, if any	Description of assets/block of assets, depreciation rate and allowable depreciation, actual cost / opening WDV and closing WDV showing additions or deduction including adjustment for CENVAT, exchange difference and subsidy, grant or reimbursement

15.8 ICDS VI: EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES**Scope**

- ♦ The Standard deals with:
 - a. treatment of transactions in foreign currencies;



- b. translating the financial statements of foreign operations;
 - **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
- c. treatment of foreign currency transactions in the nature of forward exchange contracts.
 - **Foreign currency transaction** is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when a person:
 - a) buys or sells goods or services whose price is denominated in a foreign currency; or
 - b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
 - c) becomes a party to an unperformed forward exchange contract; or
 - d) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.
 - **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.

Initial Recognition

- ◆ 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.
- ◆ 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

- ◆ At last day of each previous year:
 - a. foreign currency monetary items shall be converted into reporting currency by applying the closing rate;
 - **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;
 - b. non-monetary items in a foreign currency shall be converted into reporting currency by using the exchange rate at the date of the transaction.
 - **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;
 - c. 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.

Forward Exchange Contracts

- ◆ 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.
- ◆ 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.

Comparative study of ICDS with respective AS

Basis of difference	AS 11	ICDS VI
Revenue monetary items (like trade receivables, payables)	- Converted into reporting currency by applying the closing rate - Exchange difference recognized in P&L a/c	- Converted into reporting currency by applying the closing rate - Exchange difference recognized as income or expense subject to provisions of Rule 115
Revenue non-monetary items (e.g. Inventory)	If item is carried at historical cost: Reported at the exchange rate on the date of transaction If item is carried at fair value: Reported at the exchange rate that existed when the value was determined	Converted into reporting currency using the exchange rate at the date of the transaction
Capital monetary items relating to imported assets and domestic assets	Requires recognition in P&L A/c	- Requires recognition as income or expense subject to provisions of sec. 43A - No distinction recognized between capital and revenue items
Foreign operations	Foreign operation is a subsidiary, associate, joint venture or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise	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
Integral foreign operation	- Same principles as for own assets and liabilities - Exchange differences are recognized in P&L A/c	- Subject to sec. 43A and Rule 115, similar to AS 11 - No distinction recognized between capital and revenue items
Non-integral foreign operations	- All assets & liabilities and income & expense items are translated at closing rates - Exchange differences are accumulated in Foreign Currency Translation Reserve (FCTR) A/c and to be taken to P&L a/c on disposal of non-integral foreign operations	- Similar to AS 11 except that, (subject to sec. 43A & Rule 115) resulting exchange differences are to be recognized as income or expense instead of accumulation in FCTR A/c - No distinction recognized between capital and revenue items
Forex derivatives for hedging purpose (Capital and revenue a/c)	- Premium/discount is amortized over life of contract - Restated on MTM basis at year end and difference is recognized in P&L - Profit/ loss on cancellation or renewal is also recognized in P&L	- Same as AS without distinguishing between contracts on capital account and revenue account (subject to sec. 43A applicable to imported assets)



Forex derivative for trading / speculation purposes / firm commitments /highly probable forecast transactions	- Forward contract is restated at year end on mark to market basis and difference is recognized in P&L - No amortization of premium/discount	- Premium, discount or exchange difference shall be recognized at the time of settlement - No distinction recognized between contracts on capital account and revenue account
Forex derivatives not covered by ICDS VI (futures, interest rate swaps, etc)	- Not covered by AS 11 being a derivative contract covered by AS 30, 31 & 32 which are yet to be notified under Companies Act 2013 - Currently ICAI Guidance Note requires recognition of loss on MTM basis but gain to be ignored	- Forex derivatives not covered by ICDS VI. - ICDS I on accounting policies provides that MTM loss or an expected loss shall not be recognized unless permitted under other ICDS.

15.9 ICDS VII: GOVERNMENT GRANTS

Scope

- The 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. but does not include Government participation in the ownership of the enterprise
 - Government** refers to the Central Government, State Governments, agencies and similar bodies, whether local, national or international.
 - 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.

Recognition of Government Grants

- 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.
- Recognition of Government grant shall not be postponed beyond the date of actual receipt.

Treatment of Government Grants

Grant Relates to	Treatment
Depreciable fixed asset	The grant shall be deducted from the actual cost of the asset or from the written down value of block of assets
Non-depreciable asset 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

Not directly relatable to the asset acquired	Proportionate amount shall be deducted from the actual cost of the assets or shall be reduced from the written down value of block of assets to which the assets belonged to.
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	The grant shall be recognised as income of the period in which it is receivable
In other case	Grants shall be recognised as income over the periods necessary to match them with the related costs which they are intended to compensate

- ◆ 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

- ◆ The amount refundable in respect of a Government grant 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.
- ◆ The amount refundable in respect of a Government grant related to a depreciable fixed asset 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.

Disclosure

- ◆ Following disclosure shall be made in respect of Government grants:
 - 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;
 - nature and extent of Government grants recognised during the previous year as income;
 - 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
 - nature and extent of Government grants not recognised during the previous year as income and reasons thereof.

Comparative study of ICDS with respective AS

Basis of difference	AS 12	ICDS VII
Recognition of grant	– On reasonable assurance of compliance of attached conditions and reasonable certainty of ultimate collection – Mere receipt of grant is not sufficient	– On reasonable assurance of compliance of attached conditions and reasonable certainty of ultimate collection – Recognition cannot be postponed beyond date of actual receipt



Grant in the nature of promoter's contribution	To be credited to capital reserve and to be treated as shareholders' funds	ICDS is silent on this category
Grants relatable to depreciable fixed assets	To be reduced from cost or recognized as deferred revenue by systematic credit to P&L A/c	To be reduced from cost of fixed asset [in line with Explanation 10 to sec. 43(1)]
Relatable to non-depreciable fixed assets	- To be credited as capital reserve, if no conditions attached to the grant - To be credited to P&L A/c over period of incurring cost of meeting conditions of grant	- To be considered as income on an upfront basis, if there are no conditions attached to grant - To be treated as income over period over which cost of meeting conditions is incurred
Grants other than those covered above	Revenue grant to be credited as income or reduced from related expense	Grant to be treated as income over period over which cost of meeting conditions is incurred.
Compensation for expenses/ loss incurred or for giving immediate financial support	To be recognized as income in the year in which it is receivable	To be recognized as income in the year in which it is receivable
Disclosure requirement	Accounting policy adopted for grants including the method of presentation, extent of recognition in the financial statements, accounting of non-monetary assets given at concession/ free of cost	Requires disclosure of nature and extent of recognized as well as unrecognized grants. It also requires disclosure of reasons for non-recognition.

15.10 ICDS VIII: SECURITIES

Scope

- ♦ This part of the Standard deals with securities held as stock-in-trade. However, this part of the Standard does not deal with:
 - the bases for recognition of interest and dividends on securities;
 - securities held by a person engaged in the business of insurance;
 - 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 or the Companies Act, 2013
- ♦ *Securities* shall have the meaning assigned to it in sec. 2(h) of the Securities Contracts (Regulation) Act, 1956 and shall include share of a company in which public are not substantially interested but shall not include derivatives.

Recognition and Initial Measurement of Securities

- ♦ A security on acquisition shall be recognised at actual cost i.e., its purchase price + acquisition charges such as brokerage, fees, tax, duty or cess.
- ♦ Where a security is acquired in exchange for other securities or other asset, the fair value of the security so acquired shall be its actual cost.
 - *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.

- 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

- 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.
- The comparison of actual cost initially recognised and net realisable value shall be done categorywise (viz., shares; debt securities; convertible securities; and any other securities) and not for each individual security.
- Securities not listed on a recognised stock exchange or listed but not quoted on a recognised stock exchange shall be valued at actual cost initially recognised.

Comparative study of ICDS with respective AS

Basis of difference	AS 13	ICDS VIII
Applicability	- AS applicable to accounting for investments - AS clarifies that principles applicable to 'current investments' can apply to securities held as stock-in-trade	ICDS is applicable to securities held as stock-in-trade
Security acquired against non-monetary consideration	In case of acquisition of securities in exchange for shares or other securities issued or another asset, cost of security acquired should be recorded either at (a) fair market value of securities issued or (b) fair market value of asset given up, whichever is more clearly evident	In case of acquisition of securities in exchange for other securities issued or another asset, actual cost of security acquired shall be recorded at fair value of security acquired
Year-end valuation of securities	Current investments to be valued at lower of cost or fair value either on individual investment basis or by category of investment but not on global basis.	- Securities should be valued at lower of cost or NRV. Comparison of cost and NRV shall be done category-wise. - Securities are classified under following categories (a) shares; (b) debt; (c) convertible securities; and (d) other securities
Opening value of securities	No specific provision	- Value of opening inventory of securities shall be the same as the value of securities at the end of the immediately preceding financial year - In case of commencement of business, Cost of security on the day of commencement of business will be opening value
Valuation of unlisted or thinly traded securities	No specific provision	Valuation of unlisted or thinly traded securities shall be valued at actual cost initially recognized



Ascertainment of cost	Cost formulae are the same as those specified in AS 2 (e.g. FIFO; average cost, etc.)	Cost which cannot be ascertained by specific identification shall be determined on the basis of FIFO method or weighted average formula.

15.11 ICDS IX: BORROWING COSTS

Scope

- ♦ The Standard deals with treatment of borrowing costs. However, the Standard does not deal with the actual or imputed cost of owners' equity and preference share capital.
 - *Borrowing costs* are interest and other costs incurred by a person in connection with the borrowing of funds and include:
 - a) commitment charges on borrowings;
 - b) amortised amount of discounts or premiums relating to borrowings;
 - c) amortised amount of ancillary costs incurred in connection with the arrangement of borrowings;
 - d) finance charges in respect of assets acquired under finance leases or under other similar arrangements.

Recognition

- ♦ 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.
 - *Qualifying asset* means:
 - a. land, building, machinery, plant or furniture, being tangible assets;
 - b. know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;
 - c. inventories that require a period of 12 months or more to bring them to a saleable condition.

Borrowing Costs Eligible for Capitalisation

- ♦ **Specific Borrowing:** 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.
- ♦ **Other than specific borrowing:** The amount of borrowing costs to be capitalised shall be computed in accordance with this formula: $A \times B / C$
 - A** Borrowing costs incurred during the previous year except on specific borrowings
 - 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

Commencement of Capitalisation

- ♦ The capitalisation of borrowing costs shall commence
 - In case of specific borrowing : from the date on which funds were borrowed
 - In case of other borrowing : from the date on which funds were utilised

Cessation of Capitalisation

- ♦ Capitalisation of borrowing costs shall cease:
 - In case of asset other than inventory When such asset is first put to use
 - In case of inventory When substantially all the activities necessary to prepare such inventory for its intended sale are complete.

Disclosure

- ♦ 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.

Comparative study of ICDS with respective AS

Basis of difference	AS 16	ICDS IX
Borrowing cost	Borrowing cost includes exchange difference to the extent that they are regarded as an adjustment to interest costs	Borrowing cost does not include exchange differences arising from foreign currency borrowings
Qualifying assets	Qualifying asset defined to be an asset which necessarily takes a substantial period of time to get ready for its intended use or sale	Qualifying assets means – Inventory that require a period of 12 months or more to bring them to a saleable condition – Specified tangible and intangible assets are qualifying assets (regardless of substantial period condition)
Commencement and cessation of capitalization	Capitalisation will commence when all the three conditions are satisfied (a) incurrence of capital expenditure (b) incurrence of borrowing cost (c) construction activity is in progress and cessation from the date when asset is ready to use	<i>In case of specific borrowing:</i> Capitalization will commence from date of borrowing of funds and cessation from the date when asset is put to use <i>In case of general borrowing</i> Capitalization will commence from date of utilization of funds and cessation from the date when asset is put to use



Methodology of capitalization	<i>In case of specific borrowing:</i> Directly attributable to borrowing cost <i>In case of general borrowing:</i> Weighted average cost of borrowing applied to capital expenditure	<i>In case of specific borrowing:</i> Directly attributable to borrowing cost <i>In case of general borrowing:</i> Prorate borrowing cost allocation as per normative formulae
Income from temporary deployment of funds	Income from temporary deployment of unutilised funds from specific loans to be reduced from borrowing cost	No similar provision in ICDS
Suspension of capitalization	Capitalization of borrowing costs should be suspended during extended periods in which active development is interrupted	No similar provision in ICDS

15.12 ICDS X: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Scope

- ♦ The 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 ICDS.
- **Provision** is a liability which can be measured only by using a substantial degree of estimation.
- **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.
- **Obligating event** is an event that creates an obligation that results in a person having no realistic alternative to settling that obligation.
- **Contingent liability** is:
 - a. a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the person; or
 - b. 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.
- **Contingent asset** is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the person.
- **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.
- **Present obligation** is an obligation if, based on the evidence available, its existence at the end of the previous year is considered reasonably certain.

Recognition

Provisions

- ♦ 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.
- ♦ No provision shall be recognised for costs that need to be incurred to operate in the future. 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.

Contingent Liabilities

- ♦ A person shall not recognise a contingent liability.

Contingent Assets

- ♦ A person shall not recognise a contingent asset. 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

- ♦ 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.

Reimbursements

- ♦ 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.
- ♦ 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.
- ♦ 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

- ♦ 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.

Use of Provisions

- ♦ A provision shall be used only for expenditures for which the provision was originally recognised.

**Disclosure**

- ◆ Following disclosure shall be made in respect of each class of provision:
 - 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.

Comparative study of ICDS with respective AS

Basis of difference	AS 29	ICDS X
Onerous executory contracts	– Includes onerous executory contracts within its scope – Upfront recognition of liabilities required under onerous contracts	Onerous executory contracts excluded from the scope of ICDS
Recognition of provision	Provision shall be recognized when it is "probable" that an outflow of economic resources will be required to settle an obligation	Provision shall be recognized when it is "reasonably certain" that an outflow of economic resources will be required to settle an obligation
Recognition of reimbursement claims	Reimbursement claims are recognized when the realization of related income is "virtually certain"	Reimbursement claims are recognized when the realization of related income is "reasonably certain"
Meaning of obligation	Clarifies that obligations may be legally enforceable and may also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.	No specific guidance on meaning of 'obligation'

Clarifications Issued by CBDT [Circular 10/2017 dated 23-03-2017]**Question 1**

Preamble of ICDS-I states that this ICDS 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 purposes of maintenance of books of accounts. However, Para 1 of ICDS I states that it deals with significant accounting policies. Accounting policies are applied for maintenance of books of accounts and preparing financial statements. What is the interplay between ICDS-I and maintenance of books of accounts?

Answer

As stated in the Preamble, ICDS is not meant for maintenance of books of accounts or preparing financial statements. Persons are required to maintain books of accounts and prepare financial statements as per accounting policies applicable to them. For example, companies are required to maintain books of account and prepare financial statements as per requirements of Companies Act 2013. The accounting policies mentioned in ICDS-I being

fundamental in nature shall be applicable for computing income under the heads "Profits and gains of business or profession" or "Income from other sources".

Question 2

Certain ICDS provisions are inconsistent with judicial precedents. Whether these judicial precedents would prevail over ICDS?

Answer

The ICDS have been notified after due deliberation and after examining judicial views for bringing certainty on the issues covered by it. Certain judicial pronouncements were pronounced in the absence of authoritative guidance on these issues under the Act for computing Income under the head "Profits and gains of business or profession" or Income from other sources. Since certainty is now provided by notifying ICDS u/s 145(2), the provisions of ICDS shall be applicable to the transactional issues dealt therein in relation to assessment year 2017-18 and subsequent assessment years.

Question 3

Does ICDS apply to non-corporate taxpayers who are not required to maintain books of account and/or those who are covered by presumptive scheme of taxation like sections 44AD, 44AE, 44ADA, 44B, 44BB, 44BBA, etc. of the Act?

Answer

ICDS is applicable to specified persons having income chargeable under the head 'Profits and gains of business or profession' or 'Income from other sources'. Therefore, the relevant provisions of ICDS shall also apply to the persons computing income under the relevant presumptive taxation scheme. For example, for computing presumptive income of a partnership firm u/s 44AD of the Act, the provisions of ICDS on Construction Contract or Revenue recognition shall apply for determining the receipts or turnover, as the case may be.

Question 4

If there is conflict between ICDS and other specific provisions of the Income-tax rules, 1962 ('the Rules') governing taxation of income like rules 9A, 9B etc. of the Rules, which provisions shall prevail?

Answer

ICDS provides general principles for computation of income. In case of conflict, if any, between the provisions of Rules and ICDS, the provisions of Rules, which deal with specific circumstances, shall prevail.

Question 5

ICDS is framed on the basis of accounting standards notified by Ministry of Corporate Affairs (MCA) vide Notification No. GSR 739(E) dated 7 December 2006 u/s 211(3C) of erstwhile Companies Act 1956. However, MCA has notified in February 2015 a new set of standards called 'Indian Accounting Standards' (Ind-AS). How will ICDS apply to companies which adopted Ind-AS?

Answer

ICDS shall apply for computation of taxable income under the head "Profit and gains of business or profession" or "Income from other sources" under the Income Tax Act. This is irrespective of the accounting standards adopted by companies i.e. either Accounting Standards or Ind-AS.



Question 6

Whether ICDS shall apply to computation of Minimum Alternate Tax (MAT) u/s 115JB of the Act or Alternate Minimum Tax (AMT) under section 115JC of the Act?

Answer

MAT u/s 115JB of the Act is computed on 'book profit' that is net profit as shown in the Profit and Loss Account prepared under the Companies Act subject to certain specified adjustments. Since, the provisions of ICDS are applicable for computation of income under the regular provisions of the Act, the provisions of ICDS shall not apply for computation of MAT.

AMT u/s 115JC of the Act is computed on adjusted total income which is derived by making specified adjustments to total income computed as per the regular provisions of the Act. Hence, the provisions of ICDS shall apply for computation of AMT.

Question 7

Whether the provisions of ICDS shall apply to Banks, Non-banking financial institutions, Insurance companies, Power sector, etc.?

Answer

The general provisions of ICDS shall apply to all persons unless there are sector specific provisions contained in the ICDS or the Act. For example, ICDS VIII contains specific provisions for banks and certain financial institutions and Schedule I of the Act contains specific provisions for Insurance business.

Question 8

Para 4(ii) of ICDS-I provides that Market to Market (MTM) loss or an expected loss shall not be recognized unless the recognition is in accordance with the provisions of any other ICDS. Whether similar consideration applies to recognition of MTM gain or expected incomes?

Answer

Same principle as contained in ICDS-I relating to MTM losses or an expected loss shall apply mutatis mutandis to MTM gains or an expected profit.

Question 9

ICDS-I provides that an accounting policy shall not be changed without 'reasonable cause'. The term 'reasonable cause' is not defined. What shall constitute 'reasonable cause'?

Answer

Under the Act, 'reasonable cause' is an existing concept and has evolved well over a period of time conferring desired flexibility to the tax payer in deserving cases.

Question 10

Which ICDS would govern derivative instruments?

Answer

ICDS -VI (subject to para 3 of ICDS-VIII) provides guidance on accounting for derivative contracts such as forward contracts and other similar contracts. For derivatives, not within the scope of ICDS-VI, provisions of ICDS-I would apply.

Question 11

Whether the recognition of retention money, receipt of which is contingent on the satisfaction of certain performance criterion is to be recognized as revenue on billing?

Answer

Retention money, being part of overall contract revenue, shall be recognised as revenue subject to reasonable certainty of its ultimate collection condition contained in para 9 of ICDS-III on Construction contracts.

Question 12

Since there is no specific scope exclusion for real estate developers and Build-Operate-Transfer (BOT) projects from ICDS IV on Revenue Recognition, please clarify whether ICDS-III and ICDS-IV should be applied by real estate developers and BOT operators. Also, whether ICDS is applicable for leases.

Answer

At present there is no specific ICDS notified for real estate developers, BOT projects and leases. Therefore, relevant provisions of the Act and ICDS shall apply to these transactions as may be applicable.

Question 13

The condition of reasonable certainty of ultimate collection is not laid down for taxation of interest, royalty and dividend. Whether the taxpayer is obliged to account for such income even when the collection thereof is uncertain?

Answer

As a principle, interest accrues on time basis and royalty accrues on the basis of contractual terms. Subsequent non-recovery in either cases can be claimed as deduction in view of amendment to sec. 36(1)(vii). Further, the provision of the Act (e.g. sec. 43D) shall prevail over the provisions of ICDS.

Question 14

Whether ICDS is applicable to revenues which are liable to tax on gross basis like interest, royalty and fees for technical services for non-residents u/s. 115A of the Act?

Answer

Yes, the provisions of ICDS, shall also apply for computation of these incomes on gross basis for arriving at the amount chargeable to tax.

Question 15

Para 8 of ICDS-V states expenditure incurred on commissioning of project, including expenditure incurred on test runs and experimental production shall be capitalized. It also states that expenditure incurred after the plant has begun commercial production i.e., production intended for sale or captive consumption shall be treated as revenue expenditure. What shall be the treatment of expense incurred after the conduct of test runs and experimental production but before commencement of commercial production?

Answer

As clarified in Para 8 of ICDS- V, the expenditure incurred till the plant has begun commercial production, that is, production intended for sale or captive consumption, shall be treated as capital expenditure.



Question 16

What is the taxability of opening balance as on 1st day of April 2016 of Foreign Currency Translation Reserve (FCTR) relating to non-integral foreign operation, if any, recognised as per Accounting Standards (AS) II?

Answer

FCTR balance as on 1 April 2016 pertaining to exchange differences on monetary items for non-integral operations, shall be recognised in the previous year relevant for assessment year 2017-18 to the extent not recognised in the income computation in the past.

Question 17

For subsidy received prior to 1st day of April 2016 but not recognised in the books pending satisfaction of related conditions and achieving reasonable certainty of receipt, how shall the same be recognised under ICDS on or after 1st day of April 2016?

Answer

Para 4 of ICDS- VII read with Para 5 to Para 9 of ICDS- VII provides for timing of recognition of government grant. The transitional provision in Para 13 of ICDS-VII provides that a government grant which meets the recognition criteria on or after 1st day of April 2016 shall be recognised in accordance with ICDS- VII. All government grants actually received prior to 1st day of April 2016 shall be deemed to have been recognised on its receipt in accordance with Para 4(2) of ICDS-VII and accordingly will be outside the transitional provision and therefore the government grants received on or after 1st day of April 2016 and for which recognition criteria provided in Para 5 to Para 9 of ICDS-VII is also satisfied thereafter, the same shall be recognised as per the provisions of ICDS- VII. The grants received prior to 1st day of April 2016 shall continue to be recognised as per the law prevailing prior to that date.

E.g. if out of total subsidy entitlement of ₹ 10 Crore, an amount of ₹ 6 Crore is recognised in the books of accounts till 31st day of March 2016 and recognition of balance ₹ 4 Crore is deferred pending satisfaction of related conditions and/or achieving reasonable certainty of receipt. The balance amount of ₹ 4 Crore will be taxed in the year in which related conditions are met and reasonable certainty is achieved. If these conditions are met over two years, the amount of 4 Crore shall be taxed over the period of two years. The amount of ₹ 6 Crore for which recognition criteria were met prior to 1st day of April 2016 shall not be taxable post 1st day of April 2016.

But if the subsidy is already received prior to 1st day of April 2016, Para 13 of ICDS-VII shall not apply even if some of the related conditions are met on or after 1 April 2016. This is in view of Para 4(2) of ICDS- VII which provides that Government grant shall not be postponed beyond the date of actual receipt. Such grants shall continue to be governed by the provisions of law applicable prior to 1st day of April 2016.

Question 18

If the taxpayer sells a security on the 30th day of April 2017. The interest payment dates are December and June. The actual date of receipt of interest is on the 30th day of June 2017 but the interest on accrual basis has been accounted as income on the 31st day of March 2017. Whether the taxpayer shall be permitted to claim deduction of such interest i.e. offered to tax but not received while computing the capital gain?

Answer

Yes, the amount already taxed as interest income on accrual basis shall be taken into account for computation of income arising from such sale.

Question 19

Para 9 of ICDS-VIII on securities requires securities held as stock-in-trade shall be valued at actual cost initially recognised or net realisable value (NRV) at the end of that previous year, whichever is lower. Para 10 of Part-A of ICDS-VIII requires the said exercise to be carried out category wise. How the same shall be computed?

Answer

For subsequent measurement of securities held as stock-in-trade, the securities are first aggregated category wise. The aggregate cost and NRV of each category of security are compared and the lower of the two is to be taken as carrying value as per ICDS- VIII. This is illustrated below

Security	Category	Cost	NRV	Lower of cost or NRV	ICDS Value
A	Share	100	75	75	
B	Share	120	150	120	
C	Share	140	120	120	
D	Share	200	190	190	
	Total	560	535	505	535
E	Debt Security	150	160	150	
F	Debt Security	105	90	90	
G	Debt Security	125	135	125	
H	Debt Security	220	230	220	
	Total	600	615	585	600
Securities Total		1160	1150	1090	1135

Question 20

There are specific provisions in the Act read with Rules under which a portion of borrowing cost may get disallowed under sections like 14A, 43B, 40(a) (i), 40(a)(ia), 40A(2)(b), etc. of the Act. Whether borrowing costs to be capitalized under ICDS-IX should exclude portion of borrowing costs which gets disallowed under such specific provisions?

Answer

Since specific provisions of the Act override the provisions of ICDS, it is clarified that borrowing costs to be considered for capitalization under ICDS IX shall exclude those borrowing costs which are disallowed under specific provisions of the Act. Capitalization of borrowing cost shall apply for that portion of the borrowing cost which is otherwise allowable as deduction under the Act.

Question 21

Whether bill discounting charges and other similar charges would fall under the definition of borrowing cost?

Answer

The definition of borrowing cost is an inclusive definition. Bill discounting charges and other similar charges are covered as borrowing cost.

**Question 22**

How to allocate borrowing costs relating to general borrowing as computed in accordance with formula provided under Para 6 of ICDS-IX to different qualifying assets?

Answer

The capitalization of general borrowing cost under ICDS-IX shall be done on asset- by-asset basis.

Question 23

What is the impact of Para 20 of ICDS X containing transitional provisions?

Answer

Para 20 of ICDS - X provides that 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.

The intent of transitional provision is that there is neither 'double taxation' of income due to application of ICDS nor there should be escape of any income due to application of ICDS from a particular date. This is explained as under

Provision required as per ICDS on 31 March 2017 for items brought forward from 31st day of March 2016 ... (A)	INR 3 Crores
Provisions as per ICDS for FY 2016-17 ... (B)	INR 5 Crores
Total gross provision ... (C) = (A)+(B)	INR 8 Crores
Less: Provision already recognised for computation of taxable income in FY 2016-17 or earlier ... (D)	INR 2 Crores
Net provisions as per ICDS in FY 2016-17 to be recognised as per transition provision... (E)= (C) – (D)	INR 6 Crores

Question 24

Expenditure on most post-retirement benefits like provident fund, gratuity, etc. are covered by specific provisions. There are other post-retirement benefits offered by companies like medical benefits. Such benefits are covered by AS-15 for which no parallel ICDS has been notified. Whether provision for these liabilities are excluded from scope of ICDS X?

Answer

It is clarified that provisioning for employee benefit which are otherwise covered by AS 15 shall continue to be governed by specific provisions of the Act and are not dealt with by ICDS-X.

Question 25

ICDS-I requires disclosure of significant accounting policies and other ICDS requires specific disclosures. Where is the taxpayer required to make such disclosures specified in ICDS?

Answer

Net effect on the income due to application of ICDS is to be disclosed in the Return of income. The disclosures required under ICDS shall be made in the tax audit report in Form 3CD. However, there shall not be any separate disclosure requirements for persons who are not liable to tax audit.

15.13 METHOD OF ACCOUNTING IN CERTAIN CASES [SEC. 145A]**Valuation of stock**

- ◆ The valuation of inventory shall be made at lower of actual cost or net realisable value computed in accordance with the ICDS.
- ◆ The valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation. Such tax, duty, etc. shall include all such payment notwithstanding any right arising as a consequence to such payment.
- ◆ The inventory being 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 in accordance with the ICDS.
- ◆ The inventory being securities other than above, shall be valued at lower of actual cost or net realisable value in accordance with the ICDS
- ◆ The inventory being securities held by a scheduled bank or public financial institution shall be valued in accordance with the ICDS after taking into account the extant guidelines issued by the Reserve Bank of India in this regard.
- ◆ The comparison of actual cost and net realisable value of securities shall be made category-wise.

15.14 TAXATION OF FOREIGN EXCHANGE FLUCTUATION [SEC. 43AA]

Any gain (or loss), being computed in accordance with the ICDS, arising on account of any change in foreign exchange rates shall be treated as income (or loss).

Taxpoint

- Such gain or loss shall arise in respect of all foreign currency transactions, including those relating to:
 - i. monetary items and non-monetary items;
 - ii. translation of financial statements of foreign operations;
 - iii. forward exchange contracts;
 - iv. foreign currency translation reserves³
- The provision of sec. 43AA is not applicable in respect of cases covered u/s 43A (like computation of actual cost of the asset, etc)

15.15 LOSS AS PER ICDS [SEC. 36(1)(xviii)]

Marked to market loss or other expected loss as computed in accordance with the ICDS shall be allowed.

³ ICDS is not dealing with foreign currency translation reserves.

**15.16 COMPUTATION OF INCOME FROM CONSTRUCTION AND SERVICE CONTRACTS [SEC. 43CB]**

The profits and gains arising from a construction contract or a contract for providing services shall be determined on the basis of percentage of completion method in accordance with the ICDS.

Taxpoint

- Profits and gains arising from a contract for providing services:

Case	Method
Contract for providing services with duration of not more than 90 days	Project completion method
A contract for providing services involving indeterminate number of acts over a specific period of time	Straight line method

- For the purpose of percentage of completion method:
 - the contract revenue shall include retention money;
 - the contract costs shall not be reduced by any incidental income in the nature of interest, dividends or capital gains.

STUDY NOTE : 16

BLACK MONEY AND IMPOSITION OF TAX ACT



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

Chargeability

The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 had been introduced in the Parliament on 20-03-2015 which thereafter received President's assent on 26th May 2015 and notified in the month of July 2015.

The Act extends to the whole of India and provides that tax @ 30% shall be charged on every assessee for every assessment year in respect of total undisclosed foreign income and asset of the previous year – [Sec. 3]

Taxpoint

- ◆ Assessee means a person, being a resident other than not ordinarily resident in India within the meaning of sec. 6(6) of the Income-tax Act, by whom tax in respect of undisclosed foreign income and assets, or any other sum of money, is payable under this Act and includes every person who is deemed to be an assessee in default under this Act – [Sec. 2(2)]
- ◆ Previous year means:
 - a) the period beginning with the date of setting up of a business and ending with the date of the closure of the business or the 31st day of March following the date of setting up of such business, whichever is earlier;
 - b) the period beginning with the date on which a new source of income comes into existence and ending with the date of closure of the business or the 31st day of March following the date on which such new source comes into existence, whichever is earlier;
 - c) the period beginning with the 1st day of the financial year and ending with the date of discontinuance of the business other than business referred to in (b) or dissolution of an unincorporated body or liquidation of a company, as the case may be; or
 - d) the period of 12 months commencing on the 1st day of April of the relevant year in any other case,

- and which immediately precedes the assessment year [Sec. 2(9)]
- ◆ Undisclosed asset located outside India means an asset (including financial interest in any entity) located outside India, held by the assessee in his name or in respect of which he is a beneficial owner, and he has no explanation about the source of investment in such asset or the explanation given by him is in the opinion of the Assessing Officer unsatisfactory [Sec. 2(11)]
- ◆ Undisclosed foreign income and asset means the total amount of undisclosed income of an assessee from a source located outside India and the value of an undisclosed asset located outside India, referred to in section 4, and computed in the manner laid down in section 5 [Sec. 2(12)]
- ◆ An undisclosed asset located outside India shall be charged to tax on its value in the previous year in which such asset comes to the notice of the Assessing Officer.



- ◆ Value of an undisclosed asset means the fair market value of an asset (including financial interest in any entity) determined in such manner as may be prescribed.

Scope of total undisclosed foreign income and asset [Sec. 4]

- ◆ The total undisclosed foreign income and asset of any previous year of an assessee shall be:
 - a) the income from a source located outside India, which has not been disclosed in the return of income furnished u/s 139 of the Income-tax Act;
 - b) the income, from a source located outside India, in respect of which a return is required to be furnished u/s 139 of the Income-tax Act but no return of income has been furnished u/s 139 of the Income-tax Act; and
 - c) the value of an undisclosed asset located outside India.
- ◆ Any variation made in the income from a source outside India in the assessment or reassessment of the total income of any previous year, of the assessee under the Income-tax Act in accordance with the provisions of section 29 to section 43C (Profits and gains of business or profession) or section 57 to section 59 (Income from other sources) or section 92C (Transfer pricing) of the said Act, shall not be included in the total undisclosed foreign income.
- ◆ To avoid double taxation, the income included in the total undisclosed foreign income and asset under this Act shall not form part of the total income under the Income-tax Act.

Computation of total undisclosed foreign income and asset [Sec. 5]

- ◆ In computing the total undisclosed foreign income and asset of any previous year of an assessee:
 - ▶ No deduction in respect of any expenditure or allowance or set off of any loss shall be allowed to the assessee, whether or not it is allowable in accordance with the provisions of the Income-tax Act.
 - ▶ Any income,—
 - a) which has been assessed to tax for any assessment year under the Income-tax Act prior to the assessment year to which this Act applies; or
 - b) which is assessable or has been assessed to tax for any assessment year under this Act,shall be reduced from the value of the undisclosed asset located outside India, if, the assessee furnishes evidence to the satisfaction of the Assessing Officer that the asset has been acquired from the income which has been assessed or is assessable, as the case may be, to tax.
- ◆ The amount of deduction in case of an immovable property shall be the amount which bears to the value of the asset as on the first day of the financial year in which it comes to the notice of the Assessing Officer, the same proportion as the assessable or assessed foreign income bears to the total cost of the asset.

ILLUSTRATION

A house property located outside India was acquired by an assessee in the previous year 2009-10 for ₹ 50 lakh. Out of the investment of ₹ 50 lakh, ₹ 20 lakh was assessed to tax in the total income of the previous year 2009-10 and earlier years. Such undisclosed asset comes to the notice of the Assessing Officer in the year 2018-19. If the value of the asset in the year 2018-19 is ₹ 1 crore, the amount chargeable to tax shall be ₹ 60,00,000 i.e.:

$$₹ 1,00,00,000 - (₹ 20,00,000 / ₹ 50,00,000) = ₹ 60,00,000$$

TAX MANGEMENT

Tax authorities [Sec. 6]

- ◆ The income-tax authorities shall be the tax authorities for the purposes of this Act.
- ◆ Every such authority shall exercise the powers and perform the functions of a tax authority under this Act in respect of any person within his jurisdiction.
- ◆ The jurisdiction of a tax authority under this Act shall be the same as he has under the Income-tax Act
- ◆ The tax authority having jurisdiction in relation to an assessee who has no income assessable to income-tax under the Income-tax Act shall be the tax authority having jurisdiction in respect of the area in which the assessee resides or carries on its business or has its principal place of business.

Change of incumbent [Sec. 7]

The tax authority who succeeds another authority as a result of change in jurisdiction or for any other reason, shall continue the proceedings from the stage at which it was left by his predecessor. The assessee in such a case may be given an opportunity of being heard, if he so requests in writing, before passing any order in his case.

Assessment [Sec. 10]

- ◆ The Assessing Officer may, on receipt of an information from an income-tax authority or any other authority under any law for the time being in force or on coming of any information to his notice, serve on any person, a notice requiring him, on the specified date, to produce such accounts or documents or evidence as the Assessing Officer may require for the purposes of this Act.
 - ▶ No separate return is required to be filed under this Act
 - ▶ There is no time limit for issuance of the aforesaid notice. The Assessing Officer may issue such notice any time on the basis of information.
- ◆ The Assessing Officer may, from time to time, serve further notices requiring the production of such other accounts or documents or evidence as he may require.
- ◆ The Assessing Officer may make such inquiry, as he considers necessary, for the purpose of obtaining full information in respect of undisclosed foreign income and asset of any person for the relevant financial year or years.
- ◆ The Assessing Officer, after considering such accounts, documents or evidence, as he has obtained, and after taking into account any relevant material which he has gathered and any other evidence produced by the assessee, shall by an order in writing, assess the undisclosed foreign income and asset and determine the sum payable by the assessee.
- ◆ Such order shall be made within 2 years from the end of the financial year in which the notice was issued by the Assessing Officer [Sec. 11]
- ◆ Best Judgment Assessment: If any person fails to comply with all the terms of the notice, the Assessing Officer shall, after taking into account all the relevant material which he has gathered, make the assessment of undisclosed foreign income and asset to the best of his judgment and determine the sum payable by the assessee. [Sec. 10(4)]
 - ▶ Before making such an assessment, an opportunity of being heard is required to be given to the assessee.
- ◆ Aggrieved with the order of the Assessing Officer, the assessee may file appeal or rectification petition or revision petition (which are in line with the Income-tax Act)



	Income-tax Act	Black Money Act
Rectification	Sec. 154	Sec. 12
Notice of Demand	Sec. 156	Sec. 13
Appeals to Commissioner (Appeals)	Sec. 246A to 250	Sec. 15 to 17
Appeals to Tribunal	Sec. 252 to 255	Sec. 18
Appeals to High Court	Sec. 260A	Sec. 19
Appeals to the Supreme Court	Sec. 261	Sec. 21
Revision	Sec. 263 / 264	Sec. 23 / 24
Recovery of Tax	Sec. 220	Sec. 30
Tax Recovery Officer	Sec. 222 to 232	Sec. 31 to 39
Interest	Sec. 234 to 234C	Sec. 40
Power regarding discovery, inspection, etc.	Sec. 131	Sec. 8

♦ Liability of manager of a company [Sec. 35]

Every person being a manager at any time during the financial year shall be jointly and severally liable for the payment of any amount due under this Act in respect of the company for the financial year, if the amount cannot be recovered from the company.

However, if the manager proves that non-recovery cannot be attributed to any neglect, misfeasance or breach of duty on his part in relation to the affairs of the company, then aforesaid provision shall not be applied.

♦ Joint and several liability of participants [Sec. 36]

Every person, being a participant in an unincorporated body at any time during the financial year, or the representative assessee of the deceased participant, shall be jointly and severally liable, along with the unincorporated body, for payment of any amount payable by the unincorporated body under this Act and all the provisions of this Act shall apply accordingly.

However, if the partner of LLP proves that non-recovery cannot be attributed to any neglect, misfeasance or breach of duty on his part in relation to the affairs of the partnership, then aforesaid provision shall not be applied.

► Participant means—

- a partner in relation to a firm; or
- a member in relation to an association of persons or body of individuals [Sec. 2(7)]

Penalties & Prosecutions

Provision relating to penalties and prosecutions are enumerated here in below:

Nature of default	Sec.	Penalty	Sec.	Prosecution
Fails to disclose foreign income and asset	41	300% of tax u/s 10	51(1)	3 years to 10 years ¹
Fails to furnish return of income before expiry of the relevant assessment year ²	42	₹ 10 lakh		

Fails to disclose foreign asset or income in the return of income ²	43	₹ 10 lakh	50	6 months to 10 years ¹
Attempt to evade payment of tax, interest and penalty	44	Tax in arrear	51(2)	3 years to 10 years
Failure to: a) answer any question put to him by a tax authority b) sign any statement made by him in the course of any proceedings which a tax authority may legally require him to sign; c) attend or produce books of account or documents at the place or time, at certain place and time in response to summons issued u/s 8	45	₹ 50,000 to ₹ 2,00,000		
Makes a statement or delivers an account or statement which is false			52	6 months to 10 years ¹
Abets or induces another person to make and deliver an account or a statement or declaration which is false			53	6 months to 10 years ¹
Second and subsequent offences			58	3 years to 10 years ³

1. with fine
2. However, no penalty shall be levied, if assessee fails to report bank accounts with maximum balance upto ₹ 5,00,000 at any time during the previous year
3. Fine of ₹ 5 lakh to ₹ 1 crore.

Taxpoint:

- ◆ No penalty order shall be passed after the expiry of 1 year from the end of the financial year in which the notice for imposition of penalty is issued u/s 46 [Sec. 47]
- ◆ A person shall not be prosecuted against for an offence except with the sanction of the Principal Commissioner or Commissioner or the Commissioner (Appeals), as the case may be.
- ◆ An order imposing a penalty shall be made with the approval of the Joint Commissioner, if:
 - ▶ the penalty exceeds ₹ 1,00,000 and the tax authority levying the penalty is in the rank of Income-tax Officer; or
 - ▶ the penalty exceeds ₹ 5,00,000 and the tax authority levying the penalty is in the rank of Assistant Commissioner or Deputy Commissioner.
- ◆ **Cognizance of offence:** No court inferior to that of a metropolitan magistrate or a magistrate of the First Class shall try any offence under this Act. – Sec. 80
- ◆ No suit shall be brought in any civil court to set aside or modify any proceeding taken or order made under this Act. – Sec. 82(1)
- ◆ No prosecution, suit or other proceeding shall lie against the Government or any officer of the Government, for anything in good faith done or intended to be done, under this Act -Sec. 82(2)



Other Provisions

◆ Rounding off

- a. The amount of undisclosed foreign income and asset computed shall be rounded off to the nearest multiple of ₹ 100.
- b. Any amount payable or receivable by the assessee shall be rounded off to the nearest multiple of ₹ 10.

◆ Agreement with foreign countries or specified territories [Sec. 73]

The Central Government may enter into an agreement with the Government of any other country:

- a. for exchange of information for the prevention of evasion or avoidance of tax on undisclosed foreign income chargeable under this Act or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance;
- b. for recovery of tax under this Act and under the corresponding law in force in that country.

Taxpoint:

- ▶ The Central Government may enter into an agreement with the Government of any specified territory outside India
- ▶ The Central Government may, by notification, make such provisions as may be necessary for implementing the agreements
- ▶ 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 make such provisions as may be necessary for adopting and implementing such agreement.



Section B

International Taxation

(Syllabus - 2016)



STUDY NOTE : 17

INTERNATIONAL TAXATION



This Study Note includes:

- 17.1 Introduction
- 17.2 Tax Heaven
- 17.3 Controlled Foreign Corporation (CFC)
- 17.4 Resident of Contracting State
- 17.5 Agreement with foreign countries [Sec. 90] [Bilateral Relief]
- 17.6 Adoption by Central Government of agreements between specified associations for double taxation relief [Sec. 90A]
- 17.7 Countries with which no agreement exists [Sec. 91] [Unilateral Relief]
- 17.8 Foreign Tax Credit [Rule 128]
- 17.9 The Concepts of Permanent Establishment (PE)
- 17.10 Taxation of Business Process Outsourcing Units in India
- 17.11 Taxation of income from Air and Shipping Transport under DTAA
- 17.12 Computation of income from international transaction or specified domestic transaction having regard to arm's length price [Sec. 92]
- 17.13 Arm's length price [Sec. 92F(ii)]
- 17.14 Enterprise [Sec. 92F(iii)]
- 17.15 Meaning of international transaction [Sec. 92B]
- 17.16 Deemed International Transaction
- 17.17 Meaning of Specified Domestic Transactions [Sec. 92BA]
- 17.18 Meaning of associated enterprise [Sec. 92A]
- 17.19 Computation of arm's length price [Sec. 92C]
- 17.20 Reference to Transfer Pricing Officer [Sec. 92CA]
- 17.21 Power of Board to make safe harbour rules [Sec. 92CB]
- 17.22 Advance Pricing Agreement [Sec. 92CC]
- 17.23 Effect to Advance Pricing Agreement [Sec. 92CD]
- 17.24 Secondary adjustment in certain cases [Sec. 92CE]
- 17.25 Maintenance, keeping of information and document by persons entering into an international transaction or specified domestic transaction [Sec. 92D]



- 17.26 Report from an accountant to be furnished by persons entering into international transaction or specified domestic transaction [Sec. 92E]**
- 17.27 Special measures in respect of transactions with persons located in notified jurisdictional area [Sec. 94A]**
- 17.28 Limitation on interest deduction in certain cases [Sec. 94B]**
- 17.29 Penalty**
- 17.30 Determination of income in the case of non-residents [Rule 10]**
- 17.31 Determination of arm's length price under section 92C [Rule 10B]**
- 17.32 Other method of determination of arm's length price [Rule 10AB]**
- 17.33 Most appropriate method [Rule 10C]**
- 17.34 Applicability of General Anti-Avoidance Rule [Sec. 95]**
- 17.35 Impermissible avoidance arrangement [Sec. 96]**
- 17.36 Consequences of impermissible avoidance arrangement [Sec. 98]**
- 17.37 Treatment of connected person and accommodating party [Sec. 99]**
- 17.38 Application of this Chapter [Sec. 100]**
- 17.39 Framing of guidelines [Sec. 101]**
- 17.40 Definitions [Sec. 102]**

“Globalisation and new electronic technologies can permit a proliferation of tax regimes designed to attract geographically mobile activities. Governments must take measures, in particular intensifying their international cooperation, to avoid the world-wide reduction in welfare caused by tax-induced distortions in capital and financial flows and to protect their tax bases.

17.1 INTRODUCTION

International taxation is the study or determination of tax on a person or business subject to the tax laws of different countries or the international aspects of an individual country's tax laws. Governments usually limit the scope of their income taxation in some manner territorially or provide for offsets to taxation relating to extraterritorial income. The manner of limitation generally takes the form of a territorial, residency, or exclusionary system. Some governments have attempted to mitigate the differing limitations of each of these three broad systems by enacting a hybrid system with characteristics of two or more. Systems of taxation vary widely, and there are no broad general rules. These variations create the potential for double taxation (where the same income is taxed by different countries) and no taxation (where income is not taxed by any country). Income tax systems may impose tax on local income only or on worldwide income. Generally, where worldwide income is taxed, reductions of tax or foreign credits are provided for taxes paid to other jurisdictions. Limits are almost universally imposed on such credits. With any system of taxation, it is possible to shift or recharacterize income in a manner that reduces taxation. Jurisdictions often impose rules relating to shifting of income among commonly controlled parties, often referred to as transfer pricing rules. Residency based systems are subject to taxpayer attempts to defer recognition of income through use of related parties. A few jurisdictions impose rules limiting such deferral ("anti-deferral" regimes). Deferral is also specifically authorized by some governments for particular social purposes or other grounds. Agreements among governments (treaties) often attempt to determine who should be entitled to tax what. Most tax treaties provide for at least a skeleton mechanism for resolution of disputes

between the parties. Tax laws in India are becoming more and more complex. Globalisation of economies, signing and review of free trade agreements, increase in the number of cross border transactions, mergers, acquisitions, tax treaties, transfer pricing etc. have added to these complexities.

17.2 TAX HEAVEN

Many fiscally sovereign territories and countries use tax and non-tax incentives to attract activities in the financial and other services sectors. These territories and countries offer the foreign investor an environment with a no or only nominal taxation which is usually coupled with a reduction in regulatory or administrative constraints. The activity is usually not subject to information exchange because, for example, of strict bank secrecy provisions. These jurisdictions are known as tax havens. In other words, any country which modifies its tax laws to attract foreign capital could be considered a tax haven. The central feature of a haven is that its laws and other measures can be used to evade or avoid the tax laws or regulations of other jurisdictions. A tax haven is a state or a country or territory where income tax are levied at a low rate or no tax at all is levied. Individuals and/or corporate entities can find it attractive to establish shell subsidiaries or move themselves to areas where reduced or nil tax is charged. This creates a situation of tax competition among governments though tax heaven countries may not always be profitable. Some tax heavens have become failure like Beirut, Tangiers, Liberia, etc. Different jurisdictions tend to be havens for different types of taxes, and for different categories of people and/or companies.

Geoffrey Colin Powell (former economic adviser to Jersey) has defined it as under:

"What ... identifies an area as a tax haven is the existence of a composite tax structure established deliberately to take advantage of, and exploit, a worldwide demand for opportunities to engage in tax avoidance."

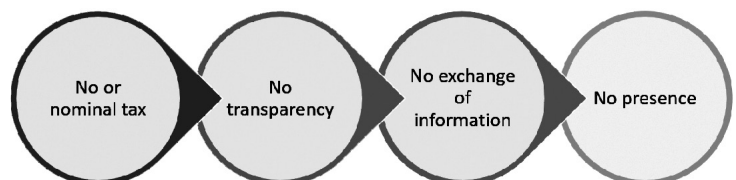
Some important destinations of tax heavens are:

In USA	Delaware, Nevada, Wyoming
In Europe	Andorra, Canary, Netherlands, Cyprus
In Asia	Mauritius, Singapore, Dubai
In Africa	Capetown, Nairobi

Key Factors

Four key factors are used to determine whether a jurisdiction is a tax haven:

- Imposes no or only nominal taxes: Tax havens impose nil or only nominal taxes (generally or in special circumstances) and offer themselves, or are perceived to offer themselves, as a place to be used by non-residents to escape high taxes in their country of residence.
- Lack of transparency: Transparency ensures that there is an open and consistent application of tax laws among similarly situated taxpayers and that information needed by tax authorities to determine a taxpayer's correct tax liability is available (e.g., accounting records and underlying documentation). A lack of transparency in the operation of the legislative, legal or administrative





provisions is another factor used to identify tax havens. The OECD is concerned that laws should be applied openly and consistently, and that information needed by foreign tax authorities to determine a taxpayer's situation is available. Lack of transparency in one country can make it difficult, if not impossible, for other tax authorities to apply their laws effectively. 'Secret rulings', negotiated tax rates, or other practices that fail to apply the law openly and consistently are examples of a lack of transparency. Limited regulatory supervision or a government's lack of legal access to financial records are contributing factors.

- Lack of effective exchange of tax information with foreign tax authorities: Whether there are laws or administrative practices that prevent the effective exchange of information for tax purposes with other governments on taxpayers benefiting from the no or nominal taxation. Tax havens typically have laws or administrative practices under which businesses and individuals can benefit from strict rules and other protections against scrutiny by foreign tax authorities. This prevents the transmittance of information about taxpayers who are benefiting from the low tax jurisdiction.
- No requirement for a substantive local presence of the entity: The absence of a requirement that the activity be substantial is important because it suggests that a jurisdiction may be attempting to attract investment and transactions that are purely tax driven. It may also indicate that a country does not provide a legal or commercial environment or offer any economic advantages that would attract substantive business activities in the absence of the tax minimising opportunities it provides. The no substantial activities criterion was included in the 1998 Report as a criterion for identifying tax havens because the lack of such activities suggests that a jurisdiction may be attempting to attract investment and transactions that are purely tax driven. In 2001, the OECD's Committee on Fiscal Affairs agreed that this criterion would not be used to determine whether a tax haven was co-operative or unco-operative.

With regard to exchange of information in tax matters, the OECD encourages countries to adopt information exchange on an "upon request" basis. Exchange of information upon request describes a situation where a competent authority of one country asks the competent authority of another country for specific information in connection with a specific tax inquiry, generally under the authority of a bilateral exchange arrangement between the two countries. An essential element of exchange of information is the implementation of appropriate safeguards to ensure adequate protection of taxpayers' rights and the confidentiality of their tax affairs.

Methodology

The methods followed in doing business through tax heavens, broadly, are as under:

Personal residency

Wealthy individuals from high-tax jurisdictions have sought to relocate themselves in low-tax jurisdictions. In most countries in the world, residence is the primary basis of taxation. In some cases the low-tax jurisdictions levy no, or only very low, income tax, capital gain tax and inheritance tax. Individuals who are unable to return to a higher-tax country in which they used to reside for more than a few days a year are sometimes referred to as tax exiles.

Asset holding

Asset holding involves utilizing a trust or a company, or a trust owning a company. The company or trust will be formed in one tax haven, and will usually be administered and resident in another. The function is to hold assets, which may consist of a portfolio of investments under management, trading companies or groups, physical assets such as real estate or valuable chattels. The essence of such arrangements is that by changing the ownership of the assets into

an entity which is not resident in the high-tax jurisdiction, they cease to be taxable in that jurisdiction. Often the mechanism is employed to avoid inheritance tax.

Trading and other business activity

Many businesses which do not require a specific geographical location or extensive labour are set up in tax havens, to minimize tax exposure. Perhaps the best illustration of this is the number of reinsurance companies which have migrated to Bermuda over the years. Other examples include internet based services and group finance companies. In the 1970s and 1980s corporate groups were known to form offshore entities for the purposes of "re invoicing". These re invoicing companies simply made a margin without performing any economic function, but as the margin arose in a tax free jurisdiction, it allowed the group to "skim" profits from the high-tax jurisdiction. Most sophisticated tax codes now prevent transfer pricing schemes of this nature.

Financial intermediaries

Much of the economic activity in tax havens today consists of professional financial services such as mutual funds, banking, life insurance and pensions. Generally the funds are deposited with the intermediary in the low-tax jurisdiction, and the intermediary then on-lends or invests the money (often back into a high-tax jurisdiction). Although such systems do not normally avoid tax in the principal customer's jurisdiction, it enables financial service providers to provide multi-jurisdictional products without adding an additional layer of taxation. This has proved particularly successful in the area of offshore funds.

Counteracting harmful tax practices

OECD has issued a report on Harmful Tax Competition and has made 19 specific recommendations, some of them are as follows:

- a. Adopt Controlled Foreign Corporations (CFC) or equivalent rules
- b. Consider foreign information reporting rules
- c. Enter into Tax Information Exchange Agreement (TIEA)
- d. Application of provision of withholding tax¹ while making payment to offshore recipients
- e. Curbing 'treaty shopping nations' of existing treaties with tax heaven
- f. Mutual assistance of tax authorities in the recovery of cross boarder tax claims
- g. More international co-operation by establishing Forum to avoid Harmful Tax Practices
- h. **Other measures**
 - Adopt foreign investment fund or equivalent rules
 - Considering restrictions on participation exemption and other systems of exempting foreign income in the context of harmful tax competition
 - Formulation and adoption of transfer pricing rules
 - Providing access to banking information for tax purposes
 - Considering co-ordinated enforcement regimes (joint audits; co-ordinated training programmes, etc.)
 - Guidelines to develop and actively promote Principles of Good Tax Administration

¹ Tax deducted at source



17.3 CONTROLLED FOREIGN CORPORATION (CFC)

With the globalization and liberalisation of economies, the tax payers in many countries have resorted to various tax deferral method to avoid the tax incidence in the home country which charges high tax rate. Among others, one of the popular methods of tax deferral is transfer of passive or investment income (such as interest, dividend and capital gains) by establishing an entity in a low tax country or tax havens. The Mechanism of tax deferrals starts by establishing an entity in a low tax jurisdiction. Such entity, since controlled by parent company, is called a "Controlled Foreign Corporation" in the home country of parent company. E.g., a 100% subsidiary of an Indian company in Texas is a CFC in India. The passive income of such CFCs is then not distributed to the shares holders of CFC to avoid levy of taxes in the parent company home country tax jurisdiction for a long time, thus deferring the incidence of tax on such Income. This artificial deferral of taxes through the holding structure in low tax or preferred tax regimes has been considered as an injurious to revenue collection targets in various countries specially the developed economies. Several countries have adopted measures aimed at preventing this artificial deferral of passive or investment income through CFC's. The CFC rules are measures to curb the practice of artificial deferral of income. CFC rules generally deeming in nature and are applied to apportion income of a CFCs to the parent entity and to subject it to taxation in the parent entity's home country. Under CFC rules any undistributed income of a CFC is deemed to be distributed to the parent company / shareholders, thus taxed in their hand in the home country tax jurisdiction.

Thus, Controlled foreign company (CFC) regimes are used in many countries as a means to prevent erosion of the domestic tax base and to discourage residents from shifting income to jurisdictions that do not impose tax or that impose tax at low rates.

USA was first to introduce the CFC rules followed by Germany, Canada, Japan, France, UK, New Zealand, Sweden, Australia, Norway, Finland, Spain, Indonesia, Portugal, Denmark, Korea, Hungary, Mexico, South Africa, Argentina, Venezuela, Italy, Israel, Egypt, Estonia, Turkey, Iceland, Brazil, China and Lithuania

While the rules applicable to CFCs and the attributes of a CFC differ from country to country, the concept of CFC regimes in general is that they eliminate the deferral of income earned by a CFC and tax residents currently on their proportionate share of a CFC's income. Typical conditions for the application of such regimes are that:

1. a domestic taxpayer "control" the CFC;
2. the CFC be located in a "low tax" jurisdiction or a jurisdiction that imposes a tax rate lower than the rate in the shareholder's country, or alternatively that the CFC be located in a "black" or "grey" list jurisdiction (as opposed to favored "white" list jurisdictions); and
3. the CFC has earned the passive income like interest, dividend, capital gains, etc.;
4. the CFC has not distributed such income to the parent company for a long time.

In case the above conditions are satisfied, the passive undistributed income of the CFC is deemed to be distributed to the shares holders and is taxed in the hands of such shareholders in the home country of such shareholder in proportion of their shareholdings.

Generally, the CFC regime is enacted by states in which tax liability is imposed on the worldwide income of resident taxpayers. Two operative factors are key to worldwide tax liability and to the generation of tax revenues on foreign source income, that is, the nexus between the state and the taxpayer; and the nexus between taxpayer and the foreign income.

17.4 RESIDENT OF CONTRACTING STATE

Residence as defined in double taxation treaties is different from residence as defined for domestic tax purposes. Tax treaties generally follow the OECD Model Convention.

For the purposes of this 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 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.

Where by reason of the provisions of aforesaid paragraph an individual is a resident of both Contracting States, then his status shall be determined as follows:

- 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);
- 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;
- 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;
- 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.

Where by reason of the aforesaid provisions, a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.

DOUBLE TAXATION RELIEF

Economic Double Taxation

- Same income taxed in two or more country but in the hands of different taxpayers
- e.g. business profit and dividend in different countries

Juridical Double Taxation

- Two or more states levy taxes on same entity on same income for identical periods
- Arises due to overlapping claims of tax jurisdictions
- Tax treaties largely prevent/mitigate juridical double taxation

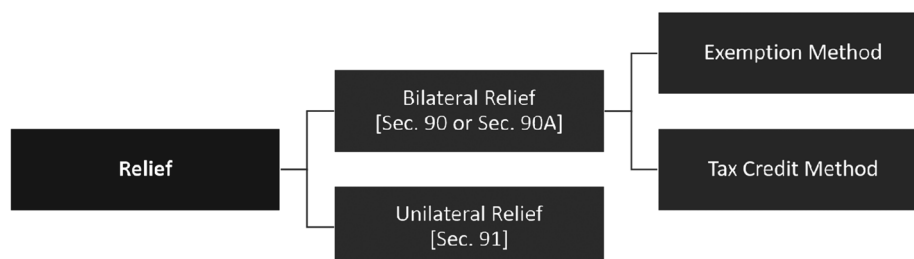
Generally, income is taxable on two basis viz. i) Source of income basis and ii) Residential Status Basis, which results into double taxation of same income of the person. Firstly, such income is taxed in the country in which such income is generated and again, the same income may be taxed on the basis of residential status of the person in another country. For instance, Mr. X, an ordinarily resident in India, earned bank interest of ₹ 1,00,000 on his money deposited into a bank located in US. In that case, such income is taxable in US on Source of income basis and again in India as he is a ordinarily resident India. In times when economies are going global and borders fading, double taxation is still



one of the major obstacles to the development of inter-country economic relations. In order to prevent this hardship or to avoid double taxation, relief is provided to the tax-payer.

Such relief is provided by two ways:

- Bilateral Relief
- Unilateral Relief



Bilateral Relief

In this, government of two countries enters into an agreement (known as 'treaties') to provide relief against double taxation of same income. The relief is granted on the basis of terms of such agreement. Generally, such agreement provides relief through following methods:

Exemption Method: In this method, one country provides exemption to such type of income. Generally, residence country gave up its right and the country of source is then given exclusive right to tax such incomes.

Credit Method: In this method resident remains liable in the country of residence on its global income, however as far the quantum of tax liabilities is concerned credit or deduction for tax paid in the source country is given by the residence country against its domestic tax as if the foreign tax were paid to the country of residence itself.

Taxpoint: In this type of relief, the mechanism for granting relief is provided in the agreement itself.

Unilateral Relief

The aforesaid method is depending on bilateral activity of both the countries. However, no country will have such an agreement with every country in the world. In order to avoid double taxation in such cases, country of residence itself may provide relief on unilateral basis.

In India, relief for avoidance of double taxation is provided in both ways. Provisions relating thereto are enumerated here-in-below:

17.5 AGREEMENT WITH FOREIGN COUNTRIES [SEC. 90] [BILATERAL RELIEF]

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 have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or
 - (ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, 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, as the case may be, or

- 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, as the case may be, 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, as the case may be,

and may make such provisions as may be necessary for implementing the agreement.

Notes

- ◆ Where the Central Government has entered into an agreement with the Government of any country or specified territory outside India for granting relief of tax or 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. However, the provisions of Chapter X-A of the Act (i.e., GAAR) shall apply to the assessee even if such provisions are not beneficial to him.
- ◆ An assessee, not being a resident, to whom DTA applies, shall not be entitled to claim any relief under such agreement unless a certificate of his being a resident in any country outside India or specified territory outside India, as the case may be, is obtained by him from the Government of that country or specified territory. Further, the assessee shall also provide such other documents and information, as may be prescribed.
- ◆ Where any term used in an agreement entered into u/s 90 is defined under the said agreement, the said term shall have the same meaning as assigned to it in the agreement; and where the term is not defined in the said agreement, but defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation, if any, given to it by the Central Government.
- ◆ Further, any term used but not defined in the Act or in the agreement shall, unless the context other-wise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.
- ◆ Further, where any term is used in any agreement and not defined under the said agreement or the Act, but is assigned a meaning to it in the notification issued, then, the meaning assigned to such term shall be deemed to have effect from the date on which the said agreement came into force.
- ◆ 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.
- ◆ "Specified territory" means any area outside India which may be notified as such by the Central Government.
- ◆ If no tax liability is imposed under this Act, the question of relief does not arise [UOI vs Azadi Bachao Andolan (2003) (SC)]
- ◆ Relief cannot be granted unless the income which has been taxed in one of the contracting countries has also suffered tax in the other contracting country. Proof has to be provided of the income having suffered double taxation.
- ◆ Sections 4 and 5 of the Income-tax Act provide for taxation of global income of an assessee but this is subject to the provisions of an agreement entered into between the Central Government and the Government of a foreign country for avoidance of double taxation. In case of any conflict between the provisions of the agreement and the Act, the provisions of the agreement would prevail over the Act in view of the provisions of sec. 90(2) [CIT v Kulandagan Chettiar (P V A L) (2004) (SC)] If any matter or income is not covered by the agreement, the Income-tax Act shall be applicable.



- ◆ In case of a remittance to a country with which a Double Taxation Avoidance Agreement is in force, the tax should be deducted at the rate provided in the Finance Act of the relevant year or at the rate provided in the Double Taxation Avoidance Agreement, whichever is more beneficial to the assessee.

ILLUSTRATION 1

Mr. Ramesh, a resident Indian, has derived the following incomes for the previous year relevant to the A.Y. 2019-20:

- a. Income from profession in India ₹ 2,44,000
- b. Income from profession in country A (Tax paid in foreign country @ 5%) ₹ 4,50,000

Compute Indian tax liability of the assessee assuming that as per treaty between India and Country A, ₹ 4,50,000 is taxable in India. However foreign tax can be set off against Indian tax liability.

Solution

Computation of total income and tax liability of Mr. Ramesh for the A.Y. 2019-20.

Particulars	Amount (₹)
Income from profession in India	2,44,000
Income from profession in Country A	4,50,000
Gross Total Income	6,94,000
Less: Deduction u/ch. VIA	Nil
Total income	6,94,000
Tax on above	51,300
Add: Health & Education cess	2,052
Tax and cess payable	53,352
Less: Relief u/s 90 [₹ 4,50,000 × 5%]	22,500
Tax payable in India (Rounded off u/s 288B)	30,850

ILLUSTRATION 2

Shri Anuj, an ordinarily resident in India, provides following details of his income for the previous year relevant to the A.Y. 2019-20

- Income from India ₹ 3,40,000
- Income from Country Z ₹ 2,00,000
- Investment in PPF ₹ 10,000

Further, it is to be noted that:

- a) India has avoidance of double taxation agreement with Country Z. According to said agreement, income is taxable in the country in which it is earned and not in other country. However, in the other country such income can be included for the purpose of computation of tax rate.
- b) Foreign income has been taxed in Country Z @ 20%.

Compute Indian tax payable.

Solution

Computation of total income and tax liability of Shri Anuj for the A.Y. 2019-20

Particulars	Amount
Income from India	3,40,000
Income from Country Z	2,00,000
Gross Total Income	5,40,000
Less: Deduction u/s 80C [Investment in PPF]	10,000
Total income	5,30,000
Tax on above	18,500
Add: Health & Education cess	740
Tax and cess payable	19,240
Less: Relief u/s 90 [$\text{₹ } 2,00,000 \times 3.63\%$]	7,260
Tax payable in India (Rounded off u/s 288B)	11,980

¹. Average rate of Indian tax = $\text{₹ } 19,240 / \text{₹ } 5,30,000 \times 100 = 3.63\%$

17.6 ADOPTION BY CENTRAL GOVERNMENT OF AGREEMENTS BETWEEN SPECIFIED ASSOCIATIONS FOR DOUBLE TAXATION RELIEF [SEC. 90A]

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 such provisions as may be necessary for adopting and implementing such agreement—

- a) for granting of relief in respect of—
 - (i) income on which have been paid both income-tax under this Act and income-tax in any specified territory outside India; or
 - (ii) income-tax chargeable under this Act and under the corresponding law in force in that specified territory outside India 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 specified territory outside India, or
- 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 specified territory outside India, 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 specified territory outside India.

Notes

- ◆ 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 for the purposes of this section.



- ◆ An assessee, not being a resident, to whom DTA applies, shall not be entitled to claim any relief under such agreement unless a certificate of his being a resident in any country outside India or specified territory outside India, as the case may be, is obtained by him from the Government of that country or specified territory. Further, the assessee shall also provide such other documents and information, as may be prescribed.
- ◆ Specified territory means any area outside India which may be notified as such by the Central Government for the purposes of this section.
- ◆ Where any term used in an agreement entered into is defined under the said agreement, the said term shall have the same meaning as assigned to it in the agreement; and where the term is not defined in the said agreement, but defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation, if any, given to it by the Central Government.
- ◆ Where any term is used in any agreement and not defined under the said agreement or the Act, but is assigned a meaning to it in the notification issued, then, the meaning assigned to such term shall be deemed to have effect from the date on which the said agreement came into force.
- ◆ Where a specified association in India has entered into an agreement with a specified association of any specified territory outside India and such agreement has been notified, for granting relief of tax, or as the case may be, 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. However, the provisions of Chapter X-A of the Act (i.e., GAAR) shall apply to the assessee even if such provisions are not beneficial to him.

17.7 COUNTRIES WITH WHICH NO AGREEMENT EXISTS [SEC. 91] [UNILATERAL RELIEF]

If any person who is resident in India in any previous year proves that:

- a) The income has accrued or arose during the previous year outside India (and which is not deemed to accrue or arise in India),
 - b) He has paid in any country income-tax on such income, by deduction or otherwise, under the law in force in that country
 - c) India does not have any agreement u/s 90 for the relief or avoidance of double taxation with that country
- then he shall be entitled to the deduction from the Indian income-tax payable by him
- (i) of a sum calculated on such doubly taxed income at the average of Indian rate of tax or
 - (ii) of a sum calculated on such doubly taxed income at the average rate of tax of the said country,
- whichever is the lower, or at the Indian rate of tax if both the rates are equal.

Notes

- a) The expression 'such doubly taxed income' really purports to indicate that it is only that portion of the income on which tax has been imposed and been paid by the assessee that is eligible for the double tax relief. Thus, where the foreign income which suffered tax in the foreign country was ₹ 88,535, and the income actually taxed in India after allowances and set off of losses (or deduction under chapter VIA) was ₹ 63,141, relief admissible would be calculated on ₹ 63,141 [CIT v. O.VR.SV.VR. Arunachalam Chettiar]
- b) Relief u/s 91 is to be calculated on income country-wise and not on basis of aggregation or amalgamation of income of all foreign countries [CIT v. Bombay Burmah Trading Corpn. Ltd. (2003)]

- c) No benefit is available on income which is deemed to accrue or arise in India, even though such income is doubly taxed.

ILLUSTRATION 3

Mr. Saha, a resident Indian, has derived the following incomes for the previous year relevant to the A.Y. 2019-20:

a.	Income from profession	₹ 3,74,000
b.	Royalty on books from foreign country Y (₹ 3,00,000 is eligible for deduction u/s 80QQB) (Tax paid in foreign country @ 20%)	₹ 5,00,000

Compute Indian tax liability of the assessee assuming that India does not have any agreement with country Y.

Solution

Computation of total income and tax liability of Mr. Saha for the A.Y. 2019-20

Particulars	Amount
Income from profession	3,74,000
Royalty earned in country Y	5,00,000
Gross Total Income	8,74,000
Less: Deduction u/s 80QQB	3,00,000
Total income	5,74,000
Tax on above	27,300
Add: Health & Education cess	1,092
Tax and cess payable	28,392
Average rate of tax [₹ 28,392 / ₹ 5,74,000 x 100]	4.95%
Rate of tax in country Y	20%
Relief u/s 91 [4.95% ¹ of ₹ 2,00,000]	9,900
Tax payable (Rounded off u/s 288B)	18,490

1. Indian average tax rate: 04.95% Foreign average tax rate: 20.00%
- Relief u/s 91 is available at lower of aforesaid rate. i.e., 4.95%

ILLUSTRATION 4

Arvind, a textile merchant and resident Indian is doing business in India and abroad. During the previous year 2018-19, he disclosed the following information:

	₹
Income from business in India	27,00,000
Income from business in Country- A with which India does not have agreement for avoidance of double taxation	15,00,000
Income-tax levied by government in Country-A	5,00,000
Loss from business in Country-B with which also India does not have agreement for avoidance of double taxation	(4,00,000)



Contribution to public provident fund	1,50,000
Payment of life insurance premium on the life of his Father and mother	20,000

Compute the tax liability of Arvind for the assessment year 2019-20.

Solution

Computation of total income and tax liability for the A.Y. 2019-20

Particulars	Amount
Income from business in India	27,00,000
Income from business in Country A	15,00,000
Income from business in Country B	(-) 4,00,000
Gross Total Income	38,00,000
Less: Deduction u/s 80C	1,50,000
Total income	36,50,000
Tax on above	9,07,500
Add: Health & Education cess	36,300
Tax and cess payable	9,43,800
Average rate of tax [$\text{₹ } 9,43,800 / \text{₹ } 36,50,000 \times 100$]	25.86%
Rate of tax in country A	33.33%
Relief u/s 91 [25.86% of ₹ 15,00,000]	3,87,900
Tax payable (Rounded off u/s 288B)	5,55,900

1. Indian average tax rate: 25.86% Foreign average tax rate: 33.33%

Relief u/s 91 is available at lower of aforesaid rate. i.e., 25.86%.

ILLUSTRATION 5

Amar, an individual, resident of India, receives the following payments after TDS during the previous year 2018-19:

- (i) Professional fees on 17.08.2018 2,40,000
- (ii) Professional fees on 04.03.2019 1,60,000

Both the above services were rendered in Pakistan on which TDS of ₹ 50,000 and ₹ 30,000 respectively has been deducted. He had incurred an expenditure of ₹ 2,40,000 for earning both these receipts / income. His income from other sources in India is ₹ 3,00,000 and he has made payment of ₹ 70,000 towards LIC. Compute the tax liability of Amar and also the relief u/s 91, if any, for A.Y.2019-20.

Solution

Computation of total income and tax liability of Mr. Amar for the A.Y. 2019-20

Particulars	Amount	Amount
Income from profession from foreign	4,80,000	
Less: Expenses	2,40,000	2,40,000

Income from profession in India		3,00,000
Gross Total Income		5,40,000
Less: Deduction u/s 80C		70,000
Total income		4,70,000
Tax on above		11,000
Add: Health & Education cess		440
Tax and cess payable		11,440
Average rate of tax [$\text{₹ } 11,440 / \text{₹ } 4,70,000 \times 100$]		2.43%
Rate of tax in Pakistan		16.67%
Relief u/s 91 [$2.43\%^\wedge$ of $\text{₹ } 2,40,000$]		5,832
Tax payable (Rounded off u/s 288B)		5,610

$^\wedge$ Relief u/s 91 is available at lower rate. i.e., 2.43%

17.8 FOREIGN TAX CREDIT [RULE 128]

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.

Taxpoint:

- ♦ **More than one year:** In a case, where such foreign income 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.
- ♦ **No credit for interest, etc.:** The credit 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.
- ♦ **No credit for disputed tax:** No credit shall be available in respect of any amount of foreign tax or part thereof which is disputed in any manner by the assessee. However, 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 6 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.

Meaning of Foreign Tax

In respect of	Foreign Tax
A country or specified territory with which India has entered into an agreement u/s 90 or 90A	Tax covered under the said agreement
Any other country or specified territory	Tax payable under the law of that country or specified territory in the nature of income-tax referred to in the Explanation to sec. 91 (i.e., "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)



Taxpoint

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:

- The credit shall be the lower of the tax payable under the Act 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 shall be ignored.
- 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.

Tax Payable under MAT or AMT

- ◆ In a case where any tax is payable u/s 115JB or 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").
- ◆ Where the amount of foreign tax credit available against the tax payable u/s 115JB or 115JC exceeds the amount of tax credit available against the normal provisions, then while computing the amount of credit u/s 115JAA or 115JD in respect of the taxes paid u/s 115JB or 115JC, as the case may be, such excess shall be ignored.

Documents Required for Credit

Credit of any foreign tax shall be allowed on furnishing the following documents by the assessee within due date of furnishing return of income:

- ▶ 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;
- ▶ 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:
 - The statement furnished and signed by the assessee 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.

Taxpoint: 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

17.9 THE CONCEPTS OF PERMANENT ESTABLISHMENT (PE)

One of the important terms that occurs in all the Double Taxation Avoidance Agreements is the term 'Permanent

Establishment' (PE) which has not been defined in the Income Tax Act. However as per the Double Taxation Avoidance Agreements, PE includes, a wide variety of arrangements i.e. a place of management, a branch, an office, a factory, a workshop or a warehouse, a mine, a quarry, an oilfield etc. Imposition of tax on a foreign enterprise is done only if it has a PE in the contracting state. Tax is computed by treating the PE as a distinct and independent enterprise.

Generally, in Indian context, 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 "permanent establishment" shall also include:

- a. a place of management;
- b. a branch;
- c. an office;
- d. a factory;
- e. a workshop;
- f. a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
- g. a warehouse in relation to a person providing storage facilities for others;
- h. a farm, plantation or other place where agricultural, pastoral, forestry or plantation activities are carried on;
- i. premises used as a sales outlet or for receiving or soliciting orders;
- j. an installation or structure, or plant or equipment, used for the exploration for or exploitation of natural resources;
- k. a building site or construction, installation or assembly project, or supervisory activities in connection with such a site or project, where that site or project exists or those activities are carried on (whether separately or together with other sites, projects or activities) for more than specified months (generally 6 months).

Exclusion

An enterprise shall not be deemed to have a permanent establishment merely by reason of :

- a. the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise ;
- b. the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display ;
- c. the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- d. the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise; or
- e. the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the enterprise.

An enterprise of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, a general commission agent or any other agent of an independent status, where that person is acting in the ordinary course of the person's business as such a broker or agent. However, when the activities of such a broker or agent are carried on wholly or principally on behalf of that enterprise itself or on behalf of that enterprise and other enterprises controlling, or controlled by or subject to the same common control as, that enterprise, the person will not be considered a broker or agent of an independent status within the meaning of this paragraph.



17.10 TAXATION OF BUSINESS PROCESS OUTSOURCING UNITS IN INDIA

Taxation of IT-enabled Business Process Outsourcing Units in India as provided in the Circular 05/2004 dated 28-9-2004 are as under:

1. 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.
2. 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. The tax treatment of the Permanent Establishment in such a case is under consideration in this circular.
3. During the last decade or so, India has seen a steady growth of outsourcing of business processes by non-residents or foreign companies to IT-enabled entities in India. Such entities are either branches or associated enterprises of the foreign enterprise or an independent Indian enterprise. Their activities range from mere procurement of orders for sale of goods or provision of services and answering sales related queries to the provision of services itself like software maintenance service, debt collection service, software development service, credit card/mobile telephone related service, etc. 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. The extent to which the profits of the non-resident enterprise is to be attributed to the activities of such Permanent Establishment in India has been under consideration of the Board.
4. A non-resident or a foreign company is treated as having a Permanent Establishment in India under Article 5 of the Double Taxation Avoidance Agreements entered into by India with different countries 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 under Article 7 of the Double Taxation Avoidance Agreements.
5. Paragraph 1 of Article 7 of Double Taxation Avoidance Agreements provides that 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. Paragraph 2 of the same Article provides that subject to the provisions of Paragraph 3, there shall in each contracting state be attributed to that Permanent Establishment the profits which it might be expected to make 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. Paragraph 3 of the Article provides that in determining the profits of a Permanent Establishment there shall be allowed as deductions 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. What are 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.
6. Paragraph 2 contains the central directive on which the allocation of profits to a Permanent Establishment is intended to be based. The paragraph incorporates the view that 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". Paragraph 3 only provides a rule applicable for

the determination of the profits of the Permanent Establishment, while paragraph 2 requires that the profits so determined correspond to the profit that a separate and independent enterprise would have made. 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".

7. "Arm's length price" would have the same meaning as in the definition in sec. 92F(iii) of the Income-tax Act. The arm's length price would have to be determined in accordance with the provisions of sec. 92 to 92F of the Act.

17.11 TAXATION OF INCOME FROM AIR AND SHIPPING TRANSPORT UNDER DTAA

The DTAA is based on four basic models of DTAA and they are (i) OECD Model Tax Convention (emphasis is on residence principle); (ii) UN Model (combination of residence and source principle but the emphasis is on source principle); (iii) US Model (required to be followed for entering into DTAA's with the US and its peculiar to the US); and (iv) Andean Model (being adopted by member States namely Bolivia, Chile, Ecuador, Columbia, Peru and Venezuela)

Income derived from the operation of Air transport in international traffic by an enterprise of one contracting state will not be taxed in the other contracting state. In respect of an enterprise of one contracting state, income earned in the other contracting state from the operation of ships in international traffic, will be taxed in that contracting state wherein the place of effective management of enterprise is situated. However, some DTA agreement contains provisions to tax the income in the other contracting state also, although at reduced rate. These provisions do not apply to coastal traffic.

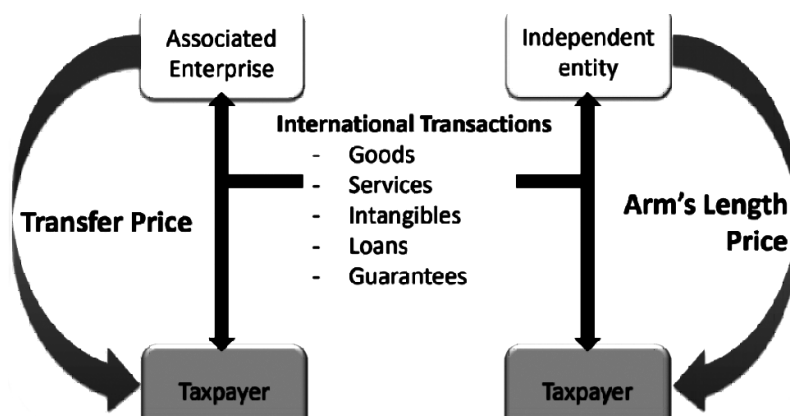
These agreements follow a near uniform pattern in as much as India has guided itself by the UN model of double taxation avoidance agreements. The agreements allocate jurisdiction between the source and residence country. Wherever such jurisdiction is given to both the countries, the agreements prescribe maximum rate of taxation in the source country which is generally lower than the rate of tax under the domestic laws of that country. The double taxation in such cases are avoided by the residence country agreeing to give credit for tax paid in the source country thereby reducing tax payable in the residence country by the amount of tax paid in the source country. These agreements give the right of taxation in respect of the income of the nature of interest, dividend, royalty and fees for technical services to the country of residence. However, the source country is also given the right but such taxation in the source country has to be limited to the rates prescribed in the agreement. The rate of taxation is on gross receipts without deduction of expenses.

TRANSFER PRICING

The increasing participation of multinational groups in economic activities in the country 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, thereby, leading to erosion of tax revenues. In other words, the course of business between a resident person and an associated non-resident or not ordinarily resident person, is so arranged that the resident makes either no profit or less than the ordinary profit in that business. Such an arrangement would deprive that Indian revenue of the tax which would otherwise be payable by the resident.

With a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in case of such multinational enterprise, new set of special provisions relating to avoidance of tax

have been introduced under chapter X in the Income tax Act. These provisions relate to computation of income from international transaction having regard to arm's length price, meaning of associated enterprises, meaning of international transaction, determination of arm's length price, keeping and maintaining of information and documents by persons entering into international transaction, furnishing of a report from an accountant by persons entering into such transactions.



17.12 COMPUTATION OF INCOME FROM INTERNATIONAL TRANSACTION OR SPECIFIED DOMESTIC TRANSACTION HAVING REGARD TO ARM'S LENGTH PRICE [SEC. 92]

The provisions are as under:

Provisions	Example	Treatment	Impact on income
Any income arising from an international transaction shall be computed having regard to the arm's length price.	X Ltd., resident, sold goods or services to its associated enterprises, XY Plc. (a foreign company), for ₹ 5 lacs whereas the arm's length price of such goods or services is ₹ 9 lacs	While computing income of X Ltd., ₹ 9 lacs shall be considered as sale value	Income of X Ltd. will be increased by ₹ 4 lacs.
The allowance for any expense or interest arising from an international transaction or specified domestic transaction ² shall also be determined having regard to the arm's length price.	R Ltd. takes a loan of ₹ 20 lacs from an associated enterprise in Ireland @ 20% p.a. whereas the arm's length rate of interest is 12% p.a.	Interest @ 12% p.a. shall be allowed as deduction to R Ltd.	Income of R Ltd. will be increased by ₹ 1,60,000/-
Where in an international transaction or specified domestic transaction, - two or more associated enterprises - enter into a mutual agreement or arrangement for the apportionment of, or any contribution to, any cost incurred - in connection with a benefit, service or facility provided to any such enterprises,	An enterprise in Germany makes research on a new product and incurred ₹ 50 lacs. Out of this, ₹ 40 lacs has been allocated to its Indian associated enterprises dealing in the same product.	While computing income of Indian enterprise, it will be required to be examined whether the Indian enterprise is deriving proportionate benefit to the research expenditure allocated	If no such benefit is available to the Indian enterprise, total income of such enterprises is suitably increased by disallowing proportionate allocated cost.

2. 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.

the cost apportioned to (contributed by), any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility.			
The provisions (in any of aforesaid situation) shall not apply in a case where the computation of income or the determination of the allowance for any expense or interest or the determination of any cost or expense allocated or contributed has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction or specified domestic transaction was entered into.	X Ltd., resident, sold goods or services to its associated enterprises, XY Plc. (a foreign company), for ₹ 5 lacs whereas the arm's length price of such goods or services is ₹ 3 lacs	The provision of transfer pricing is not applicable	No Impact

17.13 ARM'S LENGTH PRICE [SEC. 92F(ii)]

Arm's length price means

- (i) a price which is applied or proposed to be applied in a transaction
- (ii) between persons other than associated enterprises (i.e., unrelated person, resident or non-resident),
- (iii) in uncontrolled conditions.

Taxpoint: There may be more than one arm's length price.

Process

The process to arrive at the appropriate arm's length price typically involves the following processes or steps:

(a) Comparability analysis

The concept of establishing comparability is central to the application of the arm's length principle. An analysis under the arm's length principle involves information on associated enterprises involved in the controlled transactions, the transactions at issue between the associated enterprises, the functions performed and the information derived from independent enterprises engaged in comparable transactions (i.e., uncontrolled transactions). The objective of comparability analysis is always to seek the highest practicable degree of comparability, recognising that there will be unique transactions and cases where any applied method cannot be relied on. It is clear that the closest approximation of the arm's length price will be dependent on the availability and reliability of comparables. There are many factors determining the comparability of transactions for transfer pricing analysis:

(i) Characteristics of the property or services

Property, tangible or intangible, as well as services, may have different characteristics which may lead to a difference in their values in the open market. Therefore, these differences must be accounted for and considered in any comparability analysis of controlled and uncontrolled transactions. Characteristics that may be important



to consider are:

- In case of tangible property, the physical features, quality, reliability and availability of volume and supply;
- In the case of services, the nature and extent of such services; and
- In case of intangible property, the type and form of property, duration and degree of protection and anticipated benefits from use of property.

(ii) Functional analysis (Functions, Assets and Risks)

- ◆ In dealings between two independent enterprises, the compensation usually reflects the functions that each enterprise performs, taking into account assets used and risks assumed. Therefore, in determining whether controlled and uncontrolled transactions are comparable, a proper study of all specific characteristics of an international transaction or functional activity needs to be undertaken, including comparison of the functions performed, assets used and risks assumed by the parties. Such a comparison is based on a "functional analysis".
- ◆ A functional analysis seeks to identify and compare the economically significant activities and responsibilities undertaken by the independent and associated enterprises. An economically significant activity is considered to be any activity which materially affects the price charged in a transaction and the profits earned from that transaction.
- ◆ Functional analysis is thus a key element in a transfer pricing exercise. It is a starting point and lays down the foundation of the arm's length analysis. The purpose of functional analysis is to describe and analyse the operations of an enterprise and its associated enterprises.
- ◆ Functional analysis typically involves identification of 'functions performed', 'assets employed' and 'risks assumed' (therefore named a "FAR analysis") with respect to the international transactions of an enterprise. Functions that may need to be accounted for in determining the comparability of two transactions can include:
 - Research and development
 - Product design and engineering;
 - Manufacturing, production and process engineering;
 - Product fabrication, extraction and assembly;
 - Marketing and distribution functions, including inventory management and advertising activities;
 - Transportation and warehousing; and
 - Managerial, legal, accounting and finance, credit and collection, training and personnel management services.
 - Outsourcing nature of work
 - Business process management
- ◆ Risks that need to be considered while determining the degree of comparability between controlled and uncontrolled transactions include:
 - Financial risks including method of funding, funding of losses, foreign exchange risk
 - Product risk including design & development of product, after sales service, product liability risk, intellectual property risk, risks associated with R&D, obsolescence / upgrading of product

- Market risks including fluctuations in prices and demand, business cycle risks, development of market including advertisement and product promotion
 - Credit and collection risks;
 - Entrepreneurial risk including risk of loss associated with capital investment
 - General business risks related to ownership of plant, property and equipment.
- ◆ Furthermore it is not only necessary to identify the risks but to identify who bears such risks. The allocation of risk is usually based on contractual terms between the parties; however these may not always reflect the reality of a transaction or a relationship, and an allocation of risk between controlled taxpayers after the outcome of such risk is known or reasonably knowable lacks economic substance.
- ◆ Consider an example where company S, situated in country A, is the wholly-owned subsidiary of company P, situated in country B but a foreign manufacturer. The subsidiary company S acts as the distributor of goods manufactured by the parent company P and both parties execute an agreement that any product liability costs will be borne by the parent company P. However, in practice when product liability claims are raised, subsidiary company S always pays the resulting damages. In such a case the tax authorities will generally disregard the contractual arrangement and treat the risk as having been in reality assumed by subsidiary company S.

(iii) Contractual Terms

- ◆ The conduct of the contracting parties is a result of the terms of the contract between them and the contractual relationship thus warrants careful analysis when arriving at the transfer price. Other than a written contract, the terms of the transactions may be figured out from correspondence and communication between the parties involved. In case the terms of the arrangement between the two parties are not explicitly defined, then the terms have to be deduced from their economic relationship and conduct.
- ◆ One important point to note in this regard is that associated enterprises may not hold each other to the terms of the contract as they have common overarching interests, unlike independent enterprises, who are expected to hold each other to the terms of the contract. Thus, it is important to figure out whether the contractual terms between the associated enterprises are a "sham" (something that appears genuine, but when looked closer lacks reality, and is not valid under many legal systems) and/or have not been followed in reality.
- ◆ Also, explicit contractual terms of a transaction involving members of a MNE may provide evidence as to the form in which the responsibilities, risks and benefits have been assigned among those members. For example, the contractual terms might include the form of consideration charged or paid, sales and purchase volumes, the warranties provided, the rights to revisions and modifications, delivery terms, credit and payment terms etc. This material may also indicate the substance of a transaction, but will usually not be determinative on that point.
- ◆ It must be noted that contractual differences can influence prices as well as margins of transactions. The party concerned should document contractual differences and evaluate them in the context of the transfer pricing methods discussed in detail in a later chapter of this Manual, in order to judge whether comparability criteria are met and whether any adjustments need to be made to account for such differences.

(iv) Market Conditions

Market prices for the transfer of the same or similar property may vary across different markets owing to cost differentials prevalent in the respective markets. Markets can be different for numerous reasons; it is not possible



to itemise exhaustively all the market conditions which may influence transfer pricing analysis but some of the key market conditions which influence such an analysis are as follows:

Geographical location – In general, uncontrolled comparables ordinarily should be derived from the geographic market in which the controlled taxpayer operates, because there may be significant relevant differences in economic conditions between different markets. If information from the same market is not available, an uncontrolled comparable derived from a different geographical market may be considered if it can be determined that (i) there are no differences between the market relevant to the transaction or (ii) adjustments can be made to account for the relevant differences between the two markets.

Another aspect of having different geographic markets is the concept of "location savings" which may come into play during transfer pricing analysis. Location savings are the cost savings that a MNE realises as a result of relocation of operations from a high cost jurisdiction to a low cost jurisdiction. Typically, cost savings include costs of labour, raw materials and tax advantages offered by the new location. However, there might be disadvantages in relocating also; the "dis-savings" on account of relocation might be high costs for transportation, quality control, etc. The savings attributable to location into a low cost jurisdiction (offset by any "dis-savings") are referred to collectively as the "location savings". The important point, where there are such location savings, is not just the amount of the savings, but also the issues of to whom these savings belong (i.e. the captive service provider or the principal). In this respect, the allocation of location savings depends especially on the relative bargaining positions of the parties. Relative bargaining power of buyer, seller and end user is dependent on issues such as the beneficial ownership of intangible property and the relative competitive position.

The computation of location savings might seem simple in theory; however its actual computation may pose many difficulties. Moving to an offshore location might be accompanied by changes in technologies, productions volumes or production processes. In such a circumstance, the additional profit derived cannot be treated as only due to location savings as the profitability is due both to low costs and introduction of new technology. A simple comparison before and after in such a scenario would give a distorted picture of location savings.

If the tax authorities were to administer transfer pricing principles to "shift" profits without any consideration of market forces prevalent in the respective countries, then such reconfiguration of economic profile, and consequently the financial statements in the host country, would be against the principles of transfer pricing and may result in unrelieved double taxation if the tax authority in another country does not agree to reduce the profits of an associated enterprise in its country.

Government rules and regulations – Generally, government interventions in the form of price controls, interest rate controls, exchange controls, subsidies for certain sectors, anti-dumping duties etc, should be treated as conditions of the market in the particular country and in the ordinary course they should be taken into account in arriving at an appropriate transfer price in that market. The question becomes whether, in light of these conditions, the transactions by controlled parties are consistent with "uncontrolled" transactions between independent enterprises.

An example of where government rules affect the market are the Export Oriented Units (EOU's) which may be subject to beneficial provisions under the taxation laws of the country; ideally companies which enjoy similar privileges should be used as the comparables, and if that is not possible, adjustments may need to be made as part of the comparability analysis.

Level of Market – For example, the price at the wholesale level (sale to other sellers) and retail levels (sale to consumers) would generally differ, and there may be many levels of wholesalers before a product reaches the consumer.

Other market conditions – Some other market conditions which influence the transfer price include costs of production (including costs of land, labour and capital), availability of substitutes (both goods and services), level of demand/supply, transport costs, size of the market, the extent of competition.



(v) Business Strategies

- ◆ Business strategies relating to new product launches, innovations, market penetration or expansion of market share may require selling products cheaper as part of such a strategy and thus earning lower profit in the anticipation of increased profits in the coming years, once the product has become more established in the market. Such strategies must be taken into account when determining the comparability of controlled and uncontrolled transactions. E.g., "start-up" companies are prone to incurring losses during their early life and it would not generally be appropriate to include such start-ups when the tested party (i.e. the party in the controlled transaction to whom the transfer pricing method is applied) is a company with a track record over many years.
- ◆ The evaluation of the claim that a business strategy was being followed which decreased profits in the short-term but provided for higher long-term profits is one that has to be considered by the tax authorities carefully after weighing several factors. One factor being - who bears the cost of the market penetration strategy? Another factor to consider is whether the nature of relationship reflects the taxpayer bearing the cost of the business strategy –for example, a sales agent with little responsibility or risk typically cannot be said to bear costs for a market penetration strategy. Another factor is whether the business strategy itself is prima- facie plausible or needs further investigation; an endless "market penetration strategy" that has yielded no profits in many years might under examination have no such real basis in practice.

(b) Transaction analysis

The arm's length price must be established with regard to transactions actually undertaken; the tax authorities should not substitute other transactions in the place of those that have actually happened and should not disregard those transactions actually undertaken unless there are special circumstances - such as that the real economic substance of the transaction differs from its form or the transaction arrangements are not structured in the commercially rational manner that would be expected between independent enterprises. In general, restructuring of transactions should not be undertaken lightly as it may lead to double taxation due to divergent views by the nation states on how the transactions are structured. Whether authorities are able to do so will ultimately depend on their ability to do so under applicable local law, and even where it is possible, a good understanding of business conditions and realities is necessary for a fair "reconstruction". These issues are relevant not only to the administration of transfer pricing, but also to developing the underlying legislation at the beginning of a country's transfer pricing "journey" to allow effective administration (and to assist, and reduce the costs of, compliance by taxpayers) during the course of that journey.

(c) Evaluation of separate and combined transactions

- ◆ An important aspect of transfer pricing analysis is whether this analysis is required to be carried out with respect to individual international transactions or a group of international transactions having close economic nexus. In most cases, it has been observed that application of the arm's length principle on a transaction-by-transaction basis becomes cumbersome for all involved, and thus recourse is often had to the "aggregation" principle.
- ◆ For example with transactions dealing with intangible property such as the licensing of "know-how" (practical technical knowledge of how to do something, such as of an industrial process, that is not widely-held) to associate enterprises it may prove difficult to separate out the transactions involved. Similarly long-term service supply contracts and pricing of closely linked products are difficult to separate out transaction-wise.
- ◆ Another important aspect of combined transactions is the increasing presence of composite contracts and "package deals" in an MNE group; a composite contract and/or package deal may contain a number of elements including royalties, leases, sale and licenses all packaged into one deal. The tax authorities would generally consider the deal in its totality and arrive at the appropriate transfer price; in such a case



comparables need to be similar (deals between independent enterprises). In certain cases, the tax authorities might find it appropriate for various reasons to allocate the price to the elements of the package or composite contract. It must be noted that any application of the arm's length principle, whether on a transaction by transaction basis or on aggregation basis, needs to be evaluated on a case to case basis, applying the relevant methodologies to the facts as they exist in that particular case.

(d) Use of an arm's length range

- ◆ The arm's length principle as applied in practice usually results in an arm's length range (that is, a range of acceptable/comparable prices) rather than a single transfer price for a controlled transaction. The range of transfer prices exists because the transfer pricing methods attempt to reflect prices and conditions between independent parties. However at times it is difficult to make highly precise adjustments due to differences between controlled transactions and uncontrolled transactions. If only one transfer pricing method is applied, the method may indicate a single acceptable price range. If more than one transfer pricing method is being used, each method may indicate different ranges. If the range of prices that are common to the methods is used, the range is more likely to be reliable in fairly reflecting business conditions.
- ◆ If the transfer prices used by a taxpayer are within the arm's length range, adjustments should not be required. If the transfer prices used by a taxpayer are outside the range of prices determined by a tax authority, the taxpayer should be given an opportunity to explain the differences.
- ◆ If a taxpayer is able to explain the difference and provides its own transfer pricing documentation used in setting its transfer prices which supports this, a tax authority will usually decide not to make adjustment. On the other hand, if the taxpayer is unable to justify its transfer prices an adjustment may be required.

(e) Use of multiple year data

- ◆ When economic and financial data is being tested, previous years' data may truly represent the results achieved by both the controlled and uncontrolled taxpayers. The use of multiple year data allows the data to be better harmonised, as it tends to average the results over a period of time. Multiple year data can also uncover relevant abnormal economic factors affecting the results, such as strikes or other adverse conditions. Such an approach also tries to test the data thrown up in typical business cycles and thus eliminates the risk of testing data of only a particularly bad or good year.
- ◆ Furthermore, in certain industries which are more cyclical in nature the multiple year data may give a better standard of comparison than use of single year data; the automotive industry can be one example of such a cyclical industry. That is not to say, however, that use of multiple year data prevents authorities from challenging artificial attempts to take advantage of such an approach by, for example, wrongly pricing in the last year of the data in the hope that such pricing will be "absorbed" into the wider data set. Some countries consider that they are legally required to consider data on a year-by year basis; that will be a matter for domestic law, but if the choice exists when setting up a transfer pricing regime, it would generally be preferable to have a multi-year approach to deal with legitimate variations in business conditions across years.
- ◆ While using multi-year data for comparability analysis, it is in any case necessary to adjust for factors such as the occurrence of significant events in the preceding years and the role of inflation in changing prices of commodities and services.
- ◆ Overall, multiple year data provides information about the relevant business and product life cycles of the comparables; differences in business or product life cycles may have an effect on the conditions which determine comparability. Data from previous years can show whether an independent enterprise engaged in comparable transactions was affected by similar economic conditions so as to be used as a comparable or not.

(f) Losses

- ◆ In an MNE group, one of the enterprises might be suffering a loss, even a recurring one, but the overall group may be extremely profitable. The fact that there is an enterprise making losses that is doing business with profitable members of its MNE group may warrant scrutiny by the tax authorities concerned. Such a situation perhaps indicates that the loss-making enterprise is not receiving adequate compensation from the MNE group of which it is a part in relation to the benefits derived from its activities.
- ◆ However there are many facets of these losses that have to be studied such as the nature of the loss (spread across group, history of loss-making within entity and group etc), the reasons for the loss (economic downtime, business cycle, start-up business, poor management, excessive risk etc), and the period of loss (short-term, long-term) as all these factors play a significant role in determining how the loss should be treated with respect to transfer pricing.

(g) Intentional set-offs

- ◆ A deliberate or intentional set-off occurs when an associated enterprise has provided a benefit to another associated enterprise within the MNE group and is compensated in return by that other enterprise with some other benefits. These enterprises may claim that the benefit that each has received should be set-off against the benefit each provided and only the net gain or loss if any on the transactions needs to be considered for tax assessment.
- ◆ Set-offs can be quite complex; they might involve a series of transactions and not just a simple "one transaction, two party" set-off. Ideally the parties disclose all set-offs accurately and have enough documentation to substantiate their set-off claims so that after taking account of set-offs, the conditions governing the transactions are consistent with the arm's length principle.
- ◆ The tax authorities may evaluate the transactions separately to determine which of the transactions satisfy the arm's length principle. However, the tax authorities may also choose to evaluate the set-off transactions together, in which case comparables have to be carefully selected; set-offs in international transactions and in domestic transactions may not be easily comparable, such as due to the differences in the tax treatment of the set-offs under the taxation systems of different countries.

(h) Use of custom valuations

- ◆ The General Agreement on Trades and Tariff (GATT, Article VII), now part of the World Trade Organization (WTO) set of agreements, has laid down the general principles for an international system of custom valuation. Customs valuation is the procedure applied to determine the customs value of imported goods. Member countries of WTO typically harmonise their internal legislation dealing with the customs valuation with the WTO Agreement on Customs Valuation.
- ◆ In appropriate circumstances, the documented custom valuation may be used for justifying the transfer prices of imported goods in international transactions between associated enterprises. The arm's length principle is applied by many customs administrations as a principle of comparison between the value attributable to goods imported by associated enterprises and the value of similar goods imported by independent enterprises. However when there is no customs duty imposed and goods are valued only for statistical purposes, and for items which have no rate of duty, this approach would not be useful. Even when utilising the custom valuation for imports in a transfer pricing context, certain additional upward or downward adjustments may be required to derive the arm's length price for the purpose of taxation.
- ◆ Internationally, there is a great deal of focus on the interplay of transfer pricing methods on the one hand and custom valuation methods on the other hand. Debates have centred on the feasibility and desirability of the convergence of the systems surrounding the two sets of value determination. The issue is considered in more detail in a later chapter.



(i) Use of transfer pricing methods

- ◆ It is important to note at the outset that there is no one transfer pricing method which is generally applicable to every possible situation. The bottom line is that comparables play a critical role in arriving at arm's length prices; it is also abundantly clear that computing an arm's length price using transfer pricing analysis is a complex task; it requires a lot of effort and goodwill from both the taxpayer and the tax authorities in terms of documentation, groundwork, analysis and research.

17.14 ENTERPRISE [SEC. 92F(iii)]

Enterprise means a person (including a permanent establishment¹ of such person) 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:
 - (a) articles or goods; or
 - (b) know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature; or
 - (c) 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
- ◆ in 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.

¹. Permanent establishment includes a fixed place of business through which the business of the enterprise is wholly or partly carried on [Sec. 92F(iiiia)].

17.15 MEANING OF INTERNATIONAL TRANSACTION [SEC. 92B]

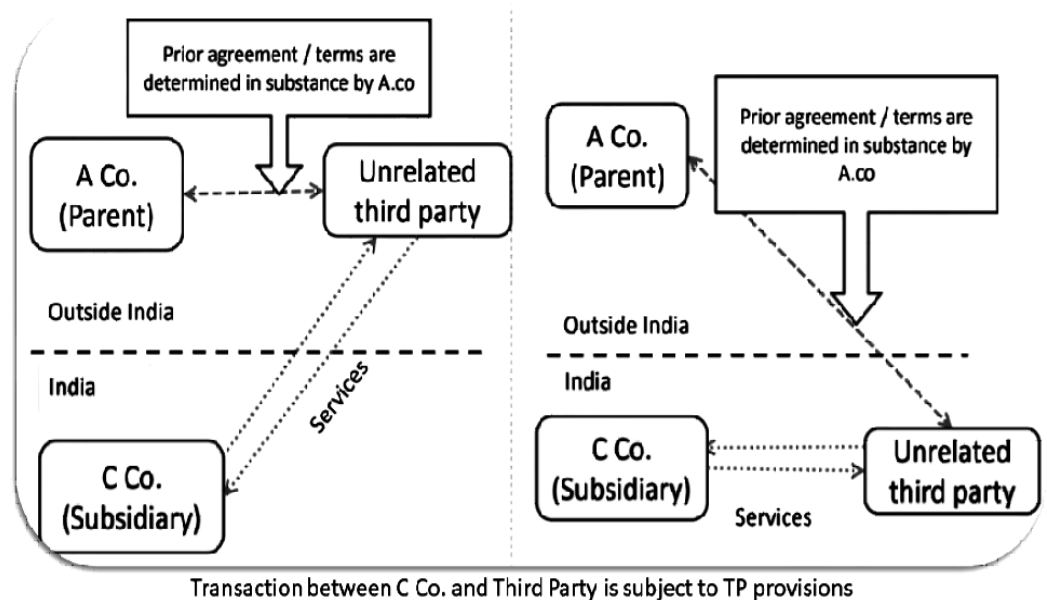
- ◆ International transaction means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of
 - (i) purchase, sale or lease of tangible or intangible property, or
 - (ii) provision of services, or
 - (iii) lending or borrowing money, or
 - (iv) any other transaction having a bearing on the profits, income, losses or assets of such enterprises; &

shall include a mutual agreement or arrangement between two or more associated enterprises

- a. for the allocation or apportionment of, or
 - b. 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 [Sec. 92B(1)]
- ♦ A transaction entered into by an enterprise with a person other than an associated enterprise shall, be deemed to be an international transaction entered into between two associated enterprises,
- (i) if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise; or
 - (ii) the terms of the relevant transaction are determined in substance between such other person and the associated enterprise

where the enterprise or the associated enterprise or both of them are non-residents irrespective of whether such other person is a non-resident or not [Sec. 92B(2)]

E.g. C Co., an Indian company, and A Co., a foreign company, are associated enterprise. Z Plc., a foreign company, (not an associated enterprise of C Co.) and A Co. enters into an agreement for determining the terms of transactions between C Co. and Z Plc. The transaction as may be entered between C Co. and Z Plc., which is governed by such an agreement existing between A Co. and Z Plc. shall be deemed to be a transaction between two associated enterprises.



Taxpoint

- ♦ Non-resident means a person who is not a 'resident' including a person who is not ordinarily resident [Sec. 2(30)]
- ♦ Transaction includes an arrangement, understanding or action in concert,—
 - (A) whether or not such arrangement, understanding or action is formal or in writing; or
 - (B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceeding. [Sec. 92F(v)]
- ♦ For a transaction to be an international transaction, it should satisfy the following two conditions cumulatively:
 - a) It must be a transaction between two associated enterprises; and
 - b) At least one of the two enterprises must be a non-resident.



17.16 DEEMED INTERNATIONAL TRANSACTION

International transaction shall include:

- a. the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;
- b. the purchase, sale, transfer, lease or use of intangible property¹, including the transfer of ownership or the provision of use of rights regarding 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;
- c. capital financing, including 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;
- d. provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;
- e. a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;

17.17 MEANING OF SPECIFIED DOMESTIC TRANSACTIONS [SEC. 92BA]

"Specified Domestic Transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:

- i. any transaction referred to in sec. 80A;
- ii. any transfer of goods or services referred to in sec. 80-IA(8);
- iii. any business transacted between the assessee and other person as referred to in sec. 80-IA(10);
- iv. any transaction, referred to in any other section under Chapter VI-A or sec. 10AA, to which provisions of sec. 80-IA(8) or (10) are applicable; or
- v. any other transaction as may be prescribed,

¹ Intangible property shall include:

- a. marketing related intangible assets, such as, trademarks, trade names, brand names, logos;
- b. technology related intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;
- c. artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;
- d. data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;
- e. engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schematics, blueprints, proprietary documentation;
- f. customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;
- g. contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements;
- h. human capital related intangible assets, such as, trained and organised work force, employment agreements, union contracts;
- i. location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;
- j. goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;
- k. methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;
- l. any other similar item that derives its value from its intellectual content rather than its physical attributes.

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of ₹ 20 crore.

Example

Sultan Ltd. took services of one of its group company, an associated enterprise enjoying tax holiday. The transaction is a specified domestic transaction. Sultan Ltd. paid ₹ 28,40,00,000 for the said service to the group company. The arms length price of such service is ₹ 17,00,00,000. The arms length price, i.e., the fair value of the service is ₹ 17,00,00,000 but by paying higher charges, Sultan Ltd. claimed a higher deduction and reduced its profit by ₹ 11,40,00,000. In this case the provisions of sec. 92 will be applicable and the income of Sultan Ltd. will be recomputed by taking into account the arms length price of the specified domestic transaction.

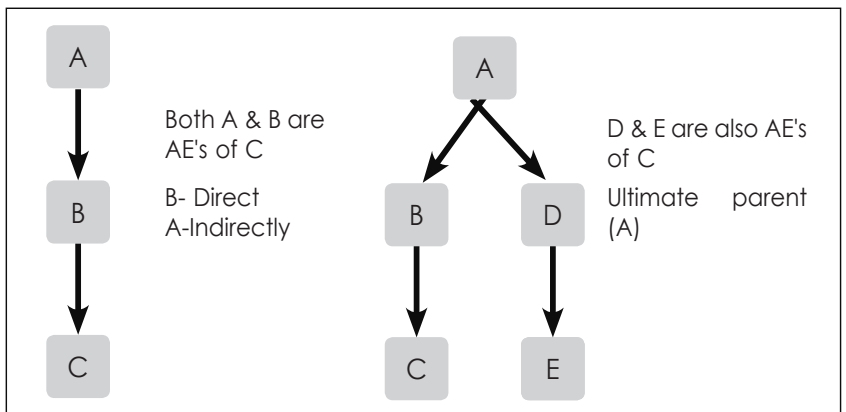
In other words, the taxable income of Sultan Ltd. will have to be computed by allowing deduction of only ₹ 17,00,00,000 on account of service charges instead of the actually paid amount of ₹ 28,40,00,000.

If in the above example, the transaction is not a specified domestic transaction, then the provisions of sec. 92 will not apply.

17.18 MEANING OF ASSOCIATED ENTERPRISE [SEC. 92A]

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.



Deemed associated enterprise [Sec. 92A(2)]

For the above purpose, two enterprises shall be deemed to be associated enterprises if, at any time during the previous year fulfil any of the following conditions (if one of following conditions are not satisfied, then mere participation in management or control or capital of the other enterprise, etc. shall not make them associate):

- one enterprise holds (directly or indirectly) shares carrying not less than 26% of the voting power (i.e., equity shares in case of company) in the other enterprise; or
- any person or enterprise holds (directly or indirectly) shares carrying not less than 26% of the voting power in each of such enterprises; or
- the manufacture or processing of goods or articles or business carried out by one enterprise is wholly (not partially) dependent on the use of know-how, patents, copyrights, 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

- (d) 90% or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or
- (e) 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; or
- (f) 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 relative of such individual; or
- (g) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family, or by a relative of a member of such Hindu undivided family, or jointly by such member and his relative; or
- (h) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than 10% interest in such firm, association of persons or body of individuals; or
- (i) a loan advanced by one enterprise to the other enterprise constitutes not less than 51% of the book value of the total assets of the other enterprise; or

Taxpoint: Revaluation of asset shall not be ignored.

- (j) one enterprise guarantees not less than 10% of the total borrowings of the other enterprise; or
- (k) more than $\frac{1}{2}$ of the board of directors or members of the governing board, or one (not $\frac{1}{2}$ of total number of executive director) or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or

Taxpoint: Mere power to appoint director is not sufficient, such power must be exercised.

- (l) more than $\frac{1}{2}$ 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 or persons; or
- (m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

HOLDING	MANAGEMENT	ACTIVITIES	CONTROL
• $\geq 26\%$ DIRECT / INDIRECT holding by enterprise (Or) • By SAME PERSON in each enterprise. • LOAN $\geq 51\%$ of total assets • GUARANTEES $\geq 10\%$ of debt • $> 10\%$ INTEREST in Firm /AOP/BOI	• Appointment $>50\%$ of DIRECTORS / one or more Executive Director by an enterprise (Or) • Appointment by same person in each enterprise	• 100% DEPENDENCE on use of intangibles for manufacture / processing / business • Direct / Indirect Supply of $\geq 90\%$ RAW MATERIALS under influenced prices and conditions • Sale under INFLUNCED prices and conditions	• One enterprise controlled BY AN INDIVIDUAL and the other by himself or hid relative or jointly • One enterprise controlled BY HUF and the other by - a member of HUF his relative or jointly by member and relative

17.19 COMPUTATION OF ARM'S LENGTH PRICE [SEC. 92C]

- ♦ The arm's length price in relation to an international transaction or specified domestic 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:

Transaction Based Methods

- comparable uncontrolled price method;
- resale price method;
- cost plus method;

Profit Based Methods

- profit split method;
- transactional net margin method;
- such other method as may be prescribed by the Board.

See Rule 10B & Rule 10AB as given in Annexure 1

- ♦ The most appropriate method shall be applied, for determination of arm's length price, in the manner as may be prescribed.

More than one arm's length price: Where more than one price is determined by the most appropriate method, the arm's length price shall be computed in such manner as may be prescribed.

- ♦ 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 following percentage of the latter, 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:

In case of wholesale trading	1%
In other case	3%

- ♦ As per sec. 92C(3), where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that:
 - the price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with above provision; or
 - any information and document relating to an international transaction or specified domestic transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sec. 92D(1) and the rules made in this behalf; or
 - the information or data used in computation of the arm's length price is not reliable or correct; or
 - the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued u/s 92D(3),

the Assessing Officer may proceed to determine the arm's length price (in accordance with above provisions) in relation to the said international transaction or specified domestic transaction, on the basis of such material or information or document available with him.



However, an opportunity shall be given by the 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 arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.

- ◆ Where an arm's length price is determined by the Assessing Officer, the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined u/s 92C(4). However:
 - ▶ No deduction u/s 10AA or under Chapter VIA shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income by the assessing officer.
 - ▶ Where the total income of an associated enterprise is computed by assessing officer on determination of the arm's length price paid to another associated enterprise from which tax has been deducted or was deductible, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise.

Due to application of transfer pricing provisions, there should be no loss to the revenue.

17.20 REFERENCE TO TRANSFER PRICING OFFICER [SEC. 92CA]

- ◆ Where any person, being the assessee, has entered into an international transaction or specified domestic transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said international transaction or specified domestic transaction u/s 92C to the Transfer Pricing Officer.
- ◆ Where a reference is made, the Transfer Pricing Officer shall serve a notice on the assessee requiring him to produce or cause to be produced on a date to be specified therein, any evidence on which the assessee may rely in support of the computation made by him of the arm's length price in relation to such international transaction or specified domestic transaction.
- ◆ On the date specified in the notice or as soon thereafter as may be, after hearing such evidence as the assessee may produce, including any information or documents referred to in sec. 92D and after considering such evidence as the Transfer Pricing Officer may require on any specified points and after taking into account all relevant materials which he has gathered, the Transfer Pricing Officer shall, by order in writing, determine the arm's length price in relation to the international transaction or specified domestic transaction [in accordance with sec. 92C(3)] and send a copy of his order to the Assessing Officer and to the assessee.
- ◆ Where a reference was made, an order may be made at any time before 60 days prior to the date on which the period of limitation referred to in sec. 153/153B for making the order of assessment or reassessment or recomputation or fresh assessment, as the case may be, expires.

In case assessment proceedings stayed in any circumstances referred to in Explanation (1) [clause (ii) or (x)] to sec. 153 and the period of limitation available to the Transfer Pricing Officer for making an order is less than 60 days, such remaining period shall be extended to 60 days and the aforesaid period of limitation shall be deemed to have been extended accordingly.

- ◆ On receipt of the order, the Assessing Officer shall proceed to compute the total income of the assessee u/s 92C(4) in conformity with the arm's length price as so determined by the Transfer Pricing Officer
- ◆ With a view to rectifying any mistake apparent from the record, the Transfer Pricing Officer may amend any order passed by him and the provisions of section 154 shall, so far as may be, apply accordingly.
- ◆ Where any amendment is made by the Transfer Pricing Officer, he shall send a copy of his order to the Assessing Officer who shall thereafter proceed to amend the order of assessment in conformity with such order of the Transfer Pricing Officer.

- ◆ Where any other international transaction, comes to the notice of the Transfer Pricing Officer during the course of the proceedings before him, the provisions of this Chapter shall apply as if such other international transaction is an international transaction referred to him.
- ◆ Where in respect of an international transaction, the assessee has not furnished the report u/s 92E and such transaction comes to the notice of the Transfer Pricing Officer during the course of the proceeding before him, the provisions of this Chapter shall apply as if such transaction is an international transaction referred to him.
- ◆ The Transfer Pricing Officer may, for the purposes of determining the arm's length price under this section, exercise all or any of the powers specified in sec. 131(1) or 133(6) or 133A.
- ◆ Transfer Pricing Officer means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorised by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D in respect of any person or class of persons.

17.21 POWER OF BOARD TO MAKE SAFE HARBOUR RULES [SEC. 92CB]

The determination of arm's length price u/s 92C or 92CA shall be subject to safe harbour rules made by the Board. Safe harbour means circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee.

Safe Harbour [Rule 10TD]

Where an eligible assessee has entered into an eligible international transaction and the option exercised by the said assessee is not held to be invalid under rule 10TE, the transfer price declared by the assessee in respect of such transaction shall be accepted by the income-tax authorities, if it is in accordance with the circumstances as specified here in below:

Sl.	Eligible International Transaction	Circumstances							
1.	Provision of software development services Software development services means: i. business application software and information system development using known methods and existing software tools; ii. support for existing systems; iii. converting or translating computer languages; iv. adding user functionality to application programmes; v. debugging of systems; vi. adaptation of existing software; or vii. preparation of user documentation, but does not include any research and development services whether or not in the nature of contract research and development services.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is: <table><tr><th>Where the value of international transaction</th><th>Not less than</th></tr><tr><td>▶ does not exceed a sum of ₹ 100 crore</td><td>17%</td></tr><tr><td>▶ exceeds ₹ 100 crore but does not exceed ₹ 200 crore</td><td>18%</td></tr></table>		Where the value of international transaction	Not less than	▶ does not exceed a sum of ₹ 100 crore	17%	▶ exceeds ₹ 100 crore but does not exceed ₹ 200 crore	18%
Where the value of international transaction	Not less than								
▶ does not exceed a sum of ₹ 100 crore	17%								
▶ exceeds ₹ 100 crore but does not exceed ₹ 200 crore	18%								



2. Provision of information technology enabled services Information technology enabled services means the following business process outsourcing services provided mainly with the assistance or use of information technology,: i. back office operations; ii. call centres or contact centre services; iii. data processing and data mining; iv. insurance claim processing; v. legal databases; vi. creation and maintenance of medical transcription excluding medical advice; vii. translation services; viii. payroll; ix. remote maintenance; x. revenue accounting; xi. support centres; xii. website services; xiii. data search integration and analysis; xiv. remote education excluding education content development; or xv. clinical database management services excluding clinical trials, but does not include any research and development services whether or not in the nature of contract research and development services;	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is: <table><tr><th>Where the aggregate value of such international transaction entered into during the previous year</th><th>Not less than</th></tr><tr><td>▶ does not exceed a sum of ₹ 100 crore</td><td>17%</td></tr><tr><td>▶ exceeds ₹ 100 crore but does not exceed ₹ 200 crore</td><td>18%</td></tr></table>	Where the aggregate value of such international transaction entered into during the previous year	Not less than	▶ does not exceed a sum of ₹ 100 crore	17%	▶ exceeds ₹ 100 crore but does not exceed ₹ 200 crore	18%		
Where the aggregate value of such international transaction entered into during the previous year	Not less than								
▶ does not exceed a sum of ₹ 100 crore	17%								
▶ exceeds ₹ 100 crore but does not exceed ₹ 200 crore	18%								
3. Provision of knowledge process outsourcing services Knowledge process outsourcing services means the following business process outsourcing services provided mainly with the assistance or use of information technology requiring application of knowledge and advanced analytical and technical skills,: i. geographic information system; ii. human resources services; iii. engineering and design services; iv. animation or content development and management;	The value of international transaction does not exceed ₹ 200 crore and the operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is: <table><tr><th>Not less than</th><th>Employee Cost in relation to the Operating Expense is</th></tr><tr><td>24%</td><td>is at least 60%</td></tr><tr><td>21%</td><td>is 40% or more but less than 60%</td></tr><tr><td>18%</td><td>does not exceed 40%</td></tr></table>	Not less than	Employee Cost in relation to the Operating Expense is	24%	is at least 60%	21%	is 40% or more but less than 60%	18%	does not exceed 40%
Not less than	Employee Cost in relation to the Operating Expense is								
24%	is at least 60%								
21%	is 40% or more but less than 60%								
18%	does not exceed 40%								

	v. business analytics; vi. financial analytics; or vii. market research, but does not include any research and development services whether or not in the nature of contract research and development services.													
4.	Advancing of intra-group loans where the amount of loan is denominated in Indian Rupees (INR) Intra-group loan means loan advanced to wholly owned subsidiary being a non-resident, where the loan: i. is sourced in Indian rupees; ii. is not advanced by an enterprise, being a financial company including a bank or a financial institution or an enterprise engaged in lending or borrowing in the normal course of business; and iii. does not include credit line or any other loan facility which has no fixed term for repayment;	The interest rate declared in relation to the eligible international transaction is not less than the 1-year marginal cost of funds lending rate of State Bank of India as on 1st April of the relevant previous year plus: <table><tr><th>Plus %</th><th>CRISIL credit rating of the associated enterprise</th></tr><tr><td>1.75%</td><td>between AAA to A</td></tr><tr><td>3.25%</td><td>BBB-, BBB or BBB+</td></tr><tr><td>4.75%</td><td>between BB to B</td></tr><tr><td>6.25%</td><td>between C to D</td></tr><tr><td>4.25%</td><td>Where credit rating of the associated enterprise is not available and the amount of loan advanced to all associated enterprise in Indian Rupees does not exceed ₹ 100 crore in the aggregate as on 31st March of the relevant previous year.</td></tr></table>	Plus %	CRISIL credit rating of the associated enterprise	1.75%	between AAA to A	3.25%	BBB-, BBB or BBB+	4.75%	between BB to B	6.25%	between C to D	4.25%	Where credit rating of the associated enterprise is not available and the amount of loan advanced to all associated enterprise in Indian Rupees does not exceed ₹ 100 crore in the aggregate as on 31st March of the relevant previous year.
Plus %	CRISIL credit rating of the associated enterprise													
1.75%	between AAA to A													
3.25%	BBB-, BBB or BBB+													
4.75%	between BB to B													
6.25%	between C to D													
4.25%	Where credit rating of the associated enterprise is not available and the amount of loan advanced to all associated enterprise in Indian Rupees does not exceed ₹ 100 crore in the aggregate as on 31st March of the relevant previous year.													
5.	Advancing of intra-group loans referred to in item (iv) of rule 10TC where the amount of loan is denominated in foreign currency.	The interest rate declared in relation to the eligible international transaction is not less than the 6-month London Inter-Bank Offer Rate of the relevant foreign currency as on 30th September of the relevant previous year plus,: <table><tr><th>Plus %</th><th>CRISIL credit rating of the associated enterprise</th></tr><tr><td>1.50%</td><td>between AAA to A</td></tr><tr><td>3.00%</td><td>BBB-, BBB or BBB+</td></tr><tr><td>4.50%</td><td>between BB to B</td></tr><tr><td>6.00%</td><td>between C to D</td></tr><tr><td>4.00%</td><td>Where credit rating of the associated enterprise is not available and the amount of loan advanced to all associated enterprise in Indian Rupees does not exceed ₹ 100 crore in the aggregate as on 31st March of the relevant previous year.</td></tr></table>	Plus %	CRISIL credit rating of the associated enterprise	1.50%	between AAA to A	3.00%	BBB-, BBB or BBB+	4.50%	between BB to B	6.00%	between C to D	4.00%	Where credit rating of the associated enterprise is not available and the amount of loan advanced to all associated enterprise in Indian Rupees does not exceed ₹ 100 crore in the aggregate as on 31st March of the relevant previous year.
Plus %	CRISIL credit rating of the associated enterprise													
1.50%	between AAA to A													
3.00%	BBB-, BBB or BBB+													
4.50%	between BB to B													
6.00%	between C to D													
4.00%	Where credit rating of the associated enterprise is not available and the amount of loan advanced to all associated enterprise in Indian Rupees does not exceed ₹ 100 crore in the aggregate as on 31st March of the relevant previous year.													



6.	Providing corporate guarantee Corporate guarantee means explicit corporate guarantee extended by a company to its wholly owned subsidiary being a non-resident in respect of any short-term or long-term borrowing. However, explicit corporate guarantee does not include letter of comfort, implicit corporate guarantee, performance guarantee or any other guarantee of similar nature	The commission or fee declared in relation to the eligible international transaction is @ not less than 1% p.a. on the amount guaranteed.
7.	Provision of contract research and development services wholly or partly relating to software development Contract research and development services wholly or partly relating to software development means the following: - research and development producing new theorems and algorithms in the field of theoretical computer science; - development of information technology at the level of operating systems, programming languages, data management, communications software and software development tools; - development of Internet technology; - research into methods of designing, developing, deploying or maintaining software; - software development that produces advances in generic approaches for capturing, transmitting, storing, retrieving, manipulating or displaying information; - experimental development aimed at filling technology knowledge gaps as necessary to develop a software programme or system; - research and development on software tools or technologies in specialised areas of computing (image processing, geographic data presentation, character recognition, artificial intelligence and such other areas); or - upgradation of existing products where source code has been made available by the principal, except where the source code has been made available to carry out routine functions like debugging of the software	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24%, where the value of the international transaction does not exceed ₹ 200 crore.
8.	Provision of contract research and development services wholly or partly relating to generic pharmaceutical drugs.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24%, where the value of the international transaction does not exceed ₹ 200 crore.

	Generic pharmaceutical drug means a drug that is comparable to a drug already approved by the regulatory authority in dosage form, strength, route of administration, quality and performance characteristics, and intended use	
9.	Manufacture and export of core auto components Core auto components means: - engine and engine parts, including piston and piston rings, engine valves and parts cooling systems and parts and power train components; - transmission and steering parts, including gears, wheels, steering systems, axles and clutches; - suspension and braking parts, including brake and brake assemblies, brake linings, shock absorbers and leaf springs	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 12%.
10.	Manufacture and export of non-core auto components Non-core auto components mean auto components other than core auto components	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 8.5%
11.	Receipt of low value-adding intra-group services Low value-adding intra-group services means services that are performed by one or more members of a multinational enterprise group on behalf of one or more other members of the same multinational enterprise group and which: - are in the nature of support services; - are not part of the core business of the multinational enterprise group, i.e., such services neither constitute the profit-earning activities nor contribute to the economically significant activities of the multinational enterprise group; - are not in the nature of shareholder services or duplicate services; - neither require the use of unique and valuable intangibles nor lead to the creation of unique and valuable intangibles; - neither involve the assumption or control of significant risk by the service provider nor give rise to the creation of significant risk for the service provider; and - do not have reliable external comparable services that can be used for determining their arm's length price,	The entire value of the international transaction, including a mark-up not exceeding 5%, does not exceed ₹ 10 crore. The method of cost pooling, the exclusion of shareholder costs and duplicate costs from the cost pool and the reasonableness of the allocation keys used for allocation of costs to the assessee by the overseas associated enterprise, is certified by an accountant.



but does not include the following services:	
i. research and development services;	
ii. manufacturing and production services;	
iii. information technology (software development) services;	
iv. knowledge process outsourcing services;	
v. business process outsourcing services;	
vi. purchasing activities of raw materials or other materials that are used in the manufacturing or production process;	
vii. sales, marketing and distribution activities;	
viii. financial transactions;	
ix. extraction, exploration, or processing of natural resources; and	
x. insurance and reinsurance	

Taxpoint

- ◆ Operating expense means the costs incurred in the previous year by the assessee in relation to the international transaction during the course of its normal operations including costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee, reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee, amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of those associated enterprises and which relate to normal operations of the assessee and depreciation and amortisation expenses relating to the assets used by the assessee, but not including the following:
 - i. interest expense;
 - ii. provision for unascertained liabilities;
 - iii. pre-operating expenses;
 - iv. loss arising on account of foreign currency fluctuations;
 - v. extraordinary expenses;
 - vi. loss on transfer of assets or investments;
 - vii. expense on account of income-tax; and
 - viii. other expenses not relating to normal operations of the assessee:
 - ▶ Reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee shall be at cost.
 - ▶ Amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of the associated enterprises and which relate to normal operations of the assessee shall be at cost
- ◆ **Operating revenue** means the revenue earned by the assessee in the previous year in relation to the international

transaction during the course of its normal operations including costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee but not including the following:

- i. interest income;
 - ii. income arising on account of foreign currency fluctuations;
 - iii. income on transfer of assets or investments;
 - iv. refunds relating to income-tax;
 - v. provisions written back;
 - vi. extraordinary incomes; and
 - vii. other incomes not relating to normal operations of the assessee.
- ◆ **Operating profit margin** in relation to operating expense means the ratio of operating profit, being the operating revenue in excess of operating expense, to the operating expense expressed in terms of percentage.
 - ◆ **Relevant previous year** means the previous year relevant to the assessment year in which the option for safe harbour is validly exercised
 - ◆ **Accountant** means an accountant referred to in the Explanation to 288(2) of the Act and includes any person recognised for undertaking cost certification by the Government of the country where the associated enterprise is registered or incorporated or any of its agencies, who fulfils the following conditions:
 - I. if he is a member or partner in any entity engaged in rendering accountancy or valuation services then:
 - i. the entity or its affiliates have presence in more than two countries; and
 - ii. the annual receipt of the entity in the year preceding the year in which cost certification is undertaken exceeds ₹ 10 crore;
 - II. if he is pursuing the profession of accountancy individually or is a valuer then:
 - i. his annual receipt in the year preceding the year in which cost certification is undertaken, from the exercise of profession, exceeds ₹ 1 crore; and
 - ii. he has professional experience of not less than 10 years.
 - ◆ **Employee cost** includes,—
 - i. salaries and wages;
 - ii. gratuities;
 - iii. contribution to Provident Fund and other funds;
 - iv. the value of perquisites as specified in sec. 17(2);
 - v. employment related allowances, like medical allowance, dearness allowance, travel allowance and any other allowance;
 - vi. bonus or commission by whatever name called;
 - vii. lump sum payments received at the time of termination of service or superannuation or voluntary retirement, such as gratuity, severance pay, leave encashment, voluntary retrenchment benefits, commutation of pension and similar payments;
 - viii. expenses incurred on contractual employment of persons performing tasks similar to those performed by the regular employees;



- ix. outsourcing expenses, to the extent of employee cost, wherever ascertainable, embedded in the total outsourcing expenses:

However, where the extent of employee cost embedded in the total outsourcing expenses is not ascertainable, 80% of the total outsourcing expenses shall be deemed to be the employee cost embedded in the total outsourcing expenses;

- x. recruitment expenses;
- xi. relocation expenses;
- xii. training expenses;
- xiii. staff welfare expenses; and
- xiv. any other expenses related to employees or the employment

- ◆ The above provision shall apply for **A.Y. 2018-19** and **A.Y. 2019-20**
- ◆ Second proviso to sec. 92C(2) provides that if the variation between the arm's length price 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, 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. However, no such comparability adjustment and allowance shall be made to the transfer price declared by the eligible assessee and accepted under this.
- ◆ The provisions of sec. 92D (Maintenance of documents, etc.) and 92E (Report from an Accountant) in respect of an international transaction shall apply irrespective of the fact that the assessee exercises his option for safe harbour in respect of such transaction.
- ◆ **Eligible assessee** means a person who has exercised a valid option for application of safe harbour rules in accordance with rule 10TE, and:
 - i. is engaged in providing software development services or information technology enabled services or knowledge process outsourcing services, with insignificant risk, to a non-resident associated enterprise (hereinafter referred as foreign principal);
 - ii. has made any intra-group loan;
 - iii. has provided a corporate guarantee;
 - iv. is engaged in providing contract research and development services wholly or partly relating to software development, with insignificant risk, to a foreign principal;
 - v. is engaged in providing contract research and development services wholly or partly relating to generic pharmaceutical drugs, with insignificant risk, to a foreign principal;
 - vi. is engaged in the manufacture and export of core or non-core auto components and where 90% or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer sales; or
 - vii. is in receipt of low value-adding intra-group services from one or more members of its group.
- ◆ For exercise of the option for safe harbour, the assessee shall furnish a Form 3CEFA to the Assessing Officer on or before the due date for furnishing the return of income for
 - a) the relevant assessment year, in case the option is exercised only for that assessment year;
 - b) or the first of the assessment years, in case the option is exercised for more than one assessment year;

- ◆ The return of income should be furnished on or before the date of submitting such Form.
- ◆ The option for safe harbour validly exercised shall continue to remain in force for the period specified in Form 3CEFA or a period of 5 years whichever is less.
- ◆ The eligible assessee may opt out of the safe harbour, for the relevant assessment year, by furnishing a declaration to that effect, to the Assessing Officer:

Safe harbour rules not apply [Rule 10TF]

Nothing contained in rules 10TA, 10TB, 10TC, 10TD or rule 10TE shall apply in respect of eligible international transactions entered into with an associated enterprise located in any country or territory notified u/s 94A or in a no tax or low tax country or territory

- ▶ No tax or low tax country or territory means a country or territory in which the maximum rate of income-tax is less than 15%.

Mutual Agreement Procedure not to apply [Rule 10TG]

Where transfer price in relation to an eligible international transaction declared by an eligible assessee is accepted by the income-tax authorities u/s 92CB, the assessee shall not be entitled to invoke mutual agreement procedure under an agreement for avoidance of double taxation entered into with a country or specified territory outside India as referred to in sec. 90 or 90A

Safe Harbour Rules in case of Specified Domestic Transaction [Rule 10THC]

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 as specified here in below:

Sl.	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	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.



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- ◆ No comparability adjustment and allowance under the second proviso to sec. 92C(2) shall be made to the transfer price declared by the eligible assessee and accepted.
- ◆ The provisions of sec. 92D and 92E 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.
- ◆ As per Rule 10THA, eligible assessee means a person who has exercised a valid option for application of safe harbour rules in accordance with the provisions of rule 10THC, and:
 - i. is a Government company engaged in the business of generation, supply, transmission or distribution of electricity; or
 - ii. is a co-operative society engaged in the business of procuring and marketing milk and milk products.
- ◆ For opting safe harbor, the assessee shall require to furnish a Form 3CEFB to the Assessing Officer on or before the due date of furnishing the return of income for the relevant assessment year.
- ◆ The return of income should be furnished on or before the date of submitting such Form.

17.22 ADVANCE PRICING AGREEMENT [SEC. 92CC]

Advance Pricing Agreement 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. The APAs offer better assurance on transfer pricing methods and are conducive in providing certainty and unanimity of approach. A framework for advance pricing agreement are as under:

- ☐ **APA is a contract**
- ☐ **Usually for multiple years**
- ☐ **Between a taxpayer and at least onw tax authority**
- ☐ **Mainly to prospectiveyresolve real or potential transfer pricing issues**
- ☐ **Involving transactions between related parties**

- ◆ The Board, with the approval of the Central Government, may enter into an advance pricing agreement with any person, determining the arm's length price or specifying the manner in which arm's length price is to be determined, in relation to an international transaction to be entered into by that person.
- ◆ The manner of determination of arm's length price, may include the methods referred to in sec. 92C or any other method, with such adjustments or variations, as may be necessary or expedient so to do.
- ◆ The arm's length price of any international transaction, in respect of which the advance pricing agreement has been entered into, shall be determined in accordance with the advance pricing agreement so entered.
- ◆ The agreement shall be valid for such period not exceeding 5 consecutive previous years as may be specified in the agreement.
- ◆ The advance pricing agreement entered into shall be binding:
 - a. on the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and

- b. on the Commissioner, and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.
- ◆ The agreement shall not be binding if there is a change in law or facts having bearing on the agreement so entered.
- ◆ The Board may, with the approval of the Central Government, by an order, declare an agreement to be void ab initio, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts.
- ◆ Upon declaring the agreement void ab initio,:
 - a. all the provisions of the Act shall apply to the person as if such agreement had never been entered into; and
 - b. for the purpose of computing any period of limitation under this Act, the period beginning with the date of such agreement and ending on the date of such order shall be excluded.

However, where immediately after the exclusion of the aforesaid period, the period of limitation, referred to in any provision of this Act, 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.

- ◆ The agreement may, subject to such conditions, procedure and manner as may be prescribed, 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 any period not exceeding 4 previous years preceding the first of the previous years, and the arm's length price of such international transaction shall be determined in accordance with the said agreement
- ◆ Where an application is made by a person for entering into an agreement, the proceeding shall be deemed to be pending in the case of the person for the purposes of the Act.
- ◆ The Board may prescribe a scheme specifying therein the manner, form, procedure and any other matter generally in respect of the advance pricing agreement. Following scheme has been framed by the Board in respect of Advance Pricing Agreement.

Meaning of expressions used in matters in respect of advance pricing agreement [Rule 10F]

- a) "agreement" means an advance pricing agreement entered into between the Board and the applicant, with the approval of the Central Government, as referred to in sec. 92CC(1);
- b) "application" means an application for advance pricing agreement made under rule 10-I;
- c) "applicant" means a person who has made an application;
- d) "bilateral agreement" means an agreement between the Board and the applicant, subsequent to, and based on, any agreement referred to in rule 44GA between the competent authority in India with the competent authority in the other country regarding the most appropriate transfer pricing method or the arm's length price;
- e) "competent authority in India" means an officer authorised by the Central Government for the purpose of discharging the functions as such for matters in respect of any agreement entered into under section 90 or 90A of the Act;
- f) "covered transaction" means the international transaction or transactions for which agreement has been entered into;
- g) "critical assumptions" means 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;



- h) "most appropriate transfer pricing method" means any of the transfer pricing method, referred to in sec. 92C(1) of the Act, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or function performed by such persons or such other relevant factors prescribed by the Board under rules 10B and 10C;
- i) "multilateral agreement" means an agreement between the Board and the applicant, subsequent to, and based on, any agreement referred to in rule 44GA between the competent authority in India with the competent authorities in the other countries regarding the most appropriate transfer pricing method or the arms' length price;
- j) "rollback year" means any previous year, falling within the period not exceeding four previous years, preceding the first of the previous years referred to in sec. 92CC(4);
- k) "tax treaty" means an agreement under section 90, or section 90A of the Act for the avoidance of double taxation;
- l) "team" means advance pricing agreement team consisting of income-tax authorities as constituted by the Board and including such number of experts in economics, statistics, law or any other field as may be nominated by the Director General of Income-tax (International Taxation);

UNILATERAL APA	BILATERAL APA	MULTILATERAL APA
APA entered into between a taxpayer and the tax administration of the country where it is subject to taxation	APA entered into between the taxpayers, the tax administration of the host country and the foreign tax administration	APA entered between the taxpayers, the tax administration of the host country and more than one foreign tax administrations

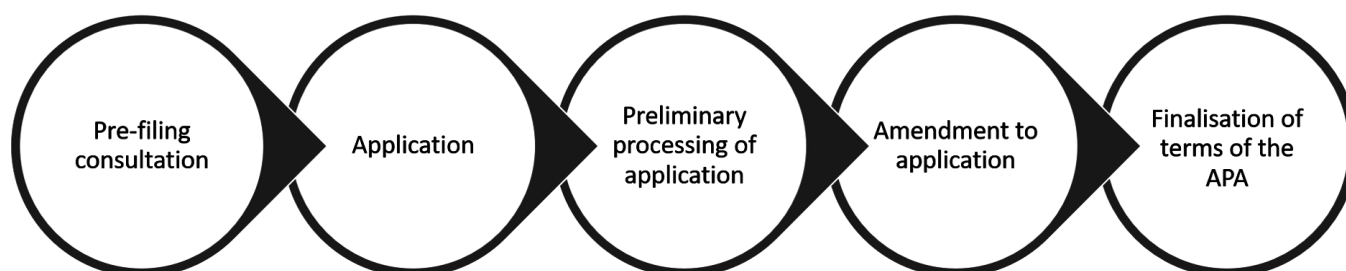
Persons eligible to apply [Rule 10G]

Any person who –

- (i) has undertaken an international transaction; or
- (ii) is contemplating to undertake an international transaction,

shall be eligible to enter into an agreement under these rules.

Process of APA



Pre-filing Consultation [Rule 10H]

- 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.
- The request for pre-filing consultation shall be made in Form No. 3CEC to the Director General of Income Tax (International Taxation).

3. On receipt of the request in Form No. 3CEC, the team shall hold pre-filing consultation with the person referred to in rule 10G.
4. The competent authority in India or his representative shall be associated in pre-filing consultation involving bilateral or multilateral agreement.
5. 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.
6. 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.

Application for advance pricing agreement [Rule 10-I]

1. Any person, referred to in rule 10G may, if desires to enter into an agreement furnish an application in Form No. 3CED alongwith the requisite fee.
2. The application shall be furnished to 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.
3. Application in Form No. 3CED may be filed by the person referred to in rule 10G 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.
4. Every application in Form No. 3CED shall be accompanied by the proof of payment of specified fees.
5. The fees payable shall be in accordance with following table based on the amount of international transaction entered into or proposed to be undertaken in respect of which the agreement is proposed:

Amount of international transaction entered into or proposed to be undertaken in respect of which agreement is proposed during the proposed period of agreement.	Fee
Amount not exceeding ₹ 100 crores	10 lacs
Amount not exceeding ₹ 200 crores	15 lacs
Amount exceeding ₹ 200 crores	20 lacs

Withdrawal of application for agreement [Rule 10J]

1. The applicant may withdraw the application for agreement at any time before the finalisation of the terms of the agreement.
2. The application for withdrawal shall be in Form No. 3CEE.
3. The fee paid shall not be refunded on withdrawal of application by the applicant.



Preliminary processing of application [Rule 10K]

1. Every application filed in Form No. 3CED shall be complete in all respects and accompanied by requisite documents.
2. If any defect is noticed in the application in Form No. 3CED or if any relevant document is not attached thereto or the application is not in accordance with understanding reached in any pre-filing consultation referred to in rule 10H, the Director General of Income-tax (International Taxation) (for unilateral agreement) and competent authority in India (for bilateral or multilateral agreement) shall serve a deficiency letter on the applicant before the expiry of 1 month from the date of receipt of the application.
3. The applicant shall remove the deficiency or modify the application within a period of 15 days from the date of service of the deficiency letter or within such further period which, on an application made in this behalf, may be extended, so however, that the total period of removal of deficiency or modification does not exceed 30 days.
4. The Director General of Income Tax (International Taxation) or the competent authority in India, as the case may be, on being satisfied, may pass an order providing that application shall not be allowed to be proceeded with if the application is defective and defect is not removed by applicant in accordance with aforesaid rule.
5. No such order shall be passed without providing an opportunity of being heard to the applicant and if an application is not allowed to be proceeded with, the fee paid by the applicant shall be refunded.

Procedure [Rule 10L]

1. If the application referred to in rule 10K has been allowed to be proceeded with, the team or the competent authority in India or his representative shall process the same in consultation and discussion with the applicant in accordance with provisions of this rule.
2. For this purpose, it shall be competent for the team or the competent authority in India or its representative to:
 - i. hold meetings with the applicant on such time and date as it deem fit;
 - ii. call for additional document or information or material from the applicant;
 - iii. visit the applicant's business premises; or
 - iv. make such inquiries as it deems fit in the circumstances of the case.
3. The applicant may, if he considers it necessary, provide further document and information for consideration of the team or the competent authority in India or his representative.
4. For bilateral or multilateral agreement, the competent authority shall forward the application to Director General of Income-tax (International Taxation) who shall assign it to one of the teams.
5. The team, to whom the application has been assigned, shall carry out the enquiry and prepare a draft report which shall be forwarded by the Director General of Income-tax (International Taxation) to the competent authority in India.
6. If the applicant makes a request for bilateral or multilateral agreement in its application, the competent authority in India shall in addition to the procedure provided in this rule invoke the procedure provided in rule 44GA.
7. The Director General of Income-tax (International Taxation) (for unilateral agreement) or the competent authority in India (for bilateral or multilateral agreement) and the applicant shall prepare a proposed mutually agreed draft agreement enumerating the result of the process including the effect of the arrangement referred to in rule 44GA(5) which has been accepted by the applicant in accordance with rule 44GA(8).
8. The agreement shall be entered into by the Board with the applicant after its approval by the Central Government.

9. Once an agreement has been entered into the Director General of Income-tax (International Taxation) or the competent authority in India, as the case may be, shall cause a copy of the agreement to be sent to the Commissioner of Income-tax having jurisdiction over the assessee.

Terms of the agreement [Rule 10M]

1. 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 items (ii) or (iii);
 - v. critical assumptions;
 - vi. rollback provision referred to in rule 10MA;
 - vii. the conditions if any other than provided in the Act or these rules.
2. 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.
3. The binding effect of agreement shall cease only if any party has given due notice of the concerned other party or parties.
4. 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.
5. The assessee which has entered into an agreement shall give a notice in writing of such change in any of the critical assumptions or failure to meet conditions to the Director General of Income Tax (International Taxation) as soon as it is practicable to do so.
6. The Board shall give a notice in writing of such change in critical assumptions or failure to meet conditions to the assessee, as soon as it comes to the knowledge of the Board.
7. The revision or the cancellation of the agreement shall be in accordance with rules 10Q and 10R respectively.

Roll Back of the Agreement [Rule 10MA]

Sec. 92CC of the Act provides for Advance Pricing Agreement (APA). It empowers the Central Board of Direct Taxes, with the approval of the Central Government, to enter into an APA with any person for determining the Arm's Length Price (ALP) or specifying the manner in which ALP is to be determined in relation to an international transaction which is to be entered into by the person. The agreement entered into is valid for a period, not exceeding 5 previous years, as may be mentioned in the agreement. Once the agreement is entered into, the ALP of the international transaction, which is subject matter of the APA, would be determined in accordance with such an APA.

In many countries the APA scheme provides for "roll back" mechanism for dealing with ALP issues relating to transactions entered into during the period prior to APA. The "roll back" provisions refers to the applicability of the methodology of determination of ALP, or the ALP, to be applied to the international transactions which had already been entered into in a period prior to the period covered under an APA. However, the "roll back" relief is provided on case to case basis subject to certain conditions. Providing of such a mechanism in Indian legislation would also lead to reduction in large scale litigation which is currently pending or may arise in future in respect of the transfer pricing matters.

1. Subject to the provisions of this rule, 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 to as "rollback provision").

2. The agreement shall contain rollback provision in respect of an international transaction subject to the following:
 - 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 specified u/s 139;
 - iii. the report in respect of the international transaction had been furnished in accordance with sec. 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. 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. 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. The applicant may, if he desires to enter into an agreement with rollback provision, furnish along with the application, the request for the same in Form No. 3CEDA with proof of payment of an additional fee of ₹ 5 lakh.

Amendments to Application [Rule 10N]

1. An applicant may request in writing for an amendment to an application at any stage, before the finalisation of the terms of the agreement.
2. The Director General of Income Tax (International Taxation) (for unilateral agreement) or the competent authority in India (for bilateral or multilateral agreement) may, allow the amendment to the application, if such an amendment does not have effect of altering the nature of the application as originally filed.
3. The amendment shall be given effect only if it is accompanied by the additional fee, if any, necessitated by such amendment in accordance with fee as provided in rule 10-I.

Furnishing of Annual Compliance Report [Rule 10-O]

1. The assessee shall furnish an annual compliance report to Director General of Income Tax (international Taxation) for each year covered in the agreement.
2. The annual compliance report shall be in Form 3CEF.
3. The annual compliance report shall be furnished in quadruplicate, for each of the years covered in the agreement,

within 30 days of the due date of filing the income tax return for that year, or within 90 days of entering into an agreement, whichever is later.

4. The Director General of Income Tax (International Taxation) shall send one copy of annual compliance report to the competent authority in India, one copy to the Commissioner of Income Tax who has the jurisdiction over the income-tax assessment of the assessee and one copy to the Transfer Pricing Officer having the jurisdiction over the assessee.

Compliance Audit of the agreement [Rule 10P]

1. 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.
2. 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.
3. The Transfer Pricing Officer shall submit the compliance audit report, for each year covered in the agreement, 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, mentioning therein his findings as regards compliance by the assessee with terms of the agreement.
4. The Director General of Income Tax (International Taxation) shall forward the report to the Board in a case where there is finding of failure on part of assessee to comply with terms of agreement and cancellation of the agreement is required.
5. The compliance audit report shall be furnished by the Transfer Pricing Officer within 6 months from the end of the month in which the Annual Compliance Report referred to in rule 10-O is received by the Transfer Pricing Officer.
6. The regular audit of the covered transactions shall not be undertaken by the Transfer Pricing Officer if an agreement has been entered into under rule 10L except where the agreement has been cancelled under rule 10R.

Revision of an agreement [Rule 10Q]

1. An agreement, subsequent to it having been entered into, may be revised by the Board, 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.
2. An agreement 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).
3. 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.



4. In case the assessee is not in agreement with the proposed revision the agreement may be cancelled in accordance with rule-10R.
5. In case the Board is not in agreement with the request of the assessee for revision of the agreement, the Board shall reject the request in writing giving reason for such rejection.
6. For the purpose of arriving at the agreement for the proposed revision, the procedure provided in rule 10 L may be followed so far as they apply.
7. 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.

Cancellation of an agreement [Rule 10R]

1. An agreement shall be cancelled by the Board for any of the following reasons:
 - i. the compliance audit referred to in rule 10P 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 agreement is to be cancelled under rule 10Q(4) or rule 10RA(7).
2. The Board shall give an opportunity of being heard to the assessee, before proceeding to cancel an application.
3. The competent authority in India shall communicate with the competent authority in the other country or countries and provide reason for the proposed cancellation of the agreement in case of bilateral or multilateral agreement.
4. 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.
5. The order of cancellation shall also specify the effective date of cancellation of the agreement, where applicable.
6. 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.
7. The order of cancellation shall be intimated to the Assessing Officer and the Transfer Pricing Officer, having jurisdiction over the assessee.

Procedure for giving effect to rollback provision of an Agreement [Rule 10RA]

1. The effect to the rollback provisions of an agreement shall be given in accordance with this rule.
2. The applicant shall furnish modified return of income referred to in sec. 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.
3. The modified return referred above 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.
4. 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.

5. 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 3 months of filing of modified return by the applicant.
6. 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.
7. 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.

Renewing an agreement [Rule 10S]

Request for renewal of an agreement may be made as a new application for agreement, using the same procedure as outlined in these rules except pre filing consultation as referred to in rule 10H.

Miscellaneous [Rule 10T]

1. Mere filing of a 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.
2. 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.

Procedure to deal with requests for bilateral or multilateral advance pricing agreements [Rule 44GA]

1. Where a person has made request for a bilateral or multilateral advance pricing agreement in an application filed in Form No. 3CED in accordance with rule 10-I, the request shall be dealt with subject to provisions of this rule.
2. The process for bilateral or multilateral advance pricing agreement shall not be initiated unless the associated enterprise situated outside India has initiated process of advance pricing agreement with the competent authority in the other country.
3. The competent authority in India shall, on intimation of request of the applicant for a bilateral or multilateral agreement, consult and ascertain willingness of the competent authority in other country or countries, as the case may be, for initiation of negotiation for this purpose.
4. In case of willingness of the competent authority in other country or countries, as the case may be, the competent authority in India shall enter into negotiation in this behalf and endeavour to reach a set of terms which are acceptable to the competent authority in India and the competent authority in the other country or countries, as the case may be.
5. In case of an agreement after consultation, the competent authority in India shall formalise a mutual agreement procedure arrangement with the competent authority in other country or countries, as the case may be, and intimate the same to the applicant.
6. In case of failure to reach agreement on such terms as are mutually acceptable to parties mentioned in sub-rule (4), the applicant shall be informed of the failure to reach an agreement with the competent authority in other country or countries.



7. The applicant shall not be entitled to be part of discussion between competent authority in India and the competent authority in the other country or countries, as the case may be; however the applicant can communicate or meet the competent authority in India for the purpose of entering into an advance pricing agreement.
8. The applicant shall convey acceptance or otherwise of the agreement within thirty days of it being communicated.
9. The applicant, in case the agreement is not acceptable may at its option continue with process of entering into an advance pricing agreement without benefit of mutual agreement process or withdraw application in accordance with rule 10J.

17.23 EFFECT TO ADVANCE PRICING AGREEMENT [SEC. 92CD]

- ◆ Where any person has entered into an agreement and prior to the date of entering into the agreement, any return of income has been furnished u/s 139 for any assessment year relevant to a previous year to which such agreement applies, such person shall furnish, within a period of 3 months from the end of the month in which the said agreement was entered into, a modified return in accordance with and limited to the agreement.
- ◆ Save as otherwise provided in this section, all other provisions of this Act shall apply accordingly as if the modified return is a return furnished u/s 139.
- ◆ If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the agreement 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, proceed to assess or reassess or recompute the total income of the relevant assessment year having regard to and in accordance with the agreement.
- ◆ Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the agreement 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 agreement taking into consideration the modified return so furnished.
- ◆ The order of assessment, reassessment or recomputation of total income shall be passed within a period of 1 year from the end of the financial year in which the modified return is furnished.
- ◆ The period of limitation as provided in sec. 153, 153B or 144C for completion of pending assessment or reassessment proceedings shall be extended by a period of 12 months.
- ◆ 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 u/s 143(2) till the expiry of the limitation period provided under that sub-section.

17.24 SECONDARY ADJUSTMENT IN CERTAIN CASES [SEC. 92CE]

"Secondary adjustment" means an adjustment in the books of account 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.

The provisions are enumerated here-in-below:

- ◆ Where a primary adjustment to transfer price, :
 - i. has been made suo motu by the assessee in his return of income;
 - ii. made by the Assessing Officer has been accepted by the assessee;
 - iii. is determined by an advance pricing agreement entered into by the assessee u/s 92CC;
 - iv. is made as per the safe harbour rules framed u/s 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 u/s 90 or 90A for avoidance of double taxation,
- the assessee shall make a secondary adjustment.
- ◆ Exception: Nothing contained in this section shall apply, if:
 - i. the amount of primary adjustment made in any previous year does not exceed ₹ 1 crore; and
 - ii. the primary adjustment is made in respect of an assessment year commencing on or before 01-04-2016.
- ◆ 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 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 in such manner as may be prescribed.
 - ▶ 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 been undertaken;
 - ▶ 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;

Example

An Indian company sells certain products to its Associated Enterprise for INR 100 crores, whereas the Arm's Length Price (ALP) of such transaction is INR 150 crores. The TPO confirms an upward adjustment (Primary adjustment) of INR 50 crores, the difference between the Selling price INR 100 crores and the ALP INR 150 crores, which is taxed in the hands of Indian company.

Subsequently, for the purpose of Secondary adjustment, it would be deemed that the AE owes INR 50 crores to Indian company (the difference between ALP and actual transfer price), which will be deemed to be a Loan or an Advance by Indian company to its AE. As a consequence, an interest would be imputed on such Loan or Advance and an Adjustment (Secondary adjustment) would be carried out in the hands of the Indian company.

17.25 MAINTENANCE, KEEPING OF INFORMATION AND DOCUMENT BY PERSONS ENTERING INTO AN INTERNATIONAL TRANSACTION OR SPECIFIED DOMESTIC TRANSACTION [SEC. 92D]

- ◆ Every person who has entered into an international transaction or specified domestic transaction shall keep and maintain such information and document in respect thereof, as may be prescribed. See Annexure 2
 - ▶ The person, being a constituent entity of an international group, shall also keep and maintain such information and document in respect of an international group as may be prescribed.



- ♦ The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceeding under this Act, require any person who has entered into an international transaction or specified domestic transaction to furnish any information or document in respect thereof, within a period of 30 days from the date of receipt of a notice issued in this regard.

However, the Assessing Officer or the Commissioner (Appeals) may, on an application made by such person, extend the period of 30 days by a further period not exceeding 30 days.

- ♦ The person, being a constituent entity of an international group, shall also keep and maintain such information and document in respect of an international group as may be prescribed. Every person who has entered into an international transaction or specified domestic transaction shall furnish the information and document in respect of such international group to the authority prescribed u/s 286(1), in such manner, on or before the date, as may be prescribed. If such person fails to furnish the information and documents, penalty of ₹ 5,00,000 shall be levied on that person u/s 271AA.

17.26 REPORT FROM AN ACCOUNTANT TO BE FURNISHED BY PERSONS ENTERING INTO INTERNATIONAL TRANSACTION OR SPECIFIED DOMESTIC TRANSACTION [SEC. 92E]

Every person who has entered into an international transaction or specified domestic transaction during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date [i.e., 30th November of the relevant assessment year] in the form 3CEB duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed.

17.27 SPECIAL MEASURES IN RESPECT OF TRANSACTIONS WITH PERSONS LOCATED IN NOTIFIED JURISDICTIONAL AREA [SEC. 94A]

- ♦ The Central Government may, having regard to the lack of effective exchange of information with any country or territory outside India, specify by notification in the Official Gazette such country or territory as a notified jurisdictional area in relation to transactions entered into by any assessee.
- ♦ If an assessee enters into a transaction where one of the parties to the transaction is a person located in a notified jurisdictional area, then—
 - i. all the parties to the transaction shall be deemed to be associated enterprises within the meaning of sec. 92A;
 - ii. any transaction in the nature of purchase, sale or lease of tangible or intangible property or provision of service or lending or borrowing money or any other transaction having a bearing on the profits, income, losses or assets of the assessee including a mutual agreement or arrangement for 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 by or to the assessee shall be deemed to be an international transaction within the meaning of sec. 92B,

and the provisions of sec. 92, 92A, 92B, 92C [except the second proviso to sec. 92C(2)], 92CA, 92CB, 92D, 92E and 92F shall apply accordingly.

- ▶ Person located in a notified jurisdictional area shall include:
 - a. a person who is resident of the notified jurisdictional area;

- b. a person, not being an individual, which is established in the notified jurisdictional area; or
- c. a permanent establishment of a person not falling above, in the notified jurisdictional area;

◆ **No deduction,—**

- i. in respect of any payment made to any financial institution located in a notified jurisdictional area shall be allowed under this Act, unless the assessee furnishes an authorisation in the prescribed form authorising the Board or any other income-tax authority acting on its behalf to seek relevant information from the said financial institution on behalf of such assessee; and
 - ii. in respect of any other expenditure or allowance (including depreciation) arising from the transaction with a person located in a notified jurisdictional area shall be allowed under any other provision of this Act, unless the assessee maintains such other documents and furnishes such information as may be prescribed [under rule 10FC], in this behalf.
- ◆ Where, in any previous year, the assessee has received or credited any sum from any person located in a notified jurisdictional area and the assessee does not offer any explanation about the source of the said sum in the hands of such person or in the hands of the beneficial owner (if such person is not the beneficial owner of the said sum) or the explanation offered by the assessee, in the opinion of the Assessing Officer, is not satisfactory, then, such sum shall be deemed to be the income of the assessee for that previous year.
- ◆ Where any person located in a notified jurisdictional area 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:
- a. 30%
 - b. at the rate or rates in force;
 - c. at the rate specified in the relevant provisions of this Act;

17.28 LIMITATION ON INTEREST DEDUCTION IN CERTAIN CASES [SEC. 94B]

Thin Capitalization

A company is typically financed or capitalized through a mixture of debt and equity. The way a company is capitalized often has a significant impact on the amount of profit it reports for tax purposes as the tax legislations of countries typically allow a deduction for interest paid or payable in arriving at the profit for tax purposes while 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 profit. For this reason, debt is often a more tax efficient method of finance than equity. Multinational groups are often able to structure their financing arrangements to maximize these benefits. For this reason, country's tax administrations often introduce rules that place a limit on the amount of interest that can be deducted in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, and thus aim to protect a country's tax base.

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. The OECD has recommended several measures in its final report to address this issue.



In view of the above, sec. 94B was inserted 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 be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is less.

The provisions are enumerated here-in-below:

Applicable to

Indian company, or a permanent establishment of a foreign company in India, being the borrower

- ▶ Permanent establishment includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

Conditions

- a) The borrower has debt issued by a non-resident, being an associated enterprise of such borrower.
 - ▶ Debt means 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";
- b) He incurs any expenditure by way of interest or of similar nature exceeding ₹ 1 crore;
- c) Such expenditure is deductible in computing income chargeable under the head "Profits and gains of business or profession"

Effect

If all the aforesaid conditions are satisfied then, excess interest shall not be deductible in computation of income under the said head.

- ◆ Excess interest means lower of the following:
 - a) An amount of total interest paid or payable in excess of 30% of earnings before interest, taxes, depreciation and amortisation (EBITDA) of the borrower in the previous year; or
 - b) Interest paid or payable to associated enterprises for that previous year

Taxpoint

- ◆ Guarantee: 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.
- ◆ Exception: The provision of sec. 94B is not applicable to an Indian company or a permanent establishment of a foreign company which is engaged in the business of banking or insurance.
- ◆ Carry forward: Where for any assessment year, the interest expenditure is not wholly deducted against income under the head "Profits and gains of business or profession", so much of the interest expenditure as has not been so deducted, shall be carried forward to the following assessment year(s), and it shall be allowed as a deduction against the profits and gains, if any, of any business or profession carried on by it and assessable for that assessment year to the extent of maximum allowable interest expenditure.
- ◆ Maximum carried forward: No interest expenditure shall be carried forward for more than 8 assessment years immediately succeeding the assessment year for which the excess interest expenditure was first computed.

Example

Computation of interest expenses disallowed u/s 94B:

₹ in crore

Particulars	Case 1	Case 2	Case 3
EBIDTA of the Indian Borrower	100	100	100
30% of the above [A]	30	30	30
Interest payable to associated enterprise [B]	35	Nil	15
Interest payable to non-associated enterprise [C]	Nil	35	20
Total Interest expense incurred [D = B + C]	35	35	35
Total interest expenses incurred in excess of 30% of EBITDA [E = D – A]	5	5	5
Interest payable to associated enterprise [B]	35	Nil	15
Excess interest [lower of (E) and (B)] being disallowed u/s 94B	5	Nil	5

17.29 PENALTY**Failure to keep and maintain information and document in respect of international transaction or specified domestic transaction [Sec. 271AA]**

If any person in respect of an international transaction or specified domestic transaction:

- fails to keep and maintain any such information and document as required by sec. 92D;
- fails to report such transaction which he is required to do so; or
- maintains or furnishes an incorrect information or document,

the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of each international transaction or specified domestic transaction entered into by such person.

Penalty for failure to furnish report under section 92E [Sec. 271BA]

If any person fails to furnish a report from an accountant as required by sec. 92E, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of ₹ 1,00,000.

Penalty for failure to furnish information or document under section 92D [Sec. 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 sec. 92D(3), the Transfer Pricing Officer or Assessing Officer or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of the international transaction or specified domestic transaction for each such failure.

However, where assessee shows reasonable cause, then no penalty u/s 271AA or 271BA or 271G shall be levied [Sec. 273B]



ANNEXURE 1

17.30 DETERMINATION OF INCOME IN THE CASE OF NON-RESIDENTS [RULE 10]

In any case in which the Assessing Officer is of opinion that the actual amount of the income accruing or arising to any non-resident person whether directly or indirectly, through or from any business connection in India or through or from any property in India or through or from any asset or source of income in India or through or from any money lent at interest and brought into India in cash or in kind cannot be definitely ascertained, the amount of such income for the purposes of assessment to income-tax may be calculated:

- i. at such percentage of the turnover so accruing or arising as the Assessing Officer may consider to be reasonable, or
- ii. on any amount which bears the same proportion to the total profits and gains of the business of such person (such profits and gains being computed in accordance with the provisions of the Act), as the receipts so accruing or arising bear to the total receipts of the business, or
- iii. in such other manner as the Assessing Officer may deem suitable.

17.31 DETERMINATION OF ARM'S LENGTH PRICE UNDER SECTION 92C [RULE 10B]

◆ For the purposes of sec. 92C(2), the arm's length price in relation to an international transaction or a specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner:

- a. comparable uncontrolled price (CUP) method, by which,—
 - i. the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;
 - ▶ **Uncontrolled transaction** means a transaction between enterprises other than associated enterprises, whether resident or non-resident – Rule 10A
 - ▶ **Transaction** includes a number of closely linked transactions
 - ii. such price is adjusted to account for differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;
 - iii. the adjusted price arrived at under (ii) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction or the specified domestic transaction
 - ▶ **Property** includes goods, articles or things, and intangible property;
 - ▶ **Services** include financial services

Taxpoint:

- ▶ Typical transactions in respect of which the comparable uncontrolled price method may be adopted are:
 - a. Transfer of goods;

- b. Provision of services;
- c. Intangibles;
- d. Interest on loans.

► CUP can be either of the following:

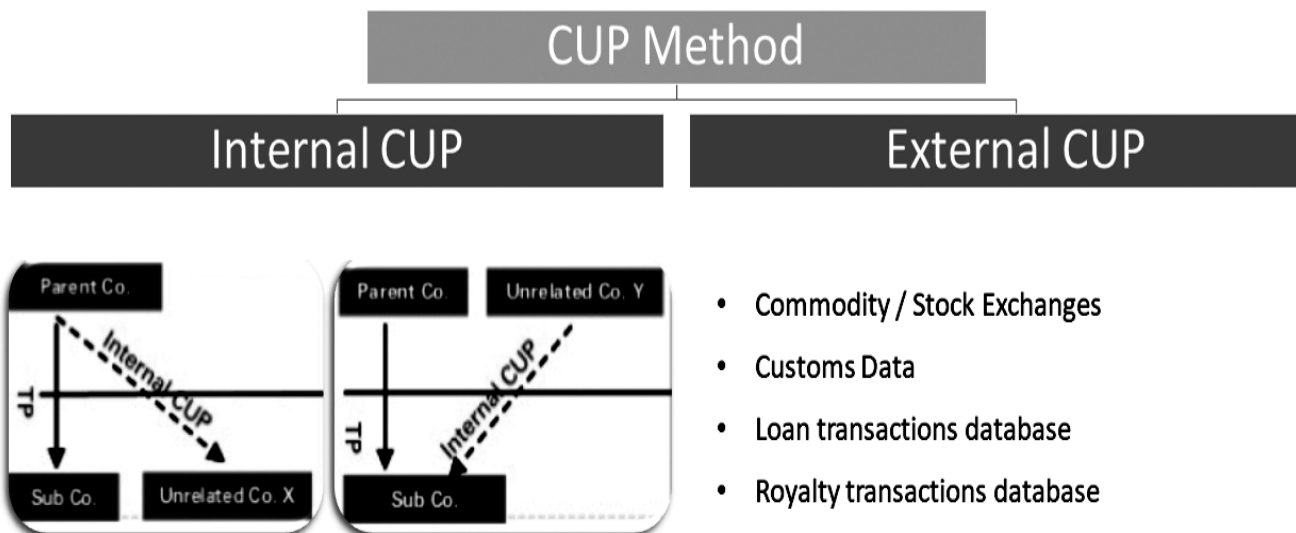
(1) Internal CUP: this would be available if the taxpayer (or one of its group entities) enters into a comparable transaction with an unrelated party where the goods or services under consideration are same or similar.

Situations where Internal CUP may be applicable:

- (a)** The tax payer or any other member of the group **sells** similar goods in similar quantities and under similar terms to an independent enterprise in a similar market.
- (b)** The tax payer or another member of the group **buys** similar goods in similar quantities and under similar terms from an independent enterprise in a similar market (an internal comparable).

(2) External CUP: this would be applicable if a transaction between two independent enterprises involves comparable goods or services under comparable conditions.

- a.** An independent enterprise **sells** the particular product in similar quantities and under similar terms to another independent enterprise in a similar market;
- b.** An independent enterprise **buys** similar goods in similar quantities and under similar terms from another independent enterprise in a similar market.



- ☐ Compare the prices charged for property or services
- ☐ Price under 'controlled transaction' is compared with 'uncontrolled transaction'
- ☐ It requires close similarity in products, property or services that are involved
- ☐ Where the prices of the product fluctuate regularly, timing of the transaction also relevant

► **Example**

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows:

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.		30
Financial Institutions	Indian Company	10
Public	Indian Company	30

AE1 Ltd., is a manufacturer of compact disc (CD) writers and its customers, inter alia, include AE2 Ltd, and M Ltd.

AE1 Ltd., during the year has supplied 10,000 nos. of the product to AE2 Ltd. at a price of ₹ 2,000 per unit and 200 nos. of the same product to AE3 Ltd., at a price of ₹ 2,750 per unit. AE1 Ltd., has sold 100 units of the same product to M Ltd. at ₹ 3,000 per unit.

Analysis of the international transaction with comparable uncontrolled transaction

	International transaction (with AE2 Ltd.)	Comparable uncontrolled transaction (with M Ltd.)	
Price	FOB	CIF	Freight and insurance ₹ 550
Quantity discount	Yes	No	One CD of ₹ 10 each for every CD writer plus ₹ 20 per CD writer
Credit	One month	Cash and carry	Cost of credit 1.25% per month
Warranty	No warranty	Six months warranty	Cost of warranty is ₹ 250 per unit

Factors to be considered while determining ALP:

- a. In the CUP method, one has to start from the price charged in the case of the comparable uncontrolled transaction.
- b. In this illustration one has to start with the price charged by AE1 Ltd., to M Ltd.
- c. The price charged to AE3 Ltd., cannot be considered as AE3 Ltd., is itself an associated enterprise of AE1 Ltd.
- d. The price charged to M Ltd., will have to be increased by the value of credit which is at the rate at 1.25% p.m. (i.e. 15% p.a.). If the similar credit were offered to M Ltd., the price charged to M Ltd. would have been higher, after factoring this cost.
- e. The price charged to M Ltd., will have to be reduced by the following
 - i. ₹ 550 representing the freight and insurance –This is for the reason that if the price to M Ltd., had been on FOB basis, it would have been less by ₹ 550.
 - ii. ₹ 250 per unit representing the estimated cost of warranty execution for a period of 6 months on the basis of a technical analysis and past experience - This is for the reason that if the warranty was not given, the price to M Ltd. would have been lower, without factoring this cost.

iii. ₹ 10 representing the cost of each CD – This is for the reason that if similar gift had been offered to M Ltd., the effective price to M Ltd., would have been less.

iv. ₹ 20 representing a quantity discount - This is for the reason that if similar discount had been offered to M Ltd., the effective price to M Ltd., would have been less.

The following points are to be noticed:

- i. All adjustments in the course of applying this method are to be made to the price charged in the uncontrolled transaction. The presence or absence of any specific features in the uncontrolled transaction as compared to the international transaction is to be adjusted for. These Methods of Computation of Arm's Length Price features are to be evaluated in monetary terms. This is a subjective process based on objective facts.
- ii. Only differences that would materially affect the price in the open market are required to be adjusted. Two points may be noted. Firstly, materiality would have to be judged in the light of various circumstances. If there are numerous adjustments, which are individually not material but collectively material, the necessary adjustments are required to be made. Secondly, the term 'open market', though not defined, would mean a transaction between a knowledgeable and a willing purchaser and a knowledgeable and willing seller where neither of them is influenced or compelled to act in a particular manner.

■ **b. resale price method, by which,—**

- i. 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, is identified;
- ii. such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;
- iii. the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;
- iv. the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;
- v. the adjusted price arrived at under (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.

Taxpoint

► The steps involved in the application of this method are:

- i. identify the international transaction of purchase of property or services;
- ii. identify the price at which such property or services are resold or provided to an unrelated party (resale price);
- iii. identify the normal gross profit margin in a comparable uncontrolled transaction whether internal or external. The normal gross profit margin is that margin which an enterprise would earn from purchase of the similar product from an unrelated party and the resale of the same to another unrelated party.



- iv. deduct the normal gross profit from the resale price.
- v. deduct expenses incurred in connection with the purchase of goods;
- vi. adjust the resultant amount for the differences between the uncontrolled transaction and the international transaction. These differences could be functional and other differences including differences in accounting practices. Further these differences should be such as would materially affect the amount of gross profit margin in the open market;
- vii. the price arrived at is the arm's length price of the international transaction;



- RPM is a method based on the price at which a product that has been purchased from a related party is resold to an unrelated enterprise.
- The resale price is reduced by the resale price margin/ gross profit margin.
- This is further reduced by the expenses incurred in connection with the purchase of product or obtaining of services.
- When goods are purchased from AE or Unrelated party and same are sold to AE, this method cannot be applied, since it can be applied only in a situation where goods are purchased from AE and same are sold to Unrelated party.

► The application of the resale price method can be understood with the following example:

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows:

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Indian Company	30
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., trades in compact disc (CD) writers. AE1 Ltd., procures CD writers both locally and in the international market. Its imports consist of CD writers purchased from AE2 Ltd. as well as other manufacturers (Non AEs).

AE1 Ltd., during the year purchased 100 CD writers from AE2 Ltd. at ₹ 2,900 per unit. These are resold to A Ltd., at a price of ₹ 3,000 per unit.

AE1 Ltd., has also purchased similar products from an unrelated supplier, viz. K Ltd., and has resold the same to M Ltd., who is also an unrelated party and has earned a gross profit of 15% on sales.

Analysis of the sales transactions

	Sales to A Ltd.	Sales to M Ltd.	
Price	Ex shop	FOR Destination with cost of freight and insurance estimated at 2% of GP	Impact of Freight and insurance on GP is 2% as the sale price increases but corresponding expenses are not debited to trading account but to profit and loss account

Quantity discount	Yes - the cost of the same is estimated at 1% of GP	No	Impact of quantity discount on GP is 1%
Free gifts	No	One CD pack for every CD writer with no change in sale price	As cost of gift is not debited to trading account but to P & L Account, there is no impact on GP
Warranty	No	6 months warranty (without change in sale price) - cost of warranty is estimated at ₹ 250 per unit	As cost of warranty is not debited to trading account but to P&L Account, there is no impact on GP

Analysis of the purchase transactions

	Purchase from AE2 Ltd. (International transaction)	Purchase from K Ltd.	
Customs duty	₹ 25 per unit	₹ 25 per unit	No impact
Freight inwards	₹ 10 per unit	Nil	Cost of purchase from K Ltd., is lower
Quantity discount	₹ 15 per unit	Nil	Cost of purchase from K Ltd., is higher
Warranty	Nil	6 months warranty purchase price remaining unchanged	No impact

Factors to be considered while determining ALP:

- a. In the above example, the international transaction is the purchase transaction entered into by AE1 Ltd., with AE2 Ltd. which should be determined on the basis of arm's length price ;

Purchase from AE2 Ltd. → AE1 → Sales to A Ltd.

- b. The comparable uncontrolled transaction is the purchase transaction entered into by AE1 Ltd., with K Ltd.

Purchase from K Ltd. → AE1 Ltd → Sales to M Ltd.

- c. The starting point for arriving at the ALP of such purchase transaction is the resale price charged to A Ltd. viz. ₹ 3,000 [Rule 10B(1)(b)(i)].
- d. From the said resale price, the normal gross profit margin which AE1 Ltd., would earn in a comparable uncontrolled transaction should be reduced. In this example, the actual gross profit margin earned by AE1 Ltd., in respect of its purchase from K Ltd, and its resale to M Ltd, is 15%.
- e. The following adjustments are made to arrive at the normal GP;

Actual gross profit margin with M Ltd.		15%
Less:		
1. Difference between Ex-shop and FOR prices	2%	



2. Difference due to quantity discount	1%	3%
Normal gross profit margin with M Ltd.		12%

Note: While arriving at normal gross profits from the actual gross profits, only the differences in the sale transactions of AE1 Ltd., with A Ltd., and M Ltd., have been taken. The differences in the purchase transactions of AE1 Ltd., with AE2 Ltd. and K Ltd., affecting the gross profits are taken separately as provided in sub rule (iv).

- f. The resale price of ₹ 3,000 to M Ltd., is reduced by the normal gross profit margin of 12%. The resultant cost of sales is ₹ 2,640 (i.e. 3,000 - 360) [Rule 10B(1)(b)(ii)].
- g. The cost of sales so arrived at is reduced by the expenses incurred in connection with the purchase (international transaction) i.e. freight of ₹ 10 and customs duty of ₹ 25. The resultant amount is ₹ 2,605 (i.e. 2640 - 25 - 10) [Rule 10B(1)(b)(iii)].
- h. The above amount is further adjusted to take into account functional and accounting differences between the international transaction and the comparable uncontrolled transaction with AE2 Ltd. the purchase transaction with K Ltd., which will affect the amount of gross profit margin as explained below.
- i. The aforesaid amount of ₹ 2605 should be increased by ₹ 10 being the freight incurred by AE1 Ltd., in the case of purchase from AE2 Ltd., but not incurred in case of purchase from K Ltd., This is for the reason that if a similar freight had been paid in respect of transaction with K Ltd, the gross profit margin from K Ltd., would have been lower and the resultant price would have been higher.
- j. A decrease by ₹ 15 representing the quantity discount allowed by AE2 Ltd., is to be made. This is for the reason that if a similar discount had been allowed in respect of transaction with K Ltd, the gross profit margin from K Ltd., would have been higher and the resultant price would have been lower.

Determination of arm's length price under resale price method

1. Associated enterprises : AE1 Ltd. and AE2 Ltd.
2. Other enterprises : K Ltd. and M Ltd.
3. International transaction : AE1 Ltd. and AE2 Ltd.
4. Bought from AE2 Ltd. and resold to : A Ltd.
5. CUT is purchase from K Ltd. and sales to M Ltd.

Details	₹ / unit
Price paid to AE2 Ltd.(FOB)	2,900
Quantity	100
Purchases cost (actual) (A)	2,90,000
Actual GP Margin on sales to M Ltd.(%)	15
Normal GP Margin on sales to M Ltd.(%)	12
Price charged to A Ltd.	3,000
Less: Normal GP margin	360
Balance	2640
Less: Expenses connected with purchase (freight & customs duty paid)	35

Price before adjustment	2,605
Add:	
Freight incurred in case of purchase from AE2 Ltd.	10
Sub total	10
Less:	
Quantity discount allowed by AE2 Ltd.	15
Sub total	15
Arm's length price	2,600
Adjusted purchase cost (B)	2,60, 000
Income increases by (A-B)	30,000

The following points are to be noticed:

- i. The resale price method is to be adopted only when goods purchased from an associated enterprise are resold to unrelated parties.
- ii. As provided in Rule 10B(1)(b)(iii), the expenses incurred in connection with the purchase from AE are to be reduced from cost of sales. In resale price method, the arm's length purchase price is arrived at reducing the normal gross profit margin from the resale price as the first step. If the computation is stopped at this step itself, the derived purchase amount would be inclusive of the such expenses. It is therefore necessary to reduce such expenses in arriving at the arm's length purchase price.
- iii. Adjustments have to be made also for accounting practices apart from functional and other differences. Differences in accounting practices may be because:
 - (a) sales and purchases have been accounted for inclusive of taxes or exclusive of taxes;
 - (b) method of pricing the goods namely, FOB or CIF;
 - (c) fluctuations in foreign exchange.
- iv. In actual practice, the resale in any financial year may be also out of opening stock. Similarly, the goods purchased during the said year may remain in closing stock. Under the resale price method, the arm's length price of purchases from AE during the financial year should be determined. The process of determination under Rule 10B(1)(b) culminates in the cost of sales rather than value of purchase during the year. This 'cost of sales' should be converted into 'value of purchase'. For this purpose, the closing stock of goods purchased from AE should be added and the opening stock of purchases from AE should be deducted.

■ c. cost plus method, by which,—

- i. the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;
- ii. the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;
- iii. the normal gross profit mark-up referred to in (ii) is adjusted to take into account the functional and other



differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;

- iv. the costs referred to in (i) are increased by the adjusted profit mark-up arrived at under (iii);
- v. the sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise;

Taxpoint

- Typical transactions where the cost plus method may be adopted are:
 - (a) provision of services;
 - (b) joint facility arrangements;
 - (c) transfer of semi finished goods;
 - (d) long term buying and selling arrangements.
- The steps involved in the application of this method are:
 - i. Determine the direct and indirect cost of production in respect of property transferred or service provided to an associated enterprise.
 - ii. Identify one or more comparable uncontrolled transactions for same or similar property or service.
 - iii. Determine normal gross profit mark-up on costs in the comparable uncontrolled transaction. Such costs should be computed according to the same accounting norms. In other words, the components of costs of comparable uncontrolled transaction should be the same as those of international transaction.
 - iv. Adjust the gross profit mark-up to account for functional and other differences between the international transaction and the comparable uncontrolled transaction. Such adjustments should also be made for enterprise level differences.
 - v. The direct and indirect cost of production in the international transaction is increased by such adjusted gross profit mark-up.
 - vi. The resultant figure is the arm's length price.

- CPM determines ALP by adding Gross Profit Margin (mark-up) earned in comparable transaction(s) / by comparable companies to the cost incurred by Tested Party under controlled transaction
- CPM is useful when tested party is supplying made-to-order goods (e.g. engineering goods) to its related party
- While RPM focuses on the control of profit margin at the distribution level, CPM focusses on the control of profit mark-up at the manufacturing level.

- The application of the cost plus method can be understood with the following example:

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows:

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Indian Company	30

Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., develops software for various customers, who include AE2 Ltd. and M Ltd.

AE1 Ltd., during the year billed AE2 Ltd. ₹ 2,00,000. The total cost (direct and indirect) for executing this work was ₹ 1,75,000.

AE1 Ltd., provided similar services to M Ltd., and earned a gross profit (GP) of 50% on costs.

Analysis of transactions

	Transactions with AE2 Ltd.	Transactions with M Ltd.
Technology support	Yes	No - value of technology support incurred by AE1 Ltd., is ₹ 17,500
Discount	Yes – Discount offered is ₹ 8,750	No
Business risks and marketing	Yes – Value of the same is estimated at ₹ 13,125	No
Credit	Yes – Cost of credit is estimated at ₹ 2,625	No

Factors to be considered while determining ALP:

- In the CPM, one has to start with the gross profit mark up which the enterprise earned in a comparable uncontrolled transaction. In this example, the comparable uncontrolled transaction is between AE1 Ltd., and M Ltd.
- Such gross profit (GP) mark up needs to be decreased by the following:
 - ◆ As AE1 Ltd., did not receive the technology support from M Ltd., it has priced its services higher resulting in its earning a higher GP with M Ltd.. The value of technology support of ₹ 17,500 received from AE2 Ltd. is 10% of cost. Therefore, the GP with M Ltd., has to be reduced by 10%.
 - ◆ AE1 Ltd. did not provide discount to M Ltd., as volume of business from M Ltd., was not as high as that from AE2 Ltd. Had AE1 Ltd., offered similar discount to M Ltd., the GP with M Ltd., would have been lower. The discount of ₹ 8,750 offered to AE2 Ltd. is 5% of cost. Therefore, the GP with M Ltd., has to be decreased by 5%.
 - ◆ AE1 Ltd., has incurred ₹ 15,000 towards marketing functions in respect of its transactions with M Ltd., which is 7.5% of its cost. However, in its transactions with AE2 Ltd. the said functions are assumed by AE2 Ltd. Had AE1 Ltd., not incurred similar expenses with M Ltd., it would have settled for a lower GP. Therefore, the GP with M Ltd., has to be reduced by 7.5%.
 - ◆ The cost of credit of ₹ 2,625 provided by AE1 Ltd., to AE2 Ltd. is 1.5% of its cost. However, in its transactions with M Ltd., such credit is not provided. Had AE1 Ltd., provided similar credit to M Ltd., it would have increased its price resulting in a higher GP. Therefore, the GP with M Ltd., has to be increased by 1.5%.
- The resultant gross profit mark up is the arm's length gross profit mark up.
- The costs of AE1 Ltd., in its transactions with AE2 Ltd. should be increased by the arm's length gross profit mark up to arrive at the arm's length income.

Determination of arm's length price under costs plus method

- Associated enterprise : AE1 Ltd. and AE2.



2. Other enterprise : AE1 Ltd. and M Ltd
3. International transaction : AE1 Ltd and AE2 Ltd
4. Comparable uncontrolled transaction : AE1 Ltd. and M Ltd

Determination of arm's length gross profit mark up

Details	
Gross profit mark up in case of M Ltd.	50.00%
Less:	
1. Technology support from AE2 Ltd.	10.00%
2. Quantity discount to AE2 Ltd not to M Ltd.	5.00%
3. Marketing functions performed by AE1 Ltd., in respect of M Ltd.	7.50%
Sub total	22.50%
Add:	
1. Cost of credit to AE2. Ltd.	1.50%
Sub total	1.50%
Arm's length gross profit mark up	29.00%

Determination of arm's length price

Details	
Direct and indirect costs incurred by AE1 Ltd. in respect of transactions with AE2 Ltd.	1,75,000
Arm's length gross profit mark up	29.00%
Arm's length income (A)	2,25,750
Actual price charged to AE2 Ltd. (B)	2,00,000
Income increases by (A-B)	25,750

The following points are to be noticed:

- i. In this method, the direct and indirect costs of production are to be determined. The terms 'direct' or 'indirect' costs are however not defined. A reference may therefore be made to the industry practice as well as the pronouncements of the ICAI.
- ii. In determining the direct and indirect cost, the following factors have to be borne in mind:
 - (a) if the plant has been under utilised the costs may have to be suitably adjusted;
 - (b) absorption costing method is normally to be preferred.
- iii. This method is to be adopted only in cases of supply of property or services to an associated enterprise. This method is not to be applied when the enterprise is in receipt of property or services from an associated enterprise.

- d. profit split method, which may be applicable mainly in international transactions or specified domestic transactions involving transfer of unique intangibles or in multiple international transactions or specified domestic transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which:

- i. the combined net profit of the associated enterprises arising from the international transaction or the specified domestic transaction in which they are engaged, is determined;
- ii. the relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;
- iii. the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under (ii);
- iv. the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction or the specified domestic transaction.
 - ▶ The combined net profit referred to in (i) 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 or specified domestic transaction in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under (ii) and (iii), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction or the specified domestic transaction.

Taxpoint

- ▶ Typical transactions where the profit-split method may be used are transactions involving:
 - a. integrated services provided by more than one enterprise for e.g., in case of financial service sector, where the activities performed by Indian company and foreign AEs in relation of a merger and acquisition transaction are so interrelated that it may not be possible to segregate them;
 - b. transfer of unique intangibles, for e.g. two associated enterprises contribute their respective intangibles to develop a new product or process and earn income from such product or process.
- ▶ There are two approaches to this method, namely, total profits split and residual profit split.

Total profits split: The steps involved are as follows:

- i. Determine the combined net profit of the associated enterprises arising from the international transactions in which they are engaged. Such profits represent the profits earned from third parties due to the combined efforts of the associated enterprises. It may be noted that the 'combined net profit' referred to in the rule is not the aggregate of entire profits earned by the associated enterprises. Example: AE1 may earn profits from certain transactions wherein there is no contribution by AE2 and vice versa. Such profits do not enter into the determination of combined net profit. Only those profits that are earned as a result of joint efforts of AE1 and AE2 should be taken as combined net profit.
- ii. Evaluate relative contribution made by each entity involved in the transaction on the basis of:
 - a. functions performed;
 - b. assets employed;
 - c. risks assumed;



- d. the reliable external market data indicating how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances. It may be noted that reference to 'external market data' indicates comparable uncontrolled transactions. The use of word 'external' does not preclude use of internal CUT. In the process of choosing CUTs, the function performed, assets used and risks taken (FAR) of the uncontrolled transactions would have been compared with the FAR of the international transactions. When the FAR of the international transaction and CUT are similar, the relative contribution adopted in the CUT should be applied to the international transaction. Any significant differences between the two should be suitably adjusted.
- iii. Thereafter, split the combined net profit in proportion to the relative contribution determined as above.
- iv. The profit so apportioned is taken to arrive at the arm's length price in relation to the international transaction. The profits so apportioned to the AE when added to the costs incurred by it in relation to international transaction would result in arm's length price.

Residual profit split approach

- ▶ In this approach, firstly, a basic return is determined for each of the enterprises and profits of each such enterprise is ascertained. This amount is reduced from the combined net profits. Residual profits are allocated on the basis of relative contribution.
- ▶ Steps involved in this approach are as follows:
 - i. Determine the combined net profit of the associated enterprises arising from the international transactions in which they are engaged.
 - ii. At the first stage, depending on functions performed, assets employed and risks assumed, determine the basic return appropriate to the respective activities. Allocate the combined net profit on the basis of above. This step results in a partial allocation of the combined net profit to each enterprise. For this purpose, the allocation is undertaken with reference to margins of comparable uncontrolled entities.
 - iii. the balance of the combined net profit is allocated on the basis of the evaluation of the relative contribution.
 - iv. the total net profit from such two-tier allocation is taken to arrive at the arm's length price. The profits so apportioned to the AE when added to the costs incurred by it in relation to international transaction would result in arm's length price.
 - PSM is used when transactions are inter-related and is not possible to evaluate separately.
 - PSM first identifies the profit to be split for the AE. The profit so determined is split between the AE on the basis of the functions performed
 - Division of profit maybe done on Contribution analysis basis or Residual analysis basis.
 - Under Contribution analysis, the assessee must use comparable uncontrolled transactions as well as factors such as risks undertaken and assets employed, to determine the division of profit
 - Under Residual analysis during division of profit, step 1 involves division of profits to each party upto the extent of just covering the costs incurred in producing the good. Step 2 involves further proportionate distribution of residual profits in accordance with each party's contribution, after carrying out step 1

► The application of the profit split-method can be understood with the following example:

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows;

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Foreign Company	30
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., is an investment advisory company, which in association with AE2 Ltd. assists its clients with foreign acquisitions.

AE3 Ltd., which is based in U.S.A., has worldwide presence. AE1 Ltd. is approached by M for identifying potential target companies for acquisitions in the USA. In order to serve M, AE1 Ltd. and AE3 Ltd., have each contributed integrally to identification of potential target and assisting M with the acquisition process. For the above, AE1 Ltd., received consideration of US\$ 50,000. The financials are as follows;

	AE1 Ltd.	AE3 Ltd.
Revenue	30,000	20,000
Cost	20,000	8,000
Profit	10,000	12,000

Factors to be considered:

- The normal basic return is ordinarily calculated as a percentage of the costs incurred or gross revenues or capital employed. In this example, it is assumed as a percentage of the cost.
- Based on the FAR analysis, the basic return for AE1 Ltd., and AE3 Ltd., are determined to be 15% and 10% respectively. Accordingly, the normal basic return for AE1 Ltd. in India for the aforesaid operation is US\$ 3000. The similar returns for AE3 Ltd., US\$ 800. The total basic return, thus, is US \$ 3,800.
- On the basis of functions performed, risks assumed and assets employed, the relative contribution may be taken at 70%, 30% for AE1 Ltd. and AE3 Ltd., respectively.

Determination of arm's length price under profit split method:

First Approach: Total Profit Split Method

- Associated enterprises : AE1 Ltd. and AE3 Ltd.
- Ultimate delivery of product is : By AE3 Ltd. to M Ltd.
- International transaction : AE1 Ltd. and AE3 Ltd.

Details	US\$
Price charged by AE3 Ltd from M Ltd	50,000
AE3 Ltd share of revenue	20,000
AE1 Ltd share of revenue	30,000
Combined total profits	22,000
Evaluation of relative contribution	



AE1 Ltd : India return – 70%	15,400
AE3 Ltd : US return – 30%	6,600
Total	22,000
Total return for AE1 Ltd	15,400
Total cost of AE1 Ltd	20,000
Income of AE1 Ltd on arm's length price (A)	35,400
Actual revenue (B)	30,000
Increased income (A-B)	5,400

Note: In this example, the basic return is not required to be taken into account.

Second Approach: Residual profit split method

Details	US\$
Price charged by AE3 Ltd from M Ltd	50,000
AE3 Ltd share of revenue	20,000
AE1 Ltd share of revenue	30,000
Combined total profits	22,000
1. Basic return	
AE1 Ltd : India return	3,000
AE3 Ltd : US return	800
Total	3,800
2. Residual net profit	18,200
AE1 Ltd: India return – 70%	12,740
AE3 Ltd: US return – 30%	5,460
Total	18,200
Total return for AE1 Ltd (12740 + 3000)	15,740
Total cost of AE1 Ltd.	20,000
Income of AE1 Ltd. on arm's length price (A)	35,740
Actual revenue (B)	30,000
Increased income (A-B)	5,740

The following points are to be noticed:

- It is the profit from a transaction with the associated enterprise that needs to be ascertained. If there are other transactions, which contribute to the profits, then the profits from transactions with associated enterprise may have to be arrived at on some approximation.
- The rule itself provides an alternative method to arrive at the arm's length price being the two-tier profit split-method;
- If in either of the alternatives, a range of figures is available, the arithmetical mean of such figures may be adopted as the arm's length price. It may however not be possible to adopt the arithmetical mean of the two alternatives.

- d. Under the two-tier split-method, the basic rate of return may have to be adopted having regard to the profits compared to the net worth of the enterprise. Such rate of return may not be uniform for all the associated enterprises involved in the transaction.
- e. This is the only method for which the Rule itself has prescribed the types of transaction to which it may be applicable.
- f. Even though the computation proceeds with the profits from a transaction, the purpose is only to arrive at the arm's length price of a transaction. It is only by substituting the arm's length price for the price in the international transaction that an adjustment may be made to the income returned.

■ e. transactional net margin method, by which,—

- i. the net profit margin realised by the enterprise from an international transaction or a specified domestic transaction] entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;
- ii. the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
- iii. the net profit margin referred to in (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;
- iv. the net profit margin realised by the enterprise and referred to in (i) is established to be the same as the net profit margin referred to in (iii);
- v. the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction or the specified domestic transaction;

Taxpoint

- Typical transactions where the transactional net margin method may be adopted are:

- (a) provision of services;
- (b) distribution of finished products where resale price method cannot be applied;
- (c) transfer of semi finished goods where cost plus method cannot be applied;
- (d) transactions involving intangibles where profit split method cannot be applied.

- The steps involved in the application of this method are:

- i. Identify the net profit margin realised by the enterprise from an international transaction. Where the assessee also has transactions, segments or businesses where the international transactions with associated enterprises are not relevant, then the net profit margin to be considered for the purposes of this TNMM method should be such net profit margin as is derived only from the transactions, segments or businesses related to the international transaction. The net profit margin may be computed in relation to costs incurred or sales effected or assets employed or any other relevant base.

For example,

- ◆ In case where the assessee acts as a distributor and the transaction pertains to import, the revenue may be used as base.
- ◆ In case the transaction involves export of services/goods, costs may be taken as base.



- ii. Identify the net profit margin from a comparable uncontrolled transaction or a number of such transactions having regard to the same base; In practice, net profit margin is ascertained at segment level where segment data are available. The unallocated expenses are allocated on a reasonable basis and the segmental net profit is determined. Where segment data are not available, net profit is normally determined at enterprise level. Where internal CUT is available transaction level net profit may be determined.
 - iii. In case internal CUT is not available, external CUT is taken. In such case, as discussed above, net profit margin should be taken at enterprise level (segmental or enterprise as a whole) of comparable companies. A search should be carried out to identify comparable companies on the basis of information and data available with the assessee. Where such information and data are not available, search may be carried out with reference to database in public domain.
 - iv. The net profit margin so identified is adjusted to take into account the transaction level and enterprise level differences if any. The Methods of Computation of Arm's Length Price differences should be those that could materially affect the net profit margin in the open market;
 - v. The adjusted net profit margin is taken into account to arrive at the arm's length price in relation to the international transaction.
- The application of the transactional net margin method may be understood with the following example:
- AE1 Ltd., is an Indian company

AE1 Ltd., manufactures compact disc (CD) writers and sells the same to AE2 Ltd., which is an associated enterprise of AE1 Ltd.

As AE1 Ltd., does not have similar transaction with a non AE, no internal CUT is available. As AE1 Ltd., does not have information and data to identify a comparable company, it has used the databases in public domain for carrying out the search. The result of the search may be summarised as follows:

	No. of companies
Search on the basis of following keywords:	
(a) Computer	800
(b) Computer hardware	250
(c) Computer peripherals	66
Sub total	1116
Elimination process :	
Companies with different activities	800
Companies with duplication when multiple database are used	75
Companies with no financials	90
Companies having significant operations like sales or purchases with related party	100
Companies reporting no operations	50
Sub total	1115
Company/companies selected – Z Ltd.	1

Note: The search criteria and filters adopted above should be taken as illustrative only.

The comparison between AE1 Ltd., and Z Ltd., is carried out as follows::

Financials	AE1 Ltd. (₹ in crores)	Z Ltd. (₹ in crores)
Sales	130	200
Other income	5	10
Total Income	135	210
Operating expenses	85	120
Interest	5	7
Depreciation	10	12
Loss on sale of undertaking	5	0
Expenses relating to non operating income	1	3
Total expenditure	106	142
Net profits	24	58
Operating margin		
Sales	130	200
Gross revenue	130	200
Operating expenses	85	120
Interest	5	7
Depreciation	10	12
Total operating cost	100	139
Operating profit	30.00	61.00
Operating margin (before interest and depreciation)	52.94	66.67
Operating margin (after depreciation but before interest)	36.84	51.52
Operating margin (after depreciation but before interest)	36.84	51.52

- Rule 10B(e)(iii) requires that transaction level and enterprise level differences should be adjusted if such differences materially affect the amount of net profit margin.

In this example, following enterprise level differences could be visualised;

- Working capital** – There may be differences in stock holding, debtors and creditors. Appropriate adjustment to eliminate the impact of above difference may be made by taking the prevailing interest rate. For this purpose, useful reference may be made to the guidelines issued by Internal Revenue Service of USA. However, in this example, it is assumed that the difference in the working capital is not significant requiring any adjustment.
- Cost of capital** – There may be difference in the manner of funding such as equity, preference, debenture, inter corporate loans etc. In order that such difference does not impact the net profit, the operating margin on operating cost before interest is taken as profit level indicator.
- Assets employed** – There may be difference in assets employed and the method of providing depreciation. In order that such difference does not impact the net profit, the operating margin on operating cost before depreciation is taken as profit level indicator.

- d. Assured or risk bearing business** – There may be a difference in the customer/ revenue model of the assessee vis-à-vis the comparables. For example, the comparables identified may be entrepreneurs bearing the market risks of business volume, customer continuity, etc and the assessee's international transaction is in the nature of captive service provider or contract manufacturer with assured volumes and/or assured compensation and/or assured business period, etc. Such differences may be eliminated by making appropriate adjustment for low-risk or risk free business.

In the above table, the transaction level differences cannot be noticed. However, some transaction level differences may exist and the same may be adjusted if requisite information is available. Some of the common transaction level differences may be as follows;

- (a) Free gifts
- (b) Extended warranty (in addition to the normal one-year)
- (c) Marketing risks
- (d) Pricing - Ex-Shop or FOR-destination.
- (e) Quantity discount

Computation of arm's length price under the transactional net margin method

- 1. Associated enterprise : AE1 Ltd. and AE2 Ltd.
- 2. International transaction : AE1 Ltd. and AE2 Ltd.
- 3. Comparable uncontrolled company : Z Ltd.

	%
Net profit margin of Z Ltd. - i.e. operating margin on cost before interest and after depreciation	51.52
Adjustments for transaction level differences	0.00
Arm's length net profit margin	51.52
	(₹ in crores)
Operating costs before interest and after depreciation	95.00
Arm's length sale revenue	143.94
Actual sales	130.00
Income increases by	13.94

The following points are to be noticed:

- a.** Different bases of determining the net profit margin [i.e. profit level indicators (PLI)] are recognised. The same basis of arriving at the net profit margin is to be adopted year after year, unless circumstances justify an alternate base;
- b.** Whichever base is selected in determining the net profit margin in an international transaction, the same basis is to be adopted for arriving at the net profit margin in the comparable uncontrolled transaction;
- c.** It is recommended that operating profit margin may be used instead of net profit margin. Operating

profit margin would eliminate the nonoperating items (the items of revenue and costs which do not result from routine business operations such as profit on sale of assets, dividend etc.). Further, the operating profit margins should be computed on the basis of financial statements of the assessee and the comparable company.

- d. The accounting treatment of expenses and depreciation is also a critical factor in computing the arm's length price. Unlike the preceding methods, the rule does not explicitly provide for adjustment on account of differing accounting practices. Nevertheless, such differing practices should also be factored in;
- e. It is not uncommon to find purchase transaction being an international transaction where TNMM is used. TNMM requires the determination of the net profit margin from an international transaction and purchase transaction as such does not result in net profit. However, as purchase is inextricably linked to earning net profit, TNMM may be used for establishing arm's length purchase value. In such case, comparable operating margin should be appropriately used to work back the arm's length purchase cost. This may be illustrated as follows:

ILLUSTRATION 1:

1. Actual Profit and loss account of the assessee

	₹ in lakhs		₹ in lakhs
Opening stock-AE purchases	100	Sales of AE purchases	800
Opening stock-Non AE purchases	150	Sales of Non AE purchases	1200
Purchases from AE	500	Closing stock-AE purchases	120
Purchases from Non AE	1000	Closing stock-Non AE purchases	160
Gross profit	530		
	2280		2280
Expenses	200	Gross profit	530
Net profit	330		
	530		530

2. Comparable operating margin (PLI being operating profit on sale): 35%

3. Profit and loss account - recast to compute arm's length price of purchase

	(₹ in lakhs)		(₹ in lakhs)
Opening stock-AE purchases	100	Sales of AE purchases	800
Purchases from AE (balancing figure)	460	Closing stock-AE purchases	120
Gross profit (brought back)	360		
	920		920
Expenses-allocated (in the ratio of sales)	80	Gross profit (worked back)	360
Net profits	280		
(applying TNMM margin on AE sales)			
	360		360



4. Arm's length value of purchase is ₹ 460 as against actual value of ₹ 500. Therefore, income increases by ₹ 40.

ILLUSTRATION 2:

1. Profit and loss account of the assessee – Actual

	₹ in lakhs		₹ in lakhs
Opening stock of raw material (AE purchases)	100	Sale of finished goods	2500
Opening stock of raw material (Non-AE purchases)	150	Closing stock of raw material (AE purchases)	120
Purchases of raw material from AE	500	Closing stock of raw material (Non-AE purchases)	160
Purchases of raw material from Non-AE	1000	Closing stock of finished goods	500
Manufacturing costs	400		
Admin, selling and finance expenses	200		
Net profit	930		
	3280		3280

2. Comparable operating margin (PLI being operating profit on sale): 45%

3. Profit and loss account - recast:

	₹ in lakhs		₹ in lakhs
Opening stock of raw material (Non-AE purchases)	150	Sale of finished goods	2500
Cost of purchase from AE (net of stock)	405	Closing stock of raw material (Non-AE purchases)	160
(balancing figure)			
Purchases of raw material from Non AE	1000	Closing stock of finished goods	500
Manufacturing costs	400		
Admin, selling and finance expenses	200		
Net profit	1125		
(arrived on basis of TNMM margin)			
	3280		3280

Arm's length Purchase value:

Cost of purchase from AE (net of stock)	405
Add : Closing stock of Raw Material	120
Add : Closing stock of Raw Material in finished goods (see Note 1 below)	20
Less : Opening stock	100
Arm's length Purchase value	445

Actual purchase	500
Excess price paid	55

Notes: 1. In the above example, the raw material cost (of purchases from AE) built into closing stock of finished goods is assumed to be ₹ 20.

2. It is assumed that there is no opening stock of finished goods.

Profit Level Indicators (PLI) and Methods

CUP	Prices
PSM	Generally, operating profit margins
RPM	Gross Margin on Operating Revenue
CPM	Gross Margin (mark-up) on Operating Cost
TNMM	Net Margin

- f. any other method as provided in rule 10AB.

Taxpoint

The application of the sixth method may be understood with the following examples:

ILLUSTRATION

AE1 Ltd. is an Indian Company.

AE1 Ltd. owns certain registered patents which it has developed by undertaking research and development.

It is a subsidiary of AE2 Ltd., a foreign company.

AE1 Ltd. has sold its registered patents to AE2 Ltd., for ₹ 50 crores. The price has been determined based on a valuation report obtained from an independent valuer.

The sale of patents is a unique transaction and AE1 Ltd or AE2 Ltd. has not entered into similar transactions with third parties and hence no internal or external CUP is available.

AE1 Ltd. may select the Other Method as the most appropriate method and use the independent valuation report for comparability purposes.

ILLUSTRATION

An Indian Company (I Co) buys back its equity shares issued to its foreign associated enterprise (AE Co).

I Co obtains a valuation report from an external firm identifying the fair market value of these shares. I Co



purchases the shares at the value determined in the valuation report. This value denotes a price that would have been charged if a third party would have bought the same shares. Hence, I Co could use Rule 10AB and rely upon the valuation report to demonstrate this transaction to be arm's length.

ILLUSTRATION

Another example where this method could be used is in cases of cost allocation arrangements where a taxpayer benefits from certain services provided by a central entity of the group and has to pay a portion of the total cost incurred by the service provider. These costs are generally allocated on the basis of allocation keys like headcount, time spent, revenues etc. and a third party outside the group may not have the capability to provide identical services. Hence, in the absence of comparable prices or transactions, Rule 10AB may be applied and the cost allocation arrangement could be justified appropriately.

- ◆ For the purposes of aforesaid rule, the comparability of an international transaction or a specified domestic transaction with an uncontrolled transaction shall be judged with reference to the following:
 - a. the specific characteristics of the property transferred or services provided in either transaction;
 - b. the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;
 - c. 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;
 - d. 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.
- ◆ An uncontrolled transaction shall be comparable to an international transaction or a specified domestic transaction if—
 - i. none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or
 - ii. reasonably accurate adjustments can be made to eliminate the material effects of such differences.
- ◆ The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction or a specified domestic transaction shall be the data relating to the financial year (hereafter in this rule and in rule 10CA referred to as the 'current year') in which the international transaction or the specified domestic transaction has been entered into.
- ◆ In a case where the most appropriate method for determination of the arm's length price of an international transaction or a specified domestic transaction, entered into on or after 01-04-2014, is the method specified in sec. 92C(1)(b), (c) or (e), then, the data to be used for analysing the comparability of an uncontrolled transaction with an international transaction or a specified domestic transaction shall be:
 - i. the data relating to the current year; or
 - ii. the data relating to the financial year immediately preceding the current, 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.

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 or a specified domestic 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.

17.32 OTHER METHOD OF DETERMINATION OF ARM'S LENGTH PRICE [RULE 10AB]

For the purposes of sec. 92C(1)(f), the other method for determination of the arm's length price in relation to an international transaction or a specified domestic 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.

17.33 MOST APPROPRIATE METHOD [RULE 10C]

The most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction or specified domestic transaction, and which provides the most reliable measure of an arm's length price in relation to the international transaction or specified domestic transaction. In selecting the most appropriate method, the following factors shall be taken into account:

- (a) the nature and class of the international transaction or specified domestic transaction;
- (b) 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;
- (c) the availability, coverage and reliability of data necessary for application of the method;
- (d) the degree of comparability existing between the international transaction or specified domestic transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
- (e) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction or specified domestic transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
- (f) the nature, extent and reliability of assumptions required to be made in application of a method.

Comparison of Methods of computing Arm's Length Price:

Methods	Product Comparability	Functional Comparability	Approach	Remarks
CUP	Very High	Medium	Prices are benchmarked	Very difficult to apply as very high degree of comparability required
RPM	High	Medium	GPM (on sales) benchmarked	Difficult to apply as high degree of comparability required
CPM	High	High	GPM (on costs) benchmarked	Difficult to apply as high degree of comparability required



PSM	Medium	Very High	Profit Margins	Complex Method, sparingly used
TNMM	Medium	Very High	Net Profit Margins	Most commonly used Method

Some Important Ratios

Cost Cover Ratio

The cost coverage ratio measures the ability of a company to cover its operating expenses through operating revenue. Given the limitation of financial information publicly available, the operating expenses of a selected comparable company are the sum of its operating revenue less EBIT.

Return on Assets Ratio

The return on assets ratio measures the amount of EBIT per rupee of asset invested. This is a profitability ratio measuring each company's operational efficiency, that is, how efficiently the assets have been deployed by the company.

Berry Ratio

Berry ratio is the ratio of gross profit to operating expenses. It measures the return on operating expenses. As the functions performed by the tax-payers are often reflected in the operating expenses, this ratio determines the relationship of the income earned in relation to the functions performed. This ratio helps in overcoming the difficulties in applying the RPM, which does not explain the creation of gross profit. This ratio is used in conducting an arm's length analysis of service-oriented industry such as limited risk distributor, advertising, marketing and engineering services. The Berry ratio may be used to test whether service providers have earned enough mark-up on their operating expenses. In essence, the Berry ratio implicitly assumes that there is a relationship between the level of operating expenses and the level of gross profits earned by routine distributors and service providers.

ANNEXURE 2

Information and documents to be kept and maintained under section 92D [Rule 10D]

1. Every person who has entered into an international transaction or a specified domestic transaction shall keep and maintain the following information and documents:
 - a. a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;
 - b. a profile of the multinational group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions or specified domestic transactions, as the case may be, have been entered into by the assessee, and ownership linkages among them;
 - c. a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted;
 - d. the nature and terms (including prices) of international transactions or specified domestic transactions

entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;

- e. a description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction or specified domestic transactions;
 - f. a record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions or specified domestic transactions entered into by the assessee;
 - g. a record of uncontrolled transactions taken into account for analysing their comparability with the international transactions or specified domestic transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions or specified domestic transactions, as the case may be;
 - h. a record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction or specified domestic transactions;
 - i. a description of the methods considered for determining the arm's length price in relation to each international transaction or specified domestic transactions or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;
 - j. a record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction or specified domestic transactions and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;
 - k. the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;
 - l. details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purposes;
 - m. any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.
- 2.** Threshold limit in case of international transaction: Nothing contained in sub-rule (1), in so far as it relates to an international transaction, shall apply in a case where the aggregate value, as recorded in the books of account, of international transactions entered into by the assessee does not exceed ₹ 1 crore

However, the assessee shall be required to substantiate, on the basis of material available with him, that income arising from international transactions entered into by him has been computed in accordance with sec. 92.

- 3.** Eligible assessee, on which safe harbour rule applies in respect of specified domestic transaction: Nothing contained in sub-rule (1), in so far as it relates to an eligible specified domestic transaction referred to in rule 10THB, shall apply in a case of an eligible assessee mentioned in rule 10THA and:
- a. the eligible assessee, referred to in rule 10THA(i) [i.e., Government company engaged in the business of generation, supply, transmission or distribution of electricity], shall keep and maintain the following information and documents:
 - 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;
- b. the eligible assessee, referred to in rule 10THA(ii) [i.e., co-operative society engaged in the business of procuring and marketing milk and milk products], shall keep and maintain the following information and documents:
- 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.
4. The information specified in aforesaid rules shall be supported by authentic documents, which may include the following:
- a. official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country;
 - b. reports of market research studies carried out and technical publications brought out by institutions of national or international repute;
 - c. price publications including stock exchange and commodity market quotations;
 - d. published accounts and financial statements relating to the business affairs of the associated enterprises;
 - e. agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions 56e[or the specified domestic transactions, as the case may be];
 - f. letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;

- g. documents normally issued in connection with various transactions under the accounting practices followed.

Taxpoint

- ◆ The information and documents specified under aforesaid rules, should, as far as possible, be contemporaneous and should exist latest by the specified date [i.e., due date u/s 139(1)].
- ◆ Where an international transaction or specified domestic transaction continues to have effect over more than one previous years, fresh documentation need not be maintained separately in respect of each previous year, unless there is any significant change in the nature or terms of the international transaction or specified domestic transaction, in the assumptions made, or in any other factor which could influence the transfer price, and in the case of such significant change, fresh documentation shall be maintained bringing out the impact of the change on the pricing of the international transaction or specified domestic transaction.
- Aforesaid information and documents shall be kept and maintained for a period of 8 years from the end of the relevant assessment year.

ILLUSTRATION 6

Discuss whether adjustment is required in the context of transfer pricing provisions where the transfer price adopted for an international transaction of sale of goods by an Indian company during the financial year 2017-18, is ₹ 50 lacs whilst the Arm's Length Price determined using the most appropriate method are ₹ 48 lacs and ₹ 56 lacs. Assume that the rate of permissible variation prescribed by the Central Government is 2% of the transfer price for this class of international transaction.

Solution

The proviso to section 92C(2) provides that where more than one price is determined by the most appropriate method, the arm's length price (ALP) shall be taken to be the arithmetical mean of such prices. However, if the arithmetical mean, so determined, is within such percentage of the transfer price notified by the Central Government, then, the transfer price shall be deemed to be the arm's length price and no adjustment is required to be made.

The arithmetical mean of the prices = $(₹ 48 + ₹ 56) / 2 = ₹ 52$ lacs.

The rate of permissible variation prescribed by the Central Government is 2% i.e. ₹ 1 lacs ($₹ 50 \text{ lacs} \times 2\%$).

Since the variation between the arm's length price of ₹ 52 lacs and the transfer price of ₹ 50 lacs is not within the limit of 2% of TP (i.e., ₹ 1 lacs), the arm's length price shall be ₹ 52 lacs.

The Assessing Officer may compute the total income of the Indian company having regard to the arm's length price of ₹ 52 lacs so determined. No deduction shall be allowed under Chapter VI-A or section 10AA in respect of ₹ 2 lacs, being the amount of income by which the total income of the Indian company is enhanced after application of the arm's length price of ₹ 52 lacs.

Note: It is assumed that the assessee has not entered into an Advance Pricing Agreement and has also not opted to be subject to Safe Harbour Rules

ILLUSTRATION 7

Brain Inc. London has 35% equity in Salem Ltd. The company Salem Ltd. is engaged in development of software and maintenance of customers across the globe, which includes Brain Inc.

During the year 2017-18, Salem Ltd. spent 2000 man hours for developing and maintaining a software for Brain Inc. and billed at ₹ 1,000 per hour. The cost incurred for executing maintenance work to Brain Inc. for Salem Ltd. amount



to ₹ 15,00,000. Similar such work was done for unrelated party Try Ltd. in which the profit was at 50%.

Brain Inc. gives technical support to Salem Ltd. which can be valued at 8% of gross profit. There is no such functional relationship with try Ltd.

Salem Ltd. gives credit period of 90 days the cost of which is 3% of the normal billing rate which is not given to other parties.

Compute ALP under cost plus method in the hands of Salem Ltd. and the impact of the same on the total income.

Solution

(A) Computation of Arms Length Gross Profit Mark-up

Particulars	%
Normal Gross Profit Mark up	50.00
Less: Adjustment for differences	
Technical support from Brain Inc [8% of Normal GP = 8% of 50%]	(4.00)
	46.00
Add: Cost of Credit to Brain Inc 3% of Normal Bill [3% × GP 50%]	1.50
Arm's Length Gross Profit mark-up	47.50

(B) Computation of Increase in Total Income of Brain Inc

Particulars	Amount (₹)
Cost of services	15,00,000
Arm's length Billed Value [Cost / [(100 – Arm's Length mark up)] [₹ 15,00,000 / (100% - 47.50%)]	28,57,143
Less: Billed amount [2,000 hours x ₹ 1,000 per hour]	20,00,000
Therefore, Increase in Total Income	8,57,143

ILLUSTRATION 8

A Co. Ltd. of Chennai and Sky Inc. of Singapore are associate enterprises. A Co. Ltd. imported 1000 television sets at ₹ 16,000 per set without any warranty period. A Co. Ltd. also imports similar TV sets from unrelated party Sign Inc. of Japan. It is imported at ₹ 15,000 per set with warranty time of 2 years. The cost of warranty in respect of goods imported from Sky Inc. for a period of 2 years would cost ₹ 2,000.

Compute arm's length price and the amount of increase in total income of A Co. Ltd. as per CUP method.

Solution

(A) Computation of Arms Length Price

Particulars	Amount (₹)
Cost of TV Set acquired from Sign Inc	15,000
Less: Cost of Warranty	2,000
Arm's Length Gross Profit mark-up	13,000

(B) Computation of Increase in Total Income

Particulars	Amount (₹)
Cost of TV Set acquired from Sky Inc [₹ 16,000 × 1,000]	1,60,00,000
Less: Arm's length Value [₹ 13,000 × 1,000]	1,30,00,000
Therefore, Increase in Total Income	30,00,000

ILLUSTRATION 9

J Inc. of Korea and CD Ltd, an Indian Company are associated enterprises. CD Ltd manufactures Cell Phones and sells them to J.K. & F Inc., a Company based at Nepal. During the year CD Ltd. supplied 2,50,000 Cellular Phones to J Inc. Korea at a price of ₹ 3,000 per unit and 35,000 units to JK & F Inc. at a price of ₹ 5,800 per unit. The transactions of CD Ltd with JK & F Inc. are comparable subject to the following considerations:

Sales to J Inc. are on FOB basis, sales to JK & F Inc. are CIF basis. The freight and insurance paid by J Inc. for each unit @ ₹ 700. Sales to JK & F Inc. are under a free warranty for Two Years whereas sales to J Inc. are without any such warranty. The estimated cost of executing such warranty is ₹ 500. Since J Inc.'s order was huge in volume, quantity discount of ₹ 200 per unit was offered to it.

Compute the Arm's Length Price and the subsequent amount of increase in the Total Income of CD Ltd, if any.

Solution

Computation of Arm's Length Price of Products sold to J Inc. Korea by CD Ltd

Particulars	(₹)	(₹)
Price per Unit in a Comparable Uncontrolled Transaction		5,800
Less: Adjustment for Differences -		
(a) Freight and Insurance Charges	700	
(b) Estimated Warranty Costs	500	
(c) Discount for Voluminous Purchase	200	(1,400)
Arms's Length Price for Cellular Phone sold to J Inc. Korea		4,400

Computation of Increase in Total Income of CD Ltd

Particulars	(₹)
Arm's Length Price per Unit	4,400
Less: Price at which actually sold to J Inc. Korea	(3,000)
Increase in Price per Unit	1,400
No. of Units sold to J Inc. Korea	2,50,000
Increase in Total Income of CD Ltd (2,50,000 × ₹ 1,400)	₹ 35 Crores

ILLUSTRATION 10 COMPARABLE SALES OF SAME PRODUCT

DSM, a manufacturer, sells the same product to both controlled and uncontrolled distributor. The circumstances surrounding the controlled and uncontrolled transactions are substantially the same, except that the controlled sales



price is a delivered price to the buyer and the uncontrolled sales are made F.O.B. DSM's factory. Differences in the contractual terms of transportation and insurance generally have a definite and reasonably ascertainable effect on price, and adjustments are made to the results of the uncontrolled transaction to account for such differences. In this case the transactions are comparable and internal CUP can be applied by comparing the prices of both, the controlled and uncontrolled transactions, albeit after subtracting the costs of transportation and insurance of the controlled transaction.

ILLUSTRATION 11 EFFECT OF GEOGRAPHIC DIFFERENCES

FM, a foreign specialty radio manufacturer, also exports its radios to a controlled U.S. distributor, AM, which serves the United States. FM also exports its radios to uncontrolled distributors to serve in South America. The product in the controlled and uncontrolled transactions is the same, and all other circumstances surrounding the controlled and uncontrolled transactions are substantially the same, other than the geographic differences. The geographic differences e.g. differences in purchasing power, levels of economic development, etc., in two different geographies, are likely to have a material effect on price, for which accurate adjustments cannot be made and hence the transactions are not comparable. Thus, CUP method cannot be applied.

ILLUSTRATION 12 EXTERNAL COMMERCIAL BORROWING

Pharma Ltd, an Indian company has borrowed funds from its parent company at LIBOR plus 150 basis points. The LIBOR prevalent at the time of borrowing is 4% for US\$, thus its cost of borrowings is 5.50%. The borrowings allowed under the External Commercial Borrowings guidelines issued under FEMA, for example, say is LIBOR plus 250 basis points, then it can be said that Pharma's borrowing at 5.50% is less than 6.50% and thus at arm's length. In this connection, one may rely on Rule 10B (2) (d) which specifies that the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the laws and government orders in force.

ILLUSTRATION 13

Megabyte Inc. of France and R Ltd. of India are associated enterprises. R Ltd. imports 3,000 compressors for Air Conditioners from Megabyte Inc. at ₹ 7,500 per unit and these are sold to Pleasure Cooling Solutions Ltd at a price of ₹ 11,000 per unit. R Ltd. had also imported similar products from Cold Inc. Poland and sold outside at a Gross Profit of 20% on Sales. Megabyte Inc. offered a quantity discount of ₹ 1,500 per unit. Cold Inc. could offer only ₹ 500 per unit as Quantity Discount. The freight and customs duty paid for imports from Cold Inc. Poland had cost R Ltd. ₹ 1,200 per piece. In respect of purchase from Cold Inc., R Ltd. had to pay ₹ 200 only as freight charges. Determine the Arm's Length Price and the amount of increase in Total Income of R Ltd.

Solution

Computation of Arm's Length Price

Particulars	Amount (₹)
Resale Price of Goods Purchased from Megabyte Inc.	11,000
Less: Adjustment for Differences –	
a) Normal Gross Profit Margin at 20% of Sale Price [20% × ₹ 11,000]	2,200
b) Incremental Quantity Discount by Megabyte Inc. [₹ 1,500 – ₹ 500]	1,000
c) Difference in Purchase related expenses [₹ 1,200 – ₹ 200]	1,000
Arms Length Price	6,800

Computation of Increase in Total Income of R Ltd

Particulars	Amount (₹)
Price at which actually bought from Megabyte Inc. of France	7,500
Less: Arms Length Price per unit under Resale Price Method	6,800
Decrease in Purchase Price per unit	700
No. of units purchased from Megabyte Inc.	3,000 units
Increase in Total Income (3,000 units × ₹ 700)	₹ 21,00,000

ILLUSTRATION 14

NBR Medical Equipments Inc. (NBR) of Canada has received an order from a leading UK based Hospital for development of a hi-tech medical equipment which will integrate the best of software and latest medical examination tool to meet varied requirements. The order was for 3,00,000 Euros. To execute the order, NBR joined hands with its subsidiary Precision Components Inc. (PCI) of USA and Bioinformatics India Ltd (BIL), an Indian Company. PCI holds 30% of BIL. NBR paid to PCI and BIL Euro 90,000 and Euro 1,00,000 respectively and kept the balance for itself. In the entire transaction, a profit of Euro 1,00,000 is earned. Bioinformatics India Ltd incurred a Total Cost of Euro 80,000 in execution of its work in the above contract. The relative contribution of NBR, PCI and BIL may be taken at 30%, 30% and 40% respectively. Compute the Arm's Length Price and the incremental Total Income of Bioinformatics India Ltd, if any due to adopting Arms Length Price determined here under.

A	Share of each of the Associates in the Value of the Order	3,00,000
	Share of BIL [Given]	1,00,000
	Share of PCI [Given]	90,000
	Share of NBR [Amount Retained = 3,00,000 – 1,00,000 – 90,000]	1,10,000
B	Share of each of the Associates in the Profit of the Order	
	Combined Total Profits	1,00,000
	Share of BIL [Contribution of 40% x Total Profit € 1,00,000]	40,000
	Share of PCI [Contribution of 30% x Total Profit € 1,00,000]	30,000
	Share of NBR [Contribution of 30% x Total Profit € 1,00,000]	30,000
C	Computation of Incremental Total Income of BIL	
	Total Cost to BIL Ltd	80,000
	Add: Share in the Profit to BIL (from B above)	40,000
	Revenue of BIL on the basis of Arm's Length Price	1,20,000
	Less: Revenue Actually received by BIL	1,00,000
	Increase in Total Income of BIL	20,000

ILLUSTRATION 15

Indco, an Indian company, has developed and manufactures a robot to be used for multiple industrial applications. The robot is considered to be an innovative technological advance. Chco, a Chinese subsidiary of Indco, has developed and manufactures a software programme which incorporates the new programme in the robot and



makes it more effective. The success of the robot is attributable to both companies for the design of the robot and the software programme.

Indco manufactures and supplies Chco with the robot for installing of the new software programme for assembly and manufacture of the robot. Chco manufactures the robot and sells to an arm's length distributor.

In light of the innovative nature of the robot and software, the group was unable to find comparables with similar intangible assets. Because they were unable to establish a reliable degree of comparability, the group was unable to apply the traditional transaction methods or the TNMM.

However, reliable data are available on robot and software manufacturers without innovative intangible property, and they earn a return of 10% on their manufacturing costs.

The total profits attributable to manufacture of robots are calculated as follows:

Particulars	Amount (₹)	Amount (₹)
Sales to the arm's length distributor		1,000
Less:		
Indco's manufacturing costs	200	
Chco's manufacturing costs	300	
Total manufacturing costs for the group		500
Gross Margin		500
Less:		
Indco's development costs	100	
Chco's development costs	50	
Indco's operating costs	50	
Chco's operating costs	100	300
Net profit		200
Indco's return to manufacturing (200 × 10%)	20	
Chco's return to manufacturing (300 × 10%)	30	50
Residual profit attributable to development		150

The split of the residual profit has been considered on the basis of the development cost considering the significance of technology in the manufacturing process.

Based on proportionate development costs

Particulars	Amount (₹)
Indco's share of residual profit $[(100/(100+50)) \times 150]$	100
Chco's share of residual profit $[50/(100+50)] \times 150]$	50

Indco's transfer price is calculated as follows:

Particulars	Amount (₹)
Manufacturing costs	200
Development costs	100

Operating costs	50
Routine 10% return on manufacturing costs	20
Share of residual profit	100
Transfer price	470

ILLUSTRATION 16

Fox Solutions Inc. a US Company, sells Laser Printer Cartridge Drums to its Indian Subsidiary Quality Printing Ltd at \$ 20 per drum. Doc Solutions Inc. has other takers in India for its Cartridge Drums, for whom the price is \$ 30 per drum. During the year, Fox Solutions had supplied 12,000 Cartridge Drums to Quality Printing Ltd.

Determine the Arm's Length Price and taxable income of Quality Printing Ltd if its income after considering the above is ₹ 45,00,000. Compliance with TDS provisions may be assumed and Rate per USD is ₹ 45. Also determine income of Doc Solutions Inc.

Solution

Computation of Total Income of Quality Printing Ltd.

Particulars	Amount (₹)	Amount (₹)
Total Income before adjusting for differences due to Arm's Length Price	1,08,00,000	
Add: Difference on Account of adopting Arm's Length Price $[12,000 \times \$20 \times ₹ 45]$	1,62,00,000	
Less: Amount under Arm's Length Price $[12,000 \times \$ 30 \times ₹ 45]$	(54,00,000)	45,00,000
Incremental Cost on adopting ALP u/s 92(3), Taxable Income cannot be reduced on applying ALP. Therefore, difference on account of ALP is ignored.		
Total Income of Quality Printing Ltd.		45,00,000

Computation of Total Income of Fox Solutions Inc.

The provisions relating to taxing income of Fox Solutions Inc., on applying Arm's Length Price for transactions entered into by a Foreign Company is given in Circular 23 dated 23.7.1969, which is as follows:

- Transactions Not Taxable in India: Transactions will not be subject tax in India if transactions are on principal-to-principal basis and are entered into at ALP, and the subsidiary also carries on business on its own.
- Transactions Taxable in India if the Indian Subsidiary does not carry on any business on its own. The following are the other considerations in this regard:
 - Adopting ALP does not affect the computation of taxable income of Fox Solutions Inc. if tax has been deducted at source or if tax is deductible.
 - Where ALP is adopted for taxing income of the Parent Company, income of the recipient Company (i.e. Quality Printing Ltd) will not be recomputed.

ILLUSTRATION 17

Khazana Ltd is an Indian Company engaged in the business of developing and manufacturing Industrial components. Its Canadian Subsidiary Techpro Inc. supplies technical information and offers technical support to Khazana for manufacturing goods, for a consideration of Euro 1,00,000 per year. Income of Khazana Ltd is ₹ 90 Lakhs. Determine



the Taxable Income of Khazana Ltd if Techpro charges Euro 1,30,000 per year to other entities in India. What will be the answer if Techpro charges Euro 60,000 per year to other entities. (Rate per Euro may be taken at ₹ 50.)

Solution

Computation of Total Income of Khazana Ltd

Particulars	Amount (₹)	Amount (₹)
When price charged for Comparable Uncontrolled Transaction	€ 1,00,000	€ 50,000
Price actually paid by Khazana Ltd [€1,00,000 × ₹ 50]	50,00,000	50,00,000
Less: Price charged in Rupees (under ALP)		
[€1,30,000 × ₹ 50]	65,00,000	
[€60,000 × ₹ 50]		30,00,000
Incremental Profit on adopting ALP (A)	(15,00,000)	20,00,000
Total Income before adjusting for differences due to Arm's Length Price	90,00,000	90,00,000
Add: Difference on account of adopting Arms Length Price [if (A) is positive]	NIL	20,00,000
Total Income of Khazana Ltd.	90,00,000	1,10,00,000

Note: u/s 92(3), Taxable Income cannot be reduced on applying ALP. Therefore, difference on account of ALP which reduces the Taxable Income is ignored.

ILLUSTRATION 18

Videsh Ltd., a US company has a subsidiary, Hind Ltd. in India. Videsh Ltd. sells mobile phones to Hind Ltd. for resale in India. Videsh Ltd. also sells mobile phones to Bharat Ltd. another mobile phone reseller. It sold 48,000 mobile phones to Hind Ltd. at ₹ 12,000 per unit. The price fixed for Bharat Ltd. is ₹ 11,000 per unit. The warranty in case of sale of mobile phones by Hind Ltd. is handled by itself, whereas, for sale of mobile phones by Bharat Ltd., Videsh Ltd. is responsible for warranty for 6 months. Both Videsh Ltd. and Hind Ltd. extended warranty at a standard rate of ₹ 500 per annum.

On the above facts, how is the assessment of Hind Ltd. going to be affected?

Solution

Computation of Arms Length Price

Particulars	Amount (₹)
Cost of Mobile Phone sold to Bharat Ltd.	11,000
Less: Cost of Warranty	250
Arm's Length Price	10,750

Computation of Increase in Total Income

Particulars	Amount (₹)
Cost of mobile phone acquired from Videsh Ltd. [₹ 12,000 × 48,000]	5,760
Less: Arm's length Value [₹ 10,750 × 48,000]	5,160
Therefore, Increase in Total Income	600

ILLUSTRATION 19

ABC India Limited ('the Company') is engaged in the business of import and sales of computers, laptops & printers. The company is a 100% subsidiary ABC Inc., USA. The company purchases laptops from ABC Inc., USA at negotiated rates and sells to independent customers in India under its own terms and conditions.

The company also trades in computers and printers which it procures from independent vendors in USA and sell to its own customers in India under its own terms and condition.

Below is the profit and loss account of the company.

Particulars	(₹)	Particulars	(₹)
Opening stock		Sales	
- Computers	500	- Computers	8,000
- Printers	200	- Printers	2,000
- Laptops	800	- Laptops	11,000
Purchases (Imports)		Closing Stock	
- Computers	5,000	- Computers	800
- Printers	1,300	- Printers	250
- Laptops	6,000	- Laptops	1,200
Gross profit c/f	9,450		
	23,250		23,250
		Gross profit c/f	9,450
Salary	2,000		
Rent	1,000		
Fright Outward	250		
Travel and Conveyance	300		
PBITD	5,900		
	9,450		9,450

Other relevant information:

- Credit period of 2 months is allowed for customers of computers and printers and hence 2% extra margin towards interest cost is factored in sale price.
- Purchase of materials accounted at landed costs. It is estimated that around 20% of the purchase cost reported in P&L is towards customs duty and clearing charges.
- Delivery of computers and printers made at company's cost. For laptop, the customers collect the goods for company premises.
- For laptop purchases, the company has incurred ocean freight (around Rs.300) whereas for computer and printers the terms of import are CIF, Chennai.

**Question and Solution****1. Identify the Associated Enterprise in the scenario?**

Ans: ABC Inc., USA by virtue of ownership criteria.

2. Identify the International transaction?

Ans: Purchase of the laptop during the year of Rs.4,800 (Rs.6,000 less 20%)

3. Which is the comparable uncontrolled transaction here?

Ans: Sale of computers and printers (since they are similar product to laptops), procured from, as well as sold to independent parties.

4. What is the normal gross profit margin on the comparable transactions?

Ans: Gross profit as per trading account	4,050
[8,000 + 2,000 + 800 + 250 – 500 – 200 – 5,000 – 1,300]	
Less: Interest elements factored in sale price [2% of [8,000 + 2,000]	200
Less: Freight outward costs	250
Normal gross profit	3,600
Normal gross profit percentage [3,600 / 10,000 × 100]	36%

At this stage, the difference in the terms of sales transactions of computers and printers vis-a-vis the sale transactions of laptops are considered. The difference in terms of purchase will be adjusted in subsequent stage.

5. What is the price of laptop being purchased from the AE, is resold to unrelated enterprise?

Ans: ₹ 11,000

6. What is the resultant cost of sales after deducting 'Normal Gross Profit Margin'

Ans: ₹ 7,040 (i.e. Rs.11,000 less 36% Normal Gross Profit Margin)

7. What are the expenses incurred in connection with purchase?

Ans: ₹ 1,200 (since it is mentioned that around 20% of the purchase cost reported in P&L is toward freight, customs duty and clearance charges)

8. What are the functional difference, including accounting practices, between the international transaction and the comparable uncontrolled transaction, which could materially affect the amount of gross profit margin?

Ans: ₹ 300 on account of ocean freight

9. What is the cost of sale after adjustment made as per 7 & 8 above?

Ans: ₹ 5,540 (i.e. ₹ 7,040 less ₹ 1,200 less ₹ 300)

10. How is the arm's length purchase price determined?

Ans: Price as arrived at 9 above	₹ 5,540
Add: Amount in closing stock (80% of Rs.1200)	₹ 960

₹ 6,500

Less: Amount in opening stock (80% of Rs.800)

₹ 640

Arm's length price of purchase

₹ 5,860

11. Is the purchase price at arm's length?**Ans:** Yes. Since the purchase price is Rs.4,800 is less than arm's length price determined at ₹ 5,860.**ILLUSTRATION 20**

Compute arm's length price from following information

Particulars	Related Party	Unrelated Party
Price paid (inclusive of taxes)	INR 25,000	INR 23,500
Delivery terms	CIF	FOB
Quantity	100 pcs	110 pcs
Availability of Input Tax Credit	No	Yes
Quantity	100 pcs	110 pcs
Freight cost	-	INR 1,200
Insurance cost	-	INR 700
Input Tax Credit	-	INR 2,000

Solution

Computation of ALP

Particulars	Amount
Price paid to unrelated party (inclusive of taxes)	INR 23,500
Adjustments of differences -	
Delivery terms – Freight cost	INR 1,200
Delivery terms – Insurance cost	INR 700
Quantity	-
Input tax credit available	(INR 2000)
Arm's Length Price	INR 23,400

ILLUSTRATION 21

Compute arm's length price from following information

Particulars	Related Party	Unrelated Party
Price paid (inclusive of taxes)	INR 25,000	INR 23,500
Delivery terms	CIF	FOB
Quantity	100 pcs	110 pcs



Availability of Input Tax Credit	No	Yes
Quantity	100 pcs	110 pcs
Freight cost	-	INR 1,200
Insurance cost	-	INR 700
Input Tax Credit	-	INR 2,000
Credit period	90 days	Upon dispatch
Interest rate on working capital	12% p.a.	-

Solution

Computation of ALP

Particulars	Amount
Price paid (inclusive of taxes)	INR 23,500
Adjustments of differences	
Delivery terms – Freight cost	INR 1,200
Delivery terms – Insurance cost	INR 700
Input Tax Credit available	(INR 2000)
Credit period (Interest on INR 23,500 for 3 months @ 12% p.a.)	INR 705
Arm's length price	INR 24,105

ILLUSTRATION 22

Compute ALP through following information:

- A Ltd. is a distributor of IT products.
- A Ltd. purchases these products from its related party, P Ltd.
- A Ltd. also trades in laptops manufactured by X Ltd.
- P Ltd as well as X Ltd would supply the warranty replacements free of cost to A Ltd.
- Other details are as under:

Particulars	P Ltd (AE)	X Ltd
Purchase price of A Ltd.	INR 15,000	INR 22,000
Sale price of A Ltd	INR 18,000	INR 26,000
Other expenses incurred by A Ltd	INR 500	INR 700

Solution

Computation of gross profit margin on unrelated transaction

Particulars	Amount (INR)
Sale price of laptop in India	26,000
Expenses incurred by A Ltd	700

Net Sale proceeds of laptop in India [A]	25,300
Purchase price [B]	22,000
Gross profit [A - B]	3,300
GP on sale (%)	12.69%

Computation of arm's length price

Particulars	Amount (₹)
Sales price of desktop in India	18,000
Less: Expenses incurred by A Ltd	500
Less: Arm's length resale margin @ 12.69 % of sale	2,284
Arm's length purchase price	15,216
Purchase price paid to AE	15,000

Thus, no adjustment is required.

ILLUSTRATION 23

A sold a machine to B (associated enterprise) and in turn B sold the same machinery to C (an independent party) at sale margin of 30% for ₹ 4,00,000 but B has incurred ₹ 4,000 in sending the machine to C. From the above data, determine arm's length price.

Solution

Particulars	Details	Amount (₹)
Sales price to B		4, 00,000
Less: Gross Margin	$4,00,000 \times 30\%$	1, 20,000
Balance		2, 80,000
Less: Expenses incurred by B		4,000
Arm's length price		2,76,000

ANNEXURE 3

The question of substance over form has consistently arisen in the implementation of taxation laws. In the Indian context, judicial decisions have varied. While some courts in certain circumstances had held that legal form of transactions can be dispensed with and the real substance of transaction can be considered while applying the taxation laws, others have held that the form is to be given sanctity. The existence of anti-avoidance principles are based on various judicial pronouncements. There are some specific anti-avoidance provisions but general anti-avoidance has been dealt only through judicial decisions in specific cases.

In an environment of moderate rates of tax, it is necessary that the correct tax base be subject to tax in the face of aggressive tax planning and use of opaque low tax jurisdictions for residence as well as for sourcing capital. Most countries have codified the "substance over form" doctrine in the form of General Anti Avoidance Rule (GAAR).

In the above background and keeping in view the aggressive tax planning with the use of sophisticated structures,



there is a need for statutory provisions so as to codify the doctrine of "substance over form" where the real intention of the parties and effect of transactions and purpose of an arrangement is taken into account for determining the tax consequences, irrespective of the legal structure that has been superimposed to camouflage the real intent and purpose. Internationally several countries have introduced, and are administering statutory General Anti Avoidance Provisions. It is, therefore, important that Indian taxation law also incorporate a statutory General Anti Avoidance Provisions to deal with aggressive tax planning. The basic criticism of statutory GAAR which is raised worldwide is that it provides a wide discretion and authority to the tax administration which at times is prone to be misused. This vital aspect, therefore, needs to be kept in mind while formulating any GAAR regime.

In addition to GAAR there also exists SAAR- Specific Anti-Avoidance Rules which specifically aim at certain arrangements of tax avoidance. SAAR have many points to its favour, since its specific there is no scope of confusion, it doesn't provide taxation authorities any discretion and from the point of view of tax payer it provides certainty regarding the nature of his arrangement. Provisions of SAAR are there in Chapter X of the Income Tax Act 1961 and some of the provisions pertaining to SAAR are in various other chapters of Income Tax Act.

It is accordingly provided in the Finance Act, 2013 to provide General Anti Avoidance Rule in the Income Tax Act to deal with aggressive tax planning w.e.f. 01-04-2018.

CHAPTER X-A GENERAL ANTI-AVOIDANCE RULE [W.E.F. 01-04-2018]

17.34 APPLICABILITY OF GENERAL ANTI-AVOIDANCE RULE [SEC. 95]

An arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement and the consequence in relation to tax arising therefrom may be determined subject to the provisions of this Chapter.

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.

17.35 IMPERMISSIBLE AVOIDANCE ARRANGEMENT [SEC. 96]

1. An impermissible avoidance arrangement means an arrangement, the main purpose of which is to obtain a tax benefit, and it—
 - (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 u/s 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. An arrangement shall be presumed, unless it is proved to the contrary by the assessee, to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the

arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.

Arrangement to lack commercial substance [Sec. 97]

1. An arrangement shall be deemed to lack commercial substance, if—
 - 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; or
 - 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. For the aforesaid purposes, 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.
3. 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.
4. The following may be relevant but shall not be 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.



17.36 CONSEQUENCES OF IMPERMISSIBLE AVOIDANCE ARRANGEMENT [SEC. 98]

1. If an arrangement is declared to be an impermissible avoidance arrangement, then, the consequences, in relation to tax, of the arrangement, including denial of tax benefit or a benefit under a tax treaty, shall be determined, in such manner as is deemed appropriate, in the circumstances of the case, including by way of but not limited to the following:
 - a. disregarding, combining or recharacterising 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 nature 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. For this purposes:
 - (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.

17.37 TREATMENT OF CONNECTED PERSON AND ACCOMMODATING PARTY [SEC. 99]

For the purposes of this Chapter, 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) the 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.

17.38 APPLICATION OF THIS CHAPTER [SEC. 100]

The provisions of this Chapter shall apply in addition to, or in lieu of, any other basis for determination of tax liability.

17.39 FRAMING OF GUIDELINES [SEC. 101]

The provisions of this Chapter shall be applied in accordance with such guidelines and subject to such conditions, as may be prescribed. Following scheme has been framed:

Application of General Anti Avoidance Rule [Rule 10U]

1. The provisions of Chapter X-A (i.e., GAAR Provisions) shall not apply 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 ₹ 3 crore;
 - 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 sec. 90 or 90A; 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 01-4-2017 by such person.
 - The provisions shall apply to any arrangement, irrespective of the date on which it has been entered into, in respect of the tax benefit obtained from the arrangement on or after 01-04-2017.

Determination of consequences of impermissible avoidance arrangement [Rule 10UA]

For the purposes of sec. 98(1), 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.

Notice, Forms for reference under section 144BA [Rule 10UB]

1. For the purposes of sec. 144BA(1), the Assessing Officer shall, before making a reference to the Commissioner, issue a notice in writing to the assessee seeking objections, if any, to the applicability of provisions of Chapter X-A in his case.
2. The notice shall contain the following:
 - i. details of the arrangement to which the provisions of Chapter X-A are proposed to be applied;
 - ii. the tax benefit arising under the arrangement;



- iii. the basis and reason for considering that the main purpose of the identified arrangement is to obtain tax benefit;
 - iv. the basis and the reasons why the arrangement satisfies the condition provided in sec. 96; and
 - v. the list of documents and evidence relied upon in respect of (iii) and (iv) above.
3. The reference by the Assessing Officer to the Commissioner u/s 144BA(1) shall be in Form No. 3CEG.
4. Where the Commissioner is satisfied that the provisions of Chapter X-A are not required to be invoked with reference to an arrangement after considering.
- i. the reference received from the Assessing Officer u/s 144BA(1); or
 - ii. the reply of the assessee in response to the notice issued u/s 144BA(2),
- he shall issue directions to the Assessing Officer in Form No. 3CEH.
5. Before a reference is made by the Commissioner to the Approving Panel u/s 144BA(4), he shall record his satisfaction regarding the applicability of the provisions of Chapter X-A in Form No. 3CEI and enclose the same with the reference

Time limits [Rule 10UC]

For the purposes of sec. 144BA:

- i. no directions u/s 144BA(3) shall be issued by the Commissioner after the expiry of 1 month from the end of the month in which the date of compliance of the notice issued u/s 144BA(2) falls;
- ii. no reference shall be made by the Commissioner to the Approving Panel u/s 144BA(4) after the expiry of 2 months from the end of the month in which the final submission of the assessee in response to the notice issued u/s 144BA(2) is received;
- iii. the Commissioner shall issue directions to the Assessing Officer in Form No. 3CEH:
 - a. in the case referred to in rule 10UB(4)(i), within a period of 1 month from the end of month in which the reference is received by him; and
 - b. in the case referred to in rule 10UB(4)(ii), within a period of 2 months from the end of month in which the final submission of the assessee in response to the notice issued u/s 144BA(2) is received by him.

17.40 DEFINITIONS [SEC. 102]

Meaning of various term used are as under:

1. "arrangement" 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;
2. "asset" includes property, or right, of any kind;
3. "benefit" includes a payment of any kind whether in tangible or intangible form;
4. "connected person" means any person who is connected directly or indirectly to another person and 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;
5. "fund" includes—
- (a) any cash;
 - (b) cash equivalents; and
 - (c) any right, or obligation, to receive or pay, the cash or cash equivalent;
6. "party" includes a person or a permanent establishment which participates or takes part in an arrangement;
7. a person shall be deemed to have a substantial interest in the business, if,—
- a. in a case where the business is carried on by a company, such person is, at any time during the financial year, the beneficial owner of equity shares carrying twenty per cent or more, of the voting power; or
 - b. in any other case, such person is, at any time during the financial year, beneficially entitled to twenty per cent or more, of the profits of such business;
8. "step" includes 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;
9. "tax benefit" includes,—
- 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;



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. 2017-18 for manufacturing of chemicals. It claims 100% deduction of profits earned from that unit in F.Y. 2018-19 and subsequent years as per sec. 10AA. Is GAAR applicable in such a case?

Interpretation:

There is an arrangement of setting up of a unit in SEZ which results into 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 submitting to the conditions 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 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 would not invoke GAAR in such a case.

Example 1C

Facts:

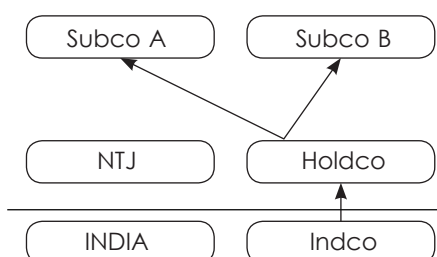
In the above example 1B, let us presume, that both units in SEZ area (say A) and non-SEZ area (say B) work independently. M/s India Chem Ltd. started taking new export orders from existing as well as new clients for unit A and gradually, the export from unit B declined. There has not been any shifting 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 sec. 10AA of the Act. Hence, the Revenue would not invoke GAAR in such a case.

Example 2**Facts:**

An Indian company (Indco) has set up a holding company (Holdco) in a no tax jurisdiction outside India (say NTJ) which has set up further subsidiary companies (Subco A and Subco B) which pay dividends to Holdco. Such dividends are not repatriated to Indco. Can GAAR be invoked to look through Holdco to tax dividends in the hands of Indco?

**Interpretation:**

Declaration / repatriation of dividend is a business choice of a company. India does not have anti-deferral provisions in the form of Controlled Foreign Company (CFC) rules in the I.T. Act. Accordingly, GAAR would not be invoked in such a case.

Example 2A**Facts:**

In the above example 2, dividend is accumulated in Holdco for a number of years and subsequently, Holdco is merged into Indco through a cross-border merger. Can GAAR be invoked on the ground that the merger route has been adopted to avoid payment of tax on dividend in India?

Interpretation:

It is true that if Holdco declares dividends to Indco before merger, then, such dividend would have been taxable in India. But the timing or sequencing of an activity is a business choice available to the taxpayer. Moreover, sec. 47 of the Act specifically exempts capital gains on cross border merger of a foreign company into an Indian company. Hence, GAAR cannot be invoked when taxpayer makes a choice about timing or sequencing of an activity to deny a tax benefit granted by the statute.

Example 3**Facts:**

The merger of a loss-making company into 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 under GAAR?



Interpretation:

As regards setting off of losses, the provisions relating to merger and amalgamation already contain specific anti-avoidance safeguards. Therefore, GAAR would not be invoked when SAAR is applicable.

Example 4

Facts:

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?

Interpretation:

GAAR provisions, would not, prima facie, apply to a decision of leasing (as against purchase of an asset). However, if it is a case of circular leasing, i.e. the taxpayer leases out an asset and through various sub-leases, takes it back on lease, thus creating a tax benefit without any change in economic substance, Revenue would examine the matter for invoking GAAR provisions.

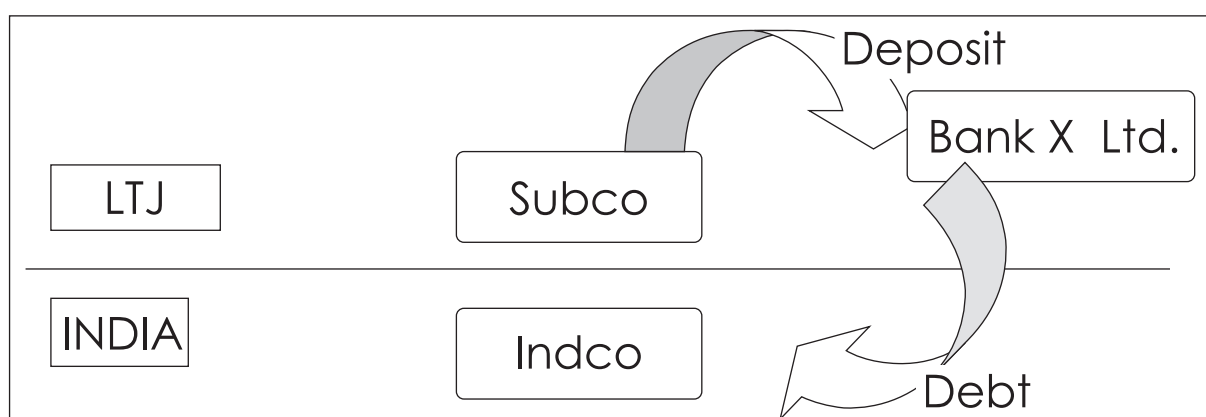
Example 5

Facts:

1. X Ltd. is a banking institution in LTJ (low tax jurisdiction);
2. There is a closely held company Subco in LTJ which is a wholly owned subsidiary of another closely held Indian company Indco;
3. Subco has reserves and, if it provides a loan to Indco, it may be treated as deemed dividend u/s 2(22)(e) of the Act.
4. Subco makes a term deposit with X Bank Ltd. and X Bank Ltd. bank based on this security provides a back to back loan to Indco.

Say, India-LTJ tax treaty provides that interest payment to a LTJ banking company is not taxable in India.

Can this be examined under GAAR?



Interpretation:

This is an arrangement whose main purpose is to bring money out of reserves in Subco to India without payment of due taxes. The tax benefit is saving of taxes on income to be received from Subco by way of dividend or deemed

dividend. The arrangement disguises the source of funds by routing it through X Bank Ltd. X Bank Ltd. may also be treated as an accommodating party. Hence the arrangement shall be deemed to lack commercial substance.

Consequently, in the case of Indco, the loan amount would be treated as dividend income received from Subco to the extent reserves are available in Subco; and no expense by way of interest would be allowed.

In the case of X Bank Ltd, exemption from tax on interest under the DTAA may not be allowed as X Ltd is not a beneficial owner of the interest, provided the DTAA has anti-avoidance rule of beneficial ownership. If such anti-avoidance rule is absent in DTAA, then GAAR may be invoked to deny treaty benefit as arrangement will be perceived as an attempt to hide the source of funds of Subco.

Example 6

Facts:

Indco incorporates a Subco in a NTJ with equity of US\$100. Subco has no reserves; it gives a loan of US\$100 to Indco at the rate of 10% p.a. which is utilized for business purposes. Indco 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 main purpose of the arrangement is to obtain interest deduction in the hands of Indco and thereby tax benefit. There is no commercial substance in establishing Subco since without it there is no effect on the business risk of Indco or any change in the cash flow (apart from the tax benefit). Moreover, it is a case of round tripping which means a case of deemed lack of commercial substance. Hence, it would be treated as an impermissible avoidance arrangement.

Consequently, in the case of Indco, interest payment would be disallowed by disregarding Subco. No corresponding relief would be allowed in the case of Subco by way of refund of taxes withheld, if any.

Example 7

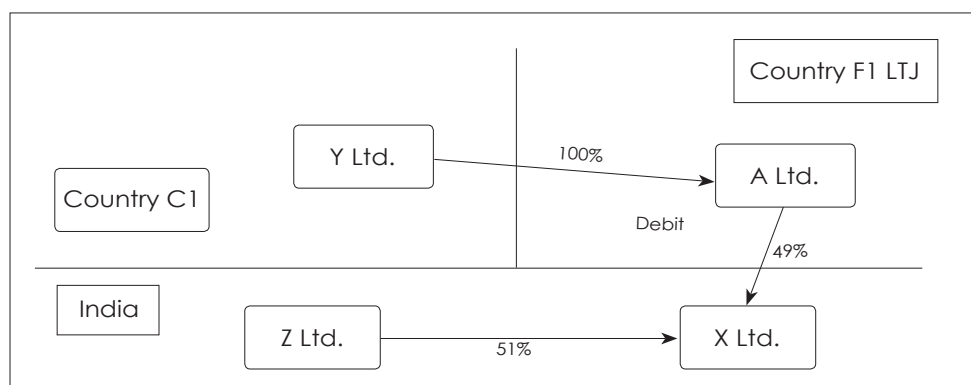
Facts:

A large corporate group has created a service company to manage all its non core activities. The service company then charges each company for the services rendered on a cost plus basis. Can the mark up in the cost of services be questioned using GAAR.

Interpretation:

There are specific anti avoidance provisions through transfer pricing regulations as regards transactions among related parties. GAAR will not be invoked in this case.

Example 8





Facts

1. Y Ltd. is a company incorporated in country C1. It is a non-resident in India.
2. Z Ltd. is a company resident in India.
3. A Ltd. is a company incorporated in country F1 and it is a 100% subsidiary of Y Ltd.
4. 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.
5. 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.
6. 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.
7. As per the joint venture agreement, 49% of X Ltd's equity is allotted to A Ltd. and 51% is allotted to Z Ltd..
8. 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 into 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, unless it is a case where Circular 789 relating Tax Residence Certificate in the case of Mauritius, or Limitation of Benefits clause in India-Singapore treaty is applicable, GAAR can be invoked.

Example 9

Facts:

A Ltd. is incorporated in country F1 as a wholly owned subsidiary of company Y Ltd. which is not a resident of F1 or of India. The India-F1 tax treaty provides for non-taxation of capital gains in India (the source country) and country F1 charges no capital gains tax in its domestic law. Some shares of X Ltd., an Indian company, are acquired by A Ltd in the year after date of coming into force of GAAR provisions. The entire funding for investment by A Ltd. in X Ltd. was done by Y Ltd. These shares are subsequently disposed of by A Ltd after 5 years. This results in capital gains which A Ltd. claims as not being taxable in India by virtue of the India-F1 tax treaty. A Ltd. has not made any other transaction during this period. Can GAAR be invoked?

Interpretation:

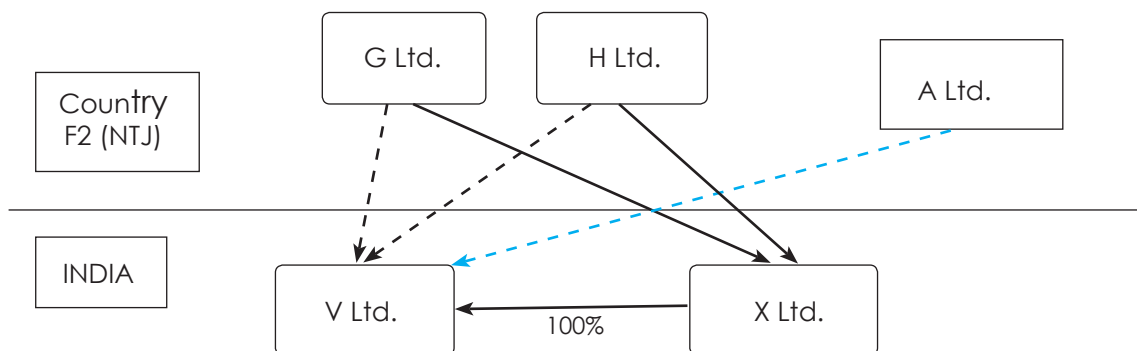
This is an arrangement which has been created with the main purpose of avoiding capital gains tax in India by routing

investments through a favourable jurisdiction. There is neither a commercial purpose nor commercial substance in terms of business risks or cash flow to Y Ltd in setting up A Ltd. It should be immaterial here whether A Ltd has office, employee etc in country F1. Both the purpose test and tainted element tests are satisfied for the purpose of invoking GAAR. Unless it is a case where Circular 789 relating Tax Residence Certificate in the case of Mauritius, or Limitation of Benefits clause in India-Singapore treaty is applicable, the Revenue may invoke GAAR and consequently deny treaty benefit.

Example 10

Facts:

The shares of V Ltd., an asset owning Indian company, was held by another Indian company X Ltd. X Ltd. was in turn held by two companies G Ltd. and H Ltd., incorporated in country F2, a NTJ. The India-F2 tax treaty provides for non-taxation of capital gains in the source country and country F2 charges no capital gains tax in its domestic law. X Ltd. was liquidated by consent and without any Court Decree. This resulted in transfer of the asset/shares from X Ltd., to G Ltd. and H Ltd. Subsequently, companies G Ltd and H Ltd sold the shares of V Ltd to A Ltd. which was incorporated in F2. The companies G Ltd and H Ltd claimed benefit of tax treaty and the resultant gains from the transaction are claimed to be not taxable. Can GAAR be invoked to deny treaty benefit?



Interpretation:

The alternative courses available to taxpayer to achieve the same result (with or without the tax benefit) are:

- ii. **Option 1** (as mentioned in facts): X Ltd. liquidated, G Ltd. and H Ltd. become shareholders of V Ltd.; A Ltd. acquires shares from G Ltd. and H Ltd.; and becomes shareholder of V Ltd.
- iii. **Option 2:** A Ltd. acquires shares of X Ltd. from G Ltd. and H Ltd.; X Ltd. is liquidated; and A Ltd. becomes shareholder of V Ltd.
- iv. **Option 3:** X Ltd. sells its entire shareholding in V Ltd. to A Ltd. and subsequently, X Ltd is liquidated.

In Options 1 & 2, there is no tax liability in India except the deemed dividend taxation to the extent reserves are available in X Ltd. This is because of the treaty between India and country F1. In option 3, tax liability arises to X Ltd., an Indian company, on sale of shares of V Ltd. Subsequently, when X Ltd. is liquidated, tax liability arises on account of deemed dividend to the extent reserves are available in X Ltd.

The taxpayer exercises the most tax efficient manner in disposal of its assets through proper sequencing of transactions. The Revenue cannot invoke GAAR as regards this arrangement.



EMERGING TRANSFER PRICING CHALLENGES IN INDIA

Transfer Pricing Regulations in India

The Indian TP regulations are based on arm's length principle. The regulations came into effect from 1 April, 2001. The regulations provide that any income arising from an international transaction between associated enterprises shall be computed having regard to the arm's length price (ALP). The concept of associated enterprises has been defined in detail in the regulations. The regulations do not provide any hierarchy of the Arm's Length Methods and support concept of "most appropriate method" which provide the most reliable measure of an arm's length result under a particular set of facts and circumstances. The regulation prescribes mandatory annual filing requirements as well as maintenance of contemporaneous documentation by the taxpayer in case international transactions between associated enterprises cross a threshold and contains stringent penalty implications in case of non-compliance. The primary onus of proving arm's length price of the transaction lies with the taxpayer. Indian transfer pricing administration prefer Indian comparables in most of the cases and also accept foreign comparables in cases where foreign associated enterprises is less or least complex entity and requisite information are available about tested party and comparables. In order to provide uniformity in application of transfer pricing law there is a specialized Directorate of transfer pricing to administer transfer pricing rule under supervision of Director General of Income tax (International Taxation). Transfer Pricing officers (TPO) are vested with powers of inspection, discovery, enforcing attendance, examining a person under oath, on-the-spot enquiry/verification and compelling the production of books of account and other relevant documents during the course of a transfer pricing audit. A dispute resolution panel (in short DRP) is available to taxpayer to resolve disputes relating to transfer pricing before disputes of final order by Assessing Officer, (which incorporates the order of TPO).

Key Current and Emerging TP Audit Issues in India

Indian transfer pricing administration over the past 10 years has witnessed several challenges in administration of transfer pricing law. Following are some of the emerging transfer pricing issues and difficulties in implementation of arm's length principle:

1. Challenges in the comparability analysis

India believes that comparability analysis is key to determine arm's length price of international transaction. However, increased market volatility and increased complexity in international transaction have thrown open serious challenges to comparability analysis and determination of arm's length price. Some of these challenges and responses of Indian transfer pricing administration in dealing with these challenges are as under:

- a. Use of contemporaneous data: Commodity price volatility, debt, recession and worries have brought volatility to world market. The volatility impede a stable business environment and result in fluctuation in margins of MNEs and their subsidiaries. In this context, use of contemporaneous comparables provides a more accurate arm's length price in a particular year.
- b. Application of data rules: The Indian transfer pricing regulation stipulates that data to be used in analyzing the comparability of uncontrolled transaction with an international transaction should be the data relating to the financial year in which international transactions have been entered into. However, the rule also provides exception and permits use of data for the preceding two years if and only if, it is proved that such data reveals a fact which could have an influence on the determination of arm's length price. Therefore, the exception comes into the play only when a proof that earlier year data could have an influence on determination of arm's length price is brought on the record.
- c. Rationale: The mandatory requirement under the law to use contemporaneous document has a solid

economic sense in the way that contemporaneous transaction reflect similar economic condition. Therefore, use of current year data is more relevant and appropriate for ensuring a higher degree of comparability of uncontrolled transaction for arriving at arm's length price in respect of international transaction. In India, contemporaneous data which may be available to the taxpayer and tax administration at the time of filing of the tax return or conducting ex post facto analysis of transfer pricing studies cannot be held as use of hindsight.

2. Issue relating to risks

- ♦ A comparison of functions performed, assets employed and risks assumed is basic to any comparability analysis. India believes that the risk of a MNE is a by-product of performance of functions and ownership, exploitation or use of assets employed over a period of time. Accordingly, risk is not an independent element but is similar in nature to functions and assets. In this context, India believes that it is unfair to give undue importance to risk in determination of arm's length price in comparison to functions performed and assets employed.
- ♦ Identification of risk and the party who bears such risks are important steps in comparability analysis. India believes that the conduct of the parties is key to determine whether the actual allocation of risk conforms to contractual risk allocation. Allocation of risk depends upon ability of parties to transaction to exercise control over risk. Core functions, key responsibilities, key decision making and level of individual responsibility for the key decisions are important factors to identify party which has control over the risks.
- ♦ In India, MNEs are making claims before the transfer pricing auditor that related parties engaged in contract R&D or other contract services in India are risk free entities. Accordingly, these related parties are entitled to only routine (low) cost plus remuneration. MNEs also contend that the risks of R&D activities or services are being controlled by them and Indian entities being risk free entities are entitled to (low) cost plus remuneration.
- ♦ The Indian transfer pricing administration does not agree with the notion that risk can be controlled remotely by the parent company and that the Indian subsidiaries or related party engaged in core functions, such as carrying out research and development activities or providing services are risk free entities. India believes that core function of R&D or services are located in India which in turn require important strategic decisions by management and employees of Indian subsidiaries or related party to design, direction of R&D activities or providing services and monitoring of R&D activities etc. Accordingly, the Indian subsidiary exercises control over the operational and other risks. In these circumstances, the ability of the parent company to exercise control over the risk - remotely and from a place where core functions of R&D and services are not located - is very limited. In these circumstances, allocation of risk to the parent MNE is not only questionable but is devoid of logical conclusion.
- ♦ India believes that the subsidiary carries out core functions and by taking strategic operational decisions controls a substantial part of risk. India believes that the parent company should be entitled to appropriate returns for provision of funds and overall direction to R&D activity or services. The Indian subsidiary should also similarly be entitled to returns on their core function including strategic decisions and control on risk related to operation of R&D activities. In this context, Indian tax administration is of the view that allocation of routine cost plus return in these cases will not reflect a true arm's length price of the transaction.

3. Arm's length range

Application of most appropriate method may set up comparable data which may result in computation of more than one arm's length price. Where there may be more than one arm's length price, mean of such prices is considered. Indian transfer pricing regulations provide that in such a case the arithmetic mean of the prices should be adopted as arm's length price. If the variation between the arithmetic mean of uncontrolled prices and price of international transaction does not exceed 3% or notified percentage of such transfer pricing, then transfer



price will be considered to be at arm's length. In case transfer price crosses the tolerance limit, the adjustment is made from the central point determined on the basis of arithmetic mean. Indian transfer pricing regulation do not mandate use of inter quartile range.

4. Comparability adjustment

- ◆ Like many other countries, Indian transfer pricing regulations provide for "reasonably accurate comparability adjustments". The onus to prove "reasonably accurate comparability adjustment" is on the taxpayer. The experience of Indian transfer pricing administration indicates that it is possible to address the issue of accounting difference and difference in capacity utilization and intensities of working capital by making comparability adjustments. However, Indian transfer pricing administration finds it extremely difficult to make risk adjustments in absence of any reliable and robust and internationally agreed methodology to provide risk adjustment. In some cases taxpayers have used Capital Asset Pricing Method (CAPM). However, the methodology was found flawed for the reasons outlined in the following paragraphs.
- ◆ The CAPM model assumes that most assets rate of return within a portfolio are normally distributed (meaning rates of return do not deviate too much from the mean). However, historically speaking, equities have been prone to large deviations from the mean much more frequently than it is generally assumed under the CAPM model. So, if an asset is actually prone to large swings in either direction from its mean, then it stands to reason that its risk aspect may not be correctly captured by the CAPM calculation.
- ◆ Capital asset pricing model is not able to capture all variations in equity returns in same industry segment. Past empirical studies have demonstrated that some stocks, although they had lower beta and implied lower risk vs. return ratio, still managed to pull off higher returns than the CAPM model would have assumed initially.
- ◆ On a more practical level, one of the shortfalls of CAPM is that the model assumes all investors have the same ideas of what constitutes risk and required rates of return, as well as the fact that the model excludes the impact of taxes and transaction costs which, in reality, have adverse impact on the expected rate of return.
- ◆ The CAPM assumes the application of the market portfolio, which is supposed to consist of all risky assets in all markets. The CAPM also assumes that investors have no individual preference as to which risky assets they wish to invest in and in which markets. Yet, investors have been known to depart from assets 'risk vs. return profiles often and particularly at times when markets were not normally distributed.
- ◆ The CAPM accepts the concepts of the market portfolio, which theorizes inclusion of literally all asset classes, including real estate, art intellectual property etc. However, in reality such a market portfolio is impossible to construct which is why it is often equated with various composites. However, limiting the market portfolio in such a manner could and it indeed has created fallacies within the CAPM model, thus rendering it at the very least empirically inconsistent.
- ◆ An important flaw relating to the computation of risk adjustment by the taxpayer is use of the "Beta" concept. It is important to remember that computation of beta is based on a presumption that high-beta shares usually give the highest returns. Over a long period of time, however, high beta shares are the worst performers during market declines (bear market) which are more common phenomena in Indian stock exchange. While someone might receive high returns from high beta shares, there is no guarantee that the CAPM return is realized. It is worthwhile to mention here that the computation of beta in this case is based on seven year average price of comparables and tested party shares; the methodology of taking an average of such a long period is highly questionable in existing volatile world market conditions.
- ◆ The Indian tax administration has also experienced difficulties in getting reliable data for computation of comparability adjustments like capacity and working capital adjustments, where methodology to provide comparability adjustment is more or less internationally agreed.

5. Location Savings

- ♦ It is view of the Indian transfer pricing administration that the concept of “location savings” - which refer to cost savings in a low cost jurisdiction like India – should be one of the major aspects to be considered while carrying out comparability analysis during transfer pricing audits. Location savings has a much broader meaning; it goes beyond the issue of relocating a business from a ‘high cost’ location to a ‘low cost’ location and relates to any cost advantage. MNEs continuously search options to lower their costs in order to increase profits. India provides operational advantages to the MNEs such as labour or skill employee cost, raw material cost, transaction costs, rent, training cost, infrastructure cost, tax incentive etc. It has also been noticed that India also provides following Location Specific Advantages (LSAs) to MNE in addition to location savings:
 - Highly specialized skilled manpower and knowledge
 - Access and proximity to growing local/regional market
 - Large customer base with increased spending capacity
 - Superior information network
 - Superior distribution network
 - Incentives
 - Market premium
- ♦ The incremental profit from LSAs is known as “location rents”. The main issue in transfer pricing is the quantification and allocation of location savings and location rents among the associated enterprises. Under arm’s length pricing, allocation of location savings and rents between associated enterprises should be made by reference to what independent parties would have agreed in comparable circumstances. The Indian transfer pricing administration believes it is possible to use the profit split method to determine arm’s length allocation of location savings and rents in cases where comparable uncontrolled transactions are not available. In these circumstances, it is considered that the functional analysis of the parties to the transaction (functions performed, assets owned and risks assumed), and the bargaining power of the parties (which at arm’s length would be determined by the competitiveness of the market - availability of substitutes, cost structure etc) should both be considered appropriate factors.
- ♦ Comparability analysis and benchmarking by taking local comparables will determine the price of a transaction with a related party in a low cost jurisdiction. However, it will not take into account the benefit of location savings which can be computed by taking into account cost difference between cost of low cost country and high cost country from where the business activity was relocated. In view of this, the price determined on the basis of local comparables is not consistent with arm’s length price because any arm’s length transaction between two unrelated parties would not be possible without benefiting both parties to the transaction.
- ♦ Hypothetically, if an unrelated third party had to compensate another party to the transaction in a low cost jurisdiction that was equal to the cost savings and location rents attributable to the location, there would be no incentive for the unrelated third party to relocate business to a low cost jurisdiction. Thus, arm’s length compensation for cost savings and location rents should be such that both parties would benefit from participating in the transaction. In other words, it should be not less than zero and not greater than the value of cost savings and locations rents; it should also reflect an appropriate split of the cost savings and location rents between the parties.

6. Intangibles

- ♦ Transfer pricing of intangibles is well known as a difficult area of taxation practice. However, the pace of



growth of the intangible economy has opened new challenges to the arm's length principle. The transactions involving intangible assets are difficult to evaluate because of the following reasons:

- Intangibles are seldom traded in the external market and it is very difficult to find comparables in the public domain.
 - Intangibles are often transferred bundled along with tangible assets. They are difficult to be detected.
- ♦ A number of difficulties arise while dealing with intangibles. Some of the key issues revolve around determination of arm's length price of rate of royalties, allocation of cost of development of market and brand in a new country, remuneration for development of marketing, Research and Development intangibles and their use, transfer pricing of co-branding etc. Some of the Indian experiences in this regard are discussed below.
- With regard to payment of royalties, MNEs often enter into agreements allowing use of brands, trademarks, know how, design, technology etc. by their subsidiaries or related parties in India. Such payments can be in a lump sum, periodical payments or a combination of both types of payments. It is an internationally agreed position that intellectual property which is owned by one entity and used by another entity generally requires royalty payment. However, the important issue in this regard is determination of the rate of royalty. The main challenge in determination of arm's length price of royalty rate is to find comparables in the public domain with sufficient information required for comparability analysis. The Indian experience suggests that it is impossible to find comparable arm's length prices in most cases. The use of profit split method as an alternative is generally not a feasible option due to lack of requisite information.
 - The Indian tax administration has noticed serious difficulties in determining the rate of royalty charged for use of brand and trademark in certain cases. In some cases the user had borne significant costs on promotion of the brand/trademark, and to promote and develop customer loyalty for brand/trademark in a new market. In these cases, royalty rate charged by the MNE will depend upon the cost borne by the subsidiary or related party to promote the brand and trademark and to develop customer loyalty for brand and product. In many cases no royalty may be charged under uncontrolled environment and the subsidiary would require arm's length compensation for economic ownership of marketing intangible developed by it and for enhancing the value of brand and trademark owned by parent MNEs in the new emerging market like India.
 - In many cases, Indian subsidiaries which use technical know-how of their parent company have incurred significant expenditure to customize such know-how and to enhance its value by their R&D efforts. Costs on activities, such as R&D activities which have contributed in enhancing the value of know-how owned by parent company is generally considered by Indian transfer pricing officer while determining arm's length price of royalty for use of technical know-how.
 - The Indian transfer pricing administration has also noted significant transfer pricing issues in cases of co-branding of new foreign brand of parent MNE (which is unknown to new market like India) with popular Indian brand name. Since the Indian subsidiary has developed valuable Indian brand in the domestic market over a period of time, incurring huge expenditure on advertisement, marketing and sales promotion, it should be entitled for arm's length remuneration for contributing to the value of foreign little known brand through market recognition by co-branding it with a popular Indian brand.

7. R&D activities

- ♦ Several global MNEs have established subsidiaries in India for research and development activities on contract basis to take advantage of the large pool of skilled manpower which are available at a lower cost. These Indian subsidiaries are generally compensated on the basis of routine and low cost plus mark up. The parent MNE of these R&D centres justify low cost plus markup on the ground that they control all the risk and their

subsidiaries or related parties are risk free or limited risk bearing entities. The claim of parent MNEs that they control the risk and are entitled for major part of profit from R&D activities is based on following contentions:

- Parent MNE designs and monitors all the research programmes of the subsidiary.
 - Parent MNE provides fund needed for R&D activities.
 - Parent MNE controls the annual budget of the subsidiary for R&D activities.
 - Parent MNE controls and takes all the strategic decisions with regards to core functions of R&D activities of the subsidiary.
 - Parent MNE bears the risk of unsuccessful R&D activities.
- ◆ The Indian transfer pricing administration always undertakes a detailed enquiry in cases of contract R&D centres. Such an enquiry seeks to ascertain correctness of the functional profile of subsidiary and parent MNE on the basis of transfer pricing report filed by the taxpayers, as well as information available in the public domain and commercial databases. After conducting detailed enquiries, the Indian tax administration often reaches the following conclusions:
- Most parent MNEs were not able to file relevant documents to justify their claim of controlling risk of core functions of R&D activities and asset (including intangible assets) which are located in the country of subsidiary or related party.
 - Contrary to the above, it was found that day to day strategic decisions and monitoring of R&D activities were carried out by personnel of subsidiary who were engaged in actual R&D activities and bore relevant operational risks.
 - The management of Indian subsidiary also took decision of allocation of budget to different streams of R&D activities and Indian management also monitored day to day performance of R&D activities.
 - It was true that in most of the cases funds for R&D activities were transferred from the MNE parent and they bore the risk of such fund. However, in addition to "capital" other important assets like technically skilled manpower, know how for R&D activities etc were developed and owned by the Indian subsidiary. Accordingly, control of risk of the asset lies both with the MNE parent and Indian subsidiary but the Indian subsidiary controls more risks as compared to the MNE parent.
- ◆ On the basis of above functional analysis, the Indian transfer pricing administration decided in most of the cases that Indian subsidiaries were not risk free entities but bore significant risk. Accordingly Indian subsidiaries were entitled to an appropriate return for their function including the strategic decision, monitoring, use of their assets and control over the risk. In view of these facts, routine cost plus compensation model was not held at arm's length price.
- ◆ Most of these R&D centres in India were actually found to be engaged in creation of unique intangibles, legal ownership of which was transferred to their parent MNEs under agreement. Such transfer took place without any appropriate compensation and patents for these intangibles were registered in the name of parent MNE. In these cases the Indian transfer pricing administration allocated additional arm's length compensation for transfer of such intangibles in addition to arm's length compensation for R&D activities.

8. Marketing Intangibles

- ◆ Transfer pricing aspect of marketing intangibles has been a focus area for the Indian transfer pricing administration. The issue is particularly relevant to India due to its unique market specific characteristics such as location advantages, market accessibility, large customer base, market premium, spending power of Indian customers etc. The Indian market has witnessed substantial marketing activities by the subsidiary/related party of the MNE groups in recent past, that have resulted in creation of local marketing intangibles.



For Indian transfer pricing administration first important step is to identify marketing intangibles. The marketing intangibles are generally identified on the basis of the efforts of Indian subsidiary/related party on:

- Enhancing the value of foreign trade mark/brand unknown to Indian market by incurring huge advertisement, marketing and sale promotion expenditure.
 - Creation of brand and product loyalty in the minds of customers.
 - Creation of efficient supply chain.
 - Establishing distributor network in the country.
 - After sale services support network in the country.
 - Conducting customer and market researches.
 - Establishing customer list etc.
- ◆ Since Indian subsidiaries/related parties (which are claimed as no risk and limited risk bearing distributors by parent MNE in order to justify low cost plus return) have incurred and borne huge expenditure on development of marketing intangibles. These entities generally incur huge losses or disclose very nominal profit as evident from their return of income. Determination of ALP in cases of marketing intangibles generally involves following steps:
- Functional analysis of profile of the Indian and parent MNE to ascertain whether the Indian taxpayer is a risk free, limited risk bearing or risk bearing entity?
 - Identification of nature, types and stages of development of marketing intangibles. The Indian entity may be engaged in different stages of development of marketing intangibles. For example if an MNE is new entrant in Indian market, the related party in India will incur substantial expenditure:
 - to create awareness about trade mark, brand and product or services of MNE group in India.
 - customer loyalty for brand and products/services for dealer network.
 - after sale services network.
 - market and customer research for creation of customer list.
- ◆ After some years of operation, the cost on developing and sustaining marketing intangible may be reduced.
- Identification of expenditure on launch of new products in India and to ascertain who had borne such expenditure.
 - to ascertain who had borne the cost of development of marketing intangibles.
 - examination of remuneration model to Indian related party.
- ◆ The Indian tax administration computes the ALP in the cases involving marketing intangibles following the concept of bright line i.e., no risk or limited risk distributor will bear the cost of only routine expenditure on advertisement, marketing and sale promotion. However, the tax administration faces following challenges in determination of the ALP:
- Whether parent MNE should reimburse the cost incurred by the Indian related party on development of marketing intangibles with or without mark-up.
 - Lack of uniform accounting codes creates a significant challenge in identification of advertisement, marketing and sales promotion (AMP) expenditure in comparable companies and tested party.
 - The developer of marketing intangibles who has economic ownership in the intangibles is entitled to additional returns. However, the difficult question is what should be the arm's length price of such returns.

- ◆ The important issue in the determination of ALP in these cases is to examine who benefits from the extraordinary AMP expenditure. Taxpayers generally claim that such extraordinary expenditure helps the business of the Indian entity also in addition to parent MNE. However, the tax authorities in India have found that Indian distributors are claimed to be no risk or low risk bearing entities and are getting fixed and routine return on cost plus basis. They do not get a share in the excess profit relatable to local marketing intangibles. Accordingly, extra-ordinary AMP expenditure does not enhance the profitability of Indian subsidiary or related party. This conclusion of the tax authorities is further supported by the fact that these so called risk-free or limited risk distributors have disclosed huge losses even when they are entitled for fixed return on cost plus basis and should not have incurred losses.
- ◆ In this context, the Transfer Pricing administration have taken a view that such Indian entities which incur excessive AMP expenses, bear risks and perform functions beyond what an independent distributor with similar profile would incur or perform for the benefit of its own distribution activities should be compensated for return on intangibles. Such compensation would be in the form of reimbursement of the excess AMP expenditure along with mark-up. Alternatively, the Indian entity should be allowed to share profit related to marketing intangibles. If no reimbursement is made in these type of cases along with mark-up, or the related party does not get an arm's length return for development of marketing intangibles in the form of its entitlement to share profits, the Indian tax administration makes adjustment on account of reimbursement of excess AMP expenditure along with a mark-up for the functions undertaken by the subsidiary/related party.

9. Intragroup Services

- ◆ Globalization and the drive to achieve efficiencies within MNE groups have encouraged sharing of resources to provides support between one or more location by way of shared services. Since these intra group services are the main component of "tax efficient supply chain management" within an MNE group, the Indian transfer pricing authorities attach high priority to this aspect of transfer pricing. The tax administration has noticed that some of the services are relatively straight forward in nature like marketing, advertisement, trading, management consulting etc. However, other services may be more complex and can often be provided on stand-alone basis or to be provided as part of the package and is linked one way or another to supply of goods or intangible assets. An example can be agency sale technical support which obligates the licensor to assist the licensee in setting up of manufacturing facilities, including training of staff. The Indian transfer pricing administration generally considers following questions in order to identify intra group services requiring arm's length remuneration:
 - Whether Indian subsidiaries have received any related party services i.e., intra group services? Nature and detail of services including quantum of services received by the related party.
 - Whether services have been provided in order to meet specific need of recipient of the services? What are the economic and commercial benefits derived by the recipient of intra group services?
 - Whether in comparable circumstances an independent enterprise would be willing to pay the price for such services?
 - Whether an independent third party would be willing and able to provide such services?
- ◆ The answers to above questions enable the Indian tax administration to determine if the Indian subsidiary has received or provided intra group services which requires arms' length remuneration. Determination of the arm's length price of intra-group services normally involve following steps:
 - Identification of the cost incurred by the group entity in providing intra group services to the related party.
 - Understanding the basis for allocation of cost to various related parties i.e., nature of allocation keys.



- Whether intra group services will require reimbursement of expenditure along with markup.
- Identification of arm's length price of markup for rendering of services.
- ◆ Identification of the services which require an arm's length remuneration is one of the main challenges before the Indian transfer pricing administration. India believes that shareholder services, duplicate services and incidental benefit from group services do not give rise to intra group services requiring arm's length remuneration. However, such conclusion would need a great deal of analysis. The biggest challenge in determination of the arm's length price is allocation of cost by using allocation keys. The nature of allocation keys generally varies with the nature of services. However, it is difficult to reach agreement between the tax administration and taxpayer on the nature of allocation of keys.
- ◆ The next challenge before the transfer pricing administration is a most commonly asked question whether or not it is necessary for services provider to make a profit. Typical example of this would include treatment of pass through cost. Another important question is how to determine a percentage of mark up and to fix the benchmark of markup are tedious processes. The fixing up of the cost base to compute the markup is another complex issue and it is a difficult decision to include or not to include various types of overhead.
- ◆ A brief review of cases where adjustments have been made by Indian transfer pricing administration has revealed that most of MNE parents do not allow any profit markup on the services rendered by Indian subsidiaries to them. However, in some exceptional cases a low markup of 5% to 10% is allowed on some services with a restricted cost base. On the other hand, where Indian subsidiaries or related parties receive intra group services, parent MNEs generally charge mark up on all the services provided to such entities, including duplicate services, shareholding services and services which provide only incidental benefits to the Indian entities. The rate of markup charged on such intra-group services is also mostly on the higher side. The Indian transfer pricing administration has also noticed that in several cases, the claim of rendering services was found to be incorrect or the services were found not to be intra-group services which required arm's length remuneration.
- ◆ In view of the above facts, transfer pricing of intra-group services is a high risk area for the Indian transfer pricing administration.

10. Financial Transactions

- ◆ Intercompany loans and guarantees are becoming common international transactions between related parties due to management of cross border funding within group entities of a MNE group. Transfer pricing of inter-company loans and guarantees are increasingly being considered some of the most complex transfer pricing issues in India. The Indian transfer pricing administration has followed a quite sophisticated methodology for pricing inter-company loans which revolves around:
 - comparison of terms and conditions of loan agreement.
 - determination of credit rating of lender and borrower.
 - Identification of comparables third party loan agreement.
 - suitable adjustments to enhance comparability.
- ◆ The Indian transfer pricing administration has come across cases of outbound loan transactions where the Indian parent has advanced to its associated entities (AE) in a foreign jurisdiction either interest free loans or loans at LIBOR/EURIBOR rates . The main issue before the transfer pricing administration is benchmarking of these loan transactions to arrive at the ALP of the rates of interest applicable on these loans. The Indian transfer pricing administration has determined that since the loans are advanced from India and Indian currency has been subsequently converted into the currency of the geographic location of the AE, the Prime

Lending Rate (PLR) of the Indian banks should be applied as the external CUP and not the LIBOR or EURIBOR rate.

- ◆ A further issue in financial transactions is credit guarantee fees. With the increase in outbound investments, the Indian transfer pricing administration has come across cases of corporate guarantees extended by Indian parents to its associated entities (AEs) abroad, where the Indian parent as guarantor agrees to pay the entire amount due on a loan instrument on default by the borrower. The guarantee helps an AE of the Indian MNE to secure a loan from the bank. The Indian transfer pricing administration generally determines the ALP of such guarantee under the comparable uncontrolled price method. In most cases, interest rates quotes and guarantee rate quotes available from banking companies are taken as the benchmark rate to arrive at the ALP. The Indian tax administration also uses the interest rate prevalent in the rupee bond markets in India for bonds of different credit ratings. The difference in the credit ratings between the parent in India and the foreign subsidiary is taken into account and the rate of interest specific to a credit rating of Indian bond is also considered for determination of the arm's length price of such guarantees.
- ◆ However, the Indian transfer pricing administration is facing a challenge due to non-availability of specialized database and transfer price of complex cases of inter-company loans in cases of mergers and acquisitions which involve complex inter-company loan instruments as well as implicit element of guarantee from parent company in securing debt





Section C

Case Study Analysis

(Syllabus - 2016)



STUDY NOTE : 18

CASE STUDY



This Study Note includes:

18.1 Case Study

18.1 CASE STUDY

CIT -vs.- M. Venkateswara Rao (2015) 370 ITR 212 (T & AP)

Partnership firm is not required to explain source of income for partners regarding amount contributed by them towards capital of firm

The assessee is a partnership firm engaged in the business of purchase and sale of arrack from the year 1982. The returns submitted for the year 1993-94 was picked up for scrutiny. The principal controversy was about the contributions made by as many as 10 partners aggregating to ₹ 76,57,263. The explanation of the assessee that the partners have paid various amounts towards contribution of their share in the capital was not accepted as source of income for the partners was not explained. The Assessing Officer increased the income of the firm by aforesaid amount considering the same as cash credit u/s 68.

Sec. 68 directs that if an assessee fails to explain the nature and source of credit entered in the books of account of any previous year, the same can be treated as income. In this case, the amount, that is sought to be treated as income of the firm is the contribution made by the partners to the capital. It is difficult to treat the pooling of such capital, as credit.

In the name of causing verification u/s 68 of the Act, the Assessing Officer has proceeded to identify the source for the respective partners to make that contribution. Such an enquiry can, at the most be conducted against the individual partners. The concerned Assessing Officer can require him to explain the source of the money contributed by him to the firm.

If there are cash credits in the books of a firm in the accounts of the individual partners and it is found as a fact that cash was received by the firm from its partners, then in the absence of any material to indicate that they are the profits of the firm, they cannot be assessed in the hands of the firm, though they may be assessed in the hands of the individual partners.

Thus, the view taken by the Assessing Officer that the partnership firm must explain the source of income for the partners regarding the amount contributed by them towards capital of the firm cannot be sustained in law.

CIT -vs.- Rajasthan and Gujarati Charitable Foundation (SC)

Amendment in Section 11(6) of the Act vide Finance Act No. 2/2014 which became effective from the Assessment Year 2015-2016 does not have retrospective effect

Assesseees are charitable institutions registered u/s 12A of the Income Tax Act (hereinafter referred to as 'Act'). For



this reason, in the previous year to the year with which we are concerned and in which year the depreciation was claimed, the entire expenditure incurred for acquisition of capital assets was treated as application of income for charitable purposes u/s 11(1)(a) of the Act. The view taken by the Assessing Officer in disallowing the depreciation which was claimed u/s 32 of the Act was that once the capital expenditure is treated as application of income for charitable purposes, the assessee had virtually enjoyed a 100% write off of the cost of assets and, therefore, the grant of depreciation would amount to giving double benefit to the assessee. Though it appears that in most of these cases, the CIT (Appeals) had affirmed the view, but the ITAT reversed the same and the High Courts have accepted the decision of the ITAT thereby dismissing the appeals of the Income Tax Department. From the judgments of the High Courts, it can be discerned that the High Courts have primarily followed the judgment of the Bombay High Court in 'Commissioner of Income Tax -vs.- Institute of Banking Personnel Selection (IBPS)' (2003) 131 Taxman 386 (Bombay), wherein the High Court has held that income of the Trust is required to be computed u/s. 11 on commercial principles after providing for allowance for normal depreciation from Trust's gross income, despite full expenditure allowed in the year of acquisition of assets. Realising that there was no specific provision in this behalf in the Income Tax Act, has made amendment in sec. 11(6) vide Finance Act No. 2/2014 providing that:

In this section where any income is required to be applied or accumulated or set apart for application, then, for such purposes the income shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as an application of income under this section in the same or any other previous year.

The said amendment became effective from the Assessment Year 2015-2016.

The Apex Court approved Delhi High Court's view that the said amendment is prospective in nature and thus, sec. 11(6) cannot be applied retrospectively.

Siemens Public Communications Network Ltd -vs.- CIT (2016) (SC)

Voluntary subsidies paid by a holding company, to protect the capital investment, to its loss-making subsidiary is capital receipt in the hands of the recipient

The subvention received by the Assessee - Company from its parent company in Germany in a situation where the assessee-company was making losses has been treated to be a revenue receipt by the Assessing Officer. Though the first Appellate Authority and the ITAT has reversed the said finding. However, the High Court has restored the view taken by the Assessing Officer referring the decisions of Apex Court in Sahney Steel & Press Works Ltd., Hyderabad -vs.- CIT (1997) 7 SCC 764 and CIT -vs.- Ponni Sugars and Chemicals Limited (2008) 9 SCC 337.

In these cases, the Apex Court has held that unless the grant-in-aid received by an Assessee is utilized for acquisition of an asset, the same must be understood to be in the nature of a revenue receipt.

However, the aforesaid view tends to overlook the fact that in both Ponni Sugars and Sahney Steel the subsidies received were in the nature of grant-in-aid from public funds and not by way of voluntary contribution by the parent Company as in the present cases. Further, the voluntary payments made by the parent Company to its loss making Indian company can also be understood to be payments made in order to protect the capital investment of the Assessee Company. Thus, it was held that the payments made to the Assessee Company by the parent Company for Assessment Years in question cannot be held to be revenue receipts.

Earlier, the same view has also been held in CIT -vs.- Handicrafts and Handlooms Export Corporation of India Ltd. (Delhi)

Ashok Prapann Sharma -vs.- CIT (2016) (SC)

In determining the cost of acquisition, the value declared in the wealth-tax return as well as the comparable sales, even if later in point of time, have to be considered

The Assessment Year in question is 1989-1990. The Assessee has been subjected to payment of income-tax on capital gains accruing from land acquisition compensation and sale of land. The dispute is as to how the cost of acquisition is to be worked out for the purposes of deduction of such cost from the receipts so as to compute taxable capital gains. The Assessing Officer as well as the First Appellate Authority took into account the declaration made in the return filed by the Assessee under the Wealth Tax Act (i.e., ₹ 2 per square yard) as the cost of acquisition. Some instances of comparable sales showing higher value at which such transactions were made (₹ 70/- per square yard) were also laid by the Assessee. The Assessing Officer has not accepted that value as cost on the ground that such sales were subsequent in point of time i.e. 1978-1979 whereas u/s 55(2) the crucial date for determination of the cost of acquisition is 1st April, 1974 (now, 01-04-2001).

The learned Tribunal took the view that the comparable sales cannot altogether be ignored. Therefore, though the comparable sales were at a higher value and determined the cost of acquisition at ₹ 50/- per square yard. However, the High Court reversed the order of the ITAT.

The Apex Court has held that a declaration in the return filed by the Assessee under the Wealth Tax Act would certainly be a relevant fact for determination of the cost of acquisition which u/s 55(2) to be determined by a determination of fair market value. However, it is equally relevant for the purposes of aforesaid determination would be the comparable sales though slightly subsequent in point of time for which appropriate adjustments can be made as had been made by the learned Tribunal.

Comparable sales, if otherwise genuine and proved, cannot be shunted out from the process of consideration of relevant materials. Further, it has been pointed out that the same had been taken into account by the learned Tribunal which is the last fact finding authority under the Act. Unless such cognizance was palpably incorrect and, therefore, perverse, the High Court should not have interfered with the order of the Tribunal. The order of the High Court overlooks the aforesaid severe limitation on the exercise of jurisdiction u/s 260A.

Susham Singla -vs.- CIT (2016)(P&H)

Annual value of the properties like the ones in the case in hand which are more than one, owned by the assessee and which admittedly remained vacant throughout the previous year would not be assessed u/s 23(1)(c) but u/s 23(1)(a)

A search was conducted upon a Jeweller Group and the appellant-assessee being related to that Group, was also subjected to such search, on the basis of which, a notice was issued to him as to why deemed income by determining annual value of properties may not be added to his income (excluding one house property which was treated as self-occupied) as appellant-assessee is found to be the owner of 3 more properties. In the return, assessee had not shown any deemed income from them, notional rent was determined and after providing the statutory deductions, added to the appellant-assessee's income. Such addition at the hands of the Assessing Officer was challenged by the appellant-assessee considering that there is no chargeability of rent which cannot be realized according to sec. 23(1)(c).

Since the properties, which had been assessed to tax, had not been let out and had remained vacant in the respective previous years, no annual value for them could be determined u/s 23(4) and it was urged that as per the provisions of sec. 23(1)(c), the annual value of such properties had to be taken as 'Nil'.



Section 23(1) has three sub sections which are as under:

Sec. 23(1)(a) provides that the annual value of any property shall be deemed to be the sum for which the property might reasonably be expected to let from year to year.

Sec. 23(1)(b) provides that where any property or any part of such property is let and the actual rent received or receivable by the owner in respect thereof is in excess of the sum, which the property might reasonably be expected to let from year to year, then the annual value of such property would be the actual amount so received or receivable.

Section 23(1)(c) is to the effect that where any property or part of such property is let but remained vacant during the whole or any part of the previous year and owing to such vacancy, the actual rent received or receivable is less than the sum, which such property might reasonably be expected to yield on being let out, then the amount so received or receivable would be the annual value of the property.

Section 23(2) is to the effect that where the property consists of a house or part of a house, which is in the occupation of the owner for the purposes of his own residence or could not actually be occupied by him for the reason that on account of his employment, business or profession, he had to reside at other places in a building, which is not owned by him, in that situation, the annual value of such house or part of the house is required to be taken as 'Nil'.

According to Section 23(4)(a), where the property referred to in Section 23(2) consists of more than one house, then Section 23(2) is to apply only in respect of one of such houses and Section 23(4)(b) provides that the annual value of the house or houses, other than the house in respect of which the assessee had exercised an option under Section 23(4)(a) shall be determined under Section 23(1) as if such house or houses had been let.

It is held that sec. 23(1)(b) and (c) would apply only to those properties which were actually let out and for which rent was actually received or receivable by the assessee. These provisions deal with the concept of real income and not notional income. Thus, the annual value of the properties like the ones in the case in hand which are more than one, owned by the assessee and which admittedly remained vacant throughout the previous year would not be assessed u/s 23(1)(c) but u/s 23(1)(a). The annual value would, therefore, be determined notionally.

Further it is to be noted that Special Leave Petition in this regard is dismissed by the Apex Court.

Pr. CIT -vs.- U. K. Paints India Pvt. Ltd (2016) (Delhi)

Provisions of sec. 14A cannot be invoked by the Assessing Officer by rejecting the suo-moto disallowances made by assessee, without assigning any reasons.

During the relevant Assessment Year, the assessee's return had reported tax exempt income of over ₹ 25 crores. The Assessing Officer framed the assessment after applying disallowance u/s 14A in respect of this exempt income and without accepting the proffered disallowance of ₹ 7.5 lakhs made by the assessee. The order was rectified u/s 154 wherein AO merely clarified that the amount of ₹ 7.5 lakh offered was not 'taken into consideration' at the time of passing the order u/s 143(3). The Assessing Officer, therefore, reduced that amount from the figure of the determined disallowance. Commissioner (Appeals) was of the opinion that the rejection of ₹ 7.5 lakh was valid and restored the matter for fresh computation to the Assessing Officer. The Tribunal held that the Assessing Officer can proceed to make an independent determination of the disallowance under Rule 8D read with sec. 14(2) after recording his satisfaction about the amount and the reasons thereof offered by the assessee voluntarily u/s 14A.

The High Court considered the reasons for disallowance, the method of computation adopted by the Assessing Officer and the various submissions made by Revenue. The High Court also went through the order of the ITAT in appellant's own case, where the ITAT had observed "there is no iota of doubt to the effect that intention behind using the expression "in relation to" in sec. 14A is to encompass not only the direct but also the indirect expenditure which has any relation to the exempt income."

The High Court observed that the principle of disallowance is stated in Section 14A(1) and Section 14A(2) prescribes the mode or methodology for the disallowance and the steps for its calculation. Unlike the other part of the statute which decree or enjoin the actual methodology and are substantive, Parliament deemed it appropriate to leave it to the rule making authority to prescribe the methodology, i.e. computation. For instance, what are taxable and in what proportion and the principles applicable are embedded in the statute in certain provisions, such as Sections 28 to 43 and Sections 80A to 80HHC when it comes to deductions. Instead of adopting that mode, the Parliament thought it appropriate to leave the mode to the rule making authority.

The High Court held that the opinion of the Assessing Officer in the latter part [of Section 14A(2)] is to be based upon an appraisal of objective material relating to the assessee's voluntary disallowance of amounts and in addition if in the course of assessment, the assessing Officer enquires from the assessee about the amounts spent, which are to be disallowed, and the assessee in fact discloses a larger amount (than the one given in the return), it is still incumbent upon the Assessing Officer to enquire into such larger amounts and determine whether it has nexus with expenditure relatable to exempt income to attract sec. 14A(1).

It is to be noted that sec. 14A(2) states that "... if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act"

Raj Dadarkar & Associates -vs.- ACIT (2017) (SC)

Income from the sub-licensing of property is taxable as house property income and not business income

The Maharashtra Housing and Developing Authority (MHADA) had constructed buildings. However, there was a reservation for Municipal retail market on the plot on which MHADA had constructed. Therefore, MHADA handed over the ground floor [stilt portion] of the above said buildings to Market Department of Municipal Corporation Greater Bombay (MCGB). In 1993, the Markets Department of the MCGB auctioned the property on a monthly license [stallage charges] basis to run the municipal market. The assessee participated in the auction and was the successful bidder. Accordingly, MCGB handed over possession of the market portion to the assessee. The premises allotted to the assessee was a bare structure, on stilts, that is, a pillar/column, sans even four walls. In terms of the auction, it was the assessee who had to make the entire premises fit to be used a market, including the construction of walls, construction of entire common amenities such as toilet blocks, etc. Accordingly, after taking possession of the premises, the assessee spent a substantial amount on additions/alternations of the entire premises, including demolishing the existing platform and, thereafter, reconstructing the same according to the new plan sanctioned by the MCGB. The assessee constructed 95 shops and 30 stalls of different carpet areas on the premises under the market name 'S Shopping Centre'. The assessee also obtained, in terms of the conditions of the auction, the necessary registration certificate for running a business under the Shop and Establishment Act and other licenses/permissions from MCGB and other Government and semi-Government bodies for carrying on trading activities on the said premises. The assessee was responsible for day-to-day maintenance, cleanliness and upkeep of the market premises. The appellant also had to incur/pay water charges, electricity charges, taxes and repair charges

The assessee collected the following types of receipts from the sub-licensees:

- Compensation from sub-licensees [same rate of stallage charges and on the same terms and condition as given to the assessee by the MCGB]
- Leave and license fees
- Service Charges for providing various services, including security charges, utilities, etc.

The assessee filed the returns of income offering the income from the aforesaid shops and stalls sub-licensed by it



as business income. The Assessing Officer computed the income from the shops, and the stalls under head 'Income from House Property'. The Commissioner (Appeals) allowed the appeal of the appellant and reversed the action of the respondent. However, the Tribunal reversed the order of the Commissioner (Appeals) and confirmed the action of the Assessing Officer. Aggrieved by the Tribunal's order, the assessee filed an appeal before the High Court. The High Court dismissed the appeal filed by the assessee.

On appeal, the Apex Court has held that wherever there is an income from leasing out of premises and collecting rent, normally such an income is to be treated as income from house property, in case provisions of sec. 22 are satisfied with primary ingredient that the assessee is the owner of the said building or lands appurtenant thereto. 'Owner of the house property' is defined in sec. 27 which includes certain situations where a person not actually the owner shall be treated as the deemed owner of a building or part thereof.

The assessee is held to be 'deemed owner' of the property in question by virtue of sec. 27. Merely because there is an entry in the object clause of the business showing a particular object, would not be the determinative factor to arrive at a conclusion that the income is to be treated as income from business. Such a question would depend upon the circumstances of each case. The Tribunal being the last forum insofar as factual determination is concerned, the findings have attained finality. The Tribunal held that the service charges received were inseparable from the basic charges of rent. Also, it was undisputed that the assessee did not undertake any systematic or organized activity of providing services to the occupiers, which can constitute receipt as business income for the assessee.

It was for the assessee to produce sufficient material on record to show that its entire income or substantial income was from letting out of the property which was the principal business activity of the assessee. Reliance placed by the assessee on the judgments in *Chennai Properties & Investments Ltd. (2015) 14 SCC 793 (SC)* and *Rayala Corporation (P) Ltd. T (2016) 15 SCC 201 (SC)* would be of no avail. In *Chennai Properties & Investments Ltd.*, the entire income of the appellant was through letting out of the two properties it owned and there was no other income of the assessee except the income from letting out of the said properties, which was the business of the assessee.

Palam Gas Service -vs.- CIT (2017) (SC)

Provision of sec. 40(a)(ia) covers the cases where the amount is actually paid.

The assessee is engaged in the business of purchase and sale of LPG cylinders. During the relevant assessment year, assessee received freight payments of ₹ 32 lakhs from Indian Oil Corporation (IOC) with whom the assessee had entered into main contract for carriage of LPG. The transportation of LPG was done through three truck-owners, to whom a total freight payment of ₹ 20 lakhs was made. As per the Assessing Officer, since the assessee has sub-contracted the transportation to these three persons within the meaning of sec. 194C, he was liable to deduct tax on ₹ 20 lakhs. The Assessing Officer thus disallowed these expenses u/s 40(a)(ia). On appeal, the Commissioner (Appeals) & the ITAT upheld the order of the Assessing Officer. On further appeal, the High Court too ruled in favour of the Revenue.

The Apex Court rejects assessee's plea that since the word used in sec. 40(a)(ia) is 'payable', no disallowance can be made where the freight charges had been paid during the year. The Apex Court acknowledges that grammatically, it may be accepted that the two words, i.e. 'payable' and 'paid', denote different meanings, but held that "when the entire scheme of obligation to deduct the tax at source and paying it over to the Central Government is read holistically, it cannot be held that the word 'payable' occurring in sec. 40(a)(ia) refers to only those cases where the amount is yet to be paid and does not cover the cases where the amount is actually paid." The Apex Court remarks that if the provision is interpreted in the manner suggested by appellant-assessee, "then even when it is found that a person, like the appellant, has violated the provisions of Chapter XVIIIB ..., he would still go scot free."

Maneklal Agarwal -vs.- DCIT (2017)(SC)***Higher rentals received from third party sub-lessees taxable in the hands of the first lessor where the lease is shown to be sham***

The assessee had leased out his property to his own family members for a nominal rent, who in turn had sub-leased it to third parties on much higher rental values. The tax authorities, at both assessment and first appellate levels, held that such sub-letting income was subject to tax in the hands of the assessee only. Upon further appeal, the order of the Commissioner (Appeals) was upheld by the Tribunal with a directive to consider municipal valuation as basis of income so charged to tax. The tax department challenged the order passed by the Tribunal before the Andhra Pradesh & Telangana High Court. The High Court allowed the revenue's appeal and dismissed the assessee appeals on the ground that the nature of lease executed by the assessee was proved to be bogus as a fact by the Tribunal, leading to a conclusion that the net rental value would be chargeable to tax in the hands of the assessee.

Aggrieved by the High Court's order, the assessee filed an appeal with the Supreme Court. The Supreme Court observed that the assessee had devised a structure to show lesser income in his hands by entering into a lease agreement with his wife, son, and daughter-in-law at very nominal rates and allowing such family members to sub-let the property at a much higher rental value. The Supreme Court relied on its own decision in ITO -vs.- Ch. Atchiah (1996) AIR 993, where it had held that the Assessing Authority has the right to tax the 'right person'. In the instant case, given the finding of fact that the first lease transaction was bogus, the assessee was found to be the 'right person', making it permissible for the revenue to tax the said rental income in the hands of the assessee. To avoid double taxation of the same income, the Supreme Court further held that the assessee's relatives could seek redressal of the taxation of income at their hands in appropriate proceedings.

Naresh Bhavani Shah(HUF) -vs.- CIT (2017) (Guj)

The assessee, a HUF, invested the funds belonging to the HUF in RBI taxable bonds. Inadvertently, it made such investment in the name of karta and PAN of Karta was mentioned instead of HUF. RBI while deducting TDS issued certificates in the name of Karta. The Assessing Officer while processing the return did not give claim to the assessee. The Assessing Officer filed a revision petition before the Commissioner but he rejected the same holding that on account of the mismatch of PAN reflected in the TDS certificate and that of the assessee, the credit could not be granted.

The High Court held that the source of the funds which came to be invested with the RBI was that of the HUF. The interest income, therefore, would belong to the HUF. At the same time, it is equally undisputed that the investment was made in the name of Karta in his individual capacity and not as a karta of the HUF. The PAN given to RBI was also that of the individual and, therefore, TDS was deducted by the RBI while paying interest to karta indicating his PAN.

In exercise of powers given in sec. 199, rule 37BA of the Income Tax Rules 1962 has been framed. Under rule 37BA(2), where whole or 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 could be given to such other person and not to the deductee provided the three conditions contained therein are satisfied. These conditions are that the deductee files a declaration with the deductor in this respect, such declaration would contain the details of the person entitled to the credit and the reasons for giving such credit and lastly the deductor issues certificate for deducting tax at source in the name of such a person.

Invariably in all cases such procedure would have to be completed before a person can rightfully claim credit of tax deducted at source where the TDS certificate shows the name and PAN of some other person.



In the instant case, however, many years have passed since the event arose. The HUF has already offered the entire interest income to tax. The department has also accepted such declaration and taxed the HUF. In view of such special facts and circumstances, the court directs the department to give such credit to the assessee upon Karta filing an affidavit before the department that the sum invested in the RBI does not belong to him, the income is also not his and that he has not claimed any credit of the tax deducted at source on such income for the relevant assessment year.

CIT -vs.- Smt. Sarika Jain (2017) (All)

ITAT wasn't competent to make addition under different section if it wasn't subject matter of appeal

The assessee was a partner in a firm, wherein he introduced certain amount of capital. Notice u/s 148 was issued to the assessee to explain the source of such capital. In reply to the said notice, the assessee submitted that she had received gift of certain amounts from 2 persons. The gifts were received through banking channel. In order to prove the aforesaid gift transactions, gift deeds were also produced before the authorities. The statement of the two donors were also recorded u/s 131 and they proved the factum of the gift. The Assessing Officer has held that gifts were not genuine as these were held to be unnatural and aforesaid amounts were added as undisclosed income of assessee u/s 68. On appeal, the Commissioner (Appeals) affirmed the said order. On further appeal, the Tribunal, held that the addition made by the Assessing Officer u/s 68 and sustained by the Commissioner (Appeals) could not be sustained. However, the Tribunal proceeded to add the aforesaid amount as the income of the assessee u/s 69-A.

Sec. 254(1) provides that the Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit.

The High Court has held that the use of the word 'thereon' is important and it reflects that the Tribunal has confined itself to the questions, which are arising or are subject matter in the appeal and it cannot be travelled beyond the same. The power to pass such orders as the Tribunal thinks fit can be exercised only in relation to the matter that arises in the appeal and it is not open to the Tribunal to adjudicate any other question or an issue, which is not in dispute and which is not the subject matter of the dispute in appeal. When said income could not be added u/s 68 and Tribunal was not competent to make said addition u/s 69A entire order of the Tribunal stand vitiated in law. Accordingly, the Tribunal was not competent to make any addition u/s 69A and as the same was not subject matter of the appeal before it.

CIT -vs.- Oryx Finance & Investment (Pvt) Ltd (2017) (Bom.)

"Amount of tax in arrears" in sec. 221 does not include interest component

The tax return of the assessee was processed u/s 143(1) against which a demand of ₹ 1.64 crores was raised. The Assessing Officer imposed penalty of ₹ 1.19 crores u/s 221(1) due to default in payment of demand. Commissioner (Appeals) deleted the penalty imposed by the Assessing Officer on the ground that interest component was to be excluded while levying penalty u/s 221(1) and since penalty exceeded tax component the order was set aside. On appeal, the Tribunal upheld the order of Commissioner (Appeals) and remitted matter back to the Assessing Officer. The definition of tax u/s 2(43) read in its entirety suggests that the "tax" means incometax, supertax and/or the fringe benefit tax, as the case may be chargeable under the provisions of the Act. The definition of tax does not take within its fold the interest component.

The definition of "interest" as envisaged u/s 2(28A) is restricted to the interest payable in respect of any moneys borrowed or debt incurred. It is the elementary rule of interpretation that when the language of a statute is clear and unambiguous, the Courts are to interpret the same in its literal sense and not to give a meaning that would cause violence to the provisions of the statute. Each word in the statute should be assigned the meaning as per the context. The provision imposing penalty will have to be strictly construed.

Reading sec. 221 in its entirety, it is abundantly clear that the aspect of default in payment of tax and the amount of interest payable are treated as distinct and separate components. The section categorically and specifically states that when an Assessee is in default or is deemed to be in default in making payment of tax, he shall in addition to the amount of arrears and the amount of interest payable u/s 220(2), be liable, to pay penalty, however the amount of penalty does not exceed the amount of tax in arrears. The terminology "default in making a payment of tax and amount of interest payable" are considered to be separate for imposition of penalty and penalty is to be levied on account of default in making a payment of tax. However, the total amount of penalty shall not exceed the amount of tax in arrears. The said penalty for non payment of the tax is in addition to the levy of interest u/s 220(2). The amount of penalty will have to be restricted on the arrears of tax, which would not include the interest component charged u/s 220(2) of the Act

Purnima Advertising Agency Pvt Ltd -vs.- DCIT (2017)(Guj)

Higher tax demand u/s 206AA cannot be raised on account of an incorrect PAN mentioned in the TDS return

The taxpayer is a company registered under the Companies Act and is engaged in the business of advertisement. During the year under consideration, the taxpayer has made payments to various recipients, on which the taxpayer has deducted tax at 2%. While filing TDS returns for the second and third quarters there was an inadvertent error since the PAN of one deductee was wrongly mentioned. There was a typographical error while putting details in TDS statement. The taxpayer had not immediately noticed this error. During the course of processing TDS returns, the Assessing Officer (AO) found that the PAN indicated by the taxpayer in the declaration did not match with the actual PAN of the deductee. The PAN provided in the TDS return did not belong to that deductee and, therefore, in terms of sec. 206AA(6)2, it would have the effect as if the deductee has not furnished the PAN to the deductor and the effect of provisions of sec. 206AA(1)3 is applicable. The AO held that the taxpayer who was required to deduct tax at the rate of 20% had deducted the same at the rate of 2%. Therefore, the AO raised a demand for the remaining tax after adjusting such tax deducted.

Section 200(3) of the Act refers to the requirement of filing a TDS statement. This provision though does not refer to any mechanism for correction of such a statement, sec. 200A(1) specifically refers to a TDS statement or a correction statement. Thus, clearly leaving the possibility of correcting a declaration once made by the taxpayer. Sec. 200A(1) (a)(iii) permits the tax authority to make an adjustment of an incorrect claim, apparent from any information in the statement.

Neither the statute nor the department completely rules out the possibility of a genuine and bona fide typographical or even mechanical error. Looking to a large number of TDS statements and entries in such statements, it would be impossible to process individual claims of corrections, whether they are based on bona fide mistakes or otherwise. The taxpayer relied on the notification wherein tax department has formulated the scheme. This notification contains detailed provisions for the processing of TDS statements. It also refers to a correction of the TDS statement. The scheme authorises the director general to specify the procedures and processes for the effective functioning of the cell where such declarations would be processed which includes the receipt of the corrected TDS statement.

Even as per the tax department, the online system permits corrections limited to two alphabetical and two numerical errors in the PAN number. Such limited permission to correct is sought to be justified on two grounds. One is that if the error is genuine and bona fide in feeding the PAN number, it is unlikely that a typographical error would travel beyond such characters and the second is that looking to the millions of statements and entries being filed by the taxpayers across the country, it would open the flood gates, if corrections are permitted without any limit.

Once the tax department recognises the possibility of errors and also makes provisions for making corrections, it would be wholly illogical to limit such corrections on arithmetical working out of only two alphabets or two numeric



being found incorrect requiring change. An error in feeding an entry or a number may have multiple origins from the typographical error of data entry operation to mechanical failures or through pure oversight referring to one column of PAN instead of another while filling up and uploading the statement. It is not necessary nor possible to envisage different situations under which such errors could crop-up and need not necessarily be confined to limited figures on the letters of the PAN being incorrect.

It is entirely one thing to suggest that the tax department would not accept any change once certain entries are uploaded, or at any rate no change would be permissible beyond a certain date. However, it is entirely another thing to suggest that the corrections may be permitted but should be limited to a number of characters where correction is needed.

In the present case, Section 200A of the Act itself refers to correction TDS statement. The intimation sent to the taxpayer of the shortfall in TDS also referred to the possibility of correction but limited it to certain characters. In the instant case, the deductee has already discharged its full tax liability. If the full effect of the tax department's decision is allowed, the deductee would not get the benefit of 2% of tax deducted by the deductor and already deposited with the government. Since the PAN does not match, the deductor would pay additional 18% which although styled in the name of TDS, would be additional to what deductee would have paid by way of tax to the department.

In the present case, with the payee having already discharged its tax liability independently, such an amount would remain in government coffers not accounted for by anyone's tax liability. Further, the tax department's contention was that the incorrect PAN could be corrected as long as a mismatch is up to two alphabets and two numeric characters are incorrect.

The decision to limit the correction to limited characters is a policy decision which should be based on logical parameters. Nevertheless, putting the limitation of permitting corrections of only four characters has no rationale relation.

Accordingly, it has been held that the decision of the tax department in not permitting the taxpayer to correct the PAN of the deductee in the TDS statement was not acceptable. The tax department shall verify the taxpayer's claim of actual deduction of tax at the prescribed rate in the case of deductee, verify that the PAN sought to be corrected by the taxpayer belongs to the said deductee and that the tax was actually deposited in the case of such a deduction.

CIT -vs.- Equinox Solution Pvt. Ltd (2017)(SC)

If an undertaking is sold as a running business with all assets and liabilities for a slump price, no part of the consideration can be attributed to depreciable assets and assessed as a short-term capital gain u/s 50(2)

Assessee company was engaged in the business of manufacturing sheet metal components at Ahmedabad, sold his entire business in one go with all its assets and liabilities to another company and claimed the sale to be of 'slump sale' in the nature of long term capital gains as the undertaking was owned by assessee for almost 6 years. The Assessing Officer rejecting assessee's contention held that it was covered u/s 50(2) and framed assessment accordingly. On appeal, the Commissioner (Appeals) allowed assessee's claim of deduction. On further appeals before ITAT and High Court, assessee succeeded.

The Apex Court observed that sec. 50(2) would apply to any block of assets transferred which assessee was using in running of his business. The Apex Court, however, opined that where the entire running business with assets and liabilities stood transferred in one go, such sale could not be treated as short-term capital assets and is in the nature of LTCG.

The Apex Court upheld assessee's claim relying upon coordinate bench ruling in Artex Manufacturing Co. and Bombay High Court ruling in Premier Automobiles Ltd. wherein similar view was taken

Mcdowell & Company Ltd -vs.- CIT (2017)(SC)***Deemed income u/s 41(1) of the amalgamating company should be reduced from the loss to be set off u/s 72A by the amalgamated company***

Assessee company took over the sick company - HPL ('amalgamating company') through the scheme of amalgamation. HPL owed a lot of money to banks and financial institutions. In its books of accounts, the interest which had accrued on the loans given by such financial companies were shown as the money payable on account of interest to the said banking companies and was reflected as expenditure on that count. As the interest payable was treated as expenditure, benefit thereof was taken in the assessment orders made. Under certain circumstances and on fulfillment of conditions laid down u/s 72A, the company which takes over the sick company is allowed to set off losses of the amalgamated company as its own losses. After amalgamation, the assessee has taken such benefit.

The banks which had advanced loans to HPL agreed to waive off the interest which had accrued prior to certain date. Since, interest was claimed as expenditure by HPL in its returns. On the waiver of this interest, it became income in terms of sec. 41(1) of the Act. In the return filed by the assessee, the assessee claimed set off of the accumulated losses which it had taken over from HPL by virtue of the provisions contained in sec. 72A of the Act. The Assessing Officer treated the aforesaid income at the hands of the assessee herein and adjusted the same from the accumulated losses. The assessment order was drawn accordingly. The assessment was upheld by the Commissioner (Appeals). However, in further appeal, the ITAT held that the aforesaid income u/s 41(1) of the Act was not at the hands of the assessee herein but it may be treated as income of the HPL and since HPL was a different assessee and a different entity, the assessee herein was not liable to pay any taxes on the said income. Later on, the High Court reverse the order of the Tribunal

The Apex Court held that waiver of liability due by amalgamating company after amalgamation is taxable in the hands of the amalgamated company u/s 41(1) as when the assessee is allowed the benefit of the accumulated losses while computing those losses, the income which accrued to it had to be adjusted and only thereafter net losses could have been allowed to be set off by the assessee company.

Shankar Dalal & others -vs.- CIT (2017)(Bom.)***Provisions of local land laws should be considered while determining the land as agricultural land.***

In the return of income, the assessee has declared that gain on sale of agricultural land is exempt since the land does not constitute "Capital Assets" as defined u/s 2(14). The Assessing Officer passed an order denying exemption giving reasons that land did not constitute agricultural land since no agricultural operations were carried out regularly and same was sold to a company engaged in the business of development of infrastructure activity. The Assessing Officer also ruled that though the land was located beyond the specified limits from the municipal limits i.e. beyond 8 kms, yet it was to be treated as capital asset. On appeal, Commissioner (Appeals) held the land as agricultural land and exempts capital gain. The Tribunal upon re-inspection held that "To the extent the land is actually used for dry crop, the land has to be regarded to be an agricultural land the balance 4/5th of the land could not be regarded to be the agricultural land".

Bombay High Court reverses ITAT order, and held that "merely because the assessee could not produce and utilize the land fully by employing labour, and/or unable to give the crop statements should not have been the criteria" The Court held that the Revenue fell in error in not considering the provisions of local land laws, as activities performed by assessee on the land were recognised as 'agricultural' activities under the Local land law.

**Mother Hospital (P) Ltd -vs.- CIT (2017)(SC)**

A lessee cannot be said to be the “owner” for purposes of claiming depreciation and the lessee is entitled to depreciation on the cost of construction incurred by him but not on the cost incurred by the owner and reimbursed by the lessee

A partnership firm had been constituted by 'M' and his family members. The said firm owned a land. The purpose of the partnership firm was to run a super speciality hospital and, accordingly, the firm started construction of the hospital building. Thereafter, an agreement was entered into between the firm and the company by which it was agreed that the firm would complete the construction of the building and hand over possession of the same on completion, on the condition that the entire cost of construction of the building would be borne by the assessee company. The assessee-company filed its return in which it claimed depreciation on the building part of the said property. The Assessing Officer rejected the claim of depreciation and added back the same.

Building which was constructed by the firm belonged to the firm. The title in case of immovable property cannot pass when its value is more than ₹ 100/- unless it is executed on a proper stamp paper and is also duly registered with the sub-Registrar. Nothing of the sort took place. In the absence thereof, it could not be said that the assessee had become the owner of the property.

Further, the Court held that it is only when assessee holds a lease right or other right of occupancy and any capital expenditure is incurred by it on construction or renovation or improvement of building, assessee would be entitled to depreciation to extent of such expenditure incurred. However, where construction is carried out by owner-lessor and expenditure is only reimbursed by assessee-lessee, Explanation 1 to section 32(1) would not come to aid of assessee.

Rajesh Kumar Aggarwal -vs.- CIT (2017)(Delhi)***Exemption u/s 54F can be granted in revision u/s 264***

The assessee for assessment year 2009-10 had claimed a set off of capital gains from sale towards house property as against capital losses and the loss in respect of shares. The set off was not permitted. In the meanwhile, the assessee had purchased new property, apparently with the intention of seeking the benefit u/s 54F. The original property was sold on 20.06.2008; the new property was purchased in July, 2008. However, the benefit of sec. 54F was not claimed when the return was filed on 30.09.2009. The assessment order disallowed the set off. This resulted in a capital gain. By then, the time to file the revised return had elapsed and the assessment was completed. The assessee filed the revision petition u/s 264 of the Act. The Commissioner rejected the assessee's revision petition stating that no documentary evidences whatsoever were filed by the assessee during the course of assessment proceedings with regard to cost of improvement made by him in the Property. Further, the assessee has also failed to bring on record reasons that prevented him from filing the copies of so called valuation report before the AO. Thus, the valuation report now filed by the assessee is a self serving document without any corroboratory evidences. As regards the claim of deduction u/s 54F, the assessee has not claimed the same in his return. Further, it has also never been raised by him during the course of assessment proceedings.

Section 264 in its operative part states that the (Principal Commissioner or) Commissioner may, either of his own motion or on an application by the assessee for revision, call for the record of any proceeding under this Act in which any such order has been passed and may make such inquiry or cause such inquiry to be made and, subject to the provisions of this Act, may pass such order thereon, not being an order prejudicial to the assessee, as he thinks fit.

The phraseology adopted by the provision is of the widest amplitude. The term “any such order as he thinks fit” is only qualified by subject to provisions of this Act. Therefore, unless there is a direct impediment to the power u/s 264 (exercisable by the Commissioner) which inhibits the grant of relief, it is per se admissible. The impediment may be in the form of a substantive provision which might place a time limit, to the grant of such relief or it may be otherwise.

In the present case, the concerned provision sec. 54F, does not per se contain any such impediment. Therefore, as far as the text of the provision goes, this Court is of the opinion that there is no bar in the grant of the relief despite the assessee apparently having missed the bus and having committed the mistake.

Pr. CIT -vs.- Ramgopal Minerals (2017)(Kar)

No cessation of liability even if creditors were untraceable but evidences of payments to them were produced

In course of assessment, the Assessing Officer made addition to assessee's income u/s 41(1) in respect of cessation / remission of trading liability of various transporters who transported the minerals for the assessee stating that the assessee had failed to produce these transporters/trade creditors before the authority, despite the summons issued to them. On further appeal, the Tribunal completely set aside the additions made by the revenue. On further appeal, High Court held that in legal parlance, merely because the creditor could not be traced on the date when the verification was made, same is not a ground to conclude that there was cessation of the liability.

Cessation of the liability has to be cessation in law, of the debt to be paid by the assessee to the creditor. The debt is recoverable even if the creditor has expired, by the legal heirs of the deceased creditor. Under the circumstances, in the present case, it can hardly be said that the liability had ceased. If the liability had not ceased or the benefit was not taken by the assessee in respect of such trade liability, the conditions precedent were not satisfied for invoking sec. 41(1).

Tribunal has clearly recorded the evidence and findings of facts in favour of the respondent-assessee that the assessee has produced the documentary evidence in the form of ledger accounts and proof of payments made through bank channel and PAN numbers also.

Burden of the Revenue to summon such creditors or transporters for establishing that the liability has ceased could not be shifted upon the respondent-assessee.

There is no perversity in the same so as to give rise to any substantial question of law arising in the present case, requiring consideration u/s 260A.

Akshar Infrastructure Pvt. Ltd -vs.- ITO (2017)(Guj.)

Assessment cannot be reopened merely on basis of DVO's report

During the year under consideration, the assessee has purchased one land at a price of ₹ 78 lakhs, however, stamp authorities valued the same at ₹ 1.85 crores. In the scrutiny assessment u/s 143(3), the AO added the difference of aforesaid amounts as deemed income, being unexplained u/s 69. During pendency of the scrutiny assessment, the AO had made reference to the District Valuation Officer (DVO) as well. However, as according to the revenue, time limit to frame the scrutiny assessment was to over, the AO without waiting for the DVO's report finalised the scrutiny assessment u/s 143(3). Against assessment order, assessee preferred appeal before CIT(Appeals). In meantime, AO received DVO's report valuing property at an amount higher than that of stamp duty valuation. AO thus requested CIT (Appeals) to enhance deemed income on the basis of DVO's report. CIT (Appeals), opined that no addition could be sustained either on basis of stamp duty valuation or valuation report of DVO. Thereafter, AO issued notice u/s 148 to reopen assessment on basis of DVO's report.

The High Court has held that since AO had completed scrutiny assessment u/s 143(3), in such a case, opinion given by DVO was not per se information for the purpose of reopening of assessment. However also once having failed before Commissioner (Appeals) to enhance unexplained investment by relying upon DVO's report, thereafter it was not open for Assessing Officer to reopen assessment on very ground i.e. relying upon DVO's report. In view of the above, held that impugned reassessment proceedings deserved to be quashed.

**CIT -vs.- Vinzas Solutions India (P.) Ltd (2017) (Mad)*****Payment made by the dealer for outright purchase of software is not tantamount to “royalty”***

The respondent-assessee was a dealer in computer software, having purchased the same from various companies. During the course of assessment proceedings, a disallowance was effected in terms of sec. 40(a)(ia) by the Assessing Officer on the ground that consideration for purchase was of the nature of 'royalty' under Explanation 4 and 5 of section 9(1)(vi) and tax ought to have been deducted at source in accordance with the provisions of section 194J. On appeal, CIT(A) affirmed the order of the Assessing Officer. On appeal, Tribunal reversed the order of CIT(A).

The term “‘royalty’ normally connotes the payment made by a person who has exclusive right over a thing for allowing another to make use of that thing which may be either physical or intellectual property or thing. The exclusivity of the right in relation to the thing for which royalty is paid should be with the grantor of that right. Mere passing of information concerning the design of a machine which is a tailor-made to meet the requirement of a buyer does not by itself amount to transfer of any right of exclusive user, so as to render the payment made therefor being regarded as 'royalty'. There is a difference between a transaction of sale of a 'copyrighted article' and one of 'copyright' itself.

The provisions of sec. 9(1)(vi) as a whole, would stand attracted in the case of the latter and not the former. Explanations 4 and 7 relied by the authorities would thus have to be read and understood only in that context and cannot be expanded to bring within its fold transaction beyond the realm of the provision.

CIT -vs.- Subhash Vinayak Supnekar (2016) (Bom.)***Investment can be made out of advance received under sale agreement for sec. 54EC relief***

The assessee entered into an agreement to sell for the subject property on 21-2-2006 and the sale deed was executed on 5-4-2007. The assessee had invested an amount of ₹ 50 lakhs from the advance received under the agreement to sale in the Rural Electrification Corporation Ltd. bonds on 2-2-2007. Assessing Officer as well as CIT(A) held that the assessee was not entitled to the benefit of section 54EC as the amount was invested in the bonds prior to the sale of the subject property on 5-4-2007. The Tribunal, however, held that even when an assessee made investment in bonds as required under section 54EC on receipt of advance as per the agreement to sell, still it was entitled to claim the benefit of section 54EC. High Court affirmed the order of the tribunal

Ian Peter Morris -vs.- ACIT (2016) (SC)***Interest u/s 234B & 234C does not apply on salary income***

The appellant-assessee along with three others had promoted a Company. The said Company was acquired by one Synergy Credit Corporation Limited (the Acquirer Company). The appellant was offered the position of Executive Director in the Acquirer Company. Further, a Non-Compete Agreement was signed between the appellant-Assessee and the Acquirer Company imposing a restriction on the appellant from carrying on any business of Computer Software development and marketing for a period of five years for which the appellant-Assessee was paid a sum of ₹ 21,00,000/-. The question that arose in the proceedings commencing with the Assessment Order is whether the aforesaid amount of ₹ 21 lakhs is on account of 'salary' or the same is a 'capital receipt'. The High Court in the order under appeal took the view that the said amount is 'salary amount' on which interest would be chargeable/leviable u/s 234B and 234C.

However, the High Court's ruling to levy interest u/s 234B & 234C on this income was challenged in appeal. The Supreme Court held that on perusal of the relevant provisions of Chapter VII of the Act, against salary, a deduction, at the requisite rate at which income tax is to be paid by the person entitled to receive the salary, is required to be

made by the employer failing which the employer is liable to pay simple interest thereon. In cases where receipt is by way of salary, deductions u/s 192 of the Act are required to be made. No question of payment of advance tax under Part 'C' of Chapter VII of the Act can arise in cases of receipt by way of 'salary'. Therefore, interest obligations u/s 234B and 234C would have no application to the present situation since the High Court has already decided that the non-Compete Agreement was by way of salary. The Apex Court thereby modified the order, deleting interest u/s 234B & 234C.

Reliance Infrastructure Ltd. -vs.- CIT (2016) (Bom.)

Foreign Taxes not being entitled to the benefit of DTAA relief, shall be allowed as expenses

The assessee has executed some projects in Saudi Arabia and paid taxes in Saudi Arabia for the income earned there. While filing return, benefit u/s 91 of the Act for relief from double taxation on the same income was claimed which was rejected by the AO on ground that the benefit is available when the amount of tax paid under foreign income is again included in the taxable income earned in India i.e. the same income must be taxed in both the countries. On the contrary, an alternative claim was put forth by the company, that, if benefit of section 91 was not given, then the tax paid in Saudi Arabia were to be allowed as a deduction to the company. The applicant assessee illustrated its claim by a hypothetical illustration, which is as under:

- a. In respect of the project in Saudi Arabia, income which is taxable is ₹ 1,000/-. The tax payable in Saudi Arabia is 10% of income. This amount of ₹ 1,000/- includes an amount of ₹ 150/- which has accrued in India and, therefore, outside the scope of doubly taxed income for the benefit of sec. 91 of the Act.
- b. Nevertheless, the assessee paid the tax on ₹ 1,000/- in Saudi Arabia @ 10% i.e. ₹ 100/-. The credit which would be given to the assessee u/s 91 of the Act is to extent of ₹ 85/- i.e. doubly taxed income amounting to ₹ 850/-. However, as no credit is given for the tax of ₹ 15/- paid in Saudi Arabia on income which is accrued in India, the deduction of ₹ 15/- should be given as an expenditure from the income of ₹ 150/- which has accrued / arising of in India.

The High Court has held that the tax which has been paid abroad would not be covered with in the meaning of Section 40(a) (ii) in view of the definition of the word 'tax' in sec. 2(43) of the Act. To be covered by sec. 40(a)(ii) of the Act, it has to be payable under the Act. We are conscious of the fact that sec. 2 of the Act, while defining the various terms used in the Act, qualifies it by preceding the definition with the word "In this Act, unless the context otherwise requires" the meaning of the word 'tax' as found in Section 2(43) of the Act would apply wherever it occurs in the Act.

However, to the extent tax is paid abroad, the Explanation to Section 40(a)(ii) of the Act provides / clarifies that whenever an Assessee is otherwise entitled to the benefit of double income tax relief u/s 90 or 91 of the Act, then the tax paid abroad would be governed by sec. 40(a)(ii) of the Act. The occasion to insert the Explanation to Section 40(a)(ii) of the Act arose as Assessee was claiming to be entitled to obtain necessary credit to the extent of the tax paid abroad u/s 90 or 91 of the Act and also claim the benefit of tax paid abroad as expenditure on account of not being covered by Section 40(a)(ii).

The tax paid in Saudi Arabia on income which has accrued and / or arisen in India is not eligible to deduction under Section 91 of the Act. Therefore, not hit by Section 40(a)(ii) of the Act. Section 91 of the Act, itself excludes income which is deemed to accrue or arise in India. Thus, the benefit of the Explanation would now be available and on application of real income theory, the quantum of tax paid in Saudi Arabia, attributable to income arising or accruing in India would be reduced for the purposes of computing the income on which tax is payable in India.

This is so as it is a tax which has been paid abroad for the purpose of arriving global income on which the tax payable in India. Therefore, to the extent the payment of tax in Saudi Arabia on income which has arisen / accrued in India has to be considered in the nature of expenditure incurred or arisen to earn income and not hit by the provisions of Section 40(a)(ii) of the Act.

**Pr. CIT -vs.- Bharat Heavy Elect. Ltd. (2016) (P&H)**

Usual clauses in contract involving payments for construction, erection & commissioning etc of plants involving inputs from technical personnel do not constitute “payments for technical services” attracting TDS obligations u/s 194J

Post TDS inspection u/s 133A of the Act, the AO found that the company had made payments to five contractors in respect of various contracts and deducted tax in respect thereof u/s 194C of the Act, whereas, all the contracts involved the provision of professional and technical services which fell within the ambit of the provisions of sec. 194J of the Act and not u/s 194C.

The question, therefore, was whether the amounts paid under the contracts constitute fees for professional or technical services attracting sec. 194J or whether they constitute payments to contractors attracting the provisions of sec. 194C?

The High Court held that testing, pre-commissioning, commissioning and post commissioning are required to be carried out by a contractor to satisfy the customer that the work has been executed in a proper manner; that the equipment has been installed as required and that its performance meets the parameters specified in the contract. The personnel that are required to test and commission the plant and equipment perform their functions not under a contract for the supply of technical services to the customer, but to satisfy the customer on behalf of the contractor that the plant and equipment has been duly supplied as per the contractual specifications.

Indeed, this entire exercise would require the deployment of technical personnel, but what is important to note is that the technical personnel are deployed not for and on behalf of the customer, but for and on behalf of the contractor itself with a view to ensuring that the contractor has supplied the equipment as per the contractual specifications. The contract entered did not involve the supply of professional or technical services within the meaning of sec. 194J

CIT vs. Greenfield Hotels & Estates Pvt. Ltd (2016)(Bom.)

Where Revenue accepts decision of a Court/Tribunal on an issue of law, not challenging it in appeal, then a subsequent decision following the earlier cannot be challenged

The revenue was in appeal against the tribunal's order of having made provisions of section 50C inapplicable to transfer of land & building, being a leasehold property. It was brought to the notice of the court that the Revenue had not preferred any appeal against the decision of the Tribunal in a like case where facts were similar and it could be inferred that it had been accepted.

The High Court followed decisions of the court in DIT -vs.- Credit Agricole Indosuez 377 ITR 102 and the Apex Court in UOI -vs.- Satish P. Shah 249 ITR 221, which laid down the salutary principle that where the Revenue has accepted the decision of the Court/Tribunal on an issue of law and not challenged it in appeal, then a subsequent decision following the earlier decision cannot be challenged.

Further, it was not the Revenue's case before the court that there were any distinguishing features either in facts or in law in the present appeal from that arising in the earlier case. In the above view, the question as framed by the Revenue did not give rise to any substantial question of law and accordingly, was not entertained

Visvesvaraya Technological University -vs.- ACIT (2016)(SC)

Mere fact that there is huge surplus (in excess of 6 to 15%) and minimal expenditure does not imply profit motive if the surplus is ploughed back into educational activities. Fees collected from students, though as per statute, is not a funding by the Government

The appellant–University has been constituted under the Visveswaraiah Technological University Act, 1994 (for short “VTU Act”). It discharges functions earlier performed by the Department of Technical Education, Government of Karnataka. The University exercises control over all Government and Private Engineering Colleges within Karnataka. For the Assessment Years 2004-2005 to 2009-2010 notices u/s 148 were issued to the appellant. Eventually returns were filed for the Assessment Years in question declaring ‘Nil’ income and claiming exemption u/s 10(23C)(iiiab) of the Act. The aforesaid claim of exemption was negated by the Assessing Officer who proceeded to make the assessments. The same view has been taken by all the Authorities under the Act and also by the High Court in the order under challenge in the present proceedings.

The entitlement for exemption under Section 10(23C) (iiiab) is subject to two conditions.

Firstly the educational institution or the university must be solely for the purpose of education and without any profit motive.

Secondly, it must be wholly or substantially financed by the government.

Both conditions will have to be satisfied before exemption can be granted under the aforesaid provision of the Act.

Universities and Educational Institutions entitled to exemption under the Act have been categorized under three different heads, namely, those covered by Section 10(23C) (iiiab); Section 10(23C)(iiiad) and 10(23C)(vi) of the Act. The requirement of the University or the educational institution existing “solely for educational purposes and not for purposes of profit” is the consistent requirement under Section 10(23C) (iiiab), 10(23C)(iiiad) and 10(23C)(vi). However, in cases of Universities covered by Section 10(23C)(iiiab) funding must be wholly or substantially by the Government whereas in cases of universities covered by Section 10(23C)(iiiad) the aggregate annual receipts should not exceed the amount as may be prescribed. Universities covered by Section 10(23C)(vi) are those other than mentioned in sub-clause (iiiab) or sub-clause (iiiad) and which are required to be specifically approved by the prescribed authority.

Having regard to the text and the context of the provisions of Section 10 (23c) (iiiab), 10 (23c) (iiiad) and 10 (23c) (vi) it will be reasonable to reach a conclusion that while Section 10 (23c) (iiiab) deals with Government Universities, Section 10 (23c) (iiiad) deals with small Universities having an annual “turnover” of less than Rupees One Crore (as prescribed by Rule 2 (BC) of the Income Tax Rules). On a similar note, it is possible to read Section 10 (23c) (vi) to be dealing with Private Universities whose gross receipts exceeds Rupees One Crore. Receipts by way of fee collection of different kinds continue to a major source of income for all Universities including Private Universities. Levy and collection of fees is invariably an exercise under the provisions of the Statute constituting the University. In such a situation, if collection of fees is to be understood to be amounting to funding by the Government merely because collection of such fees is empowered by the Statute, all such receipts by way of fees may become eligible to claim exemption under Section 10 (23c) (iiiab). Such a result which would virtually render the provisions of the other two Sub-sections nugatory cannot be understood to have been intended by the Legislature and must, therefore, be avoided.

It will, therefore, be more appropriate to hold that funds received from the Government contemplated under Section 10(23c)(iiiab) of the Act must be direct grants/contributions from governmental sources and not fees collected under the statute. Accordingly, exemption u/s 10(23C)(iiiab) has been denied.

ADIT -vs.- E-Funds IT Solution Inc (2017) (SC)

Outsourcing services provided by E-Funds Corporation, USA to its Indian affiliate does not constitute Permanent Establishment under the India-USA Tax Treaty

E-Funds Corporation (“E-Funds US”) is a company incorporated in the USA and part of a group which is engaged in the business of electronic payments, ATM management service, decision support & risk management and similar professional services.



E-Funds US and its group company, E-Funds IT Solutions Group Inc ("**E-Funds IT US**") entered into contracts with their clients in the US, for the provision of Information Technology Enabled Services ("**ITES**"). These contracts were assigned or sub-contracted to e-Funds International India Private Limited ("**E-Funds India**"), an indirect subsidiary of E-Funds US in India, for execution. Under the terms of the agreements between E-Funds India and the two US entities, E-Funds India provided support services to E-Funds US and E-Funds IT US, which in turn enabled them to render services to their clients. The Assessing Officer ("**AO**"), relying upon the Functions, Assets and Risks Analysis ("**FAR Analysis**") performed in relation to E-Funds US and E-Funds India, observed that:

- E-Funds US allowed E-Funds India to use its technology and infrastructure for provision of IT enabled services for free;
- E-Funds US even undertook marketing activities for E-Funds India and the latter did not bear any significant risks in the overall services;

In light of this, the AO concluded that:

- E-Funds India was a fixed place PE of E-Funds US and E-Funds IT US in India since the US entities had a fixed place in India through which they were carrying on their own business.
- Thus, the income attributable to E-Funds US and E-Funds IT US, which was not included in the income earned by E-Funds India, was to be taxed in India.

This view was upheld by the Commissioner (Appeals) ("CIT(A)") who concluded that in addition to a fixed place PE, there also existed a service PE and an agency PE. On appeal, the findings of CIT(A) in relation to the existence of fixed place PE and a service PE were affirmed by the Income Tax Appellate Tribunal ("Tribunal"). The Tribunal did not rule on the existence of an agency PE as arguments on that ground had not been furthered by the Income Tax Department ("Revenue"). The findings of all the above authorities were set aside by the Delhi High Court ("High Court"), which ruled that E-Funds India did not constitute a PE of E-Funds US or E-Funds IT US in India. Aggrieved by the ruling of the High Court, the Revenue preferred an appeal before the Supreme Court.

The Supreme Court, after hearing all contentions put forth by the parties, arrived at the following conclusions:

1. Determination of Fixed Place PE

The Supreme Court relied on its previous decision in Formula One World Championship Ltd vs. CIT to hold that a fixed place would constitute a PE of a non-resident only when such fixed place was "at the disposal" of that non-resident. A fixed place would be treated as being "at the disposal" of a non-resident enterprise when that enterprise has right to use the said place and has control thereupon. Merely having access to such a place, for the purposes of business, would not suffice. Control should be of a considerable amount and usually control would be present where the foreign entity can employ the place of business at its discretion.

In the present case, the Supreme Court noted that neither E-Funds US nor E-Funds IT US had a physical premise in India at its disposal nor did they have control over use of E-Funds India's premises for their business.

It further observed that the finding of the lower authorities regarding the existence of a PE, was based mainly on the fact that the business of the US entities was being outsourced to a 100% subsidiary in India and this resulted in a PE. On this aspect, the Supreme Court affirmed the observations of the High Court to the effect that a subsidiary of a foreign parent carrying on business in the source State does not by itself create a PE in the source State. The High Court had observed that close association between the entities or interactions or transactions between them were not appropriate tests to determine the existence of a PE. It had further held that neither the assigning of a contract nor sub-contracting, nor provision of intangible software free of cost would be relevant in determining a PE. Moreover, even if the foreign entities had reduced their expenditure by transferring the business to the Indian subsidiary, it would not by itself create a fixed place PE.

All of these observations were affirmed by the Supreme Court, which noted that it was "fundamentally erroneous" to say that merely by contracting with a 100% subsidiary, a PE would be created. In any event, E-Funds India had only rendered back office support services to both US entities, and as such, it could not be said that the business of either US entity had been carried on through E-Funds India.

On that basis, the Supreme Court held that the outsourcing of work by E-Funds US and E-Funds IT US to India would not result in the creation of a fixed place PE of E-Funds US or E-Funds IT US in India.

2. Determination of Service PE

Article 5(2)(l) of the India – US Tax Treaty provides that a service PE would be constituted in India where a US enterprise furnished services within India through employees or other personnel. The Revenue had argued that personnel engaged by E-Funds India for the provision of support services to E-Funds US and E-Funds IT US were de facto working under the control of the US entities, and as such, constituted a service PE of the US entities in India.

On facts, the Court observed that none of the customers of E-Funds US or E-Funds IT US were located in India, or receiving services in India. As such, the primary requirement that services be furnished “within India” had not been satisfied. On that basis, the Court did not go into the question of control over the personnel engaged by E-Funds India. In any event, E-Funds India merely undertook auxiliary operations that facilitated the provisioning of the main service (i.e. ITES) by E-Funds US and E-Funds IT US abroad. As such it could not be stated that a service PE had been created in India in terms of the India – US Tax Treaty.

3. Determination of Agency PE

On the question of whether a E-Funds India could be said to constitute the agency PE of E-Funds US and E-Funds IT US, the Supreme Court agreed with the view of the High Court that since the Revenue had not raised the argument of agency PE before the Tribunal or the High Court, it could not be raised at the level of the Supreme Court. In any event, it was observed that an agency PE could only be constituted in terms of Article 5(4) of the India – US Tax Treaty. Since the tests under Article 5(4) had not been satisfied with respect to E-Funds India, no agency PE could be said to have been constituted.

4. Mutual Agreement Procedure

In the present case, the competent authorities of India and the US had initiated proceedings under the Mutual Agreement Procedure (“MAP”) article of the India – US Tax Treaty and had entered into an agreement as to attribution of profits between the US entities and E-Funds India. The Revenue contended that the PE issue stood determined owing to certain statements made in the MAP Settlement Agreement to the effect that the US entities had PEs in India. It was argued that these statements should continue to remain applicable to the E-Funds Group as there had been no subsequent change in the factual position of the Group.

On this point, the Court had concluded that MAP proceedings had been initiated on a without prejudice basis and that the existence of a PE was a question of law that needed to be determined purely on merits. Referring to Paragraph 3.6 of the OECD Manual on MAP Procedure, the Supreme Court observed that it was “very clear” that a MAP Settlement Agreement was time and case specific and could not be considered precedent for subsequent years. Thus, statements made in a MAP Settlement Agreement for a previous year could not be used in determining PE status for a subsequent year.

Merely holding a subsidiary in India which provides services to the parent, would not constitute a fixed place PE. A subsidiary would have to conform to the principles required to be considered a PE, and only if they are satisfied, would it be considered as a PE

Pr CIT -vs.- Prem Pal Gandhi (2018) (P&H)

The appreciation in the value of the shares is high does not justify the transactions being treated as fictitious

The assessee purchased shares of a company during the assessment year 2006-2007 at ₹ 11/- and sold the same in the assessment year 2008-2009 at ₹ 400/- per share. The Assessing Officer added the appreciation to the assessee's income on the suspicion that these were fictitious transactions and that the appreciation actually represented the assessee's income from undisclosed sources. The CIT (Appeals) and the Tribunal held that the Assessing Officer had



not produced any evidence whatsoever in support of the suspicion. On the other hand, although the appreciation is very high, the shares were traded on the National Stock Exchange and the payments and receipts were routed through the bank. There was no evidence to indicate for instance that this was a closely held company and that the trading on the National Stock Exchange was manipulated in any manner.

In these circumstances, following the judgement in *The Pr. CIT -vs.- Sh. Hitesh Gandhi*, it has held that there is no substantial question of law in the present appeal.

R.B Shreeram Durgaprasad -vs.- CIT (2016) (Bom.)

Penalty order is illegal and without jurisdiction if it was passed during pendency of assessment proceeding

Certain addition was made to assessee income in reassessment proceedings. The assessee filed appeal before the Tribunal against such addition. The Assessing Officer levied penalty u/s 271(1)(c) upon assessee, while the appeal was pending before the tribunal. On reference, the assessee contended that in terms of section 275(1) (a), penalty proceedings could not have been initiated pending appeal before the Tribunal.

The High Court ruled in favor of the assessee by contending that the language of section 275(1)(a) clearly shows that the order imposing penalty cannot be passed if the appeal against basic order of assessment is pending before the competent superior authority. Here, though 1st appellate authority had disposed of the appeal, further appeal of assessee before the Tribunal was very much pending. The order imposing penalty, therefore, appears to be premature and, therefore, illegal and without jurisdiction. The notices for initiation of those proceedings are during the pendency of appeal before the Tribunal. Essential ingredients of section 275(1) are clearly not in contemplation of notice issuing authority on these dates. The form or language of these notices shows clear nonapplication of mind in this respect. It is obvious that such notices initiating the penalty proceedings could not have been issued before order of the Tribunal.

Triune Energy Services (P) Ltd Vs DCIT (2016) (Delhi)

Where assessee purchased business as going concern, consideration paid in excess of value of tangible assets was classifiable as goodwill eligible for depreciation and, therefore, further exercise to value goodwill was not warranted

The assessee company purchased business of another company as going concern in slump sale. The amount paid over and above net value of assets was capitalized as goodwill. The valuation reports trifurcated value of goodwill into (a) technical knowhow; (b) valuation for business on hand and (c) non-compete fees. The assessee claimed depreciation on above items. The Assessing Officer treated the transaction in nature of succession and did not admit the assessee's claim for depreciation. He also did not accept valuation report. The Commissioner (Appeals) upheld order of the Assessing Officer. The Tribunal held that specific valuation could not be ascribed to any specific intangible asset in absence of specific material. It, therefore, agreed with lower authorities holding that the assessee was not entitled to depreciation on technical knowhow, valuation of business and non-compete fee mentioned in the report. It, however, accepted assessee's alternate contention that entire sum paid towards intangibles could be considered as goodwill on which depreciation must be allowed. It, however, remitted matter to the Assessing Officer to determine whether valuation of goodwill was appropriate. The assessee filed an appeal to High Court.

The High Court held that from an accounting perspective, it is well established that 'goodwill' is an intangible asset, which is required to be accounted for when a purchaser acquires a business as a going concern by paying more than the fair market value of the net tangible asset, that is, assets less liabilities. The difference in the purchase consideration and the net value of assets and liabilities is attributable to the commercial benefit that is acquired by the purchaser. Such goodwill is also commonly understood as the value of the whole undertaking less the sum total of its parts. In view of Accounting Standard 10 as issued by the ICAI the assessee's contention was right that the consideration paid

by the assessee in excess of value of tangible assets was rightly classified as goodwill. In the facts of the present case, the Tribunal has rejected the view that the slump sale agreement was a colourable device. Once having held so, the agreement between the parties must be accepted in its totality. The agreement itself does not provide for splitting up of the intangibles into separate components. Indisputably, the transaction in question is slump sale which does not contemplate separate values to be prescribed to various assets (tangible and intangible) that constitute the business undertaking, which is sold and purchased. The agreement itself indicates that slump sale included sale of goodwill and the balance sheet specifically recorded goodwill at ₹ 40.58 crore. Goodwill includes a host of intangible assets, which a person acquires, on acquiring a business as a going concern and valuing the same at the excess consideration paid over and above the value of net tangible assets is an acceptable accounting practice. Thus, a further exercise to value the goodwill is not warranted. ly the appeal of the assessee was allowed.

Stovekraft India vs. CIT (2017) (Himachal Pradesh)

Substantial expansion cannot be confined to one expansion. As long as requirement of Section 80-IC(8) (ix) is met, there can be number of multiple substantial expansion and correspondingly, there can be more than one initial Assessment year.

Assessee started its business activity/came into operation with effect from 6.1.2005 and treating the Financial Year 2005-2006 (Assessment Year 2006- 2007), as initial assessment year, claimed deduction on profits @ 100% under Section 80-IC of the Income Tax Act, 1961 (hereinafter referred to as the Act). Sometime in the Financial Year 2009-2010, the assessee carried out "substantial expansion" of the "Unit" and by treating the said Financial Year to be the "initial assessment year", further claimed deduction @ 100%, instead of 25%, under Section 80-IC of the Act. The Assessing Officer disallowed the claim, holding the assessee entitled to deductions not @ 100% but on reduced basis @ 25%, as provided under Section 80-IC.

The availability of deduction u/s 80-IC is subject to the fulfilment of certain conditions – such as the nature of business undertaken by the taxpayer, period within which the Undertaking claiming such deduction is set up etc. In relation to Himachal Pradesh, this deduction is available in the following circumstances:

- i. If the Undertaking sets up certain specified businesses within the Time Window (New Business Category)
 - ii. If the Undertaking undertakes 'Substantial Expansion' within the Time Window (Substantial Expansion Category)
- 'Substantial Expansion' has been defined to mean increase in the investment in the plant and machinery by at least 50% of the book value of existing plant and machinery (before taking into consideration the depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken.

The quantum of deduction in both the above categories is 100% for the first five years (Initial Period) and 25% for the next five years (Later Period).

The assessee set up an Undertaking in the state of Himachal Pradesh during the Time Window and thus, claimed the deduction for 100% of profits derived from such Undertaking for the Initial Period on account of falling within the New Business Category. After the expiry of this Initial Period, the quantum of deduction available to the taxpayer would have been reduced to 25% of profits. However, in the last year of this Initial Period, the taxpayer undertook Substantial Expansion and thus, sought to claim the deduction in respect of 100% profits for another period of five years – this time, on account of falling within the Substantial Expansion Category.

Thus, in total, the taxpayer claimed the deduction in respect of 100% profits for 10 years (5 years under the New Business Category and 5 years under the Substantial Expansion Category).

The Assessing Officer and the first appellate authority as well as the second appellate authority held that while the taxpayer can claim the deduction in respect of 100% profits under the New Business Category, the taxpayer was not entitled to claim the deduction under the Substantial Expansion Category. Their reason for denying this benefit was



that this benefit is available only to an Undertaking which is set up prior to the Time Window (i.e. on or after 7 January 2003 but before 1 April 2012) and not to an Undertaking which is set up during this Time Window.

The High Court analyzed the relevant legislative provisions and noticed that section 80-IC of the IT Act does not create distinction between the old units, i.e. the units which stand established prior to 7 January 2003 (the cutoff date), and the new units established thereafter. In view of this, the High Court held that the artificial distinction (between units established prior to 7 January 2003 and units established thereafter) sought to be inserted by the income-tax authorities results in discrimination. Basis this, the High Court reversed the ruling of the ITAT and held that even though the taxpayer was established after 7 January 2003 (the cutoff date), it was entitled to claim deduction in respect of its 100% profits for the second batch of five years even under the Substantial Expansion Category. This was in addition to the deduction in respect of its 100% profits already claimed for five years under the New Business Category. The argument of the income-tax authorities that this would amount to claiming deduction at the rate of 100% for ten years, and not just the first five years of being set up/Substantial Expansion, did not find merit with the High Court. In coming to its conclusion, the High Court also observed that the object, intent and purpose of section 80-IC of the IT Act is only to provide incentive for economic development, industrialisation and enhanced employment opportunities in these states. A provision in a taxing statute granting incentives for promoting growth and development should be construed liberally. Since a provision intended for promoting economic growth has to be interpreted liberally, the restriction on it, too, has to be construed so as to advance the objective of the section and not to frustrate it. It is necessary to resort to a construction which is reasonable and purposive to make the provision meaningful.

Hightension Switchgears Pvt Ltd -vs.- CIT (2016) (Kolkata)

No TDS on transportation charges reimbursed by buyer if seller is liable to pay such charges to GTA

During the year 2006-07, a seller had sold certain goods to the assessee(buyer). Under the contract of sale, the seller was bound to send the goods to the buyer and to pay the transportation charges to the GTA (Goods Transport Agency). It was, however, entitled to recover the transportation charges from the buyer. The assessee reimbursed the freight component to the seller and claimed deduction of the same. The Tribunal held that the assessee was liable to deduct tax at source as per section 194C in respect of freight component. Since the assessee had failed to deduct tax at source in respect thereof, the lower authorities were justified in disallowing the freight component as per section 40(a)(ia). Assessee on further appeal to High Court.

The High Court ruled in favour of the assessee by contending that even assuming that the supplier in transporting the goods to the assessee acted as an agent of the assessee and the assessee has reimbursed the freight charges to the supplier, who in turn has paid to the concerned transporter as held by the Tribunal is conceptually correct, no other conclusion is possible. The agent being the supplier in the instant case has admittedly paid to the transporter and has also deducted tax at source. When the agent has complied with the provision, the principal cannot be visited with penal consequences. For one payment there could not have been two deductions. Moreover, when a person acts through another, in law, he acts himself

ITC Ltd. -vs.- CIT (TDS) (2016) (SC)

Tips collected by hotel from customers and paid to employees couldn't be taxable as salary and hence TDS u/s 192 is not applicable

The assessees are engaged in the business of owning, operating, and managing hotels. Surveys conducted at the business premises of the assessees allegedly revealed that the assessees had been paying tips to its employees but not deducting taxes thereon. The Assessing Officer treated the receipt of the tips as income under the head "salary" in the

hands of the various employees and held that the assessee was liable to deduct tax at source from such payments u/s 192. The assessee was treated by the Assessing Officers as assessee-in-default u/s 201(1). The Assessing Officers in various assessment orders worked out the different amounts of tax to be paid by all the aforesaid assessee u/s 201(1), as also interest. The CIT (Appeals) allowed the various appeals of the assessee holding that the assessee could not be treated as assessee-in-default u/s 201(1) for non-deduction of tax on tips collected by them and distributed to their employees. Appeals filed by the Revenue to the Income Tax Appellate Tribunal (ITAT) came to be dismissed by the Tribunal. Against the said orders of the Tribunal, appeals were preferred by the Revenue to the High Court.

The High Court held, after considering Sections 15, 17 and 192 of the Income Tax Act, that tips would amount to 'profit in addition to salary or wages' and would fall under Section 15(b) read with Section 17(1)(iv) and 17(3)(ii). Even so, the High Court held that when tips are received by employees directly in cash, the employer has no role to play and would therefore be outside the purview of Section 192 of the Act. However, the moment a tip is included and paid by way of a credit card by a customer, since such tip goes into the account of the employer after which it is distributed to the employees, the receipt of such money from the employer would, according to the High Court, amount to "salary" within the extended definition contained in Section 17 of the Act.

The Apex Court held that first and foremost, under sec. 192(1) thereof, "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. In the facts of the present case, the person who is responsible for paying the employee is not the employer at all, but a third person – namely, the customer.

Also, if an employee receives income chargeable under a head other than the head "salaries", then Section 192 does not get attracted at all. Income from tips would be chargeable in the hands of the employees as income from other sources, such tips being received from customers and not from the employer, Section 192 would not get attracted at all on the facts of the present case.

Further, there should be a vested right in an employee to claim any salary from an employer or former employer, whether due or not if paid; or paid or allowed, though not due. There is no vested right in the employee to claim any amount of tip from his employer. Tips being purely voluntary amounts that may or may not be paid by customers for services rendered to them would not, therefore, fall within Section 15(b) at all.

Section 15(b) necessarily has reference to the contract of employment between employer and employee, and salary paid or allowed must therefore have reference to such contract of employment. The amount of tip paid by the employer to the employees has no reference to the contract of employment at all. Tips are received by the employer in a fiduciary capacity as trustee for payments that are received from customers which they disburse to their employees for service rendered to the customer. There is, therefore, no reference to the contract of employment when these amounts are paid by the employer to the employee.

CIT -vs.- Anil Kumar & Co. (2016) (Kar.)

No addition could be made on estimated basis without rejecting books of account of assessee

The assessee was a partnership firm carrying on the business as cotton merchants and commission agents. The assessee filed its return of income for the AY 2006-2007, declaring total income of INR NIL. On such return being selected for scrutiny assessment order came to be framed under section 143(3) after issuing notice and hearing the assessee. The AO noticed that the gross profit declared by the assessee for the earlier assessment years and the present assessment year were at variance and as such the gross profit was adopted at 4 per cent of the total turnover. On appeal, the Commissioner (Appeals) concluded that differential gross profit of Rs.5.99 lakhs was to be sustained as against gross profit of Rs. 32.44 lakhs made by the Assessing Officer. On further appeal, the Tribunal allowed the appeal of the assessee and deleted the addition made by the Commissioner (Appeals) on gross profit. On further, appeal to High Court.



The tribunal has rightly held that when the books of account of the assessee had not been rejected and assessment having not been framed u/s 144, the A.O and the Commissioner (Appeals) were in error in resorting to an estimation of income and such exercise undertaken by them was not sustainable. Section 145(3) lays down that the Assessing Officer can proceed to make assessment to the best of his judgment under section 144 only in the event of not being satisfied with the correctness of the accounts produced by the assessee. In the instant case the Assessing Officer has not rejected the books of account of the assessee. To put it differently the Assessing Officer has not made out a case that conditions laid down in section 145(3) are satisfied for rejection of the books of account. Thus, when the books of account are maintained by the assessee in accordance with the system of accounting, in the regular course of his business, same would form the basis for computation of income. In the instant case it is noticed that neither the Assessing Officer nor the Commissioner (Appeals) have rejected the books of account maintained by the assessee in the course of the business. As such tribunal has rightly rejected or set aside the partial addition made by Assessing Officer for arriving at gross profit and sustained by the Commissioner (Appeals) and rightly held that entire addition made by the Assessing Officer was liable to be deleted. The said finding is based on sound appreciation of facts and it does not give rise for framing substantial question of law.

CIT -vs-. Kotak Securities Ltd (2016) (SC)

Transaction charge paid to BSE isn't 'FTS' as BSE isn't providing customized services to members

By the impugned order dated 21st October, 2011 passed in the aforesaid appeal, the High Court of Bombay has held that the transaction charges paid by a member of the Bombay Stock Exchange to transact business of sale and purchase of shares amounts to payment of a fee for 'technical services' rendered by the Bombay Stock Exchange. Therefore, under the provisions of Section 194J of the Income Tax Act, 1961 (for short "the Act"), on such payments TDS was deductible at source. The said deductions not having been made by the appellant - assessee, the entire amount paid to the Bombay Stock Exchange on account of transaction charges was not deducted in computing the income chargeable under the head "profits and gains of business or profession" of the appellant - assessee for the Assessment Year in question i.e. 2005-2006. This is on account of the provisions of Section 40(a)(ia) of the Act. Notwithstanding the above, the Bombay High Court held that in view of the apparent understanding of both the assessee and the Revenue with regard to the liability to deduct TDS on transaction charges paid to the Bombay Stock Exchange right from the year 1995 i.e. coming into effect of Section 194J till the Assessment Year in question, benefit, in the facts of the case, should be granted to the appellant - assessee and the disallowance made by the Assessing Officer under Section 40(a)(ia) of the Act must be held to be not correct.

The Apex Court ruled in favor of the assessee by contending that "we hold that the view taken by the Bombay High court that the transaction charges paid to the Bombay Stock Exchange by its members are for 'technical services' rendered is not an appropriate view. Such charges, really, are in the nature of payments made for facilities provided by the Stock Exchange. No TDS on such payments would, therefore, be deductible under Section 194J of the Act".

IVRCL-KBL (JV) -va.- ACIT (2016) (Andhra Pradesh)

Credit of TDS won't be denied to a contractor even if entire work has been sub-contracted to others

The assessee was a joint-venture executing civil contract works. It was awarded contracts by the Irrigation Department of the State Government. The assessee gave said contracts subsequently on sub-contract basis to one of its constituents without any margin. The assessee filed its return claiming refund of tax deducted at source from bills paid by the State Government. The assessing authority contended that as no real work was carried on by the assessee, no income had accrued to it and therefore, credit for TDS was not allowable in the hands of the assessee in terms of Rule 37BA (2)(i) of the income tax rules, 1962.

The High Court ruled in favour of the assessee by contending that there are two distinct and independent contracts. There is no privity of contract between the government and the constituent of the assessee i.e. sub-contractor. The rights and obligations under the first contract are only that of the Government and the assessee; and those, in the second contract, are only that of the assessee and the sub-contractor. The contractual obligation, to execute the work for the Government, is that of the assessee joint venture alone, and not that of the constituent member of the JV i.e. the sub-contractor. It is evident, therefore, that the contractual receipts under the first contract is only that of the assessee; and the income, arising out of the said contract, is assessable only in their hands, and not in the hands of the sub-contractor. The High Court set aside the order passed by the AO and directed to determine the quantum of credit for TDS which the assessee is entitled to and refund the amount so computed to assessee in accordance with law

Raja Harpal Singh Inter College -vs.- PCIT (2016) (All.)

Penalty is to be imposed for delay in filing of TDS returns even if there is no loss to revenue

The assessee- College has been deducting tax but had not e-filed TDS statements in time for AY 2008-09 to AY 2012-13. On receiving notice from the department, the assessee college filed the return on 08-02-2013 / 09-02-2013 but no explanations were offered regarding late filing of return. AO, therefore levied penalty u/s 272A(2)(k). On appeal, assessee offered explanation that prior to joining of a regular Principal in college on 25-1-2010, only officiating Principals had been working, who did not have an idea that e-TDS statements were required to be filed. CIT (A) accepting assessee explanation calculated penalty with effect from 1-4-2010 as regular Principal of college assumed charge of office on 25-1-2010. The Tribunal rejected assessee plea.

On further appeal to High Court, the Court upheld the levy of penalty u/s 272A(2)(k) for the assessee's failure to furnish e-TDS quarterly statements within the prescribed time limit for a period of 5 years in spite of the notices issued by the Department. It rejected the contention of the assessee that since TDS was deducted on a timely basis no penalty could be levied for non-filing TDS statements as it did not lead to a loss of revenue and held that the department could not accurately process the returns on whose behalf the tax had been deducted until such information was furnished by the assessee and that the filing of such statements not only increased the reach of the department but also enabled the creation of an audit trail which could be utilized effectively to combat tax evasion.

CIT -vs.- Priya Blue Industries (P) Ltd (2016) (Guj)

Finished products obtained from ship breaking activity are usable as such and hence, are not 'waste and scrap' though commercially known as scrap, thus provision of TCS is not applicable.

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 is liable to collect tax at source from the buyers of scrap. Accordingly, demand u/s 201(1) alongwith interest u/s 201(1A) was raised. The assessee claimed that such items are usable as such, and are hence not 'scrap', thus, provisions relating to collection of tax at source is not applicable.

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". 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.

On further appeal, the High Court concurred with the view of the Tribunal.

CIT -vs.- Society for the promotion of Education, Adventure Sport and Conservation of Environment (2016)(SC)

Non disposal of an application for registration before the expiry of six months as provided u/s 12AA (2) results in deemed grant of registration

In *Society for the Promotion of Education, Adventure Sport & Conservation of Environment vs. Commissioner of Income Tax* (2008) 216 CTR (All) 167, the Allahabad High Court held that non-disposal of an application for registration before the expiry of six months as provided u/s 12AA (2) would result in deemed grant of registration. However, this was reversed by the Full Bench of the Allahabad High Court in *CIT vs. Muzafar Nagar Development Authority* (2015) 372 ITR 209. The appeal filed by the department in the case of *Society for the Promotion of Education* came up before the Supreme Court.

The Supreme Court ruled in favour of the assessee by contending that the short issue is with regard to the deemed registration of an application under Section 12AA of the Income Tax Act. The Apex Court has taken the view that once an application is made under the said provision and in case the same is not responded to within six months, it would be taken that the application is registered under the provision.

Kalpna Shantilal Haria -vs.- ACIT (2017) (Bombay)

Sanction for issuing a reopening notice cannot be mechanical but has to be on due application of mind.

This petition under Article 226 of the Constitution of India challenges notice dated 8th March, 2017 issued u/s 148 of the Income Tax Act, 1961 seeking to reopen the assessment for Assessment Year 2014-15. The impugned notice was issued by the Assistant Commissioner of Income Tax after having obtained necessary sanction from the Joint Commissioner of Income Tax in terms of Section 151(2) of the Act. In its objection, the petitioner objected to the reasons recorded in impugned reopening notice dated 8th March, 2017 and inter alia pointed out that the Joint Commissioner of Income Tax has mechanically granted the sanction without due application of mind. The sanction given by the Joint Commissioner of Income Tax on the application by the Assessing Officer seeking his approval in the prescribed form. The prescribed form filled by the Assessing Officer indicated that the notice has been issued under Section 143(b) of the Act. The Joint Commissioner of Income Tax has while granting the sanction has recorded the word "satisfied". The Assessing Officer rejected the petitioner's objection.

There can be no dispute with regard to the application of Section 292B of the Act to sustain a notice from being declared invalid merely on the ground of mistake in the notice. However, the issue here is not with regard to the mistake / error committed by the Assessing Officer while taking a sanction from the Joint Commissioner of Income Tax but whether there was due application of mind by the Joint Commissioner of Income Tax while giving the necessary sanction for issuing the impugned notice. It is a settled principle of law that sanction granted by the higher Authority for issuing of a reopening notice has to be on due application of mind. It cannot be an mechanical approval without

examining the proposal sent by the Assessing Officer. Prima facie, it appears to us that if the Joint Commissioner of Income Tax would have applied his mind to the application made by the Assessing Officer, then the very first thing which would arise is the basis of the notice, as the provision of law on which it is based is no longer in the statute. Non pointing out the mistake / error by the Joint Commissioner of Income Tax on the part of the Assessing Officer is prima facie evidence of non-application of mind on the part of the sanctioning authority while granting the sanction.

Indus Towers Limited -vs.- DCIT (2017) (Delhi)

Delay in issuing a notice u/s 143(2) would be fatal to the re-assessment proceedings

The Petitioner is the successor to India Cellular Towers Infrastructure Ltd. ('ICTIL'). ICTIL and India Cellular Limited ('ICL') filed a scheme of arrangement ('demerger scheme') under Sec. 391 to 394 of the Companies Act, 1956 on 17th/24th April, 2009 for transfer of the passive infrastructure (PI) assets owned by ICL to ICTIL with effect from 1st January, 2009. On 3rd and 31st August 2009, the High Court of Delhi and High Court of Gujarat, respectively, approved the demerger scheme. ICTIL filed a return of income for the AY 2009-10 on 26th September, 2009. On 29th September, 2009, the demerger scheme became effective upon its submission to the Registrar of Companies. As a result, the PI assets owned by ICL stood transferred to ICTIL with effect from 1st January, 2009.

On February 22, 2013, the AO issued a notice u/s. 148 of the Act to ICTIL for re-opening the assessment for AY 2009-10, which already stood concluded, requiring ICTIL to file its return of income within 30 days of the receipt of the notice. The re-opening was ordered because of the receipt of capital assets by ICTIL on 'nil' consideration from ICL and the demerger approved by the High Court was not compliant with the Act. ICTIL requested that the revised return filed by it on March 31, 2010 u/s. 139(5) of the Act should be considered as the return filed in response to the notice was rejected by the Assessing Officer.

Aggrieved, the assessee preferred an appeal before the Delhi High Court.

It was assessee's contention that belief of Assessing Officer was a mere change of opinion and the proceedings have been initiated on the basis of no material and, therefore, assumption of jurisdiction was plainly unsustainable in law. It was further contended that in terms of the proviso to Sec. 153(1), time limit for completion of AY 2009- 10 was December 31, 2011. In addition, the proviso to Sec. 143(2) requires that notice for assessment should be issued within six months from the end of the financial year in which the return was furnished by an assessee.

The High Court held that law on this point was fairly well settled in the decisions in ACIT -vs.- Hotel Blue Moon [2010] 321 ITR 362 (SC) reiterated in CIT -vs.- Madhya Bharat Energy Corporation [2011] 337 ITR 389 (Del) and Pr. CIT -vs.- Jai Shiv Shankar Traders (P.) Ltd. [2016] 383 ITR 448 (Del)]. In the last mentioned judgment, the division bench had held that the delay in issuing a notice under Sec. 143(2) would be fatal to the reassessment proceedings.

The High Court quashed the impugned notice dated 22nd February, 2013 issued to the Petitioner u/s. 148 as well as the consequential order dated 20th January, 2014 disposing of its objections as well as the reassessment proceedings pursuant thereto.

CIT -vs.- Henkel Spic India Ltd (2015)(SC)

Interest on share application is not taxable in pre allotment period

Assessee opened a public issue of shares on January 29, 1992 and the date of closure of this issue was February 3, 1992. Proceeds which were received from the applicants to the share capital were deposited in the Bank by the assessee for 46 days as per the requirement under law. The shares were allotted in June, 1992 and those applicants



who were not allotted the shares, their application money was refunded along with interest. The assessee earned interest on the above application amount deposited in bank. The assessing officer wants to tax the aforesaid interest income in AY 1992-1993 as the money was received between 29.01.1992 and 03.02.1992 and the interest earned thereupon in the said financial year.

The High Court ruled in favour of the assessee by contending that as per section 73 of the Companies Act assessee was required to keep the application money in a separate Bank account in a trust and that "No part of this fund, either principal or interest accrued thereon, can be utilized by the company until the allotment process is completed". HC had thus accepted assessee's stand that interest accrued to assessee only on allotment of shares since before that amount was kept in trust belonging to the applicants and therefore this income accrued only in AY 1993-1994.

On further appeal, the Apex Court concurred with the view of the High Court.

CIT -vs.- M/s Thyssen Krupp Industries Private Ltd (2015)(Bom)

An Adjustment with respect to transfer pricing has to be confined to transactions with Associated Enterprises and cannot be made with respect to transactions with unrelated third parties

The assessee is in the business of execution of turnkey contracts involving design, manufacture, supply, erection and commissioning of sugar plants, cement plants, etc. During the subject Assessment Year, the assessee entered into international transactions with its Associated Enterprises (AE), as well as transactions with independent parties. The TPO proposed an addition on account of enhancement of profit margin on all transactions of the assessee. Aggrieved by the order, assessee filed an appeal with ITAT. The tribunal held that only transactions entered into by an assessee with its AE are subject to transfer pricing adjustment and not otherwise. Thus, allowing the assessee's appeal before it. Aggrieved by the order, the revenue filed an appeal with High Court.

The High Court dismisses revenue appeal by contending that as per Chapter X of the Act, redetermination of the consideration is to be done only with regard to income arising from International Transactions on determination of ALP. The adjustment which is mandated is only in respect of International Transaction and not transactions entered into by assessee with independent unrelated third parties, therefore this adjustment is beyond the scope and ambit of Chapter X of the Act.

Berger Paints India Ltd. -vs.- CIT (2017) (SC)

Securities premium shall not be considered as a part of the capital employed for the purpose of sec. 35D.

The appellant is a Limited Company engaged in the business of manufacture and sale of various kinds of paints. A notice was issued by the A.O. to the appellant (assessee) under Section 143(2) of the Act which called upon the appellant to explain as to on what basis the appellant had claimed in the return a deduction under the head "preliminary expenses" amounting to Rs.7,03,306/- being 2.5% of the "capital employed in the business of the company" under Section 35D of the Act. The appellant (assessee) replied to the notice. The appellant (assessee) contended therein that it had issued shares on a premium which, according to them, was a part of the capital employed in their business. The appellant, therefore, contended that it was on this basis, it claimed the said deduction and was, therefore, entitled to claim the same under Section 35D of the Act. The A.O. did not agree with the explanation given by the appellant. He was of the view that the expression "capital employed in the business of the company" did not include the "premium amount" received by the appellant on share capital. The Commissioner (Appeals) has deleted the addition. However, the Tribunal reversed the view taken by the Commissioner (Appeals). The High Court concurred with the Tribunal.

The Apex Court observed that if the intention of the Legislature were to treat the amount of "premium" collected by the Company from its shareholders while issuing the shares to be the part of "capital employed in the business of the company", then it would have been specifically said so in the Explanation (b) of sub-section (3) of Section 35D of the Act. It was, however, not said. Non-mentioning of the words does indicate the legislative intent that the Legislature did not intend to extend the benefit of Section 35D to such sum.

The company's accounts do not show the reserve and surplus as a part of its issued, subscribed and paid up capital. It is taken as part of share holders fund but the same was not a part of the issued, subscribed and paid up capital of the Company

Similarly, Companies Act which deals with the "issue of shares at premium and discount" requires a company to transfer the amount so collected as premium from the shareholders and keep the same in a separate account called "securities premium account". It does not anywhere says that such amount be treated as part of capital of the company employed in the business for one or other purpose.

Thus, securities premium shall not be considered as a part of the capital employed for the purpose of sec. 35D.

National Travel Services -vs.- CIT (2018) (SC)

Section 2(22)(e) gets attracted inasmuch as a loan has been made to a shareholder, who is the beneficial owner of shares holding not less than 10% of the voting power in the Company.

A reading of the amended definition would indicate that, after 31.05.1987, a "shareholder" is now a person who is the beneficial owner of shares holding not less than 10% of the voting power of the Company. After amendment of year 1988 carried out in section 2(22)(e), in order to invoke provisions of said section, 'shareholder' has only to be a person who is beneficial owner of shares.

One cannot be a registered owner and beneficial owner in the sense of a beneficiary of a trust or otherwise at the same time. It is clear therefore that the moment there is a shareholder, who need not necessarily be a member of the Company on its register, who is the beneficial owner of shares, the Section gets attracted without more. To state, therefore, that two conditions have to be satisfied, namely, that the shareholder must first be a registered shareholder and thereafter, also be a beneficial owner is not only mutually contradictory but is plainly incorrect.

Also, what is important is the addition, by way of amendment, of such beneficial owner holding not less than 10% of voting power. This is another indicator that the amendment speaks only of a beneficial shareholder who can compel the registered owner to vote in a particular way.

PCIT -vs.- Tejua Rohitkumar Kapadia (2018) (SC)

Purchases cannot be treated as bogus u/s 69 if

- a. they are duly supported by bills;
- b. all payments are made by account payee cheques;
- c. the supplier has confirmed the transactions;
- d. there is no evidence to show that the purchase consideration has come back to the assessee in cash;
- e. the sales out of purchases have been accepted; and
- f. the supplier has accounted for the purchases made by the assessee and paid taxes thereon

**CIT -vs.- Mahindra and Mahindra Ltd (2018) (SC)**

The company, way back, decided to expand its jeep product line by including FC-150 and FC-170 models. For this purpose, on 18.06.1964, it entered into an agreement with Kaiser Jeep Corporation (for short 'the KJC') based in America wherein KJC agreed to sell the dies, welding equipments and die models to the assessee. The final price of the tooling and other equipments was agreed at \$6,50,000/- including cost, insurance and freight (CIF). Meanwhile, the Respondent took all the requisite approvals from the concerned Government Departments. The said toolings and other equipments were supplied by the Kaiser Jeep Corporation through its subsidiary Kaiser Jeep International Corporation (KJIC).

However, for the procurement of the said toolings and other equipments, the KJC agreed to provide loan to the Respondent at the rate of 6% interest repayable after 10 years in installments. For this purpose, the Respondent addressed a letter dated 07.06.1965 to the Reserve Bank of India (RBI) for the approval of the said loan agreement. The RBI and the concerned Ministry approved the said loan agreement.

Later on, it was informed to the Respondent that the American Motor Corporation (AMC) had taken over the KJC and also agreed to waive the principal amount of loan advanced by the KJC to the Respondent and to cancel the promissory notes as and when they got matured.

The ITO concluded that with the waiver of the loan amount, the credit represented income and not a liability. Accordingly, the ITO held that the sum of Rs 57,74,064/- was taxable u/s 28.

It was contended that since an amount is waived off, for which the company is claiming exemption, it actually amounts to income at the hands of the assessee in the sense that an amount which ought to be paid by it is now not required to be paid. As a result, the case of the Revenue falls within the ambit of sec. 28(iv) and, alternatively within sec. 41.

The term "loan" generally refers to borrowing something, especially a sum of cash that is to be paid back along with the interest decided mutually by the parties. In other terms, the debtor is under a liability to pay back the principal amount along with the agreed rate of interest within a stipulated time. It is a well-settled principle that creditor or his successor may exercise their "Right of Waiver" unilaterally to absolve the debtor from his liability to repay. After such exercise, the debtor is deemed to be absolved from the liability of repayment of loan subject to the conditions of waiver. The waiver may be a partly waiver i.e., waiver of part of the principal or interest repayable, or a complete waiver of both the loan as well as interest amounts. Hence, waiver of loan by the creditor results in the debtor having extra cash in his hand. It is receipt in the hands of the debtor/assessee.

On a plain reading of sec. 28 (iv), prima facie, it appears that for the applicability of the said provision, the income which can be taxed shall arise from the business or profession. Also, in order to invoke the provision of sec. 28(iv), the benefit which is received has to be in some other form rather than in the shape of money. In the present case, it is a matter of record that the amount of ₹ 57,74,064/- is having received as cash receipt due to the waiver of loan. Therefore, the very first condition of sec. 28(iv) is not satisfied in the present case.

On a perusal of sec.41(1), it is evident that it is a sine qua non that there should be an allowance or deduction claimed by the assessee in any assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee. Then, subsequently, during any previous year, if the creditor remits or waives any such liability, then the assessee is liable to pay tax under Section 41 of the IT Act. The objective behind this Section is simple. It is made to ensure that the assessee does not get away with a double benefit once by way of deduction and another by not being taxed on the benefit received by him in the later year with reference to deduction allowed earlier in case of remission of such liability.

There is difference between 'trading liability' and 'other liability'. Section 41 (1) of the IT Act particularly deals with the remission of trading liability. Whereas in the instant case, waiver of loan amounts to cessation of liability other than trading liability. Hence, such waiver of loan is not taxable in hands of the respondent.

UOI -vs.- Tata Tea Co. Ltd (2017) (SC)***Dividend distribution tax u/s 115-O be levied in respect of the dividend declared out of agricultural income.***

As per entry 82 of List I the Union Parliament has the competence to tax 'income other than agricultural income'. Sec. 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. 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.

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 and not on 40% of dividend declared or distributed.

ITO -vs.- TechSpan India Private Ltd (2018) (SC)***Change of opinion in case of reassessment***

In order to constitute "change in opinion", the assessment earlier made must either expressly or by necessary implication have expressed an opinion on the subject matter of reopening. If the assessment order is non-speaking, cryptic or perfunctory in nature, it may be difficult to attribute to the AO any opinion on the questions that are raised in the proposed re-assessment proceedings. The reassessment cannot be struck down as being based on "change of opinion" if the assessment order does not address itself to the aspect sought to be examined in the re-assessment proceedings.

CIT -vs.- S. V. Gopala Rao (2017) (SC)

The Central Board of Direct Taxes (CBDT) issued a Circular u/s 119 of the Income Tax Act, 1961. In fact, it amended the provisions contained in Rule 68B of the IInd Schedule to the Income Tax Act, 1961, which otherwise have statutory force. Such legislative provisions cannot be amended by CBDT in exercise of its power under Section 119 of the Act. The High Court has, therefore, rightly held the circular ultra virus and quashed the same.

CIT -vs.- Vasisth Chay Vyapar Limited (2018) (SC)***In case of NBFCs, income from NPAs would be taxable on receipt basis***

The assessee, an NBFC, had advanced certain Inter-Corporate Deposits (ICD) to another company. As no interest could be received on such deposits for more than six months, in terms of directions given by the Reserve Bank of India (RBI), the taxpayer treated the said ICDs as NPA and did not offer interest income on ICDs.

However, the tax officer imputed interest on said ICDs to income of the assessee by applying mercantile system of accounting. The tax officer contended that RBI directives could not override the provisions of the Act.

The CIT(A) affirmed the order of the tax officer. On further appeal, the Income Tax Appellate Tribunal (ITAT) held in favour of the taxpayer and deleted the addition made by the AO.

The Delhi HC held in favour of the assessee that income in the hands of NBFCs is to be recognised as per the RBI prudential norms regardless of the fact even if they deviate from the mercantile system of accounting. The Hon'ble SC confirmed the order of Delhi HC and accordingly, rejected Revenue's appeal against the order of the Delhi HC.

**Honda Siel Cars India Ltd. -vs.- CIT (2017) (SC)**

Technical fee paid under a technical collaboration agreement for setting up a joint venture company in India is to be treated as capital expenditure, if upon termination of the agreement, the joint venture would come to an end

The assessee, Honda Siel Cars India Ltd., is a joint venture company between Honda Motors, a Japanese company and Siel Ltd., an Indian company. The assessee and Honda Motors entered into a technical collaboration agreement (TCA) on May 21, 1996 under which a technical fee of 30.5 million USD was payable by the assessee in five equal instalments on a yearly basis. Under the TCA, Honda Motors had to provide manufacturing facilities, know-how, technical information, information regarding intellectual property rights to the assessee which the assessee was entitled to exploit only as a licensee, without any proprietary rights. The assessee treated the technical fees as revenue while the Revenue authorities contended that it is capital in nature.

The Apex Court held that, in this case, technical fee is capital in nature since upon termination of TCA, the joint venture itself would come to an end. It is further held that if limited rights to use technical know-how is obtained for a limited period for improvising the existing business, the expenditure is revenue in nature. However, if technical know-how is obtained for setting up a new business, the know-how is a capital expenditure.

Director, Prasar Bharati -vs.- CIT (2018) (SC)

Payment made by the Prasar Bharati Doordarshan Kendra to various accredited advertising agencies to secure more business was in the nature of commission liable to TDS u/s 194H

The appellant, 'Prasar Bharati Doordarshan Kendra', was functioning under the Ministry of Information and Broadcasting of Government of India. In the course of business activities which included running of TV channels, the appellant had been regularly telecasting advertisements of several advertising agencies.

With a view to have better regulation of the practice of advertising, the appellant entered into an agreement with various advertising agencies. As per the agreement, in order to receive the status of 'accredited' agencies, the said agencies had to make an application to the appellant and in return they were allowed to telecast advertisement of several consumer products manufactured by several companies on the appellant's TV channel. One of the stipulations in the said agreement was that the appellant would pay commission of 15% to the agency which the agency was allowed to retain from the revenue generated from the telecasting of advertisements.

The AO held that since the payments made by the appellant to the agencies were in the nature of commission, the provisions of sec. 194H were attracted and the appellant defaulted in not deducting the TDS on such payments.

On further appeal before the Apex Court, it was argued by the appellant that the relationship between appellant and the accredited agencies was not that of principal and agent and it was rather in the nature of principal-to-principal. It was further argued that in terms of agreement, the agencies purchased the air time from the appellant and sold it in the market to their customers after retaining 15% commission given to them by the appellant and therefore, the transaction cannot be regarded as being in between principal and agent.

The Apex Court considered the agreements entered into by the appellant with the accredited agencies and discussed the provisions of sec. 194H of the Act and held that the provisions of sec. 194H are applicable to the appellant because the payments made by the appellant pursuant to the agreement in question were in the nature of payment made by way of "commission" and, therefore, the appellant was under statutory obligation to deduct the income tax at the time of credit or/and payment to the payee.

The conclusion of the High Court is clear from the undisputed facts emerging from the record of the case because

the agreement itself has used the expression "commission" in all relevant clauses; Second, there is no ambiguity in any clause and no complaint was made to this effect by the appellant; Third, the terms of the agreement indicate that both the parties intended that the amount paid by the appellant to the agencies should be paid by way of "commission" and it was for this reason, the parties used the expression "commission" in the agreement; Fourth, keeping in view the tenure and the nature of transaction, it is clear that the appellant was paying 15% to the agencies by way of "commission" but not under any other head; Fifth, the transaction in question did not show that the relationship between the appellant and the accredited agencies was principal to principal rather it was principal and Agent; Sixth, it was also clear that payment of 15% was being made by the appellant to the agencies after collecting money from them and it was for securing more advertisements for them and to earn more business from the advertisement agencies; Seventh, there was a clause in the agreement that the tax shall be deducted at source on payment of trade discount; and lastly, the definition of expression "commission" in the Explanation appended to Sec. 194H being an inclusive definition giving wide meaning to the expression "commission", the transaction in question did fall under the definition of expression "commission" for the purpose of attracting rigor of Sec. 194H of the Act.

Once it is held that the provisions of Sec. 194H apply to the transactions, it is obligatory upon the appellant to have deducted the income tax while making payment to the advertisement agencies. The non-compliance of sec. 194H by the assessee attracts the rigor of sec. 201 which provides for consequences of failure to deduct or pay the tax as provided u/s 194H of the Act.

The appellant had relied on the decision of the Allahabad High Court in the case of Jagran Prakashan Ltd. -vs.- DCIT (TDS) (2012) 345 ITR 288, which was distinguished by the Apex Court on the fact that in the case of Jagran Prakashan Ltd. the parties did not have any agreement like the one in the present case. Accordingly, the appellant's case was dismissed.

Tooltech Global Engineering P. Ltd. vs. ACIT (2015) (Bom)

Chapter X of the Act, is an anti-avoidance measure and not an anti-evasion measure. The object of the Transfer Pricing Officer is to put a stop to capital erosion and transfer of profits from one taxable territory to another taxable territory.

The assessee had granted certain loans to its associated enterprises (AE) on which no interest was charged. The AO was of the opinion that the granting of loans to AE is an international transaction. After so holding the AO worked out interest income thereon to determine the Arm's Length Price. The said order was affirmed by the Tribunal. The assessee challenged the said order in appeal before the Hon'ble High Court.

The primary contention of the assessee before the Hon'ble High Court was that by virtue of reworking interest on loans granted to AE the AO / Department has sought to tax notional or hypothetical income and not real income and as per the provisions of the Income-tax Act, 1961 only real income could have been taxed and therefore the addition as regards notional interest income was not sustainable.

The Hon'ble High Court dismissed the appeal holding that, Chapter X of the Act, is an anti-avoidance measure and not an anti-evasion measure. It is not premised on the basis that the transactions entered into between the parties suffers from under/over invoicing. The value of the transactions is brought in line with the consideration which would pass between two independent parties i.e. non-related / non-associated enterprises, by legislative mandate. It was further held that the Legislature has introduced special provisions in respect of International Transactions to bring the income to tax having regard to Arm's Length Price (ALP). In such case, the parties are obliged to establish the ALP of the International Transactions entered into between the two AE to bring to tax the real income i.e. the correct price of the transactions, shorn of, the price arrived at on account of relationship. It means the real income on application of a new measure. The object of the Transfer Pricing Officer is to put a stop to capital erosion and transfer of profits from one taxable territory to another taxable territory.



Renault Nissan Automotive India Private Ltd. -vs.- DRP & Others (2018) (Madras)

Cryptic order passed/ directions issued by the DRP without application of mind, simply accepting the TPO's order, without independent reasoning and findings, is liable to be set aside.

The TPO rejected the overseas tested party approach adopted by the assessee and the economic adjustments claimed by the assessee and proposed TP adjustment. The assessee-filed objection before the DRP against the draft assessment order incorporating the adjustment made by the TPO. The DRP issued directions to the AO, which in effect, accepted the conclusion arrived by the TPO in toto.

The assessee filed the writ petition before the High Court against the said directions of the DRP primarily contending that the DRP had passed the order in total non-application of mind to the objections raised by the assessee. It contended that the DRP was not justified in rejecting the objections and confirming the TPO's order simply by stating that it was in agreement with the findings rendered by the TPO without any detailed discussions and independent findings on each issue.

The Court held that perusal of the DRP's order clearly indicated that apart from extracting objections raised by the Petitioner and the relevant portion of the TPO's order dealing with such objection, the DRP had not further discussed anything on the said objection in detail as to how the objections raised by the assessee could not be sustained or as to how the findings rendered by the TPO on such issue had to be accepted.

Noting that sec. 144C(5) r.w.s. 144C(6) contemplates that DRP shall issue directions only after inter alia considering objections raised by the assessee, evidences filed by assessee etc., the Court held that issuance of such directions could not be made mechanically or as an empty formality. It held that, on the other hand, the DRP had to issue directions only after considering the above stated materials and such consideration must be apparent on the face of the order.

It thus held that, in absence of independent reasoning and finding, the DRP had passed a cryptic order without application of mind.

Accordingly, it set aside the DRP's order and directed it to pass a fresh order after considering the objections raised by the assessee in detail and giving independent reasons and findings.



Objective Question Bank

(Syllabus - 2016)



STUDY NOTE : 19

MULTIPLE CHOICE QUESTIONS



Choose the correct alternative

1. Every person, being a company, has to file its return of income only if it has any positive income or if it wants to carry forward the loss (if any).
- a. True
 - b. False**

Reason:

Every person, being a company and firm, has to file its return of income compulsorily, irrespective of its income being profit or loss. Thus, the statement given in the question is false

2. The Chief Executive Officer of every political party has to file the return of income of the party if the total income of the party without giving effect to the provisions of section _____ exceeds the maximum amount not chargeable to income-tax.
- a. 11
 - b. 12
 - c. 13
 - d. 13A**

Reason:

As per sec. 139(4B), the Chief Executive Officer of every political party has to file the return of income of the party if the total income of the party without giving effect to the provisions of sec. 13A exceeds the maximum amount not chargeable to income-tax.

3. What is the due date of filing the return of income in case of a company who is required to furnish a report in Form No. 3CEB under section 92E?
- a. September 30 of the assessment year
 - b. November 30 of the assessment the year**
 - c. July 31 of the assessment year
 - d. June 30 of relevant assessment the year

Reason:

As per explanation 2 to sec. 139(1), the due date of filing the return in case of a company who is required to furnish a report in Form No. 3CEB u/s 92E is November 30 of the assessment year.

4. One of the following, can be carried forward even return of income is filed after due date:
- a. Unabsorbed Depreciation**
 - b. Business Loss



- c. Short term capital loss
- d. Long term capital loss

Reason:

Unabsorbed depreciation can be carried forward even if the return of loss is submitted after the due date, as it is not covered under Chapter VI of set off or carry forward of losses but covered u/s 32(2).

5. Return filed under following sections can be revised u/s 139(5)

- a. 139(1)
- b. 139(4)
- c. 139(5)
- d. All of the above

Reason:

If an assessee discovers any omission or wrong statement (bonafide in nature) in the return filed u/s 139(1) or 139(4), he can revise his return u/s 139(5) within specified time. Further, a revised return can again be revised within specified time.

6. Assessment under following section is termed as scrutiny assessment

- a. 143(3)
- b. 144
- c. Both of the above
- d. None of the above

Reason:

Assessment u/s 144 is termed as "Best Judgment Assessment". Assessment u/s 143(3) is termed as 'Scrutiny Assessment'

7. Which of the following can be corrected while processing the return of income under section 143(1)?

- a. any arithmetical error in the return
- b. any error in the return of income
- c. any mistake in the return of income
- d. any claim by the taxpayer which is against law

Reason:

Processing of the return u/s 143(1) is like preliminary checking of the return of income. At this stage no detailed scrutiny of the return of income is carried out. The total income or loss is computed after making the basic adjustments (if any), like (i) any arithmetical error in the return; or (ii) an incorrect claim, if such incorrect claim is apparent from any information in the return.

8. Intimation u/s 143(1) can be sent within a period of ____ year from the end of the financial year in which the return of income is filed

- a. 1
- b. 2

- c. 3
- d. 4

Reason:

No intimation shall be **sent** after the expiry of 1 year from the end of the financial year in which the return is made. The period of limitation will run from the date of filing of latest revised return.

9. **Notice u/s 143(2) (i.e. notice of scrutiny assessment) should be served within a period of _____ from the end of the financial year in which the return is filed.**
- a. **6 months**
 - b. 12 months
 - c. 24 months
 - d. 18 months

Reason:

To carry out assessment u/s 143(3), the Assessing Officer should serve a notice u/s 143(2). Notice u/s 143(2) should be served within a period of 6 months from the end of the financial year in which the return is filed.

10. **The objective of carrying out assessment u/s 147 is to bring under the tax net _____**
- a. Any money, bullion, jewellery, valuable article, etc. which are undisclosed
 - b. **Any income which has escaped assessment**
 - c. Any of the above
 - d. Both of the above

Reason:

The objective of carrying out assessment or reassessment or recomputation u/s 147 is to bring under the tax net any income which has escaped assessment. Sec. 147 is also known as Income Escaping Assessment.

11. **As per section 115JB, every taxpayer being a company is liable to pay MAT, if the Income tax payable on the total income, computed as per the provisions of the Income-tax Act in respect of any year is less than _____**
- a. 15.50%
 - b. 18.00%
 - c. **18.50%**
 - d. 20.00%

Reason:

As per sec. 115JB, every taxpayer being a company is liable to pay MAT, if the Income-tax payable on the total income, computed as per the provisions of the Income-tax Act in respect of any year is less than 18.50% of its bookprofit.

12. **MAT shall not apply to any income accruing or arising to a company from**
- a. **Life insurance business**
 - b. Banking business
 - c. Business of transmission of electricity



- d. All of the above

Reason:

The provision of section 115JB is not applicable to any income accruing or arising to a company from life insurance business referred to in sec. 115B

- 13. Book profit for the purposes of section 115JB means net profit as shown in the Statement of the Profit and Loss prepared in accordance with _____ of the Companies Act as increased and decreased by certain items prescribed in this regard.**

- a. Schedule V
- b. Schedule IV
- c. Schedule III**
- d. Schedule II

Reason:

As per Explanation 1 to sec. 115JB(2), "book profit" for the purposes of section 115JB means net profit as shown in the Statement of the Profit and Loss prepared in accordance with Schedule III of the Companies Act as increased and decreased by certain items prescribed in this regard.

- 14. In case of non-corporate taxpayer, AMT is levied @ _____% of adjusted total income.**

- a. 18.50%**
- b. 20.00%
- c. 18.00%
- d. 15.00%

Reason:

In case of non-corporate taxpayer, AMT is levied @ 18.5% of adjusted total income.

- 15. Every non-corporate taxpayer to whom the provisions of AMT apply is required to obtain a report from a chartered accountant in Form No. _____ on or before the due date of filing the return of income**

- a. 29
- b. 29A
- c. 29B
- d. 29C**

Reason:

Every non-corporate taxpayer to whom the provisions of AMT apply is required to obtain a report from a chartered accountant in Form No. 29C on or before the due date of filing the return of income

- 16. Every company to whom the provisions of MAT apply is required to obtain a report from a chartered accountant in Form No. _____ on or before the due date of filing the return of income**

- a. 29
- b. 29A
- c. 29B**

d. 29C

Reason:

Every company to whom the provisions of MAT apply is required to obtain a report from a chartered accountant in Form No. 29B on or before the due date of filing the return of income

17. While computing book profit u/s 115JB, one of the following is required to be reduced from the net profit

- a. Unabsorbed Depreciation as per books of account
- b. Brought forward business loss as per books of account
- c. Brought forward loss or unabsorbed depreciation, whichever is less as per books of account**
- d. Income-tax paid or payable if not already debited to the Statement of Profit and Loss

Reason:

Brought forward loss or unabsorbed depreciation, whichever is less as per books of account is required to be reduced from the net profit while computing book profit u/s 115JB

18. While computing adjusted total income u/s 115JC, total income is required to be increased, among others, by one of the following:

- a. Deduction under chapter VIA
- b. Deduction claimed u/s 80P
- c. Deduction claimed u/s 80H to sec. 80RRB
- d. Deduction claimed u/s 80H to sec. 80RRB (other than sec. 80P)**

Reason:

For the purpose of computing adjusted total income u/s 115JC, total income shall be increased by the amount claimed as deduction u/s 80H to sec. 80RRB (other than sec. 80P), u/s 35AD (less depreciation u/s 32) and u/s 10AA.

19. MAT Credit can be carried forward and set off for

- a. 10 years
- b. 15 years**
- c. 5 years
- d. Not available for carried forward

Reason:

The amount of tax credit shall be carried forward and set off but such carry forward shall not be allowed beyond the 15th assessment year immediately succeeding the assessment year in which tax credit becomes allowable.

20. Generally, a domestic company is taxable @ 30%, however in one circumstances, it is taxable @ 25%

- a. Where its total turnover or gross receipts during the previous year 2016-17 does not exceed ₹ 250 crore**
- b. Where its total turnover or gross receipts during the previous year 2015-16 does not exceed ₹ 50 crore
- c. Where its total turnover or gross receipts during the previous year 2014-15 does not exceed ₹ 250 crore
- d. None of the above



Reason:

Where total turnover or gross receipts of the company during the previous year 2016-17 does not exceed ₹ 250 crore, the company is taxable @ 25%.

21. As per section 178(3), the _____ of a company has to intimate the tax authority before he parts with any of the assets of the company or the properties in his hands and has to set aside the amount if any intimated to him by the tax authorities.
- a. Managing Director
 - b. Manager
 - c. Chartered Accountant
 - d. Liquidator

Reason:

As per section 178(3), the liquidator of a company has to intimate the tax authority before he parts with any of the assets of the company or the properties in his hands and has to set aside the amount if any intimated to him by the tax authorities

22. Prosecution can be launched and the taxpayer can be punished if he commits wilful failure to produce before the tax authorities the accounts and documents as demanded under section _____.
- a. 154
 - b. 147
 - c. 143(1)
 - d. 142(1)

Reason:

Section 142(1) deals with the general provisions relating to an inquiry before assessment. U/s 142(1), the Assessing Officer can issue notice asking the taxpayer to file the return of income, if he has not filed the return of income or to produce or cause to be produced such accounts or documents as he may require and to furnish in writing and verified in the prescribed manner information in such form and on such points or matters (including a statement of all assets and liabilities of the taxpayer, whether included in the accounts or not) as he may require. Sec. 276D provides for prosecution in the case of wilful failure by the taxpayer to produce accounts and documents under section 142(1)

23. As per section _____, the tax authorities can direct the taxpayer to get his accounts audited from a Chartered Accountant nominated by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.
- a. 153A
 - b. 148
 - c. 142(2A)
 - d. 44AB

Reason:

As per sec. 142(2A), the Assessing Officer may direct the taxpayer to get his accounts audited or re-audited from a chartered accountant as nominated by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner and to furnish a report of such audit in the prescribed form.

24. Any mistake which is apparent from the record in any order passed by the Assessing Officer can be rectified under section _____.

- a. 154
- b. 147
- c. 143
- d. 254

Reason:

Any mistake which is apparent from the record in an order passed by the Assessing Officer can be rectified u/s 154.

25. No order of rectification can be passed after the expiry of _____ from the end of the financial year in which order sought to be rectified was passed

- a. 2
- b. 3
- c. 4
- d. 6

Reason:

No order of rectification can be passed after the expiry of 4 years from the end of the financial year in which order sought to be rectified was passed. The period of 4 years is from the date of order sought to be rectified and not 4 years from the date of original order. Hence, if an order is revised, set aside, etc., then the period of 4 years will be counted from the date of such fresh order and not from the original order.

26. In case of an application made by the assessee u/s 154, the income-tax authority shall rectify the order/refuse the rectification within _____ from the end of the month in which the application is received by the authority.

- a. 4 years
- b. 2 years
- c. 1 year
- d. 6 months

Reason:

In case of an application made by the assessee u/s 154, the income-tax authority shall rectify the order/refuse to do so within 6 months from the end of the month in which the application is received by the authority.

27. If a person fails to comply with the provisions relating to PAN (i.e. obtaining PAN, quoting PAN, etc.), then penalty can be levied under section _____

- a. 270A
- b. 272
- c. 272A
- d. 272B

Reason:

Section 272B provides for penalty of ₹ 10,000 in case of default by the taxpayer in complying with the provisions relating to PAN, i.e., not obtaining PAN, even though he is liable to obtain PAN or knowingly quoting incorrect PAN



in any prescribed document in which PAN is to be quoted or intimating incorrect PAN to the person deducting tax or person collecting tax.

28. MAT stands for _____

- a. Minimum Alternate Tax**
- b. Minimum Allowed Tax
- c. Minimum Applicable Tax
- d. Minimum Adjustable Tax

Reason:

MAT stands for Minimum Alternate Tax and AMT stands for Alternate Minimum Tax. Initially the concept of MAT was introduced for companies and progressively it has been made applicable to all other taxpayers in the form of AMT.

29. A foreign company in which the Indian company holds _____ in nominal value of the equity share capital will be treated as foreign specified company for the purpose of section 115BBD of the Act.

- a. 25% or more
- b. 26% or more**
- c. 50% or more
- d. 51% or more

Reason:

A foreign company in which the Indian company holds 26% or more in nominal value of the equity share capital will be treated as foreign specified company for the purpose of section 115BBD of the Act

30. Dividend received from foreign company will be included in the total income of the tax payer and will be charged to tax at _____.

- a. 15%
- b. 20%
- c. 30%
- d. Normal rate of tax applicable to the assessee**

Reason:

Dividend received from foreign company will be included in the total income of the tax payer and will be charged to tax at the rates applicable to the taxpayer. However, dividend from specified foreign company being defined u/s 115BBD is taxable @ 15%

31. An appeal to the Commissioner of Income-tax (Appeals) shall be filed in Form No. _____.

- a. 35**
- b. 36
- c. 34C
- d. 35B

Reason:

An appeal to the Commissioner of Income-tax (Appeals) shall be filed in Form No. 35.

32. Section _____ specifies the orders against which an appeal can be filed before the Commissioner of Income-tax (Appeals).

- a. 246A**
- b. 260A
- c. 253
- d. 261

Reason:

Section 246A specifies the orders against which an appeal can be filed before the Commissioner of Income-tax (Appeals).

33. The Commissioner of Income-tax (Appeals) is the _____ appellate authority

- a. First**
- b. Second
- c. Third
- d. Fourth

Reason:

The Commissioner of Income-tax (Appeals) is the first appellate authority

34. As per section 211(1), payment of advance tax made on or before _____ shall be treated as advance tax paid during the financial year.

- a. 30th September
- b. 30th June
- c. 31st December
- d. 31st March**

Reason:

As per section 211(1), payment of advance tax made on or before 31st March shall be treated as advance tax paid during financial year

35. As per section 142A, a Valuation Officer should send a report to the Assessing Officer within _____ from the end of the month in which a reference is made by the Assessing Officer under section 142A.

- a. 12 months
- b. 6 months**
- c. 1 months
- d. 2 months

Reason:

As per section 142A(6), a Valuation Officer should send a report to the Assessing Officer within 6 months from the end of the month in which a reference is made by the Assessing Officer under section 142A(1).



36. As per section 115QA(3), tax to credit of Government in case of distributed income of domestic company for buy-back of shares shall be deposited within _____ days from date of payment of any consideration to the shareholder on buy-back of shares.

- a. 7 days
- b. 14 days**
- c. 10 days
- d. 30 days

Reason:

As per section 115QA(3), tax to credit of Government in case of distributed income of domestic company for buy-back of shares shall be deposited within 14 days from date of payment of any consideration to the shareholder on buy-back of shares

37. Under section 12AA, an order of granting or refusing registration of trust shall be passed within _____ from the end of the month in which application u/s 12A(1)(aa) is received

- a. 6 months**
- b. 12 months
- c. 2 months
- d. 24 months

Reason:

U/s 12AA, an order of granting or refusing registration of trust shall be passed within 6 months from the end of the month in which application u/s 12A(1)(aa) is received

38. An application (in quadruplicate) for advance ruling by a resident applicant for determination of his tax liability arising out of one or more transactions valuing Rs.100 crore or more in total which has been undertaken or is proposed to be undertaken by him is to be made in Form No._____.

- a. 34D
- b. 34DA**
- c. 34E
- d. 34EA

Reason:

An application (in quadruplicate) for advance ruling shall be made by a resident applicant, for determination of his tax liability arising out of one or more transactions valuing Rs.100 crore or more in total which has been undertaken or is proposed to be undertaken by him, in Form No. 34DA

39. Provisions relating to advance ruling are provided in sections _____.

- a. 80C to 80U
- b. 245A to 245L
- c. 237 to 245
- d. 245N to 245V**

Reason:

Provisions relating to advance ruling are provided in sections 245N to 245V.

- 40. If the amount of income in respect of which the penalty is imposed or imposable for the relevant year(s) exceeds ₹ _____, then no order reducing or waiving the penalty under section 273A(1) shall be made by the Principal Commissioner or Commissioner, except with the previous approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General, as the case may be**
- a. 1,00,000
 - b. 2,00,000
 - c. 5,00,000**
 - d. 10,00,000

Reason:

If the amount of income in respect of which the penalty is imposed or imposable for the relevant year or, where such disclosure relates to more than one year, the aggregate amount of such income for those years exceeds a sum of ₹ 5,00,000, no order reducing or waiving the penalty under section 273A(1) shall be made by the Principal Commissioner or Commissioner, except with the previous approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General, as the case may be.

- 41. Principal Commissioner or Commissioner of Income-tax is empowered to grant relief from penalty to taxpayers in genuine cases. Such power is granted under section 273A and section _____.**
- a. 273B
 - b. 273AA**
 - c. 273
 - d. 274

Reason:

Apart from enacting penalty provisions, the Income-tax Act also designed provisions empowering the Principal Commissioner or Commissioner of Income-tax to grant relief from penalty to taxpayers in genuine cases. Such power is granted under section 273A and section 273AA.

- 42. As per section _____ when any specified domestic transaction is carried out between associated enterprises, the said transaction should be carried out at arm's length price.**
- a. 90
 - b. 91
 - c. 92**
 - d. 90A

Reason:

As per section 92, when any specified domestic transaction is carried out between associated enterprises, the said transaction should be carried out at arm's length price. In other words, income arising or allowance of any expenses to an entity resulting from specified domestic transactions with associated enterprise should be computed by having regard to arm's length price of such transaction.

- 43. The provisions of sec. 92 will apply only if the aggregate value of specified domestic transactions entered into by the taxpayer during the year exceeds a sum of ₹ _____.**
- a. 100 crore



- b. 5 crore
- c. 10 crore
- d. **20 crore**

Reason:

The provisions of section 92 will apply only if the aggregate value of specified domestic transactions entered into by the taxpayer during the year exceeds a sum of ₹ 20 crore.

44. Section _____ deals with methods of computation of arm's length price.

- a. 94
- b. 93
- c. **92C**
- d. 91

Reason:

Section 92C deals with methods of computation of arm's length price.

45. Arm's length price is to be determined by applying _____

- a. **Resale Price Method**
- b. Fair Market Value Method
- c. Stamp Duty Value Method
- d. Indexed Cost of Acquisition Method

Reason:

The arm's length price in relation to an international transaction or specified domestic 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:

Transaction Based Methods

- a. comparable uncontrolled price method;
- b. resale price method;
- c. cost plus method;

Profit Based Methods

- d. profit split method;
- e. transactional net margin method;
- f. such other method as may be prescribed by the Board.

46. Advance Pricing Agreement shall be valid for such period not exceeding _____ consecutive previous years as may be specified in the agreement.

- a. **5**
- b. 3

- c. 10
- d. 2

Reason:

As per sec. 92CC, Advance Pricing Agreement shall be valid for such period not exceeding 5 consecutive previous years as may be specified in the agreement.

47. As per sec. 94B, interest expenses claimed by an entity to its associated enterprises shall be restricted to ____ of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is less.
- a. 30%
 - b. 25%
 - c. 20%
 - d. 50%

Reason:

As per sec. 94B, interest expenses claimed by an entity to its associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is less.

48. If any person fails to keep and maintain any such information and document as required by sec. 92D in respect of an international transaction or specified domestic transaction, the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to ____
- a. ₹ 5,00,000
 - b. 2% of the value of each international transaction or specified domestic transaction entered into by such person
 - c. ₹ 1,00,000
 - d. 1% of the value of each international transaction or specified domestic transaction entered into by such person

Reason:

If any person fails to keep and maintain any such information and document as required by sec. 92D in respect of an international transaction or specified domestic transaction, the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of each international transaction or specified domestic transaction entered into by such person

49. Uncontrolled transaction means a transaction between _____, whether resident or non-resident
- a. enterprises other than associated enterprises
 - b. associated enterprises
 - c. any enterprises
 - d. none of the above

Reason:

Uncontrolled transaction means a transaction between enterprises other than associated enterprises, whether resident or non-resident



50. Information and documents required to maintained u/s 92D shall be kept and maintained for a period of _____ from the end of the relevant assessment year.

- a. 8 years**
- b. 5 years
- c. 10 years
- d. 16 years

Reason:

Information and documents required to maintained u/s 92D shall be kept and maintained for a period of 8 years from the end of the relevant assessment year.

51. The return of income is to be furnished in _____.

- a. ITNS 281
- b. Form 26AS
- c. Form 26Q
- d. None of these**

Reason:

Form ITNS 281 is used for payment of tax deducted at source. Form 26AS. Form 26AS, also called as Annual Statement, is a consolidated tax statement which has all tax related information (TDS, TCS, Refund etc) associated with a PAN. Quarterly TDS return (other than salary) is required to be filed in Form 26Q.

52. When an assessee has paid advance tax more than the tax due on the returned income and the return is filed before the 'due date' specified in section 139(1), the refund amount is eligible for interest @ —

- a. 1% per month
- b. ½% per month**
- c. ¾% per month
- d. 1.50% per month

Reason:

As per sec. 244A, interest @ ½% p.m. is payable on refund due to the assessee.

53. Assessing Officer or the assessee, as the case may be, on receipt of notice that an appeal against the order of the Commissioner (Appeals) has been filed by the other party, may file a memorandum of cross objection with the Tribunal in Form _____ and within _____ days of receipt of notice that appeal has been filed by the other party.

- a. Form 36A; 15 days
- b. Form 36A; 45 days
- c. Form 36A; 30 days**
- d. Form 36; 60 days

Reason:

Memorandum of cross objection shall be filed in Form 36A within 30 days of receipt of notice that appeal has been filed by the other party.

54. Where revision u/s 264 has been initiated by the assessee, the application must be made within _____ from the date on which the order in question was communicated to the assessee or the date on which he otherwise came to know of it, whichever is earlier.

- a. 1 year
- b. 4 years
- c. 2 years
- d. 30 days

Reason:

Where revision u/s 264 has been initiated by the assessee, the application must be made within 1 year from the date on which the order in question was communicated to the assessee or the date on which he otherwise came to know of it, whichever is earlier.

55. A survey is conducted in the premises of the assessee and assessments are reopened for some assessment years. An application for settlement could be made to the Settlement Commission when the additional amount of income-tax payable on the income disclosed in the application exceeds ₹ —

- a. 50 lakhs
- b. 25 lakhs
- c. 10 lakhs
- d. 100 lakhs

Reason:

Where an application before the Commission is filed in a case where proceedings for assessment or reassessment have been initiated as a result of search or as a result of requisition of books of account or assets, etc., additional amount of income tax payable on the income disclosed in application should exceeds ₹ 50 lakh. In any other case, additional amount of income tax payable on the income disclosed in application should exceeds ₹ 10 lakh.

56. X Marine Lines Inc., a Singapore company engaged in shipping business collected ₹ 150 lakh towards carrying goods from Chennai Port. Its presumptive income chargeable to tax in India would be ₹

- a. 15 lakhs
- b. 11.25 lakhs
- c. 12 lakhs
- d. Nil

Reason:

$\text{₹ } 150 \text{ lakh} \times 7.5\% = \text{₹ } 11.25 \text{ lakhs}$

57. When an assessee fails to furnish any information relating to a specified domestic transaction, the quantum of penalty as a percentage of value of the transaction would be —

- a. 2%
- b. 1%
- c. 5%
- d. 3%



Reason:

As per sec. 271AA, if any person in respect of an international transaction or specified domestic transaction fails to maintain or furnishes an incorrect information or document, the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of each international transaction or specified domestic transaction entered into by such person.

58. Countries that employ explicit policies designed to attract international trade oriented activities by minimization of taxes and reduction or elimination of other restrictions on business operations is described as _____.

- a. Tax Havens
- b. Tax Planning
- c. Tax Evasion
- d. Tax Management

Reason:

Many fiscally sovereign territories and countries use tax and non-tax incentives to attract activities in the financial and other services sectors. These territories and countries offer the foreign investor an environment with a no or only nominal taxation which is usually coupled with a reduction in regulatory or administrative constraints. The activity is usually not subject to information exchange because, for example, of strict bank secrecy provisions. These jurisdictions are known as tax havens. In other words, any country which modifies its tax laws to attract foreign capital could be considered a tax haven. The central feature of a haven is that its laws and other measures can be used to evade or avoid the tax laws or regulations of other jurisdictions. A tax haven is a state or a country or territory where income tax are levied at a low rate or no tax at all is levied.