PAPER – 7 : DIRECT TAX LAWS

PART – III : QUESTIONS AND ANSWERS

QUESTIONS

Basic Concepts

1. "The object for which subsidy/assistance is given by the Government determines the nature of the subsidy – Revenue or Capital". – Discuss the relevance of the rationale of the Supreme Court ruling in *Ponni Sugar Mills'* case in respect of such subsidy received on or after 1.4.2015.

Residential Status and Scope of Total Income

2. Mr. Anand is an Indian citizen and a member of the crew of a Singapore bound Indian ship engaged in carriage of passengers in international traffic departing from Chennai port on 6th June, 2015. From the following details for the P.Y.2015-16, determine the residential status of Mr. Anand for A.Y.2016-17, assuming that his stay in India in the last 4 previous years (preceding P.Y.2015-16) is 400 days and last seven previous years (preceding P.Y.2015-16) is 750 days:

Particulars	Date
Date entered into the Continuous Discharge Certificate in respect of joining the ship by Mr. Anand	6th June, 2015
Date entered into the Continuous Discharge Certificate in respect of signing off the ship by Mr. Anand	9th December, 2015

3. ABC Inc., a Swedish company headquartered at Stockholm, not having a permanent establishment in India, has set up a liaison office in Mumbai in April, 2015 in compliance with RBI guidelines to look after its day to day business operations in India, spread awareness about the company's products and explore further opportunities. The liaison office takes decisions relating to day to day routine operations and performs support functions that are preparatory and auxiliary in nature. The significant management and commercial decisions are, however, in substance made by the Board of Directors at Sweden. Determine the residential status of ABC Inc. for A.Y.2016-17.

Income which do not form part of total income [Charitable Trusts]

4. An institution having yoga as its main object is registered under section 12AA. Its total receipts for the P.Y.2015-16 is ₹ 40 lakhs, out of which receipts from business activity is ₹ 10 lakhs. Discuss whether the institution would continue to retain its "charitable status" and be eligible for exemption under section 11 for A.Y.2016-17, if its registration has not been cancelled.

   Would your answer be different if the above institution has "advancement of any other object of general public utility" as its main object and applies its receipts from business activity towards its main object?

Profits and gains of business or profession

5. Alpha Ltd. set up a manufacturing unit in Vaishali district of Bihar on 1st April, 2015. The company invested ₹ 20 crore in acquisition of new plant and machinery on 3rd May, 2015 and another ₹ 20 crore in acquisition of plant and machinery on 21st December, 2015, out of which ₹ 10 crore was second hand plant and machinery. The new plant and machinery were installed and put to use from the date of acquisition. You are required to calculate the depreciation allowable under section 32.

   Discuss whether Alpha Ltd. would be eligible for any other benefit in respect of such investment in plant and machinery.

   What would be the position if such manufacturing unit is set up by Alpha & Co., a firm, instead of Alpha Ltd.?

6. Discuss, with the aid of case laws, whether the following expenditure would qualify for deduction under section 37 while computing income under the head "Profits and gains of business or profession" –

   (i) Commission paid to doctors by a diagnostic centre for referring patients for diagnosis;

   (ii) Freebies provided by pharmaceutical companies to medical practitioners; and

   (iii) Amount paid by a construction company as regularization fee for compounding an offence for violating building bye-laws

Capital Gains

7. Mrs. Aparna, a resident individual, sold her house property on 16.01.2016. On the said transaction, she earned a long-term capital gain of ₹ 1,91,50,000. She invested a sum of ₹ 35,00,000 in bonds of NHAI on 05.03.2016. She further invested a sum of ₹ 45,00,000 in bonds of RECL on 05.05.2016. She purchased a house property for ₹ 60 lakhs in Malaysia on 15.3.2016. She purchased two flats situated adjacent to each other in Pune on 25.7.2016 through two different sale deeds from two different buyers for ₹ 25 lakhs each and constructed a door to link both the flats so that she can use the same as a single house property. Her other income representing interest on fixed deposits for the financial year 2015-16 was ₹ 32,000. Compute the tax payable by her for the A.Y.2016-17.

Capital Gains & Income from other sources

8. Kashvi purchased a residential house in Meerut from her colleague Bhavna at ₹ 20 lacs on 10th January, 2016. The value determined by the Stamp Valuation Authority for stamp duty purpose amounted to ₹ 25 lakhs. Bhavna had purchased the house on 31st January, 2013 at a cost of ₹ 8 lakhs. Kashvi sold the flat for ₹ 40 lacs on 15th March, 2016.

   Determine the effect of the above transactions on the assessments of Kashvi and Bhavna for assessment year 2016-17, assuming that value for stamp duty purpose in case of the second sale was not more than the sale consideration.

Income of other persons included in assessee's total income

9. (i) Mr. Arnab has gifted a flat valued at ₹ 50 lakhs to his wife, Mrs. Sowmya, who in turn has gifted the same to Mrs. Sahana, their daughter-in-law. The flat was let out at ₹ 30,000 per month throughout the year. Compute the total income of Mr. Arnab and Mrs. Sahana.

   What would be your answer if the said flat was gifted to his son, Mr. Rishabh, who is the husband of Mrs. Sahana?

   (ii) Mr. Vishal gifted a sum of ₹ 9 lakhs to his brother's wife Mrs. Meena on 30.8.2015. On 10.9.2015, his brother, Mr. Vaibhav gifted a sum of ₹ 7 lakhs to Mr. Vishal's wife, Geetha. The gifted amounts were invested as fixed deposits in banks by Mrs. Meena and Mrs. Geetha on 1.10.2015 at 8% interest. Discuss the consequences of the above under the provisions of the Income-tax Act, 1961 in the hands of Mr. Vishal and Mr. Vaibhav.

Set-off and carry forward of losses

10. Mr. Ashwin, carrying on sole proprietary business, died on 31st March, 2015. On his death, the same business was continued by his legal heirs, by forming a firm. As on 31st March 2015, a determined business loss of ₹ 12 lakhs is to be carried forward under the Income-tax Act, 1961.

    Discuss whether the firm consisting of all legal heirs of Mr. Ashwin would get a right to have this business loss adjusted against its business income for A.Y.2016-17.

Deductions from gross total income

11. X Ltd. has commenced the operations of manufacture of goods in a factory on 1.5.2011. It had employed new regular workmen in its factory, the details of whom are as follows –

Previous year	Number of new regular workmen employed during the year	Number of regular workmen leaving employment	Total number of regular workmen as at the end of the Previous year
2011-12	300	-	300
2012-13	300	50	550
2013-14	-	20	530
2014-15	-	30	500

In the P.Y.2015-16, due to capacity addition, it employs the following workmen, including casual workmen and workmen through contract labour, the particulars of whom are given below –

	Nature of workmen	Number employed	Date of employment	Monthly wages paid per workmen (₹)
(i)	Casual workmen	35	20.5.2015	2,000
(ii)	Workmen employed through contract labour	20	20.5.2015	2,500
(iii)	Regular workmen	55	1.5.2015	4,000
		15	31.7.2015	4,000
		10	21.8.2015	4,000

Compute the deduction, if any, under section 80JJAA available to X Ltd. for A.Y.2016-17, if the profits and gains derived from manufacture of goods in the factory for the A.Y.2016-17 is ₹ 8.17 lakhs.

Would deduction under the said section be available, if the details given above pertained to Mr.X instead of X Ltd.?

Inter-relationship between accounting and taxation

12. M/s. XYZ, a partnership firm, was dissolved on 1.4.2015. How is inventory on the date of dissolution of a firm to be valued, where the firm's business is to be continued by Mr.X, one of its partners? What was the manner in which such inventory would have been valued had the dissolution taken place on 31.1.2015 instead of 1.4.2015?

Assessment of various entities

13. L, M and N are investment funds incorporated in India in the form of a limited liability partnership (LLP). For P.Y.2015-16, the following are the particulars relating to the income earned by these funds -

Particulars	L	M	N
	₹		
Business Income		3,00,000	(1,50,000)
Capital Gains	12,00,000	18,00,000	(4,50,000)
Income from Other Sources [Interest on deposits]	6,00,000	7,20,000	9,00,000

(i) Compute the total income of the investment funds and unit-holders for A.Y.2016-17, assuming that:

(1) each investment fund has 30 unit holders each having one unit; and

(2) income from investment in the investment fund is the only income of the unit-holder.

(ii) Determine the amount of loss to be carried forward by Investment Fund N and/or its unit holders to A.Y.2017-18.

(iii) Is distribution tax payable by the Investment Funds on income distributed to unit holders?

(iv) In case the Investment Funds do not distribute the entire income earned during the P.Y.2015-16 to the unit holders by 31.3.2016, would the income chargeable to tax in the hands of unit holders, as computed in (i) above, undergo a change?

14. The following are the details pertaining to M/s. XYZ, a partnership firm, for the year ended 31-3-2016:

(i) Gross total income of ₹ 420 lakhs, which includes a profit of ₹ 380 lakhs from an undertaking engaged in the business of developing a highway project having a turnover of ₹ 15 crores.

(ii) The profits of the undertaking are eligible for deduction under section 80-IA. This is the fourth year and the deduction available is ₹ 340 lakhs.

(iii) The firm has not undertaken any international transaction or specified domestic transaction during the said year.

Since M/s. XYZ has encountered some issues relating to tax implications of certain transactions in respect of which it wants to seek opinion of tax consultants, it is planning to file the return of income only in the month of December, 2016.

You are required to work out the total income and tax liability of the firm in both the scenarios - namely, where the return is filed on 30-09-2016 and when the same is filed in December, 2016; and advise the firm the right course of action to minimize tax liability.

Double Taxation Relief

15. Mr. Vikas, an individual resident in India aged 55 years, furnishes you the following particulars of income earned in India, Foreign Countries "A" and "B" for the previous year 2015-16. Compute the total income and tax payable by Mr. Vikas in India for A.Y. 2016-17 assuming that India has not entered into double taxation avoidance agreement with countries A & B.

Particulars	₹
Indian Income:	
Income from business carried on in Mumbai	9,20,000
Interest on savings bank with IDBI Bank	24,000
Income earned in Foreign Country "A" [Rate of tax – 12%]:	
Agricultural income in Country "A"	72,000
Royalty income from a book on art from Country "A" (Gross)	8,00,000
Expenses incurred for earning royalty	70,000
Income earned in Foreign Country "B" [Rate of tax – 23%]:	
Dividend received from a company incorporated in Country "B"	2,25,000

Rent from a house situated in Country "B" (gross)	3,30,000
Municipal tax paid in respect of the above house (not allowed as deduction in Country “B”)	10,000

Assessment Procedure

16. The Assessing Officer completed the assessment under section 143(3) on the basis of the returned income filed by Phi Ltd. for a certain assessment year. However, the Assessing Officer initiated reassessment proceeding under section 147 as he had reason to believe that income had escaped assessment on account of certain deductions allowed under section 37 which are not incurred wholly and exclusively for the purpose of business and accordingly, he issued notice under section 148. However, after sufficient enquiries made by him, he came to the conclusion that no additions were required on account of these expenses, since such expenses were ultimately found to be incurred wholly and exclusively for the purpose of the business of Phi Ltd. However, the Assessing Officer made additions on account of disallowances under section 40A(2) in respect of other expenses which were not the original "reason to believe" and passed his reassessment order under section 147. The Assessing Officer is of the view that *Explanation 3* to section 147 permits him to assess the income which has escaped assessment and which comes to his notice subsequently in the course of proceeding under section 147, even though the said issues were not part of the reasons recorded in the notice under section 148. Is the action of the Assessing Officer valid, considering the facts of this case?

Appeals and Revision

17. Discuss, with the aid of decided case laws, the correctness or otherwise of the following statements –
    (i) An assessee can make a fresh claim (i.e., a claim not made in the return of income) before an appellate authority only by filing a revised return of income;
    (ii) The Appellate Tribunal has the power to re-appreciate the correctness of its earlier decision under section 254(2);

18. What are the circumstances when an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, enabling the Commissioner to exercise revisionary jurisdiction under section 263(1)?

Penalties

19. PQR Ltd., engaged in the specified business of setting up and operating a warehousing facility for storage of food grains, filed its return of income for A.Y.2013-14 on 28th September, 2013. In the return of income of the earlier year i.e., A.Y.2012-13, PQR Ltd. had claimed deduction@100% of cost of ₹ 8 lakhs incurred on purchase of the first building on 1.1.2012 for operating the warehousing facility. In computing its business

income for A.Y.2013-14, it had claimed a weighted deduction@150% of the cost of ₹ 10 lakhs incurred on purchase of the second building on 1.4.2012 for operating the warehousing facility under section 35AD. PQR Ltd. had commenced operations on 1.1.2012, whereas the benefit of weighted deduction@150% was available only where the business was commenced on or after 1.4.2012. The company was under the impression that since the new building was purchased on 1.4.2012, it was eligible for weighted deduction@150% under section 35AD. The Assessing Officer, disallowed ₹ 5 lakhs, being the excess 50% of cost of the second building which was claimed as weighted deduction under section 35AD, since the same was only eligible for deduction@100%. He also levied penalty under section 271(1)(c). PQR Ltd. agreed with the disallowance made but contended that there no concealment of particulars of income so as to attract penalty under section 271(1)(c), since it had furnished all the details correctly in its return of income and no information given by the company was found to be incorrect or erroneous or false. Discuss the correctness of PQR Ltd.'s contention.

Provisions for deduction and collection of tax at source

20. Discuss the correctness or otherwise of the following statements –

    (i) All co-operative banks are exempted from the requirement to deduct tax at source on interest on time deposits credited/paid to its members.

    (ii) Interest on recurring deposits are not subject to tax deduction at source.

SUGGESTED ANSWERS/HINTS

1. The Supreme Court in, *CIT v Ponni Sugar Mills (2008) 306 ITR 392,* observed that it is the object for which the subsidy/assistance is given which determines the nature of the incentive subsidy. If the object of the subsidy scheme was to enable the assessee to run the business more profitably then the receipt is on revenue account. On the other hand, if the object of the assistance under the subsidy scheme was to enable the assessee to set up a new unit or to expand the existing unit then the receipt of the subsidy was on capital account. The rationale of the Supreme Court ruling has been applied in many cases and accordingly, grants given with a view to develop backward area or to enable industries to trade over financial crisis or to generation of employment in a State have been regarded as being capital in nature. For instance, in *CIT v. Rasoi Ltd. (2011) 335 ITR 438 (Cal.)*, it was held that subsidy received by the assessee from the Government of West Bengal under the scheme of industrial promotion for expansion of its capacities, modernization and improving its marketing capabilities was a capital receipt, not chargeable to tax. In *CIT v. Kisan Sahkari Chini Mills Ltd. (2010) 328 ITR 27 (All.)*, it was held that incentive received under the scheme formulated by the Central Government for recoupment of capital employed and repayment of loans taken for setting up/expansion of a sugar factory was a capital receipt.

However, with effect from A.Y.2016-17, government grants have been specifically included in the definition of income under section 2(24) and the taxability of such grants would be governed by ICDS VII on Government Grants.

The Central Government has[1], in exercise of the powers conferred under section 145(2), notified ten income computation and disclosure standards (ICDSs) to be followed by all assessees, following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or "Income from other sources". This notification has come into force with effect from 1st April, 2015, and shall accordingly apply to the A.Y. 2016-17 and subsequent assessment years.

ICDS VII deals with the treatment of government grants. As per this ICDS, except in case of government grant relating to a depreciable fixed asset, which has to be reduced from written down value or actual cost, all other grants have to be recognized as upfront income or as income over the periods necessary to match them with the related costs which they are intended to compensate.

Further, in line with the requirement in ICDS VII, sub-clause (xviii) has been included in the definition of income under section 2(24). Accordingly, assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement, by whatever name called, by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee is included in the definition of income. The only exclusion is the subsidy or grant or reimbursement which has been taken into account for determination of the actual cost of the asset in accordance with *Explanation 10* to section 43(1).

Thus, the rationale of the Supreme Court ruling in *Ponni Sugar Mills*' case that the object for which the Government subsidy was given would determine the nature of the subsidy is not relevant in respect of subsidy received on or after 1.4.2015, consequent to amendment of section 2(24) and notification of ICDS VII on Government Grants with effect from A.Y.2016-17.

2. As per section 6, an individual is treated as resident if he has stayed for 182 days in India during the previous year or if he has stayed for 60 days in the current previous year and 365 days in total during the four preceding previous years. However, where an Indian citizen leaves India as a member of crew of an Indian ship or for the purpose of employment outside India, he will be resident only if he stayed for 182 days during the previous year.

Explanation 2 has been inserted by the Finance Act, 2015 in section 6(1) to provide that in the case of an Individual, being a citizen of India and a member of the crew of a foreign

[1] *vide* Notification No. 32/2015 dated 31.3.2015

bound ship leaving India, the period or periods of stay in India shall, in respect of such voyage, be determined in the prescribed manner and subject to the prescribed conditions.

Accordingly, the CBDT has prescribed the manner of determination of period of stay. For the purposes of section 6(1), in case of an individual, being a citizen of India and a member of the crew of a ship, the period or periods of stay in India shall, in respect of an eligible voyage, not include the period beginning on the date entered into the Continuous Discharge Certificate in respect of joining the ship by the said individual for the eligible voyage and ending on the date entered into the Continuous Discharge Certificate in respect of signing off by that individual from the ship in respect of such voyage.

Eligible voyage refers to a voyage undertaken by a ship engaged in the carriage of passengers or freight in international traffic where –

(i) for the voyage having originated from any port in India, has as its destination any port outside India; and

(ii) for the voyage having originated from any port outside India, has as its destination any port in India.

In this case, the voyage is undertaken by an Indian ship engaged in the carriage of passengers in international traffic, originating from a port in India (i.e., the Chennai port) and having its destination at a port outside India (i.e., the Singapore port). Hence, the voyage is an eligible voyage for the purposes of section 6(1). Therefore, the period beginning from 6th June, 2015 and ending on 9th December, 2015, being the dates entered into the Continuous Discharge Certificate in respect of joining the ship and signing off from the ship by Mr. Anand, an Indian citizen who is a member of the crew of the ship, has to be excluded for computing the period of his stay in India. Accordingly, 187 days [25+31+31+30+31+30+9] have to be excluded from the period of his stay in India. Consequently, Mr. Anand's period of stay in India during the P.Y.2015-16 would be 179 days [i.e., 366 days – 187 days]. Since his period of stay in India during the P.Y.2015-16 is less than 182 days, he is a non-resident for A.Y.2016-17.

Note - Since the residential status of Mr. Anand is "non-resident" for A.Y.2016-17 consequent to his number of days of stay in P.Y.2015-16 being less than 182 days, his period of stay in the earlier previous years become irrelevant.

3. Section 6(3) has been substituted by the Finance Act, 2015 with effect from A.Y.2016-17 to provide that a company would be resident in India in any previous year, if-

(i) it is an Indian company; or

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

In this case, ABC Inc. is a foreign company. Therefore, it would be resident in India for P.Y.2015-16 only if its place of effective management, in that year, is in India.

Explanation to section 6(3) defines "place of effective management" to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made. In the case of ABC Inc., its place of effective management for P.Y.2015-16 is not in India, since the significant management and commercial decisions are, in substance, made by the Board of Directors outside India in Sweden.

ABC Inc. has only a liaison office in India through which it looks after its routine day to day business operations in India. The place where decisions relating to day to day routine operations are taken and support functions that are preparatory or auxiliary in nature are performed are not relevant in determining the place of effective management.

Hence, ABC Inc., being a foreign company is a non-resident for A.Y.2016-17, since its place of effective management is outside India in the P.Y.2015-16.

4. Section 2(15) defines "charitable purpose" to include relief of the poor, education, *yoga*, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, the "advancement of any other object of general public utility" shall not be a charitable purpose, if the institution is carrying on any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income derived from such activity.

Since *yoga* has been specifically included in the definition of "charitable purpose" by the Finance Act, 2015 with effect from A.Y.2016-17, it would no longer fall under the residual clause "advancement of any other object of general public utility". Therefore, an institution having yoga as its main object would not be subject to the restrictions which are applicable to the "advancement of any other object of general public utility". Such institution would continue to retain its "charitable" status, even if it derives income from an activity in the nature of trade.

However, if an institution having its main object as "advancement of any other object of general public utility", derives income from an activity in the nature of trade during a financial year, it would lose its "charitable" status for that year, even if it applies such income for its main objects.

It may be noted that if the receipts from such activity does not exceed 20% of the total receipts in that year, then, the institution would not lose its "charitable" status, even its main object is "advancement of any other object of general public utility", provided such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

In this case, the receipts from such activity are 25% of total receipts. Hence, the institution will lose its charitable status and will not get the benefit of tax exemption under section 11 or 12 in the P.Y.2015-16, even if it applies such receipts for its main object and irrespective of whether the registration issued is cancelled or not.

5. (i) Computation of depreciation under section 32 for Alpha Ltd. for A.Y. 2016-17

Particulars		₹ (in crores)
Plant and machinery acquired on 03.05.2015		20.00
Plant and machinery acquired on 21.12.2015		20.00
WDV as on 31.03.2016		40.00
Less: Depreciation @ 15% on ₹ 20 crore	3.00	
Depreciation @ 7.5% (50% of 15%) on ₹ 20 crore	1.50	
Additional Depreciation@35% on ₹ 20 crore	7.00	
Additional Depreciation@17.5% (50% of 35%) on ₹ 10 crore	1.75	13.25
WDV as on 01.04.2016		26.75

Alpha Ltd. would also be eligible for benefit of deduction under sections 32AC and 32AD.

Computation of deduction under section 32AC & 32AD for Alpha Ltd. for A.Y. 2016-17

Particulars	₹ (in crores)
Deduction under section 32AC(1A) @ 15% on ₹ 30 crore (since investment in new plant and machinery acquired and installed in the previous year 2015-16 by Alpha Ltd., a manufacturing company, exceeds ₹ 25 crore)	4.50
Deduction under section 32AD @ 15% on ₹ 30 crore (since the manufacturing unit is set up in a notified backward area in the State of Bihar)	4.50
Total benefit	9.00

(ii) Yes, the answer would be different, where the manufacturing unit is set up by a firm. The deduction under section 32AC is available only to corporate assessees, and therefore, the deduction of ₹ 4.50 crore under section 32AC would not be available if the manufacturing unit is set up by Alpha & Co., a firm. However, the firm would be eligible for deduction of ₹ 4.50 crore under section 32AD.

Notes:

(1) As per the second proviso to section 32(1)(ii), where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount of deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

Therefore, normal depreciation on plant and machinery acquired and put to use on 21st December, 2015 is restricted to 7.5% (being 50% of 15%) and additional depreciation is restricted to 17.5% (being 50% of 35%).

(2) As per third proviso to section 32(1)(ii), the balance additional depreciation of ₹ 1.75 crore, being 50% of ₹ 3.50 crore (35% of ₹ 10 crore) would be allowed as deduction in the A.Y.2017-18.

(3) As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, *inter alia*, in the business of manufacture or production of any article or thing. In this case, since new plant and machinery acquired was installed by a manufacturing unit set up in a notified backward area in the State of Bihar, the rate of additional depreciation is 35% of actual cost of new plant and machinery. Since new plant and machinery of ₹ 10 crore was put to use for less than 180 days, additional depreciation@17.5% (50% of 35%) is allowable as deduction. However, additional depreciation shall not be allowed in respect of second hand plant and machinery of ₹ 10 crore.

Likewise, the benefit available under sections 32AC and 32AD would not be allowed in respect of second hand plant and machinery.

Accordingly, additional depreciation and deduction under sections 32AC and 32AD have not been provided on ₹ 10 crore, being the actual cost of second hand plant and machinery acquired and installed in the previous year.

6. (i) No; the expenditure is not allowable as deduction under section 37.

The Punjab & Haryana High Court, in *CIT v. Kap Scan and Diagnostic Centre P. Ltd. (2012) 344 ITR 476*, observed that as per the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, no physician shall give, solicit, receive, or offer to give, solicit or receive, any gift, gratuity, commission or bonus in consideration of a return for referring any patient for medical treatment.

The demanding as well as paying of such commission is bad in law. It is not a fair practice and is opposed to public policy. Applying the rationale and considering the purpose of *Explanation* to section 37(1), the assessee would not be entitled to deduction of payments made in contravention of law. Similarly, payments which are opposed to public policy being in the nature of unlawful consideration cannot also be claimed as deduction. Thus, the High Court held that commission paid to doctors for referring patients for diagnosis is not allowable as a business expenditure

(ii) No; the expenditure is not allowable as deduction under section 37.

The Himachal Pradesh High Court in, *Confederation of Indian Pharmaceutical Industry (SSI) v. CBDT (2013) 353 ITR 388*, observed that as per Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, every medical practitioner and his or her professional associate is prohibited from accepting any gift, travel facility, hospitality, cash or monetary grant from any pharmaceutical and allied health sector industries. This is a salutary regulation in the interest of the patients and the public, considering the increase in complaints against the medical practitioners prescribing branded medicines instead of generic medicines, solely in lieu of gifts and other freebies granted to them by some particular pharmaceutical industries.

The Court also observed that CBDT, considering the fact that the claim of any expense incurred in providing freebies to medical practitioners is in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, has, *vide Circular No.5/2012 dated 1.8.2012*, clarified that the expenditure so incurred shall be inadmissible under section 37(1). The disallowance shall be made in the hands of such pharmaceutical company which has provided aforesaid freebies and claimed it as a deductible expense in its accounts against income.

Note: The Court, however, observed that if the assessee satisfies the assessing authority that the expenditure incurred is not in violation of the regulations framed by the Medical Council then it may legitimately claim a deduction, but it is for the assessee to satisfy the Assessing Officer that the expense is not in violation of the Medical Council Regulations.

(iii) No; the expenditure is not allowable as deduction under section 37.

The Karnataka High Court in, *Millennia Developers (P) Ltd. v. DCIT (2010) 322 ITR 401,* held that the amount paid by way of regularisation fee to compound an offence for deviations made while constructing a structure and for violating the plan sanctioned in terms of approved building bye laws is in the nature of penalty, and hence does not qualify for deduction under section 37. Merely describing the payment as a regularisation fee or compounding fee would not alter the character of the payment.

7. Computation of total income of Mrs. Aparna for the A.Y.2016-17

	Particulars	₹
A	Long term capital gains	1,91,50,000
	Less: Deduction under section 54 [See Note 1 below]	50,00,000
		1,41,50,000
	Less: Deduction under section 54EC [See Notes 2 & 3 below]	50,00,000
	Long term capital gain	91,50,000
B	Income from Other Sources [Interest on fixed deposit]	32,000
	Total Income	91,82,000

As per section 112, in case of an individual, being a resident where her total income includes long-term capital gain and other income, the tax payable on the total income is the aggregate of the amount of income tax on long-term capital gains@ 20% and the amount of income tax on the total income as reduced by the amount of long term capital gain, had the total income so reduced been her total income.

However, the unexhausted basic exemption limit can be exhausted against long-term capital gains, and tax would be leviable on the balance long-term capital gains @ 20%. Therefore, the basic exemption limit of ₹ 2,50,000 should be first adjusted against other income of ₹ 32,000 and the unexhausted basic exemption limit of ₹ 2,18,000 should be adjusted against the long-term capital gains of ₹ 91,50,000. The balance long-term capital gains of ₹ 89,32,000 would be taxable@20% plus education cess@2% and secondary and higher education cess@1%. Therefore, the tax payable by the assessee would be ₹ 18,39,992.

Notes:

(1) Section 54 provides that exemption thereunder can be availed in respect of investment made in <u>one</u> **residential house** <u>situated in India</u>. Therefore, Mrs. Aparna cannot avail exemption under section 54 in respect of investment in house property situated outside India at Malaysia. .

The next issue is whether Mrs. Aparna can claim exemption under section 54 in respect of ₹ 50 lakhs invested in two flats situated next to each other in Pune, where necessary modification has been effected to use the same as a single house. On this issue, the Karnataka High Court in *CIT v. D. Ananda Basappa (2009) 309 ITR 329* observed that where the assessee had shown that the flats were situated side by side and the builder had also certified that he had effected modification of the flats to make them as a single house by constructing a door between the apartments, it was immaterial that the flats were purchased through different sale deeds from two different buyers. The Court observed that these were not the grounds to hold that the assessee did not have the intention to purchase the two flats to be used as one house. The Court held that the assessee was entitled to exemption under section 54 in respect of purchase of both the flats to form one residential house.

Therefore, in this case, Mrs. Aparna can avail exemption in respect of investment of ₹ 50 lakhs in purchase of two flats situated next to each other in Pune, since necessary modification has been effected to use the two flats as a single house property. Also, she has made the investment in purchase of two flats within the stipulated period of two years after the date of transfer.

(2) In order to claim exemption under section 54EC, the assessee has to invest in specified bonds of RECL or NHAI within a period of 6 months from the date of transfer of the asset.

(3) However, investments in such bonds by an assessee during any financial year cannot exceed ₹ 50 lakhs.

Further, second proviso to section 54EC(1) also provides that the investment made by an assessee in bonds of NHAI/RECL, out of capital gains arising from transfer of one or more original assets, during the financial year in which the original asset or assets are transferred and in the subsequent financial year should not exceed ₹ 50 lakhs.

In this case, Mrs. Aparna has invested ₹ 35 lakhs in bonds of NHAI in the F.Y.2015-16 and ₹ 45 lakhs in bonds of RECL in the F.Y.2016-17, both within six months from the date of transfer. However, since the amount of investment made during the financial year in which asset transferred and in the subsequent financial year cannot exceed ₹ 50 lakhs, she is eligible to claim exemption of only ₹ 50 lakhs under section 54EC.

8. Tax treatment in the hands of the seller, Ms. Bhavna

Section 50C provides that where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by an authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration received or accruing as a result of such transfer for computing capital gain.

In the instant case, Ms. Bhavna sold the residential house in Meerut to her colleague Ms. Kashvi for ₹ 20 lacs, whereas the stamp duty value was ₹ 25 lacs. Therefore, stamp duty value shall be deemed to be the full value of consideration for sale of the property. Therefore, short-term capital gain arising to Ms. Bhavna for assessment year 2016-17 will be ₹ 17 lacs (i.e. ₹ 25 lacs - ₹ 8 lacs). The gain is a short-term capital gain since the residential house was held by her for a period of less than 36 months immediately preceding the date of transfer.

Tax treatment in the hands of the buyer, Ms. Kashvi

The taxability provisions under section 56(2)(vii) includes within its scope, any immovable property, being land or building or both, received for inadequate consideration by an individual or HUF.

As per section 56(2)(vii), where any immovable property is received for a consideration which is less than the stamp duty by an amount exceeding ₹ 50,000, the difference between the stamp duty value and the consideration shall be chargeable to tax in the hands of the recipient (Individual/HUF) as the income from other sources. The provisions of section 56(2)(vii) would be attracted in this case, since the difference exceeds ₹ 50,000. Therefore, ₹ 5 lacs, being the difference between the stamp duty value of the property (i.e., ₹ 25 lacs) and the actual consideration (i.e., ₹ 20 lacs) would be taxable in the hands of Ms. Kashvi, under the head 'Income from Other Sources'.

As per section 49(4), the cost of acquisition of such property for computing capital gains would be the value which has been taken into account for section 56(2)(vii). Accordingly ₹ 25 lacs would be taken as the cost of acquisition of the residential house. Therefore, on sale of the residential house by Ms. Kashvi, ₹ 15 lacs (i.e. ₹ 40 lacs – ₹ 25 lacs) would be chargeable to tax as short-term capital gain in her hands for A.Y. 2016-17.

9. (i) As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, shall be deemed to be the owner of the house

property so transferred.

Therefore, in this case, Mr. Arnab would be the deemed owner of the flat transferred to his wife Mrs. Sowmya without consideration.

As per section 64(1)(vi), income arising to the son's wife from assets transferred, directly or indirectly, to her by an individual otherwise than for adequate consideration would be included in the total income of such individual.

Income from let-out flat is ₹ 2,52,000 [i.e., ₹ 3,60,000, being the actual rent calculated at ₹ 30,000 per month *less* ₹ 1,08,000, being deduction under section 24@30% of ₹ 3,60,000]

In this case, income of ₹ 2,52,000 from let-out flat arising to Mrs. Sahana, being Mr. Arnab's son's wife, would be included in the income of Mr. Arnab, applying the provisions of section 27(i) and section 64(1)(vi). Such income would, therefore, not be taxable in the hands of Mrs. Sahana.

In case the flat was gifted to Mr. Arnab's son, Mr. Rishabh, the clubbing provisions under section 64 would not apply, since Mr. Rishabh is not a minor child. Therefore, the income of ₹ 2,52,000 from letting out of flat gifted to his son, Mr. Rishabh, would be taxable in Mr. Rishabh's hands.

It may be noted that the provisions of section 56(2)(vii) would not be attracted in the hands of the recipient of flat, since the receipt of property in each case was from a "relative" of such individual. Therefore, the stamp duty value of flat would not be chargeable to tax in the hands of the recipient of immovable property, even though the flat was received by her or him without consideration.

Note - The question can also be answered by applying the provisions of section 64(1)(vi) directly to include the income of ₹ 2,52,000 arising to Mrs. Sahana in the hands of Mr. Arnab [without first applying the provisions of section 27(i) to deem Mr. Arnab as the owner of the flat transferred to his wife Mrs. Sowmya without consideration], since section 64(1)(vi) speaks of clubbing of income arising to son's wife from indirect transfer of assets to her by her husband's parent, without consideration. Gift of flat by Mr. Arnab to Mrs. Sahana, via Mrs. Sowmya, can be viewed as an indirect transfer by Mr. Arnab to Mrs. Sahana.

(ii) In this case, Mr. Vishal gifted a sum of ₹ 9 lakhs to his brother's wife Mrs. Meena on 30.8.2015 and simultaneously, his brother, Mr. Vaibhav gifted a sum of ₹ 7 lakhs to Mr. Vishal's wife, Geetha, on 10.09.2015. The gifted amounts were invested as fixed deposits in banks by Mrs. Meena and Mrs. Geetha. These transfers are in the nature of cross transfers. Accordingly, the income from the assets transferred would be assessed in the hands of the deemed transferor because the transfers are so intimately connected to form part of a single transaction and each transfer constitutes consideration for the other by being mutual or otherwise.

If two transactions are inter-connected and are part of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted. It was so held by the Apex Court in *CIT vs. Keshavji Morarji (1967) 66 ITR 142*.

Accordingly, the interest income arising to Vishal's wife, Geetha, in the form of interest on fixed deposits would be included in the total income of Mr. Vishal and interest income arising in the hands of his brother Vaibhav's wife, Meena, would be taxable in the hands of Mr. Vaibhav as per section 64(1), to the extent of amount of cross transfers i.e., ₹ 7 lakhs.

This is because both Mr. Vishal and his brother, Mr. Vaibhav are the indirect transferors of the income to their respective spouses with an intention to reduce their burden of taxation.

However, the interest income earned by Mrs. Meena on fixed deposit of ₹ 7 lakhs alone would be included in the hands of Mr. Vaibhav and not the interest income on the entire fixed deposit of ₹ 9 lakhs, since the cross transfer is only to the extent of ₹ 7 lakhs.

10. Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then, the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that generally, set-off of business losses should be claimed by the same person who suffered the loss and the only exception to this provision is when the business passes on to another person by inheritance.

The facts of the case given in the question are similar to the case *CIT v. Madhukant M. Mehta (2001) 247 ITR 805*, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor would be available to the firm.

In this case, the business of Mr. Ashwin was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 78(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of ₹ 12 lakhs of Mr. Ashwin for set-off against its business income of A.Y.2016-17.

11. (i) Deduction under section 80JJAA is available where the gross total income of an assessee includes any profits and gains derived from manufacture of goods in a factory and the assessee has employed new regular workmen in such factory in the previous year. The deduction shall be 30% of additional wages (i.e., wages paid to new regular workmen in excess of 50 workmen employed by the assessee in such factory during the previous year). However, in case of an existing factory, no deduction shall be allowed if the increase in the number of regular workmen employed during the year is less than 10% of the existing number of workmen employed in such factory as on the last day of the preceding year.

It may be noted that the deduction under section 80JJAA would be allowable for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

In this case, X Ltd. is eligible for deduction under section 80JJAA for A.Y.2016-17 since its gross total income includes profits and gains derived from the manufacture of goods in a factory and it has employed new regular workmen in its factory in the P.Y.2015-16 in excess of 10% of existing number of workmen as on 31.3.2015.

New regular workmen employed during the P.Y.2015-16 = 55 [See Working Note below]

Existing workmen as on 31.3.2015 = 500

New regular workmen is in excess of 10% of existing workmen as on 31.3.2015.

The deduction under section 80JJAA would be 30% of additional wages paid to the new regular workmen employed by it in such factory during the previous year.

Additional wages = ₹ 4,000 per month ×11 months × 55 workmen = ₹ 24,20,000

Deduction under section 80JJAA = 30% of ₹ 24,20,000 = ₹ 7,26,000.

Working Note:

Number of new regular workmen

Particulars		No. of workmen	
Total number of workmen employed during the year			135
Less:	Casual workmen employed during the year	35	
	Workmen employed through contract labour	20	
	Workmen employed for a period of less than 300 days during the P.Y.2015-16 (workmen employed on 31.7.2015 and 21.8.2015)	25	80
Total number of new regular workmen employed during the P.Y.2015-16			55

"Regular workman" does not include a casual workman or a workman employed through contract labour or any other workman employed for a period of less than 300 days during the previous year.

Note – In respect of new regular workmen employed in the P.Y.2011-12, deduction under section 80JJAA would have been allowed for three assessment years i.e., A.Y.2012-13 to A.Y.2014-15. Likewise, in respect of new regular workmen employed in the P.Y.2012-13, deduction under section 80JJAA would have been allowed for three assessment years i.e., A.Y.2013-14 to A.Y.2015-16.

(ii) From A.Y.2016-17, deduction under section 80JJAA is not restricted to Indian companies alone. It would be available to any assessee satisfying the conditions mentioned in the said section. Therefore, Mr. X would be entitled to deduction under section 80JJAA for A.Y.2016-17, since he satisfies the conditions mentioned thereunder.

12. Under section 145(1), income chargeable under the heads "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee. Section 145(2) empowers the Central Government to notify in the Official Gazette from time to time, income computation and disclosure standards to be followed by any class of assessees or in respect of any class of income. Accordingly, the Central Government has, in exercise of the powers conferred under section 145(2), notified ten income computation and disclosure standards (ICDSs) to be followed by all assessees, following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or "Income from other sources". This notification shall come into force with effect from 1st April, 2015, and shall accordingly apply to the A.Y.2016-17 and subsequent assessment years.

In case of dissolution of a partnership firm or association of persons or body of individuals, Paragraph 24 of ICDS II on Valuation of Inventories requires the inventory on the date of dissolution to be valued at the net realisable value, notwithstanding whether business is discontinued or not.

Accordingly, where the firm M/s. XYZ is dissolved on 1.4.2015, inventory has to be valued at net realizable value, even if the firm's business is continued by partner X.

This requirement in ICDS II is, however, in deviation from the Supreme Court ruling in *Shakti Trading Co. vs. CIT (2001) 250 ITR 871,* where it was held that if the firm is dissolved due to death of a partner and the surviving partners reconstitute the firm and continue the business as before, the firm is entitled to adopt cost or market price, whichever is lower.

Therefore, if the firm M/s.XYZ was dissolved on 31.1.2015, being a date prior to 1.4.2015, when ICDSs became effective, the valuation of inventory would be governed by the Supreme Court ruling in *Shakti Trading Company*'s case and the same has to be valued at the lower of cost or net realizable value. However, if the dissolution takes place on 1.4.2015, it would be governed by ICDS II and the inventory has to be valued at the net realizable value, notwithstanding whether business is discontinued or not.

13. (i) Computation of total income of the investment funds for A.Y.2016-17

Particulars	L	M	N
	₹		
Business Income	Nil	3,00,000	Nil
Capital Gains [Exempt under section 10(23FBA)]	-	-	-
Income from other sources [Exempt under section 10(23FBA)]	-	-	-
Total Income	**Nil**	**3,00,000[2]**	**Nil**

[2] The total income of Investment Fund M would be chargeable to tax@30% since the fund is a LLP.

Computation of total income of a unit holder of the investment funds for A.Y.2016-17

Particulars	L	M	N
	₹		
Business Income [Exempt under section 10(23FBB)]	-	-	-
Capital Gains [₹ 12,00,000/30, ₹ 18,00,000/30, Nil]	40,000	60,000	-
Income from other sources [₹ 6,00,000/30, ₹ 7,20,000/30, (₹ 9,00,000 - ₹ 1,50,000)/30]	20,000	24,000	25,000
Total Income	60,000	84,000	25,000

Notes:

(1) As per section 10(23FBA), income other than profits and gains of business or profession is exempt in the hands of the Investment fund. Such income is taxable in the hands of the unit holders as if he had directly made the investment. Section 115UB(3) provides the nature of such income from Investment Fund in the hands of unit holders[3].

(2) Income under the head "Profits and gains of business or profession" is taxable in the hands of the Investment Fund. Hence, such income is exempt in the hands of the unit holders as per section 10(23FBB).

(ii) Where in any previous year, the net result of computation of total income of the investment fund [without providing for exemption under section 10(23FBA)] is a loss under any head of income and such loss cannot be or is not wholly set-off against income under any other head of income of the said previous year, then, the same has to be carried forward for set-off as per Chapter VI at the Fund level. Consequently, the loss incurred by the Investment Fund under any head of income cannot be passed on to the investors.

Accordingly, in case of Investment Fund N, the business loss of ₹ 1,50,000 has to be set-off against income from other sources of ₹ 9,00,000. The balance income of ₹ 7,50,000 is taxable in the hands of the unit holders. Loss of ₹ 4,50,000 under the head "Capital gains" cannot be set-off against income from other sources. The same has to be carried forward by Investment Fund N for set-off against income under the head "Capital gains" in the A.Y.2017-18.

(iii) Dividend distribution tax leviable under Chapter XII-D and tax on distributed income leviable under Chapter XII-E would not apply to income paid by an Investment Fund to its unit holders. Therefore, no distribution tax is payable by the Investment Funds on income distributed to its unit holders.

[3] As per section 115UB(3), the income paid or credited by the Investment Fund shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder as if it had been received by, or had accrued or arisen to, the Investment Fund.

(iv) Section 115UB(6) provides that if the income accruing or arising to, or received by, an Investment Fund, during a previous year is not paid or credited to the unit-holders, it shall be deemed to have been credited to the account of the unit-holder on the last day of the previous year in the same proportion in which such person would have been entitled to receive the income had it been paid in the previous year.

Therefore, income chargeable to tax in the hands of unit holders would not undergo a change, even if the Investment Funds do not distribute the entire income earned by them during the P.Y.2015-16 to the unit holders by 31.3.2016.

14. As per section 80AC, while computing the total income of an assessee of a previous year *(P.Y. 2015-16, in this case)* relevant to any assessment year *(A.Y. 2016-17, in this case),* any deduction is admissible, *inter alia,* under section 80-IA, such deduction shall not be allowed unless it furnishes a return of income for such assessment year on or before the due date specified in section 139(1).

Since the turnover of the partnership firm M/s.XYZ has exceeded ₹ 100 lakhs in the previous year 2015-16, it would be subject to audit under section 44AB, in which case the due date of filing its return of income for A.Y.2016-17 would be 30th September, 2016 as per section 139(1).

Computation of total income and tax liability of M/s. XYZ for A.Y.2016-17

I. Where the firm files its return of income on 30th September 2016:

Particulars	₹ in lakhs
Gross Total Income	420.00
Less: Deduction under section 80-IA	340.00
Total Income	80.00
Tax liability@30%	24.00
Add: Education cess@2% and secondary and higher education cess@1%	0.72
Regular income-tax payable	24.72
Computation of Alternate Minimum Tax payable [Section 115JC]	
Total Income	80.00
Add: Deduction under section 80-IA	340.00
Adjusted Total Income	420.00
Alternate Minimum Tax (AMT) @ 18.5% on ₹ 420 lakhs	77.70
Add: Surcharge@12% (Since adjusted total income > ₹ 1 crore)	9.32
	87.02
Add: Education cess@2% and SHEC@1%	2.61
Total tax payable (AMT)	89.63

Since the regular income-tax payable by the firm is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income of the firm for P.Y.2015-16 and it shall be liable to pay income-tax on such total income@18.5% [Section 115JC(1)]. Therefore, the tax payable for the A.Y.2016-17 would be ₹ 89.63 lakhs.

Tax credit for Alternate Minimum Tax [Section 115JD]	₹ in lakhs
Total tax payable for A.Y.2016-17 (Alternate Minimum Tax)	89.63
Less: Regular income-tax payable	24.72
To be carried forward for set-off against regular income-tax payable (upto a maximum of ten assessment years).	64.91

II. Where the firm files its return of income in December 2016:

Where the firm files its return in December, 2016, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under section 80-IA would not be available. In such circumstances, the gross total income of ₹ 420 lakhs would be the total income of the firm.

Particulars	₹ in lakhs
Income-tax@30% of ₹ 420 lakhs	126.00
Add: Surcharge@12% (since total income exceeds ₹ 100 lakhs)	15.12
Income-tax (plus surcharge)	141.12
Add: Education cess@2% and SHEC@1%	4.23
Total tax liability	145.35

Right course of action to minimize tax liability

The right course of action to minimize tax liability would be to file the return of income under section 139(1) on or before the due date 30.9.2016 and claim deduction under section 80-IA. In such a case, the firm can claim deduction of ₹ 340 lakhs under section 80-IA. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return under section 139(5) within 31.3.2018 (i.e., within one year from the end of A.Y.2016-17) which would replace the original return filed under section 139(1). A return filed under section 139(1) [i.e., on or before the due date of filing return of income] can only be revised under section 139(5). A belated return filed under section 139(4) cannot be revised.

If the firm files the return of income under section 139(1) on or before 30.9.2016, its tax liability would stand reduced to ₹ 89.63 lakhs, as against ₹ 145.35 lakhs to be paid if return is furnished after due date. Further, it would also be eligible for tax credit for alternate minimum tax under section 115JD to the extent of ₹ 64.91 lakhs. Therefore, the firm is advised to file its return of income on or before 30.9.2016.

15. Computation of total income of Mr. Vikas for A.Y.2015-16

Particulars	₹	₹
Income from House Property [House situated in Country B]		
Gross Annual Value[4]	3,30,000	
Less: Municipal taxes paid in Country B	10,000	
Net Annual Value	3,20,000	
Less: Deduction under section 24 – 30% of NAV	96,000	
		2,24,000
Profits and Gains of Business or Profession		
Income from business carried on in India		9,20,000
Income from Other Sources		
Interest on savings bank with IDBI Bank	24,000	
Agricultural income in Country A	72,000	
Dividend received from a company in Country B	2,25,000	
Royalty income from a book of art in Country A (after deducting expenses of ₹ 70,000)	7,30,000	10,51,000
Gross Total Income		21,95,000
Less: Deduction under Chapter VIA		
Under section 80QQB – Royalty income of a resident from a work of art[5]		3,00,000
Under section 80TTA – Interest on savings bank account, subject to a maximum of ₹10,000.		10,000
Total Income		18,85,000

Computation of tax liability of Mr. Vikas for A.Y.2015-16

Particulars	₹
Tax on total income [30% of ₹ 8,85,000 + ₹ 1,25,000]	3,90,500
Add: Education cess and SHEC@3%	11,715
	4,02,215
Less: Rebate under section 91 (See Working Note below)	1,56,057
Tax Payable	2,46,158
Tax payable (rounded off)	2,46,160

[4] Rental income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.
[5] It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.

Calculation of Rebate under section 91:		₹
Average rate of tax in India [i.e., ₹ 4,02,215 / ₹ 18,85,000 x 100]	21.34%	
Average rate of tax in country A	12%	
Doubly taxed income pertaining to country A[6]	₹	
Agricultural Income	72,000	
Royalty Income [₹ 8,00,000 – ₹ 70,000 (Expenses) – ₹ 3,00,000 (deduction under section 80QQB)]	4,30,000	
	5,02,000	
Rebate under section 91 on ₹ 5,02,000 @12% [being the lower of average Indian tax rate (21.34%) and foreign tax rate (12%)]		60,240
Average rate of tax in country B	23%	
Doubly taxed income pertaining to country B		
Income from house property	2,24,000	
Dividend	2,25,000	
	4,49,000	
Rebate under section 91 on ₹ 4,49,000 @21.34% (being the lower of average Indian tax rate (21.34%) and foreign tax rate (23%)]		95,817
Total rebate under section 91 (Country A + Country B)		1,56,057

Note: Mr. Vikas shall be allowed deduction under section 91, since the following conditions are fulfilled:-

(a) He is a resident in India during the relevant previous year i.e., P.Y.2015-16.

(b) The income in question accrues or arises to him outside India in foreign countries A & B during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign countries "A" and "B" in his hands and it is presumed that he has paid tax on such income in those countries.

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[6] Doubly taxed income includes only that part of income which is included in the assessees total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount – *CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).*

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Countries A and B where the income has accrued or arisen.

16. As per section 147, the Assessing Officer may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice in the course of proceedings under that section.

The issue under consideration is whether the Assessing Officer can make an assessment on the basis of an issue which came to his notice during the course of assessment, when the issues, which originally formed the basis of issue of notice under section 148, were dropped in its entirety.

There are two different views in this regard. One view is based on the Delhi High Court ruling in *Ranbaxy Laboratories Ltd. v. CIT (2011) 336 ITR 136.* Another view is based on the Punjab & Haryana High Court ruling in *CIT v. Mehak Finvest P Ltd (2014) 367 ITR 769.*

The Delhi High Court, in *Ranbaxy Laboratories Ltd. v. CIT (2011) 336 ITR 136*, observed that the words "and also" used in section 147 are of wide amplitude. The language of the section is indicative of the position that the assessment or reassessment must be of the income, in respect of which the Assessing Officer has formed a 'reason to believe' for the issue of notice under section 148 and also in respect of any other income which comes to his notice subsequently during the course of the proceedings as having escaped assessment. The correct interpretation, therefore, would be to regard the words 'and also' as being "conjunctive and cumulative with" and not "in alternative to" the first part of the sentence, namely, "the Assessing Officer may assess and reassess such income".

If the income, the escapement of which was the basis of the formation of the "reason to believe", is not assessed or reassessed, it would not be open to the Assessing Officer to independently assess only that income which comes to his notice subsequently in the course of the proceedings under the section as having escaped assessment. If he intends to do so, a fresh notice under section 148 would be necessary.

Considering the rationale of the Delhi High Court ruling, the action of the Assessing Officer in passing a reassessment order under section 147 by making additions on account of disallowances under section 40A(2) in respect of other expenses, when the original "reasons to believe" ceased to exist, is not valid.

However, the Punjab & Haryana High Court, in *Mehak Finvest P Ltd.'s* case, expressed a different view on this issue, based on *Explanation 3* to section 147, which clarifies that the Assessing Officer may, for the purpose of assessment or reassessment under this section, assess or reassess the income in respect of any issue, which has escaped assessment, and such issue comes to his notice subsequently in the course of the proceedings under this section, notwithstanding that the reasons for such issue have not been included in the reasons recorded under section 148(2). The High Court noted that *Explanation 3 to section 147* nowhere postulates or contemplates that the Assessing Officer cannot make any additions on any other ground unless some addition is made on the basis of the original ground for which reassessment proceeding was initiated. It cited the dismissal of special leave petition (SLP) against the High Court ruling in *Majinder Singh Kang's* case by the Supreme Court on 19.08.2011 as the binding precedent.

The Punjab & Haryana High Court, accordingly, held that even though no addition is made on the original grounds which formed the basis of initiation of reassessment proceedings, the Assessing Officer is empowered to make additions on another ground for which reassessment notice might not have been issued but which came to his notice subsequently during the course of proceedings for reassessment

If the rationale of the Punjab & Haryana High Court ruling is applied to the case on hand, the action of the Assessing Officer in passing a reassessment order under section 147 by making additions on account of disallowance under section 40A(2) in respect of other expenses, when the original "reasons to believe" ceased to exist, is valid.

> ***Note*** *– The question can be answered on the basis of the rationale of the Delhi High Court ruling in Ranbaxy Laboratories' case or the Punjab and Haryana High Court ruling in Mehak Finvest P Ltd.' s case.*

17. (i) The statement is not correct.

The Bombay High Court, in CIT v. Pruthvi Brokers & Shareholders (2012) 349 ITR 336, observed the decision of the Supreme Court, in the case of *Jute Corporation of India Ltd. v. CIT (1991) 187 ITR 688* and *National Thermal Power Corporation. Ltd v. CIT (1998) 229 ITR 383*, that an assessee is entitled to raise additional claims before the appellate authorities. The appellate authorities have jurisdiction to permit additional claims before them, however, the exercise of such jurisdiction is entirely the authorities' discretion.

The Bombay High Court held that additional grounds can be raised before the Appellate Authority even otherwise than by way of filing return of income. However, in case the claim has to be made before the Assessing Officer, the same can only be made by way of filing a revised return of income.

(ii) The statement is not correct.

In *CIT v. Earnest Exports Ltd. (2010) 323 ITR 577,* the Bombay High Court observed that the power under section 254(2) is limited to rectification of a mistake apparent on record and therefore, the Tribunal must restrict itself within those parameters. Section 254(2) is not a carte blanche for the Tribunal to change its own view by substituting a view which it believes should have been taken in the first instance. Section 254(2) is not a mandate to unsettle decisions taken after due reflection. The High Court, therefore, held that re-appreciation of the correctness of the earlier decision on merits is beyond the scope of the power conferred under section 254(2)

18. Under section 263(1), if the Principal Commissioner or Commissioner considers that any order passed by the Assessing Officer is erroneous in so far as it is prejudicial to the

interests of the Revenue, he may, after giving the assessee an opportunity of being heard and after making an enquiry, pass an order enhancing or modifying the assessment made by the Assessing Officer or cancelling the assessment and directing fresh assessment.

Explanation 2 has been inserted by the Finance Act, 2015 with effect from 1st June, 2015 to provide that an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the Revenue, if, in the opinion of the Principal Commissioner or Commissioner,—

(1) the order is passed without making inquiries or verification which should have been made;

(2) the order is passed allowing any relief without inquiring into the claim;

(3) the order has not been made in accordance with any order, direction or instruction issued by the CBDT under section 119;

(4) 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.

19. The issue under consideration in this case is whether making an incorrect claim in the return of income would tantamount to concealment of particulars or furnishing of inaccurate particulars for attracting the penal provisions under section 271(1)(c) when no information given in the return of income is found to be incorrect.

This issue came up before the Supreme Court in *CIT v. Reliance Petro Products Pvt. Ltd. (2010) 322 ITR 158*. The Supreme Court observed that in order to attract the penal provisions of section 271(1)(c), there has to be concealment of the particulars of income or furnishing inaccurate particulars of income. Where no information given in the return is found to be incorrect or inaccurate, the assessee cannot be held guilty of furnishing inaccurate particulars. Making an incorrect claim (i.e. a claim which has been disallowed) would not, by itself, tantamount to furnishing inaccurate particulars.

The Apex Court held that where there is no finding that any details supplied by the assessee in its return are incorrect or erroneous or false, there is no question of imposing penalty under section 271(1)(c). A mere making of a claim, which is not sustainable in law, by itself, will not amount to furnishing inaccurate particulars regarding the income of the assessee.

Applying the rationale of the above Supreme Court ruling to the case on hand, penalty under section 271(1)(c) cannot be imposed on PQR Ltd. merely for making an incorrect claim which is not sustainable in law, since the company had furnished all the details in the return of income correctly and no information given by the company was found to be incorrect or erroneous or false.

The contention of PQR Ltd. is, therefore, correct.

20. (i) The statement is not correct.

Section 194A(3)(v) has been amended by the Finance Act, 2015 to specifically provide that with effect from 1st June, 2015, the exemption available thereunder from deduction of tax at source from payment of interest to members by a co-operative society shall not apply to the payment of interest by the co-operative banks to its members.

However, the exemption available under section 194A(3)(viia)(a) to primary agricultural credit society or a primary credit society or a co-operative land mortgage bank or a co-operative land development bank from deduction of tax in respect of interest credited or paid on deposits shall continue to apply. Therefore, these co-operative credit societies/banks would not be required to deduct tax on interest credited or paid to depositors consequent to amendment of section 194A(3)(v).

Further, the exemption under section 194A(3)(v) from deduction of tax from interest paid by a co-operative society to another co-operative society shall continue to apply to co-operative banks and, therefore, a co-operative bank shall not be required to deduct tax from the payment of interest on time deposit to a depositor, being a co-operative society.

(ii) The statement is not correct.

Prior to amendment by the Finance Act, 2015, the definition of "time deposits" under section 194A excluded "recurring deposit" from its scope. Therefore, payment of interest on recurring deposits by banking company or co-operative bank was not subject to TDS under section 194A.

Since recurring deposit is also made for a fixed tenure and is, therefore, similar to time deposit, the definition of 'time deposits' in section 194A has been amended by the Finance Act, 2015 with effect from 1st June, 2015 to include "recurring deposits" within its scope for the purposes of deduction of tax under section 194A. Therefore, interest on recurring deposits would now be subject to tax deduction under section 194A. It may be noted that the existing threshold limit of ₹ 10,000 for non-deduction of tax shall also be applicable in case of interest payment on recurring deposits.

Applicability of Finance Act, Assessment Year etc. for May, 2016 – Final Examination

Paper 7 : Direct Tax Laws & Paper 8 : Indirect Tax Laws

Applicability of Finance Act, Assessment Year etc. for May, 2016 Examination

The provisions of direct tax laws (income-tax) and indirect tax laws, as amended by the Finance Act, 2015, including notifications and circulars issued up to 31st October, 2015, are applicable for May, 2016 examination. The relevant assessment year for Paper 7: Direct Tax Laws is A.Y.2016-17.

ANNEXURE

Part I: Statutory Update – Direct Tax Laws

Significant Notifications and Circulars issued between 1.5.2015 and 31.10.2015

I. NOTIFICATIONS

1. Nature of Business Relationship, for the purpose of clause (b)(viii) of *Explanation* below section 288(2), prescribed [Notification No. 50/2015, dated 24.6.2015]

   Explanation below section 288(2) defines an "accountant" to mean a "Chartered Accountant" as defined in section 2(1)(b) of the Chartered Accountants Act, 1949, holding a valid certificate of practice under section 6(1) of the said Act, but does not include [except for appearing as an authorized representative under section 288(1)] in case of a non-corporate assessee, *inter alia* a person who, whether directly or indirectly, has business relationship with the assessee of such nature as may be prescribed.

   Consequently, the CBDT has, in exercise of the powers conferred by section 295 read with sub-clause (b) (*viii*) of *Explanation* below section 288(2), inserted Rule 51A prescribing the nature of business relationship. Accordingly, the term "business relationship" shall be construed as any transaction entered into for a commercial purpose, other than,—

   (i) 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;

   (ii) commercial transactions which are in the ordinary course of business of the entity at arm's length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by entities engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses."[1]

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[1] Section 141(3) of the Companies Act, 2013 contains a similar disqualification in case of a company; for which purpose "business relationship" has been defined in the like manner in Rule 10(4) of the Companies (Audit & Auditors) Rules, 2014. It may be noted that in case of a company, a person who is not eligible for appointment as an auditor of the said company in accordance with section 141(3) of the Companies Act, 2013 is not included in the definition of "accountant" [except for appearing as an authorised representative under section 288(1)]

2. No tax to be deducted in respect of the income specified under section 10(23FBA) received by an Investment Fund [Notification No. 51/2015, dated 24.6.2015]

Section 197A(1F) provides that no deduction of tax shall be made from such specified payment to such institution, association or body or class of institutions, associations or bodies as may be notified by the Central Government.

Accordingly, the Central Government has, vide this notification, notified that no tax has to be deducted in respect of payments of the nature specified in section 10(*23FBA*) [i.e., any income other than the income chargeable under the head "Profits and gains of business or profession"] received by any investment fund.[2]

3. Notification of Cost Inflation Index for Financial Year 2015-16 [Notification No. 60/2015, dated 24.7.2015]

Clause (v) of Explanation to section 48 defines "Cost Inflation Index", in relation to a previous year, to mean such Index as the Central Government may, by notification in the Official Gazette, specify in this behalf, having regard to 75% of average rise in the Consumer Price Index (Urban) for the immediately preceding previous year to such previous year.

Accordingly, the Central Government has, in exercise of the powers conferred by clause (v) of Explanation to section 48, specified the Cost Inflation Index for the financial year 2015-16 as 1081.

S. No.	Financial Year	Cost Inflation Index	S. No.	Financial Year	Cost Inflation Index
1.	1981-82	100	19.	1999-2000	389
2.	1982-83	109	20.	2000-01	406
3.	1983-84	116	21.	2001-02	426
4.	1984-85	125	22.	2002-03	447
5.	1985-86	133	23.	2003-04	463
6.	1986-87	140	24.	2004-05	480
7.	1987-88	150	25.	2005-06	497
8.	1988-89	161	26.	2006-07	519
9.	1989-90	172	27.	2007-08	551

[2] "Investment Fund" means any fund established or incorporated in India in the form of a trust or a company or a LLP 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 (AIF) Regulations, 2012, made under the SEBI Act, 1992.

10.	1990-91	182	28.	2008-09	582
11.	1991-92	199	29.	2009-10	632
12.	1992-93	223	30.	2010-11	711
13.	1993-94	244	31.	2011-12	785
14.	1994-95	259	32.	2012-13	852
15.	1995-96	281	33.	2013-14	939
16.	1996-97	305	34.	2014-15	1024
17.	1997-98	331	35.	2015-16	1081
18.	1998-99	351			

4. **Basis for determining the period of stay in India for an Indian citizen, being a member of the crew of a foreign bound ship leaving India [Notification No. 70/2015, dated 17.8.2015]**

Section 6(1) of the Income-tax Act, 1961 provides that an individual is said to be resident in India in any previous year, if he—

(a) is in India in that year for a period or periods amounting in all to 182 days or more; or

(b) having within the four years preceding that year been in India for a period or periods amounting in all to 365 days or more, is in India for a period or periods amounting in all to 60 days or more in that year.

However, where an Indian citizen leaves India as a member of crew of an Indian ship or for the purpose of employment outside India, he will be resident only if he stayed in India for 182 days during the previous year.

Thus, under section 6(1), the conditions to be satisfied by an individual to be a resident in India are provided. The residential status is determined on the basis of the **number of days of his stay in India** during a previous year.

However, in case of **foreign bound ships** where the destination of the **voyage is outside India**, there is **uncertainty** regarding the manner and the basis of **determining the period of stay in India for an Indian citizen, being a crew member.**

To remove this uncertainty, *Explanation 2* **has been inserted to section** 6(1) to provide that in the case of an individual, being a citizen of India and a member of the crew of a foreign bound ship leaving India, the **period or periods of stay in India** shall, in respect of such voyage, be determined in the **prescribed manner** and subject to the prescribed conditions.

Accordingly, the CBDT has, in exercise of the powers conferred by *Explanation 2* to section 6(1) read with section 295, vide this notification, with retrospective effect from 1st April, 2015, inserted Rule 126 in the Income-tax Rules, 1962 to compute the period of stay in such cases.

According to Rule 126, in case of an individual, being a citizen of India and a member of the crew of a ship, the **period or periods of stay in India** shall, in respect of an eligible voyage, **not include** the period **commencing from the date** entered into the Continuous Discharge Certificate in respect of **joining the ship** by the said individual for the eligible voyage and **ending on the date** entered into the Continuous Discharge Certificate in respect of **signing off by that individual from the ship** in respect of such voyage.

The Explanation to this Rule defines the meaning of the following terms:

Terms	Meaning
Continuous Discharge Certificate	This term has the meaning assigned to it in the Merchant Shipping (Continuous Discharge Certificate-cum-Seafarer's Identity Document) Rules, 2001 made under the Merchant Shipping Act, 1958.
Eligible voyage	A voyage undertaken by a ship engaged in the carriage of passengers or freight in international traffic where- (i) for the voyage having originated from any port in India, has as its destination any port outside India; and (ii) for the voyage having originated from any port outside India, has as its destination any port in India.

5. **Certain districts of Bihar notified as backward areas under the first proviso to section 32(1)(iia) and section 32AD(1) [Notification No. 71/2015, dated 17.8.2015]**

In order to encourage the setting up of industrial undertakings in the backward areas of the States of Andhra Pradesh, Bihar, Telangana and West Bengal, section 32AD(1) provides for a deduction of an amount equal to 15% of the actual cost of new plant and machinery acquired and installed in the assessment year relevant to the previous year in which such plant and machinery is installed, if the following conditions are satisfied by the assessee–

(a) the assessee sets up an undertaking or enterprise for manufacture or production of any article or thing on or after 1st April, 2015 in any backward area notified by the Central Government in the State of Andhra Pradesh or Bihar or Telangana or West Bengal; and

(b) the assessee acquires and installs new plant and machinery for the purposes of the said undertaking or enterprise during the period between 1st April, 2015 and 31st March, 2020 in the said backward areas.

Further, in order to encourage acquisition and installation of plant and machinery for setting up of manufacturing units in the notified backward areas of the States of Andhra Pradesh, Bihar, Telangana and West Bengal, first proviso has been inserted to section 32(1)(iia) to allow higher additional depreciation at the rate of 35% (instead of 20%) in respect of the actual cost of new machinery or plant (other than a ship and aircraft) acquired and installed during the period between 1st April, 2015 and 31st March, 2020 by a manufacturing undertaking or enterprise which is set up in the notified backward areas of these specified States on or after 1st April, 2015.

Accordingly, the Central Government has, vide this notification, notified the following 21 districts of the State of Bihar as backward areas under the first proviso to section 32(1)(iia) and section 32AD(1): -

S. No.	District	S. No.	District
1.	Patna	12.	Samastipur
2.	Nalanda	13.	Darbhanga
3.	Bhojpur	14.	Madhubani
4.	Rohtas	15.	Purnea
5.	Kaimur	16.	Katihar
6.	Gaya	17.	Araria
7.	Jehanabad	18.	Jamui
8.	Aurangabad	19.	Lakhisarai
9.	Nawada	20.	Supaul
10.	Vaishali	21.	Muzaffarpur
11.	Sheohar		

6. News agency notified for the purpose of section 10(22B) [Notification No. 72/2015, dated 24.8.2015]

Section 10(22B) provides that any income of a news agency set up in India solely for collection and distribution of news as the Central Government may notify shall be exempt, subject to the condition that such news agency applies its income or accumulates it for application solely for collection and distribution of news and does not distribute its income in any manner to its members.

Accordingly, the Central Government has, through this notification, specified the Press Trust of India Limited, New Delhi as a news agency set up in India solely for collection and distribution of news, for the purpose of section 10(22B) for three assessment years 2016-17 to 2018-19. The income of such news agency will not be included in computing the total income of a previous year of such agency for these three years, provided it applies its income or accumulates it for application solely for collection and distribution of news and does not distribute its income in any manner to its members.

7. **Exemption in respect of transport allowance under Rule 2BB extended to deaf and dumb employees [Notification No. 75/2015, dated 23.09.2015]**

The CBDT has, in exercise of the powers conferred by section 295 read with section 10(14), amended Rule 2BB, which *inter alia* provides the limit of exemption of up to ₹ 1,600 p.m., in respect of transport allowance granted to an employee and up to ₹ 3,200 p.m., for an employee who is blind or orthopedically handicapped, with disability of lower extremities, to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty.

Consequent to the amendment made vide this notification, the exemption up to ₹ 3,200 p.m. in respect of transport allowance can be claimed by a blind ***or deaf and dumb*** or orthopedically handicapped employee with disability of lower extremities to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty.

8. **Simplification of format and procedure for self-declaration in Form No.15G & 15H [Notification No. 76/2015, dated 29.09.2015]**

Tax payers seeking non-deduction of tax from certain incomes are required to file a self-declaration in Form No. 15G or Form No.15H as per section 197A. In order to reduce the cost of compliance and ease the compliance burden for both the tax payer and the tax deductor, the CBDT has simplified the format and procedure for self-declaration of Form No.15G or 15H. The procedure for submission of the Forms by the deductor has also been simplified.

Under the simplified procedure contained in new Rule 29C, a payee can submit the self-declaration either in paper form or electronically. The deductor will not deduct tax and will allot a Unique Identification Number (UIN) to all self-declarations in accordance with the procedure as specified by the Principal Director General of Income-tax (Systems) under sub-rule (7) of new Rule 29C. The particulars of self-declarations will have to be furnished by the deductor along with UIN in the quarterly TDS statements. The requirement of submitting physical copy of Form 15G and 15H by the deductor to the income-tax authorities has been dispensed with. The deductor will, however be required to retain Form No.15G and 15H for seven years. The revised procedure shall be effective from 1st October, 2015.

9. **Transfer Pricing Rules amended to incorporate "range concept" and "use of multi-year data" [Notification No. 83/2015, dated 19.10.2015]**

Section 92C(2) provides that the arm's length price (ALP) in relation to an international transaction or specified domestic transaction has to be determined by applying the most appropriate method.

As per the first proviso to section 92C(2), where more than one price is determined by applying the most appropriate method, the ALP shall be taken to be the arithmetical mean of such prices.

However, if the variation between the ALP so determined and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage, not exceeding 3%, as may be notified by the Central Government, the price at which the transaction has actually been undertaken would be deemed to be the ALP.

In the year 2014, the Finance Minister, in his budget speech, had proposed to introduce the "range concept" for determination of ALP, for aligning Transfer Pricing Regulations in India with the best practices.

Accordingly, a third proviso was inserted in section 92C(2) to provide that in case of an international transaction or specified domestic transaction undertaken on or after 1.4.2014, where more than one price is determined by the most appropriate method, the ALP shall be computed in the prescribed manner (based on "range concept" to be specified by way of Rules) and the computation methodology given in the first and second proviso, based on arithmetic mean, shall be ignored.

The CBDT has, in exercise of the powers conferred by section 92C read with section 295 prescribed the manner of computation of arm's length price applicable for international transactions and specified domestic transactions undertaken on or after 1.4.2014.

Incorporation of "Range Concept" in Transfer Pricing Rules

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[3] 1% in respect of wholesale trading and 3% in respect of all other cases (for A.Y.2015-16) [Notification No.86/2015 dated 29.10.2015]. Wholesale trading, for this purpose, means an international transaction or specified domestic transaction of trading in goods, which fulfils the following conditions, namely:-

(i) purchase cost of finished goods is 80% or more of the total cost pertaining to such trading activities; and

(ii) average monthly closing inventory of such goods is 10% or less of sales pertaining to such trading activities.

		is a whole number, then, the median shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.

Use of multiple year data:

Sub-rule (5) has been inserted in Rule 10B to provide that in case the most appropriate method for determination of ALP of a transaction entered into on or after 1.4.2014 is the resale price method or cost plus method or the transactional net margin method, then, the data to be used for analyzing the comparability of an uncontrolled transaction with an international transaction shall be –

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

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

However, where the data relating to the current year is subsequently available at the time of determination of arm's length price of an international transaction 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.

II. CIRCULARS

1. Tax not to be deducted from payments made to Corporations whose income is exempt under section 10(26BBB) [Circular No. 7/2015, dated 23-04-2015]

The CBDT had earlier issued Circular No. 4/2002 dated 16.07.2002 which laid down that there would be no requirement for tax deduction at source from payments made to such entities, whose income is unconditionally exempt under section 10 and who are statutorily not required to file return of income as per the section 139.

Section 10(26BBB), inserted by the Finance Act, 2003 w.e.f. 01.04.2004, exempts any income of a corporation established by a Central, State or Provincial Act for the welfare and economic up liftment of ex-service-men being the citizen of India. The corporations covered under section 10(26BBB) are also statutorily not required to file return of income as per the section 139.

Now, the CBDT has, vide this circular, clarified that since corporations covered under section 10(26BBB) satisfy the two conditions of Circular No. 4/2002 i.e., unconditional exemption of income under section 10 and no statutory liability to file return of income under section 139, they would also be entitled for the benefit of the said circular.

Hence, there would be no requirement for tax deduction at source from the payments made to such corporations since their income is anyway exempt under section 10.

2. Clarifications on Rollback Provisions of Advance Pricing Agreement Scheme [Circular No. 10/2015, dated 10-06-2015]

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

Keeping in mind the benefits offered by the APAs, sections 92CC and section 92CD were introduced in the transfer pricing regime by the Finance Act, 2012 to provide a framework for formulation of APAs between the tax payer and the income-tax authorities.

Subsequently, the Advance Pricing Agreement Scheme was notified vide Notification No. 36/2012, dated 30/8/2012, thereby inserting Rules 10F to 10T and Rule 44GA in the Income-tax Rules, 1962.

In order to reduce current pending as well as future litigation in respect of the transfer pricing matters, the Finance (No. 2) Act, 2014 has inserted sub-section (9A) in section 92CC to provide for a roll back mechanism in the APA scheme.

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

The CBDT has, vide Notification No.23/2015 dated 14.3.2015, in exercise of the powers conferred by section 92CC(9) and 92CC(9A) read with section 295, prescribed the conditions, procedure and manner for determining the arm's length price or for specifying the manner in which arm's length price is to be determined in relation to an international transaction in which the roll back provisions have to be given effect to[4].

Subsequent to this notification of the rules, the CBDT has issued Circular No.10/2015 dated 10.6.2015 adopting a Question and Answer format to clarify certain issues arising out of the said Rules. The questions raised and answers to

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[4] Refer pages 16.34-16.38 of November 2015 Edition of the Study Material of Final Paper 7 : Direct Tax Laws or pages 136-140 of Supplementary Study Paper – 2015 of Final Course for Notification No.23/2015 dated 14.3.2015.

such questions as per the said Circular are given hereunder:

Question 1

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

Answer

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

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

Question 2

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

Answer

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

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

Question 3

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

Answer

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

Question 4

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

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

Answer

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

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

Question 5

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

Answer

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

Question 6

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

Answer

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

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

Question 7

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

Answer

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

Question 8

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

Answer

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

Question 9

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

Answer

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

Question 10

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

Answer

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

Question 11

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

Answer

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

Question 12

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

Answer

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

Question 13

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

Answer

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

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

Question 14

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

Answer

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

3. Deduction in respect of cost of production allowable under section 37 in the case of Abandoned Feature Films [Circular No. 16, dated 6.10.2015]

The deduction in respect of the cost of production of a feature film certified for release by the Board of Film Censors in a previous year is provided in Rule 9A.

In the case of abandoned films, however, since certificate of Board of Film Censors is not received, in some cases no deduction was allowed by applying Rule 9A of the Rules or by treating the expenditure as capital expenditure.

The CBDT has examined the matter in light of judicial decisions on this subject. The order of the Hon'ble Bombay High Court dated 28.1.2015 in ITA 310 of 2013 in the case of *Venus Records and Tapes Pvt. Ltd.* on this issue has been accepted and the aforesaid disputed issue has not been further contested.

Consequently, it is clarified that Rule 9A does not apply to abandoned feature films and that the expenditure incurred on such abandoned feature films is <u>not</u> to be treated as a capital expenditure. The cost of production of an abandoned feature film is to be treated as revenue expenditure and allowed as per the provisions of section 37 of the Income-tax Act, 1961.

Part II: Judicial Update – Direct Tax Laws

Significant Legal Decisions

Residential Status and Scope of Total Income

1. Can consideration for supply of software embedded in hardware tantamount to 'royalty' under section 9(1)(vi)?

   CIT v. Alcatel Lucent Canada (2015) 372 ITR 476 (Del)

   Facts of the case: The assessee, a company incorporated in France, was engaged in manufacture, trade and supply equipment and services for GSM Cellular Radio Telephones Systems. It supplied hardware and software to various entities in India. Software licensed by the assessee embodied the process which is required to control and manage the specific set of activities involved in the business use of its customers. Software also made available the process to its customers, who used it to carry out their business activities. The Assessing Officer contended that the consideration for supply of software embedded in hardware is 'royalty' under section 9(1)(vi).

   Appellate Authorities' Views: The Commissioner (Appeals) and Tribunal held that the consideration for supply of embedded software (which is part of the hardware supplied to the assessee customers) did not constitute royalty and therefore, section 9(1)(vi) was not attracted.

   High Court's Observations: The High Court, at the outset, noted that the Tribunal had relied upon the precedent in the case of *DIT v. Ericsson A.B. (2012) 343 ITR 470 (Del),* where the High Court observed that what was sold by the assessee to its Indian customers was a GSM which consisted of both hardware and software. The High Court had also observed that -

   (i) the software that was loaded on the hardware did not have any independent existence;

   (ii) the software supply is an integral part of GSM mobile telephone system and is used by the cellular operators for providing cellular services to its customers;

   (iii) the software is embedded in the system and there could not be any independent use of such software;

   (iv) this software merely facilitates the functioning of the equipment and is an integral part of the hardware.

   Further, the High Court had also referred the decision of the Apex Court in Tata Consultancy Services v. State of Andhra Pradesh (2004) 271 ITR 401, wherein it was held that software incorporated on a media would be goods liable to sales tax.

High Court's Decision: The High Court concurred with the decision of the Tribunal holding that where payment is made for hardware in which the software is embedded and the software does not have independent functional existence, no amount could be attributed as 'royalty' for software in terms of section 9(1)(vi).

Incomes which do not form part of total income

2. **Where an institution engaged in imparting education incidentally makes profit, would it lead to an inference that it ceases to exist solely for educational purposes?**

Queen's Educational Society v. CIT (2015) 372 ITR 699 (SC)

Facts of the case: The assessee, an educational institution, showed a net surplus of ₹ 6.59 lakhs and ₹ 7.83 lakhs, respectively, for the assessment years 2000-01 and 2001-02. Since it was established with the sole object of imparting education, it claimed exemption under section 10(23C)(iiiad). The Assessing Officer rejected the claim of exemption on the ground that the assessee has made profits and did not exist solely for educational purposes. The Commissioner (Appeals) allowed the assessee's claim and the Tribunal dismissed the Revenue's appeal holding that the assessee was engaged undoubtedly in imparting education and the profit was only incidental to the main object of spreading education. However, the High Court restored the order of the Assessing Officer on the reasoning that the institution made profit, year on year, and hence, was not eligible for tax exemption.

Supreme Court's Observations: The Supreme Court observed that the provisions of section 10(23C)(iiiad) provide for three requirements, namely,

(i) the education institution must exist solely for educational purposes;

(ii) it should not be for purposes of profit; and

(iii) the aggregate annual receipts of such institution should not exceed the amount as may be prescribed. Such monetary limit is ₹ 1 crore as per Rule 2BC.

The Supreme Court concurred with the Tribunal's reasoning that profit is only incidental to the main object of spreading education. If there is no surplus arising out of the difference between receipts and outgoings, the trust will not be able to achieve the objectives. Any education institution cannot be run in rented premises for all the times and without necessary equipment and without paying to the staff engaged in imparting education. The assessee is not getting any financial aid/assistance from the Government or other philanthropic agency and, therefore, to achieve the objective, it has to raise its own funds. However, such surplus would not come within the ambit of denying exemption under section 10(23C)(iiiad).

Further, the Apex Court made reference to the tests culled out in its own decisions in the case of *Addl. CIT v. Surat Art Silk Cloth Manufacturers Association [1980] 121 ITR 1,* *Aditanar Educational Institution v. Addl. CIT [1997] 224 ITR 310 and American Hotel and Lodging Association Educational Institute v. CBDT [2008] 301 ITR 86*, which would apply for determining whether an educational institution exists solely for education purposes and not for purposes of profit.

The Apex Court, after analyzing the legal provisions and precedents, summed up the law common to section 10(23C)(iiiad)/(vi):

(a) Where an educational institution carries on the activity of education primarily for educating persons, the fact that it makes a surplus does not lead to the conclusion that it ceases to exist solely for educational purposes and becomes an institution for the purpose of making profit;

(b) The predominant object test must be applied – the purpose of education should not be submerged by a profit making motive;

(c) A distinction must be drawn between the making of surplus and an institution being carried on "for profit". Merely because imparting of education results in making a profit, it cannot be inferred that it becomes an activity for profit;

(d) If after meeting expenditure, surplus arises incidentally from the activity carried on by the educational institution, it will not cease to be one existing solely for educational purposes; and

(e) The ultimate test is whether on an overall view of the matter in the concerned assessment year, the object is to make profit as opposed to educating persons.

<u>Apex Court's Decision</u>: Based on the above principles and tests, the Apex Court upheld the Tribunal's view that the assessee was engaged in imparting education and the profit was only incidental to the main object of spreading education. Hence, it satisfies the conditions laid down in section 10(23C)(iiiad) for claim of exemption thereunder.

<u>Profits and gains from business or profession</u>

3. Under what head of income should income from letting out of godowns and provision of warehousing services be subject to tax - "Income from house property" or "profits and gains of business or profession"?

CIT v. NDR Warehousing P Ltd (2015) 372 ITR 690 (Mad)

<u>Facts of the case</u>: The assessee engaged in the business of warehousing, handling and transport business claimed income from letting out of buildings and godowns as business income. The Assessing Officer assessed such income as "Income from house property".

<u>Appellate Authorities' Observations</u>: The Commissioner (Appeals) observed that the assessee's activity was not merely letting out of warehouses but storage of goods with provision of several auxiliary services such as pest control, rodent control and fumigation service to prevent the goods stored from being affected by vagaries of moisture and

temperature. Further, service of security and protection was also provided to the goods stored. There is, therefore, no dispute that the assessee carries on the activity in an organised manner. These activities are more than mere letting out of the godown for tenancy.

The Tribunal noted that the objects clause of the memorandum of association of the company clearly shows that the assessee-company was incorporated with the object of carrying on the business of warehousing and letting/renting of godowns and providing facilities for storage of articles or things and descriptions whatsoever. The profit and loss account of the assessee-company shows that its main source of income is storage charges and maintenance or user charges. Even substantial part of the expenses also relate to the salaries of employees engaged in the maintenance and upkeep of the godowns and warehouses. Based on these facts, Tribunal concurred with the findings of the Commissioner (Appeals) and held that the income of the assessee from letting out of warehouses and godowns is chargeable under the head "Profits and gains of business or profession" and not "Income from house property".

<u>High Court's Decision</u> : The High Court observed that the Commissioner (Appeals) as well as the Tribunal had not only gone into the objects clause of the memorandum of the assessee but also individual aspects of the business to come to the conclusion that it was a case of warehousing business, and, therefore, the income would fall under the head "Profits and gains of business or profession".

Accordingly, the High Court held that the income earned by the assessee from letting out of godowns and provision of warehousing services is chargeable to tax under the head "Profits and gains of business or profession" and not under the head "Income from house property".

4. Can section 41(1) be invoked in respect of long standing credit balances of sundry creditors admitted as liability in the Balance Sheet?

Principal CIT v. Matruprasad C.Pandey (2015) 377 ITR 363 (Guj)

<u>Facts of the case</u>: A notice under section 142(1) was served upon the assessee along with a detailed questionnaire. On verification of the Balance Sheet, the Assessing Officer noticed that the assessee had shown sundry creditors amounting to ₹197.73 lakhs in the Balance Sheet, for which the assessee was asked to furnish a copy of the ledger account of the last three years, break-up of the amounts outstanding along with complete name, address, PAN and confirmation letters. The assessee failed to produce the break-up of the amounts appearing in the Balance Sheet and therefore, a show cause notice was issued as to why the amounts should not be added to his total income as unexplained credit. The Assessing Officer further observed that in this case, the outstanding liabilities of ten sundry creditors, who were very old, was ₹ 56.52 lakhs and the payment has reached the stage of cessation. Consequently, the Assessing Officer treated the long standing creditors as no longer payable/cessation of liabilities under section 41(1) and

hence, added such amount to the total income by invoking the provisions of section 41(1).

<u>Appellate Authorities' Views:</u> The Commisioner (Appeals) confirmed the addition of ₹ 56.52 lakhs by invoking section 41(1). However, the Appellate Tribunal deleted such addition in respect of outstanding credit balances of certain parties brought forward from earlier years by invoking section 41(1).

<u>High Court's Observations</u>: The High Court observed that the Assessing Officer invoked section 41(1) by doubting certain creditors which were appearing in the balance sheet for the past several years. At no point of time earlier, the Assessing Officer doubted the credit worthiness or identity of the creditors.

The Court referred the decision of its own division bench in the case of *CIT v. Nitin S.Garg (2012) 22 taxmann.com 59* wherein it was observed that where the assessee had continued to show the admitted amounts as liabilities in its Balance Sheet and no interest had been paid on those loans, section 41(1) cannot be invoked merely because they were outstanding for the last so many years. The Division Bench noted that the Assessing Officer shall have to prove that the assessee has obtained the benefits in respect of such trading liabilities by way of remission or cessation thereof.

<u>High Court's Decision</u> : The High Court held that addition on the ground that the amounts were outstanding for several years cannot be made under section 41(1) unless and until it is found that there was remission or cessation of liability that too during the previous year, relevant to the assessment year in question. Even if the credit balances are outstanding for long time, such balances cannot be subjected to tax by invoking section 41(1), unless there is a remission/cessation of liability in the year under question.

5. **Where the lump sum amount paid as One Time Settlement (OTS), without bifurcation of interest and principal, has been offered to tax under section 41(1), can the assesseee claim benefit of deduction of interest (interest paid plus interest waived) under section 43B?**

CIT v. KLN Agrotechs (P) Ltd (2015) 375 ITR 301 (Kar.)

<u>Facts of the case</u>: The assessee company is engaged in the business of manufacture and trading of refined edible oil. It had taken working capital loan from Canara Bank aggregating to ₹ 441.30 lakhs. Due to default in repayment of loan, the bank declared the account as NPA. The total outstanding payable by the company was ₹ 635.26 lakhs which included principal amount of ₹ 441.30 and interest amount of ₹ 193.96 lakhs. During the assessment year in question, the assessee arrived at One Time Settlement (OTS) scheme with the bank. As per the OTS, the assessee paid ₹ 378.72 lakhs (against the total outstanding of ₹ 635.26 lakhs) to the bank.

In the return filed, the assessee offered as income ₹ 256.54 lakhs being the difference between the amount outstanding (₹ 635.26 lakhs) and the actual amount paid

(₹ 378.72 lakhs). The assessee also claimed the interest of ₹193.96 lakhs as deduction under section 43B.

The Revenue rejected the claim of deduction under section 43B in respect of ₹ 193.96 lakhs and charged to tax the entire amount of ₹ 256.54 lakhs considering the actual amount paid as the amount adjusted towards the principal outstanding amount.

Appellate Tribunal's view: The Appellate Tribunal, however, allowed the claim of the assessee holding that the assessee cannot be subjected to double jeopardy i.e., it could not be subjected to tax on the entire waived amount as well as subjected to disallowance of interest under section 43B, as the said two effects are mutually exclusive and cannot co-exist.

High Court's Observations & Decision : The High Court concurred with the Tribunal's view that if out of the total sum of ₹ 256.54 lakhs which has been offered and subjected to tax by the assessee in its return, the amount of unpaid interest of ₹ 193.96 lakhs is deducted then the waived principal sum would come to ₹ 62.58 lakhs (i.e., ₹441.30 lakhs *minus* ₹ 378.72 lakhs), which is the amount which ought to have been taxed under section 41(1).

Based on the above reasoning, the High Court held that either the interest amount has to be allowed as deduction under section 43B or the sum offered for tax (as waived by the bank) has to be reduced by the amount of interest. In either case, the effective amount which is subjected to tax, would come to the same.

Note - The rationale of the Karnataka High Court ruling in the above case can be explained with the help of a simple example:

The following are particulars of OTS scheme of A Ltd. with ABC Bank -

	Particulars	*Principal*	*Interest*	*Total*
		₹ in lakhs		*₹ in lakhs*
(1)	*Amount Outstanding (Working Capital loan)*	*400*	*150*	*550*
(2)	*Payment under OTS scheme with bank*			*300*
	Option 1	*150*	*150*	
	Option 2	*300*	*-*	
	Option 3	*200*	*100*	
(3)	*Waiver [(1) – (2)]*			*250*
	Option 1	*250*	*-*	
	Option 2	*100*	*150*	
	Option 3	*200*	*50*	

In all three cases above, let us assume that A Ltd. has offered ₹ 250 lakhs (i.e., ₹ 550 lakhs - ₹ 300 lakhs) as income under section 41(1) and claimed the interest paid/waived as deduction under section 43B.

*In **Option** 1, A Ltd. has rightly offered ₹ 250 lakhs, being waiver of principal amount, as income under section 41(1). In this case, the interest of ₹ 150 lakhs actually paid would be deductible under section 43B on payment basis.*

*In **Option** 2, A Ltd. should have offered only ₹ 100 lakhs, being waiver of principal amount, as income under section 41(1). However, it has offered the entire amount of ₹ 250 lakhs waived, as income under section 41(1). Therefore, A Ltd.'s claim of ₹ 150 lakhs, being interest waiver, as deduction under section 43B would result in effectively bringing to tax the principal waiver of ₹ 100 lakhs.*

*In **Option** 3, A Ltd. should have offered only ₹ 200 lakhs, being waiver of principal amount, as income under section 41(1) and claimed interest of ₹ 100 lakhs paid as deduction under section 43B. However, A Ltd. has offered the entire amount of ₹ 250 lakhs waived, as income under section 41(1). Therefore, A Ltd. claim for deduction of ₹ 150 lakhs [₹ 100 lakhs, being interest paid + ₹ 50 lakhs, being interest waived] under section 43B would effectively bring to tax the principal waiver of ₹ 200 lakhs.*

This, in effect, is the rationale of the court ruling, i.e., where the entire amount waived has been offered as income under section 41(1), the claim of interest waived and interest paid as deduction under section 43B would effectively bring to tax, the principal amount waived.

Capital Gains

6. **Can advance given for purchase of land, building, plant and machinery tantamount to utilization of capital gain for purchase and acquisition of new machinery or plant and building or land, for claim of exemption under section 54G?**

Fibre Boards (P) Ltd v. CIT (2015) 376 ITR 596 (SC)

Facts of the case: The assessee-company had an industrial unit in Thane, which had been declared a notified urban area by notification dated September 22, 1967, issued under section 280Y(d) of the Income-tax Act, 1961 *vide* Notification dated 22.09.1967. The assessee, in order to shift its industrial undertaking from an urban area to a non-urban area, sold its land, building and plant and machinery situated at Thane and out of the capital gains so earned, paid advances of various amounts to different persons for purchase of land, plant and machinery, construction of factory and building in the year 1991-92. The assessee claimed exemption under section 54G of the Income-tax Act, 1961, on the capital gains earned from the sale proceeds of its erstwhile industrial undertaking situated in Thane in view of the advances so made, which was more than the capital gains earned by it. The Assessing Officer refused to grant exemption to the assessee under section 54G on the ground that the non-urban area had not been declared to be so by any general or special order of the Central Government and that giving advances did not amount to utilisation of capital gains for acquiring the assets.

Appellate Authorities' views: The CIT (Appeals) dismissed the case of the assessee while the Appellate Tribunal allowed the appeal by stating that even an agreement to purchase is good enough and that Explanation to section 54G is declaratory in nature and would be retrospectively applicable.

High Court's Decision: The High Court reversed the order of the Appellate Tribunal and denied the exemption on the reasoning that the notification declaring Thane to be an urban area stood repealed with the repeal of the section under which it was made. Further the expression "purchase" in the section 54G cannot be equated with the expression "towards purchase" and accordingly the advance for purchase of land, plant and machinery would not entitle the assessee to claim exemption under section 54G.

Supreme Court's Observations: The Apex Court observed that, on a conjoint reading of the Speech of the Finance Minister introducing the Finance Bill, 1987, and the Notes on Clauses and Memorandum explaining the provisions of the Finance Bill of 1987, it becomes clear that the idea of omitting section 280ZA of the Income-tax Act, 1961 and introducing section 54G on the same date was to do away with the tax credit certificates scheme together with the prior approval required by the Board and to substitute the repealed provision with the new scheme contained in section 54G. Once section 280ZA was omitted from the statute book, section 280Y(d) having no independent existence would for all practical purposes also cease to exist. Section 280Y(d) which was a definition section defining "urban area" for the purpose of section 280ZA alone was also omitted subsequently by the Finance Act, 1990. Apart from this, section 54G(1) by its *Explanation* introduces the very definition contained in section 280Y(d) in the same terms. It is obvious that both provisions are not expected to be applied simultaneously and it is clear that the *Explanation* to section 54G(1) repeals, by implication, section 280Y(d).

Unlike section 6 of the General Clauses Act, 1897 which saves certain rights, section 24 merely continues notifications, orders, schemes, rules, etc., that are made under a Central Act which is repealed and re-enacted with or without modification. The idea of section 24 of the 1897 Act is, as its marginal note shows, to continue uninterrupted subordinate legislation that may be made under a Central Act that is repealed and re-enacted with or without modification.

Section 54G gives a time limit of 3 years after the date of transfer of capital asset in the case of shifting of industrial undertaking from urban area to any area other than urban area. The expression used in section 54G(2) is that the amount "which is not utilized by him for all or any of the purposes aforesaid has to be deposited in the capital gain account scheme".

For the purpose of availing exemption, all that was required for the assessee is to "utilise" the amount of capital gain for purchase and acquisition of new machinery or plant and building or land. Since the entire amount of capital gain, in this case, was utilized by the assessee by way of advance for acquisition of land, building, plant and machinery, the assessee was entitled to avail exemption/deduction under section 54G.

Supreme Court's Decision :To avail exemption under section 54G in respect of capital gain arising from transfer of capital assets in the case of shifting of industrial undertaking from urban area to non-urban area, the requirement is satisfied if the capital gain is given as advance for acquisition of capital assets such as land, building and / or plant and machinery.

Note – In this case, two issues have been touched upon, namely, whether notification of an area as an urban area under a repealed provision would hold good under the re-enacted provision and whether advance given for purchase of an eligible asset would tantamount to utilisation of capital gains for purchase of the said asset for availing exemption under section 54G. The former issue was decided taking support from section 24 of the General Clauses Act, 1897, which provides for uninterrupted subordinate legislation in case of repeal and re-enactment, with or without modification. The latter issue was also decided in favour of the assessee by holding that payment of advance for purchase of eligible asset would tantamount to utilisation of capital gains for purchase of the said asset.

7. Whether, for the purpose of computing the period of holding of the property, the date of allotment letter issued by the builder of the flat or the date of registration of the property has to be considered for determining the nature of capital asset – long-term or short-term?

CIT v. S.R.Jeyashankar (2015) 373 ITR 120 (Mad)

Facts of the case: In the present case, the assessee had entered into an agreement with M/s Vishranthi Homes Pvt. Ltd.(VHPL) for purchase of undivided share in a piece of land as well as for construction of a flat under a project promoted by the said builder *vide* agreement dated February 22, 2005. Over a period of time, the payments were made and the transaction was concluded with registration of undivided share of land on August 4, 2005. Thereafter, the assessee sold the entire unit by a sale deed dated April 10, 2008, well after 36 months from the date of agreement i.e., February 22, 2005, and claimed the difference between the sale consideration and the indexed cost of acquisition as long-term capital gains. The Assessing Officer, however, took a view that the undivided share of land was registered on August 4, 2005, and since the property was purchased in the month of August, 2005, and sold in April, 2008, the capital gains arising from sale will be assessed as short-term capital gains only and, accordingly, the Assessing Officer denied benefit of section 2(29A) of the Income-tax Act, 1961 and made addition.

Appellate Authorities' Views: The Commissioner (Appeals) placed reliance on Circular No.471 dated 15.10.1986 and allowed the claim of the assessee. The Tribunal, after taking into consideration the decisions of the Punjab and Haryana High Court, in the cases of *Mrs. Madhu Kaul v. CIT [2014] 363 ITR 54 and Vinod Kumar Jain v. CIT [2012] 344 ITR 501 a*nd Circular No. 471, dated 15.10.1986, held that the date of allotment of the flat has to be adopted as date of acquisition of the immovable property when it comes to acquiring a flat from the promoter of the flat by way of executing construction agreement and not the date of the sale deed for purchase of the undivided share in land. Accordingly, the Tribunal confirmed the order of the Commissioner (Appeals).

<u>High Court's Observations</u>: The Madras High Court noted that the Tribunal had relied on the decision of the Punjab and Haryana High Court in *Mrs. Madhu Kaul's case,* where it was held that the date of allotment under a scheme framed by the DDA is to be taken as the date of acquisition and the mere fact that the actual possession was delivered later does not distract the fact that the allottee was conferred a right to hold the property on issuance of allotment letter and the payment of balance instalments, identification of a particular flat and delivery of possession are consequential acts that relate back to and arise from the date rights were conferred by the allotment letter. In effect, the Punjab & Haryana High Court held that the allottee gets the title to the property on issuance of allotment letter and payment in instalments is only a consequential act upon which delivery of possession to the property flows. The Madras High Court also noted that the Punjab & Haryana High Court had taken a similar view in *Vinod Kumar Jain's* case.

In this case, the Madras High Court observed that the right to the property flows from the date of agreement with the builder i.e., from February, 2005. Over a period of time, payments were made and the transaction was concluded in accordance with the terms of the agreement by registering the undivided share in land and handing over of the flat subsequently.

<u>High Court's Decision</u>: Accordingly, the Madras High Court held that the assessee had rightly claimed the benefit of long-term capital gain, since the holding period exceeded 36 months (i.e., from 22.02.2005, being the date of agreement, to 10.04.2008, being the date of sale of property).

<u>Deductions from Gross Total Income</u>

8. Can the Commissioner reject an application for grant of approval under section 80G(5) on the ground that the trust has failed to apply 85% of its income for charitable purposes?

CIT v. Shree Govindbhai Jethalal Nathavani Charitable Trust (2015) 373 ITR 619 (Guj)

Facts of the case: The assessee trust filed an application in Form 10G for grant of approval under section 80G(5)[1]. It also filed copies of trust deed and registration certificate dated 18th August, 2011 with the approving authority. As per the trust deed, the main objects of the trust are educational, social activities, etc. In order to verify the facts stated in the application, the trust was asked to produce books of account, relevant vouchers, donation book and minutes in original. On perusal of the books for financial year 2011-12, it was found that the trust had not applied 85% of its income and therefore, the Commissioner rejected the application of the assessee seeking approval under section 80G(5) and Rule 11AA of the Income-tax Rules, 1962.

Tribunal's view: On appeal, the Tribunal noted the decision of Punjab and Haryana High Court in the case of *CIT v. O.P. Jindal Global University (2013) 38 Taxmann 366*, in which it was held that at the time of granting approval of exemption under section 80G, only the objects of the trust are required to be examined and the aspect of application of funds can be examined by the Assessing Officer at the time of framing the assessment. Consequently, the Tribunal held that the Commissioner has erred in refusing to grant recognition to the trust under section 80G(5).

High Court's Observations: The High Court was of the view that the issue in the present case is now not *res integra* in view of the decision of the Division Bench of this Court in the case of *N.N.Desai Charitable Trust v. CIT (2000) 246 ITR 452 (Guj).* In that case, the Division Bench observed that, while considering the application for the purpose of section 80G, the authority cannot act as an assessing authority and the enquiry should be confined to finding out if the institution satisfies the prescribed conditions. The Division Bench also made the following observations:

(i) Section 80G does not relate to assessment of the trust or the institution whose income is not liable to be included in the computation of taxable income under various provisions of the Act. Primarily, section 80G is related to giving deduction in respect of donations made by a person to such trusts and institutions.

(ii) There are two distinct concepts. The first is whether an institution or fund is such whose income is not liable to be included in the computation of total income, has to be determined on the basis of its status or character. The second is the actual assessment of income, which necessarily takes place in future after donation is received by the donee, on fulfilment of other conditions about application of income by the eligible trusts, which in the very nature of things can operate only after receipt of income. The two are different concepts.

[1] Section 80G(5)(i) provides that donation to any institution or fund would qualify for deduction thereunder only if it is established in India for a charitable purpose and derives such income which would not be liable to inclusion in its total income under the provisions of sections 11 and 12 or section 10(23AA)/(23C).

(iii) The liability to assessment is neither affected on account of grant of recognition under section 80G nor on whether the donor ultimately gets deduction in respect of such donation. Once a trust is registered under section 12AA, its income from property includes donation which is covered by section 11(1)(d) or under section 12. Such donations are deemed to be income from property, which are not to be included in the total income under section 11 or section 12. The enquiry under section 80G, hence, cannot go beyond that.

(iv) The scope of enquiry cannot include an enquiry as to whether, at the close of the previous year, the donee-trust will actually be able to apply 85% of its income because non-fulfillment of some conditions by the donee-trust as regards application or accumulation cannot be ascertained *in praesenti*, when the donation is made. The question of whether the trust will be able to apply 85% of its income can be determined only from the facts existing at the close of the assessment year.

The High Court also noted that similar views were expressed by the Punjab and Haryana High Court in the case of *CIT v. O. P. Jindal Global University (2013) 38 Taxmann.com 366.*

<u>High Court's Decision</u>: The High Court, thus, concurred with the decision of the Tribunal setting aside the order passed by the Commissioner refusing to grant registration under section 80G(5) to the assessee-trust due to the reason that it has not applied 85% of its income for charitable purposes.

<u>Assessment Procedure</u>

9. **Can a notice under section 148 for a particular assessment year be issued solely on the ground that survey under section 133A was carried on at the business premises of the assessee, where nothing had been found therein which would indicate escapement of income chargeable to tax for the said assessment year?**

Hemant Traders v. ITO (2015) 375 ITR 167 (Bom)

<u>Facts of the case</u>: In the present case, the assessee is a partnership firm and registered as a Commission agent of the onion potato market under the Agricultural Produce Market, Committee, Navi Mumbai. The firm is regularly assessed to income-tax. The firm filed a return of income for A.Y.2010-11 on October 14, 2010 along with audit report, audited Balance Sheet and Profit & Loss Account for the year ended 31.3.2010. The return was processed and intimation under section 143(1) was issued on 20.02.2012, seeking clarification. No assessment order was passed. The assessee claimed that the profit as per the return of income was accepted. Meanwhile, a survey under section 133A was carried out at the business premises of the assessee on 7th January 2011 pertaining to A.Y. 2011-12. However, the survey party did not find any discrepancy in the books of account. Further, the survey report did not contain any reference to any transactions for

A.Y. 2010-11. In March 2014, the assessee was issued a notice under section 148 for the A.Y. 2010-11 based on the said survey.

The assessee preferred a writ challenging the issue of notice on the reasoning that no satisfaction was recorded of the escapement of income in the survey report or in any other relevant material. *Ex-facie,* the reassessment was bad in law.

High Court's Observations: The High Court perused the survey report which recorded that there was a group of assessees who were engaged in wholesale trading of potato on commission basis. The survey was conducted based on the allegations that these parties were resorting to hoarding of potatoes and making huge profits by fluctuating the day-to-day price of potatoes in the market. During survey, the assessee's books of account, cash balance and stocks were physically verified and inventory prepared. The report revealed cash difference of ₹ 5,020 and the explanation given was that the same pertained to the day-to-day and miscellaneous expenditure incurred on the day of survey. The report also revealed physical stock difference of 672 bags of potatoes. The explanation for such difference was recorded.

Neither the survey report nor any other material indicated escapement of income chargeable to tax for A.Y. 2010-11. The Assessing Officer had nothing before him to record his belief or satisfaction that escapement of income had taken place.

Merely because survey had taken place cannot be a ground for reopening the assessment without valid material or evidence at the time of issue of notice. Whenever there was shortage of potatoes in the market, such powers of survey were invoked. Where nothing has been found during the survey operations to indicate that income chargeable to tax has escaped assessment, then the survey report ought not to be the basis for reopening of assessment. Something more was required in law for the Assessing Officer to exercise his powers.

High Court Decision: The High Court, accordingly, held that since there is absolutely no material to indicate escapement of income for the relevant assessment year, the issue of notice to initiate reassessment proceedings under section 148 on the basis of survey which had taken place is not valid. Therefore, the proceedings initiated under section 148 are quashed at the threshold itself.

10. **Will the subsequent amendment of law with retrospective effect validate a reassessment notice issued on a different ground before the retrospective amendment was made?**

Godrej Industries Ltd v. B.S.Singh Dy.CIT (2015) 377 ITR 1 (Bom)

Facts of the case: The assessee-company filed its return of income for the assessment year 2000-01 declaring total income as 'Nil' and a book profit of ₹ 52.70 crores. This resulted in 'book profit' being assessed to income-tax. Later, the Assessing Officer issued notice under section 148 for the reason that income chargeable to tax had escaped assessment on the ground that the provision for doubtful debts and provision for depletion of long-term investment debited to the profit and loss account were unascertained liabilities and, hence, in terms of clause (c) of the *Explanation* to section 115JA, i.e., they were to be added back to the net profit for arriving at the book profits.

The assessee preferred a writ challenging the maintainability of the notice issued under section 148.

Revenue's Contention: The Revenue contended that at the time of issuing the impugned notice on March 29, 2007, the position was not clear. The position became clear only when Parliament introduced/added clause (g) to the *Explanation* to section 115JA of the Act with retrospective effect from April 1, 1998, and which reads as under:

"(g) the amount or amounts set aside as provision for diminution in the value of any asset."

Thus, the Revenue submitted that the impugned notice is sustainable on the basis of above clause (g) of the *Explanation* to section 115JA, inserted by the Finance (No.2) Act, 2009 retrospectively with effect from 1st April, 1998.

High Court's Observations: The High Court observed that an identical issue had come up in *Rallis India Ltd. v. Asst. CIT [2010] 323 ITR 54 (Bom)* wherein a reopening notice was, *inter alia*, issued on the ground that the book profits have to be increased by the provision made for doubtful debts and for diminution in the value of investment in view of clause (c) of the *Explanation* to section 115JB. In the said case, the High Court recorded the fact that the Apex Court had, in *CIT v. HCL Comnet Systems and Services Ltd. [2008] 305 ITR 409*, held that the provision for doubtful debts is a provision made for diminution in the value of assets and is not a liability. Thus, it would not fall under clause (c) of the *Explanation* to section 115JA of the Act. Consequent to the aforesaid decision of the Apex Court, the Parliament has amended the *Explanation* both under section 115JA as well as section 115JB of the Act in 2009 by adding clause (g) and clause (i) with retrospective effect from April 1, 1998, and April 1, 2001, respectively. The Court held that though the amendment was made with the retrospective effect, the critical date is the date on which the Assessing Officer exercises jurisdiction under section 148 of the Act and the subsequent amendment could not have been and is in fact not a ground on which the Assessing Officer sought to reopen the assessment. It was held that the validity of a reopening notice of Assessing Officer is to be determined with reference to the reasons which are recorded in support of thereof and nothing else.

In this case also, it is clear that the reasons stated for reopening the assessment are that provision for doubtful debts and depletion in value of investments are both amounts set aside for meeting liabilities other than ascertained liabilities and hence, constitute income escaping assessment. The reasons recorded are not valid as the said items were not related to liabilities as perceived by the Assessing Officer. These provisions are made to take care of the likely fall in the value of assets.

The High Court observed that it is the Assessing Officer's belief at the time of issuing the reassessment notice that determines the validity of the notice. In this case, he wanted to apply clause (c) of the *Explanation* to section 115JA and whereas the issues got covered by subsequent amendment by means of insertion of clause (g) to the *Explanation* to section115JA by the Finance (No.2) Act, 2009 with retrospective effect from 1.4.1998. The subsequent event could not put life into the Assessing Officer's reason that income chargeable to tax had escaped assessment when the reasons as originally recorded are still born.

High Court's Decision: The position of law on the date of issue of notice under section 148 must be looked into and the retrospective amendment subsequent to issue of notice could not validate a notice issued earlier. It could only amount to change of opinion and the notice for reopening of assessment would become unsustainable.

The High Court, accordingly, allowed the writ and held that the reason for reopening the assessment cannot get validated by the retrospective amendment of law.

Note – It may be noted that section 115JA levying MAT was applicable from A.Y.1997-98 to A.Y.2000-01. From A.Y.2001-02, MAT is attracted under section 115JB. Clause (c) of Explanation 1 to section 115JB requires addition of amount set aside to provisions made for meeting liabilities, other than ascertained liabilities, to the net profit for arriving at the book profit for levy of MAT. Clause (i) was inserted by the Finance (No.2) Act, 2009 retrospectively with effect from 1st April, 2001 providing for addition of amount set aside as provision for diminution in the value of any asset, to the net profit for arriving at the book profit for levy of MAT. The rationale of the above ruling would, therefore, also apply in the context of examining the validity of notice issued for reopening an assessment on the basis of clause (c) of Explanation 1 to section 115JB, consequent to subsequent retrospective insertion of clause (i) in Explanation 1 to section 115JB.

11. Can the Assessing Officer make a reassessment on fresh grounds when the original reasons recorded for reopening the assessment does not survive?

N. Govindaraju v. ITO (2015) 377 ITR 243 (Kar)

Facts of the case: The assessee, an individual, deriving income from house property, transport business, capital gains and other sources filed his return of income declaring total income of ₹ 4.82 lakhs and agricultural income of ₹ 1.62 lakhs. The return was processed under section 143(1). Subsequently, a notice under section 148 was issued stating that the assessee had converted agricultural land into non-agricultural purposes, formed sites and sold the same but while arriving at the indexation benefit it was taken up to the date of sale instead of the date of conversion as per section 45(2). Thus, the reason for reassessment was the excessive indexation benefit availed by the assessee. However, in reassessment, the Assessing Officer adopted fair market value which was less than what was adopted by the assessee and also sought to disallow 50% of the expenses incurred on transfer. The original reason which prompted the reassessment was dropped and based on fresh grounds, reassessment was completed.

Issue under consideration: One of the issues under consideration before the High Court was whether the reassessment based on fresh grounds would be valid when the original reason which prompted the reassessment, does not survive.

Assessee's contention *vis-s-vis* Revenue's contention: The assessee contended that the reason for which notice was issued has to survive and it is only thereafter that "any other income" which is found to have escaped assessment can also be assessed or reassessed in such proceeding. On the other hand, the Revenue claimed that section 147 is in two parts which have to be read independently; the phrase "such income" in the first part is with regard to reasons which have been recorded and the phrase "any other income" is with regard to cases where no reasons are recorded in the notice but they come to the notice of the Assessing Officer during the course of reassessment proceeding. Both being independent, once the satisfaction in the notice is found sufficient, addition can be made on all grounds i.e., for reasons which have been recorded and also for items for which no reasons were recorded. All that is necessary is that, during the course of the proceedings under section 147, income chargeable to tax must have escaped assessment.

High Court's Observations: The High Court observed that the controversy revolved around *Explanation 3* to section 147 inserted by the Finance (No.2) Act 2009 retrospectively with effect from 1.4.1989. The Court took note of Circular No.5/2010 issued by CBDT after the amendment in Paragraph 47 with caption 'Clarificatory amendment in respect of reassessment proceeding under section 147". Para 47.3 reads as under:

"Therefore, to articulate the legislative intention clearly *Explanation 3* has been inserted in section 147 to provide that the Assessing Officer may examine, assess or reassess any issue relevant to income which comes to his notice subsequently in the course of proceedings under this section, notwithstanding that the reason for such issue has not been included in the reasons recorded under section 148(2)".

The High Court observed that it is true that if the foundation goes, then, the structure cannot remain. Meaning thereby, if notice has no sufficient reason or is invalid, no proceedings can be initiated. However, this can be verified at the initial stage by challenging the notice. If the notice is challenged and found to be valid, or where the notice is not at all challenged, then, in either case, it cannot be said that notice is invalid. As such, if the notice is valid, then the foundation remains and the proceedings on the basis of such notice can continue. The High Court reiterated that once the proceedings have been initiated on a valid notice, it becomes the duty of the Assessing Officer to levy tax on the entire income (including "any other income") which may have escaped assessment and comes to his notice during the course of the proceedings initiated under section 147.

<u>High Court's Decision</u>: The High Court held that, in effect, once satisfaction of reasons for the notice is found sufficient i.e. if the notice under section 148(2) is found to be valid, then, the Assessing Officer may do reassessment in respect of any other item of income which may have escaped assessment, even though the original reason for issue of notice under section 148 does not survive.

This decision has dissented from the decisions in the case of *CIT v. Jet Airways (I) Ltd (2011) 331 ITR 236 (Bom); Ranbaxy Laboratories Ltd v. CIT (2011) 336 ITR 136 (Del).*

Note – In this case, the reassessment on the basis of reasons, which did not form the original reasons to believe, but were subsequently discovered by the Assessing Officer, was held to be valid, even though the original reasons did not survive.

However, the High Court further delved into the additional grounds, and held that the Tribunal was not justified in arriving at the fair market value of the property in question on 1.4.1981 without considering the material on record, including the valuation report, filed by the assessee. The matter was thus to be remanded to the Assessing Officer for determination of the fair market value of the property in question in accordance with law.

Further, without assigning any reason, the Assessing Officer had disallowed 50% of the total expenditure claimed by the assessee towards transfer and brokerage charges, even when the same had been paid by cheque and the receipt for which was obtained from the broker. When the specific case of the assessee was that heavy brokerage had to be paid because the property was under litigation and that it was occupied by unauthorised persons for which payment had to be made to get it vacated, disallowance could not be made on the ground that brokerage was generally being paid at the rate of 1-2%. The High Court opined that when the said brokerage was paid by cheque and there was sufficient reason for paying higher brokerage, the entire amount ought to have been allowed and disallowance of 50% was not justified in law.

Thus, in this case, though the High Court upheld that reassessment could be made on fresh grounds even when the original reasons recorded for reopening the assessment did not survive, additions made on the basis of such fresh grounds were turned down by the High Court, since the reasons were not justified to merit such additions.

<u>Appeals and Revision</u>

12. Can mere non-mention or non-discussion of enquiry made by the Assessing Officer in the assessment order justify invoking revisionary jurisdiction under section 263?

CIT v. Krishna Capbox (P) Ltd (2015) 372 ITR 310 (All)

<u>Facts of the case</u>: The assessee filed its return of income declaring total income of ₹ 8.15 lakhs. The return was processed under section 143(1) and later, the case was selected for scrutiny and statutory notice under section 143(2) was issued. During the

course of scrutiny, the Assessing Officer raised certain queries which were answered by the assessee. The Assessing Officer, after being satisfied with the replies given, completed the assessment by accepting the declared income. Subsequently, the Commissioner invoked revisionary jurisdiction under section 263 by holding that the Assessing Officer had not made enquiry on certain aspects, such as -

(i) Non-verification of source of investment in respect of addition in fixed assets;

(ii) Non-confirmation of sundry creditors by the assessee;

(iii) Non-enquiry of unsecured loan by the Assessing Officer;

(iv) Not obtaining the copy of bank statements;

(v) Non-verification of genuineness of shareholders;

(vi) Deduction of freight paid without deduction of tax at source.

Assessee's contention *vis-a-vis* Revenue's Contention: The assessee contended that all the aspects contested by the Commissioner were enquired by the Assessing Officer. The Revenue took the defence that no enquiry was made by the Assessing Officer in respect of the issues set out in the notice issued under section 263 and hence, revisionary jurisdiction was correctly assumed.

Tribunal's view: The Tribunal noted that all necessary enquiries were made and all the requisite documents were placed in the paper book. Once enquiry was made, mere non-discussion or non-mention in the assessment order cannot lead to the assumption that the Assessing Officer did not apply his mind or that he had not made any enquiry on the subject for invoking section 263.

High Court's Observations: The High Court noted the Bombay's High Court's view in *Cellular Ltd. v. DCIT (2008) 301 ITR 407* that if a query is raised during the assessment proceedings and responded to by the assessee, the mere fact that it is not dealt with in the assessment order would not lead to a conclusion that no mind had been applied to it.

High Court's Decision: The High Court concurred with the decision of the Tribunal and held that since the relevant enquiries and replies are available on 'record' (i.e., the paper book), the Commissioner cannot invoke revisionary jurisdiction merely because there was no mention of such enquiry and verification in the assessment order.

Note - The Finance Act, 2015 inserted Explanation 2 to section 263(1) to clarify, inter alia, that an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, if in the opinion of the Principal Commissioner or Commissioner, the order is passed without making inquiries or verification which should have been made.

The rationale of this ruling would hold good even after insertion of Explanation 2 to section 263(1), since in this case, the Tribunal has recorded a finding of fact that necessary enquiries have been made by the Assessing Officer even though the same *was not specifically mentioned in the assessment order. Mere non-discussion or non-mention about the enquiry made by the Assessing Officer in the assessment order cannot be a ground for invoking revisionary jurisdiction under section 263.*

13. Can the Commissioner invoke revisionary jurisdiction under section 263, when the subject matter of revision (i.e., whether the manner of allocation of revenue amongst the members of AOP would affect the allowability and/or quantum of deduction under section 80-IB) has been decided by the Commissioner (Appeals) and the same is pending before the Tribunal?

CIT v. Fortaleza Developers (2015) 374 ITR 510 (Bom)

Facts of the case: The assessee, an Association of Person (AOP) consisting of promoters and builders, was constituted by means of an agreement dated April 29, 2003 between M/s Raviraj Kothari and Co. (RRK) and M/s Sanand Properties Pvt. Ltd. (SPPL). The AOP filed its return of income for the assessment year 2007-08 declaring total income of ₹ 4.14 lakhs after claiming deduction under section 80-IB(10) of ₹ 1454.47 lakhs. The assessment was completed under section 143(3) disallowing fully the claim of deduction under section 80-IB(10). The assessee preferred an appeal before Commissioner (Appeals) who held that the assessee had fulfilled all the conditions laid down in section 80-IB(10) and hence, directed the Assessing Officer to allow the deduction.

The order of Commissioner (Appeals) was challenged before the Tribunal by the Revenue. During the pendency of the appeal before the Tribunal, the Commissioner issued a notice under section 263 asking the assessee to show cause as to why the assessment order should not be set aside. The notice under section 263 specified that the method of allocation of revenue gave the assessee undue benefit by way of a higher claim of deduction under section 80-IB(10) contrary to clause (7) of the AOP agreement.

Clause (7) of the agreement laid down that SPPL shall be entitled to 35% of the amount received from the purchasers of the housing units. Out of the balance 65% of the said receipts, all required and relevant expenditure for the purpose of the business of the AOP shall be met with and whatever net balance remains thereafter, shall be determined as the share of income of RRK.

On perusal of clause (7) of the agreement, the Commissioner contended that share of revenue pertaining to SPPL was not eligible for deduction under section 80-IB(10). Accordingly, the Commissioner set aside the assessment order of the assessee and directed to recompute the income on the basis of the clause (7) of the AOP agreement. The assessee challenged the revision order passed by the Commissioner under section 263 before the Tribunal.

Appellate Authorities' Views: The Tribunal observed that the quantum of deduction under section 80-IB(10) will depend upon the income earned from the project in question. The quantum of deduction will not depend on the mode of distribution of shares amongst members of the association of persons as income of association of persons is taxable at the maximum marginal rate. It is also observed by the Tribunal that the allowability or otherwise of deduction under section 80-IB(10) is not dependent upon the manner in which the profit has been distributed amongst the members of the AOP but is dependent upon the income earned from an eligible project and the fulfilment of the conditions laid down in the section. Also, the deduction is available to an undertaking and not to the individual constituent of an undertaking. The Tribunal further held that the Commissioner cannot exercise jurisdiction under section 263 in respect of deduction under section 80-IB, which was the subject matter of appeal.

High Court's Views: The High Court took note of all the facts and sequence of events with regard to the matter in appeal. The Court was of the view that the contract between the two parties was self-explanatory and the interpretation placed by the assessee on clause (7) and claiming deduction under section 80-IB(10) is in order.

High Court's Decision : When the order of the first appellate authority is complete and the appeal is pending before the Tribunal, the Commissioner is precluded from invoking section 263 for revision of the very same matter decided by the first appellate authority since clause (c) of the *Explanation 1* to section 263 debars the same.

Accordingly, the High Court held that the order passed by the Assessing Officer got merged with the order of the first appellate authority. The very same issue cannot be revised by invoking revisionary jurisdiction under section 263.

Deduction, Collection and Recovery of Tax

14. Whether chit dividend paid to subscribers of chit fund is in the nature of 'interest' in terms of section 2(28A) to attract deduction of tax at source under section 194A?

CIT v. Avenue Super Chits (P) Ltd (2015) 375 ITR 76 (Kar)

Facts of the case: The assessee-company engaged in chit fund business had several chit groups which consisted of 25 to 40 customers each. Each subscriber has to subscribe an equal amount based on the value of chit. There are two types of chit. One is the lottery system and other is auction system. Under the auction system, during each instalment of the chit, the highest bidder got the chit amount. The unsuccessful members would earn dividend [chit dividend as defined under section 2(h) of Chit Fund Act, 1982].

Revenue's Contentions: The Revenue contended that when the successful bidder in an auction took the prize money earlier to the period to which he is entitled, he is liable to pay an amount to others who contributed to take the prize money, the amount so paid is nothing but interest which is liable for tax deduction under section 194A. The assessee had failed to do so, and therefore, he is treated as an assessee-in-default under section 201 and is liable to pay interest under section 201(1A).

Appellate Authorities Views : The Commissioner (Appeals) held that the amount paid by way of dividend could not be called as 'interest' in terms of section 2(28A) of the

Income-tax Act, 1961 and hence, there was no liability on the part of the assessee to deduct tax at source. The Tribunal affirmed the findings of Commissioner (Appeals).

High Court's Observations: The High Court noted the decision of *CIT v. Sahib Chits (Delhi) (P) Ltd (2010) 328 ITR 342 (Del)* wherein section 2(28A) was referred to decide that chit dividend cannot be treated as interest. Further, section 194A has no application to such (chit) dividend and therefore, there is no obligation on the part of the assessee to make any deduction under section 194A before such dividend is paid to the subscribers of the chit.

High Court's Decision : The High Court held that the above judgment squarely applies to the facts of this case. Therefore, auction chit dividend paid to subscribers of the chit is not 'interest' as defined in section 2(28A) of the Income-tax Act, 1961 and therefore, tax deduction in terms of section 194A is not attracted.

Notes:

(1) Meaning of certain terms:

Term	*Section*	*Meaning*
Dividend	*2(h) of Chit Fund Act, 1982*	*The share of the subscriber in the amount of discount available under the chit agreement for rateable distribution among the subscribers at each instalment of the chit.*
Discount	*2(g) of the Chit Fund Act, 1982*	*The sum of money or the quantity of grain which a prized subscriber is, under the terms of the chit agreement, required to forego and which is set apart under the said agreement to meet the expenses of running the chit or for distribution among the subscriber or for both.*
Interest	*2(28A) of the Income-tax Act, 1961*	*Interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized.*

(2) Example (to explain the concept of Chit Fund):

Let us suppose 50 persons come together to organise a chit and each of them undertake to contribute ₹ 1,000. The total chit amount would be ₹ 50,000 (₹ 1,000 × 50). Let us further suppose that the fund would operate for a period of 50 months. Thus, the member subscribers and the number of months for which the *chit would operate would be the same. In this example, at the end of each month, an amount of ₹ 50,000 (₹ 1,000 × 50) would be available in the kitty of the chit fund. The said amount would be put to auction and those subscribers who are interested in drawing the money early because of their needs may participate in the auction. The successful bidder, who is normally the person who offers the highest discount, is given the chit amount.*

For example, let us assume that there are three bidders offering to take the chit for ₹ 50,000. They offer ₹ 40,000, ₹ 35,000 and ₹ 33,000, respectively. The chit would be given to that subscriber who is willing to take it for ₹ 33,000, since he has offered a discount of ₹ 17,000. This leaves a balance of ₹ 17,000 in the kitty. The amount of ₹ 17,000 which represents the discount which the successful bidder has foregone becomes the dividend which is to be distributed to the subscribers.

15. Where remuneration paid to doctors is variable based on number of patients and treatment given to them, would the liability to deduct tax at source arise under section 192 or under section 194J?

CIT v. Manipal Health Systems (P) Ltd (2015) 375 ITR 509 (Kar)

Facts of the case: The assessee-company is an institution providing health services. A survey under section 133A was conducted on the business premises of the assessee in order to ascertain the TDS compliance. While conducting the survey, the Assessing Officer found that the assessee company has deducted tax on payment made to doctors under section 194J. The Assessing Officer came to a conclusion that there existed an employer-employee relationship between the hospital and the doctors engaged by it, and hence, the assessee was required to deduct tax at source under section 192. Accordingly, the Assessing Officer computed the liability for short deduction of tax at source under section 201(1) and section 201(1A). The assessee challenged the said demand before the Commissioner (Appeals).

Appellate Authorities' Views: The Commissioner (Appeals) allowed the claim holding that the doctors cannot be construed as employees of the assessee-company. The Tribunal dismissed the appeal filed by the Revenue.

High Court's Observations: The High Court observed that to decide whether the relationship of employer-employee existed or not, the contract entered into between the parties has to be seen - whether the same is a "contract for service" or a "contract of service". In order to ascertain the nature of contract, multiple-factor tests have to be applied. The independence test, control test, intention test are some of the tests adopted to distinguish between 'contract for service' and 'contract of service'.

The High Court examined the terms of the contract entered into between the asseesee-company and the doctors. As per the said terms,

- The remuneration paid to the doctors depends on the treatment given to patients and on the number of patients - if the number of patients are more, remuneration would be on a higher side or if no patients, no remuneration;
- The timing of the doctors is fixed; and
- They cannot have private practice or attend any other hospital.

It was observed that mere provision of non-competition clause in the agreement shall not change the nature of contract from profession to that of employment. Imposing a condition of bar to private practice is to make use of the expertise, skill of a doctor exclusively for the assessee-company, i.e., to get the attention and focus of the professional skill and expertise only to the patients of the assessee-company and to discourage doctors from transferring patients to their own clinics or any other hospital. The High Court also noted the Tribunal's finding that none of the doctors are entitled to gratuity, provident fund, leave travel allowance and other terminal benefits. It is also pertinent to note that the doctors have filed their returns of income for the relevant assessment years showing the income received from the assessee-company as professional income and the same is said to have been accepted by the Department.

In *CIT (TDS) v. Apollo Hospitals International Ltd. (2013) 359 ITR 78*, the Gujarat High Court took a view that consultant doctors were not getting salary but payment to them was in the nature of professional fees liable to tax deduction at source under section 194J.

High Court's Decision: Considering the totality of facts and terms of the agreement, the Court held that in this case, the consultancy charges paid to doctors rendering professional service would be subject to tax deduction under section 194J and not section 192.