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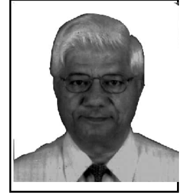

## Happiness

The ultimate goal of a human being is to be happy. Each one of us wants to be happy and try in his own way to find happiness. Some thoughtful people say leave "sansar" and " family" and you would be happy, on the other side a strong argument is made that happiness can be achieved even while being part of this "sansar" and "family". One thing is sure that happiness is a feeling, a state of mind. We generally are happy when we get what we desire, and are able to keep away from what we do not desire. A simple question whether a desire is motivator or destroyer? It depends, on the quality of the desire and by what means you fulfill your desire. Hitler had a noble desire of uniting Europe but the instrument or method used was wrong and ultimately there was 2nd world war.

Let us see an illustration:

**A mother is happy because she nurtures her child without any expectation and her love is selfless, so one can say that happiness is in "selfless giving".**

Against this, if you 'get' whatever you want, you are happy. For example, a small child wants her mother and cries… (one who cries… for God like a little child, he definitely feels the "sparsh" of God) and when that child realizes her mother is around, the child is happy. Likewise, a student wants good marks and wants admission in MBBS and with hard work he gets it, he is happy. A person wants to become Prime Minister and he becomes the Prime Minister, he is happy. The list can be of anything or object but in nutshell, if desire of "getting" is satisfied, one is happy. Thus, "Happiness" is in receiving and also as seen above, in selfless giving. However, the basic difference is that the happiness achieved on fulfillment of desires is dependent on external factors on which one does not have any control. Happiness achieved on fulfillment of desires is a conditioned happiness. In fact, the Lord in verse 62 and 63 of Chapter 2 of Bhagwad Gita has warned that desires are the root cause of the downfall of a human being.

**Thinking about sense objects brings an attachment towards them. Attachment breeds desire, and desire leads to anger, which in turn leads to delusion. When you are deluded, you lose your memory and with the loss of memory, the power or discrimination is destroyed; with the destruction of discrimination, your Self itself is lost.**

How to curtail or leave these desires or improve upon the quality of desires requires a very deep study and a powerful determination. Are there any principles for being happy? Yes,

In Bhagwat Gita it is said that:

**Practising Yoga will vanquish the troubles of one who performs his duties diligently, and who is disciplined and balanced in his eating, sleeping and working hours.** (Verse 17, Chapter 6)

One can be happy if he is regular and balanced in his food, enjoyment, working habit and sleep With daily *abhyas* (study ) one can curtail *'kaam', 'krodh'*, *'Trushna' 'Moh'* and *Maad.*

Let us do our work with our best efforts, complete planning and confidence, respect everyone, respect our society and respect our nation. Whatever task is performed should be judged with the standards of scriptures, have faith in Almighty and surely success and happiness will be at our doorsteps.

Hard work, self discipline and helping others are the keys for gaining success. As far as hard work is concerned, there is no shortcut, one has to work hard, be disciplined and get rid of temptations.

Emerson said" It is one of the most beautiful compensations of life that no man can sincerely try to help another without helping himself. Happiness is a perfume you cannot pour on others without getting a few drops on yourself".

"One is happy as a result of one's own efforts, once one knows the necessary ingredients of happiness— simple tastes, a certain degree of courage, self-denial to a point, love of work. And above all, a clear conscience".

-George Sand

# Editorial

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## *Swachh Mann, Swachh Bharat!*

The nation today, collectively, is trying hard to come out of the clutches of clutter, filth and muck spread all around. The Prime Minister of the country has initiated the campaign *'Swachh Bharat'* which was not just essential but in fact was long due, considering the state of cleanliness in India. The probability of the success of the initiative appears to be very high for the simple reason that it is started by a person who has a great impact over the masses, especially the youth where his fan following is more than anybody else in the country.

Different people are looking differently towards the campaign. There are pessimists who believe it is next to impossible to make India a clean nation, and then are critics who are busy concentrating more on persons rather than the idea. Third is the category of people who appreciate the campaign but expect *'achhe din'* to happen on its own and lastly it is the people who are optimistic, taking on themselves to do their bit for the accomplishment of the collective objective of *'Swachh Bharat'*. The basic difference between the last category of persons and rest of the three is the mindset, their thoughts.

Generally, it is the manner in which we approach towards a thing makes it good or bad. To be positive it is necessary to have such positive attitude towards everything including the nation or profession. Better we have a check on the quality of our thoughts we entertain or else we shall always be in the bracket of the first three categories of people. It is said that it is the quality of thoughts that determine our result and not the action, because action is followed after a thought. The mission 'Clean India' is possible when we have a 'Clean Mind'. It is only when we have trained our mind, to be positive, constructive, appreciative, supportive, we can think of having a clean India.

As a chartered accountant, to begin with, the *'Swachh Bharat'* campaign can be started from our offices. Quite often we find, more so at the time tax audits that our offices are in a state of complete mess. Why should an office of a professional be in such a state? Even at the times other than audits, our tables are loaded with files and loose papers as if lying since ages. We don't even bother to clear the journals and mails received. It is not just about the physical clearance of the files but the problem is in setting our priorities in order. If we are able to set things right in through planning and execution, it gets reflected physically as well. As a benefit, clean surroundings always result in improved efficiency.

Without a doubt, the Clean India campaign is a big task and would not be possible until all contribute in it. It is very easy to turn a blind eye and move away but then a question arises, are we doing enough as a responsible and an educated citizen of this great nation. It may not be necessary to do great things but we can definitely start in our own small way. Beginning with our home, offices and then to surroundings, all can be achieved once we ensure that we shall be living with a clean mind!

***Namaste,***
CA. Ashok Kataria

# From the President

**CA. Shailesh C. Shah**
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Dear Esteemed Readers

On the Independence Day, Prime Minister Narendra Modi gave the slogan 'Make in India'. The new concept initiated by the Government of India is a program to promote India as a global manufacturing destination, facilitate investment, foster innovation, and build best-in-class manufacturing infrastructure. India has already marked its presence as one of the fastest growing economies. Today India is ranked among the top 3 attractive destinations for inbound investments and the manner in which the present Government is going about its foreign policy, investors all round the globe seem to find a new interest and a better opportunity.

The industrial output figures suggested that Indian manufacturing sector is lagging behind for a long time and thus the campaign has been perfectly timed. The time when many global companies are looking for an alternative to China in view of the rising productions costs, "Make in India" is appearing more luring to the investors. There is no doubt that the initiative seeks to make India a manufacturing superpower and with this the government is set to roll out a red carpet to global companies and inviting them to set up manufacturing bases in India.

A question arises in the minds of many people about the success of the 'Make in India' campaign. I reckon the probability of success is higher because of various and valid reasons. First of all, India is full of natural resources; secondly we are a country of the youth having a large working population that can fit with the productive cycle in the manufacturing industry. Thirdly, the demand generated by the population of more than 1 billion. Lastly, the government's willingness to support the manufacturing sector is a big strength that can change the approach and attitude of the industrialists.If this sector develops it can cater to the demand of various items that are imported improving balance of foreign currency inflow and outflow and can also boost e-commerce that is fast taking over from the traditional methods of business. The biggest advantage that e-commerce offers, is that it has a lot of variety to offer to the consumer as compared to a physical store, since it does not have any constraints of physical space.

Make in India campaign of the Government would result in increase in inbound investment, which in turn will increase the demand of Chartered Accountants. Assuming the success of the Make in India campaign I hope it will open up new avenues for the Chartered Accountants. With the opening up of new manufacturing industries the Chartered Accountants will have new job opportunities. Similarly those who are in practice will have new avenues as advisor in the field of investment , valuations, mergers and acquisition , transfer pricing, corporate law, securities law, foreign exchange , management consultancy etc. Time will tell whether the India will become a super power in the coming years as imagined by many including our Prime Minister Narendra Modi or not but the profession of chartered accountancy, for sure, would be the largest beneficiary.

At the Association, with a view to have in depth study and proper understanding of how to submit details before the assessing officer, an intensive study program on the topic of Income Tax Assessment Proceedings was organised, spreading over 4 sessions. All the participants thoroughly enjoyed, appreciated and actively participated in the course. The details of the forthcoming events are given in the Association news. This year's slogan of the Association is 'nurturing knowledge – fostering fellowship.' Various educational programs have been organized till now to nurture knowledge. Now it's time to foster fellowship. The Association has for the first time organized cricket tournament with tennis ball so as to enable senior members participate, apart from the regular cricket matches that are held over the years. All members are invited to take part in the activities of the Association.

With regards
CA. Shailesh C. Shah
President

# Exemption under the head Capital Gains – Few Beneficial Issues

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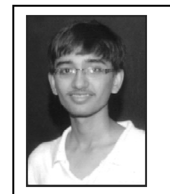

## 1. Introduction

This article encompassing current issues in Capital Gains has been drafted considering various pronouncements of Courts and Income Tax Appellate Tribunals delivered recently. The authors have tried to meticulously analyze the provisions and explain the relevant issues hoping that this would help the readers in making proper representation in the ongoing assessment proceedings. This article would be of great help and assistance to the practicing professionals and readers.

## 2. Issues arising under Section 54

### 2.1 Whether Exchange of old flat for a new flat under a development agreement amounts to construction and thus extended time limit of 3 years is applicable?

Redevelopment of properties has become quite common off late. In such a situation, the assessee exchanges his old flat for a new flat in the redevelopment scheme. In such a situation, the exchange amounts to transfer within the meaning of section 2(47) of the Act.

The issue that emerges for consideration is that whether the new flat acquired by the assessee qualifies as investment for the purpose of claiming exemption u/s. 54 of the Act?

The department has in several cases taken a stand that acquisition of flat under the development agreement does not amount to purchase or construction within the meaning of section 54.

It is pertinent to note that whenever an assessee purchases a flat from a builder as a part of construction project, it amounts to construction and not purchase. Similarly what happens under a redevelopment agreement is that the assessee exchanges the old flat for a new flat to be constructed by the builder. Thus, such a transaction would amount to construction only and time limit of 3 years would be applicable.

Similar view has also been adopted In the case of **Jatinder Kumar Madan v/s ITO (I.T.A. No. 6921/Mum/2010) and Smt. Veena Gope Shroff Vs. ITO [2013] 33 taxmann.com 344 (Mum- Trib**

Further, for the benefit of readers, it is hereby clarified that in such circumstances the Fair Market Value of the new house shall be considered as the full value of consideration for the sale of old house.

### 2.2 Can Capital Gain arising out of sale of multiple flats be invested in multiple flats to avail exemption u/s. 54?

Section 54 differs from the provisions of section 54F on a point that under Section 54F, the exemption will not be available when the assessee owns more than one residential house other than the new asset on the date of transfer of the original asset.

However, Section 54 of the Act provides no such condition. There is no restriction placed anywhere in the Section 54 that exemption is available only in relation to sale of one residential house. Therefore, in case the assessee has sold two residential houses, being long-term assets, the capital gain arising from the second residential house is also a capital gain arising from the transfer of a long-term asset being a residential house. The provision of Section 54 therefore will also be applicable

to the sale of second residential house and similarly to a third residential house and so on. Whenever the exemption available is restricted to one asset, a suitable provision is incorporated in the relevant section itself.

Thus in a case, there is sale of more than one residential house, the exemption will be available in relation to each set of sale and corresponding investment in the residential houses.

However, the exemption is **not available on an aggregate basis** but has to be computed considering **each sale and the corresponding purchase** adopting a combination beneficial to the assessee.

The said view also finds support from the decision rendered in the case of **Rajesh Keshav Pillai V. ITO (ITA No 6661/M/2009) (Mum-Trib)**

**Note:**

At present, when one house is sold and proceeds are invested in multiple houses which are adjacent to each other, the exemption u/s. 54 is available, having regard to the decision rendered in the case of Ananda Basappa. However, after the amendment brought out by Finance Act 2014, such exemption is not available. Now, exemption is available in respect of investment in one house only. However, it is clarified that the decision rendered in the case of Rajesh Pillai (Supra) would still hold good in a case when multiple flats are sold and consideration is invested in multiple flats. What is proposed to be covered by the amendment is a situation when a single flat is sold and investment is made in multiple flats.

## 3. Issues arising u/s. 54EC

### 3.1 Whether fiction created by Section 50 extends to Section 54EC?

The issue that arises many times is that whether the exemption available under Section 54EC of the Income Tax Act is also available in respect of short term capital gain arising from the transfer of 'long term capital asset' in wake of deeming fiction created under Section 50 of the Act?

For the purpose of claiming exemption under section 54EC there should be a transfer of long term capital asset. Now, what is contemplated by section 50 is that the **gain** on transfer of long term capital asset being a depreciable asset **shall be short term in nature**. The fiction of Section 50 by no means converts the long term capital asset into a short term capital asset.

The Gujarat High Court has in the case of **CIT Vs. Aditya Medisales Ltd. (2013) 38 taxmann.com 244 (Gujarat)** held that there is nothing in Section 50 to suggest that the fiction created in Section 50 is not only restricted to Sections 48 and 49 but also applies to other provisions. On the contrary, Section 50 makes it explicitly clear that the deemed fiction created in sub-sections (1) and (2) of Section 50 is restricted only to the mode of computation of capital gains contained in Sections 48 and 49. Secondly, it is well-established in law that a fiction created by the Legislature has to be confined to the purpose for which it is created.

Thus, Section 54EC being an independent section will not be bound by the provisions of Section 50. The depreciable asset, if held for more than 36 months, shall be a long term capital asset as per the provisions of section 2(29A). Therefore, the exemption u/s. 54EC cannot be denied on account of fiction created by section 50

### 3.2 Remedy to the Assessee if NHAI/REC bonds are not available at any point of time during the period of six months from date of Transfer.

Section 54EC provides exemption from long term capital gain arising from transfer of a long term capital asset, provided investment is made in the specified bonds within 6 months from the date of transfer.

There may arise a situation wherein the assessee wishes to invest in the specified bonds i.e. NHAI and REC but subscription to those bonds might not be open at the time when the assessee chooses so. In such a situation, the delay in investment is not due to fault of assessee but for the fact that the bonds are not available.

The High Court of Bombay has in the case of **CIT Vs. Cello Plast (ITA Nos. 3731 of 2010) (Bom.)** held that the assessee is **entitled to wait till the last date**toinvestinthebonds.Evenif the bonds are available for a part of period during the 6 months from the date of transfer, but not as on the expiry of 6 months' period it **makes no difference**because the assessee s **right to buy the bonds upto the last date**cannotbeprejudiced.

*It is observed that Lex not cogit impossibila*(lawdoesnotcompelamantodo that which he cannot possibly perform) and *impossibilum nulla oblignto est*(lawdoes not expect a party to do the impossible) are well known maxims in law.

The High Court has held that in such a case, an assessee would be entitled to a reasonable extension which must then be decided, depending upon the facts of each case. Further, the assessee cannot be forced to purchase alternative bonds if a particular bond is not available since 54EC confers a choice investing either in the REC bonds or the NHAI bonds.

### 3.3 Definition of 'month' for the purpose of Section 54EC

Sections 54E, 54EA, 54EB & 54EC require the investment to be made "*within a period of six months after the date of such transfer*". The subtle question is that whether the word "month" refers in this section a period of 30 days or it refers to the month only. This phrase has otherwise not been used by the legislator in any other provisions of IT Act, 1961 or IT Rule, 1982

The term 'month' is not defined in The Income Tax Act. According to Section 3(35) of the General Clauses Act, 1897 month means **a month reckoned according to the British calendar**.

The question that emerges is whether "month" means a "lunar month" or a "calendar month". The meaning would depend on intention for the usage of the term "month". In British Calendar a month is a unit of period used in a Calendar. It may not be out of context to mention that this system was invented by Mesopotamia.

An average length of a month is 29.53 days; but in a calendar year there are 7 months with 31 days, 4 months having 30 days and one month has 28/29 days. It can be possible that under common parlance probably it meant a lunar month but in calculating the specified number of months that had elapsed after occurrence of a specified event then a General Rule is that the period of a month ends on the last day. Therefore, a month ends by the last date of that month. .

The Special Bench of Ahmedabad ITAT has in the case of **Alkaben P. Patel (ITA Nos. 1973/Ahd/2012)** held that in the absence of any definition of the word 'month' in the Act, the definition of General Clauses Act 1897 shall be applicable and hence the period of investment of six months for the purpose of Section 54EC should be reckoned from the end of the month in which transfer of capital asset takes place. Similar view has been taken in the case of **Yahya E. Dhariwala, 49 SOT 458 (Mum) and Aquatech Engineers, 36 CCH 167 (Mum Trib.)**,

**3.4 Whether the time period of six months is to be reckoned from date of transfer or receipt of consideration?**

Section 54EC requires the assessee to invest the consideration received on transfer of capital asset in specified bonds in order to avail exemption from the capital gains earned.

However, there may arise a situation when the consideration for sale of capital asset is received subsequently, after the sale of capital asset. In such a case, a question arises as to whether the period of 6 months for the purpose of investment u/s. 54EC is to be reckoned from the date of transfer of the asset or from the receipt of consideration.

Section 54EC requires the assessee to make the investment within 6 months ***from the date of transfer***. Thus, if the language of the section is strictly construed, the assessee is required to invest the consideration within 6 months from date of transfer even if the consideration is received several months after the date of transfer.

However, if the period of 6 months is reckoned from the date of transfer, then it would lead to an impossible situation by asking assessee to invest money in specified asset before actual receipt of the same.

This view also finds place in various judicial pronouncements. The Hon'ble Andhra Pradesh High Court has in the case of **S. Gopal Reddy Vs. CIT (1990) 181 ITR 378 (AP)** observed that under the provisions of section 54E of the Act, what is to be invested in specified assets is "the consideration or any part thereof" and unless the consideration is received, or accrues, there is no question of investing it.

Few supporting decisions for the aforesaid proposition are **CIT Vs. Janardhan Dass** (late through legal heir Shyam Sunder) **(2008) 299 ITR 210 (All)** and Chanchal **Kumar Sircar V. ITO (2012) 50 SOT 289 (Kol.)**

**3.5 Whether the exemption u/s. 54EC is to be considered before claiming set off of brought forward capital loss or after?**

The basic issue under consideration is whether exercise of setting off of brought forward long-term capital loss is to be done before claiming deduction under Section 54EC or post set off of such loss.

A joint reading of the provisions of section 54EC and Section 74 would demonstrate that the exercise of setting off of the carried forward capital loss u/s. 74 is to be undertaken once the income under the head capital gains is computed. Now in order to compute the income under the head capital gains, exemption u/s. 54EC ought to have been provided.

Hence, exemption u/s. 54EC is to be considered before claiming set off of brought forward capital loss.

The decisions of courts and tribunals adopting the above view are **Tata Power Co. Ltd V. Addl CIT (2011) 47 SOT 470 (Mum.)** and **CIT Vs. Vijay M. Mahataney (2013) 92 DTR 180 (Mad.).**

**4. Issues arising u/s. 54F**

**4.1 Whether exemption u/s. 54F is available if construction is not fully completed within 3 years or sale deed is not executed within the stipulated period?**

There may arise a situation wherein the assessee starts the construction of the house but the construction could not be completed within the stipulated time period of 3 years. In such a case, the department normally takes a stand that assessee shall not be entitled to a deduction u/s. 54F since the construction is not complete.

However, one has to bear in mind that S. 54F is a beneficial provision for promoting the construction of residential house & requires to be **construed liberally** for achieving that purpose. The intention of the Legislature was

to **encourage investments** in the acquisition/ construction of a residential house and ***completion of construction or occupation is not the requirement of law.***

The words used in the section are 'purchased' or 'constructed'. The condition precedent for claiming benefit u/s 54F is that the capital gain should be parted by the assessee and invested either in purchasing a residential house or in constructing a residential house.

If after making the entire payment, merely because a registered sale deed had not been executed and registered in favour of the assessee before the period stipulated, he cannot be denied the benefit of section 54F of the Act. Similarly, if he has invested the money in construction of a residential house, merely because the construction was not complete in all respects and it was not in a fit condition to be occupied within the period stipulated, that would not disentitle the assessee from claiming the benefit under section 54F of the Act

The above issue has also directly been covered in favour of assessee by the following decision of the Madras High Court in the case of **CIT v. Sardarmal Kothari [2008] 302 ITR 286 and** of the the Karnataka High Court in the case of **CIT V. Sambandam Udaykumar (2012) 251 CTR 317 (Kar.)**.

### 4.2 Deduction u/s. 54F in case of joint names in deed of purchase

As a matter of common practice in our country, property is generally purchased in joint names of family members. In such a situation, an issue arises as to whether only proportionate deduction is available to the assessee particularly when the co owner is merely a name lender and the payment is fully made by the assessee under section 54F.

It is pertinent to note here that Section 54F mandates that the house should be purchased by the assessee. However it does not stipulate that the house needs to be purchased in the name of the assessee.

Such view has been affirmed in the decisions rendered in the case of **CIT Vs. Gurnam Singh (2010) 327 ITR 278 (P&H)**, **Jt. CIT vs. Smt. Armeda K. Bhaya (2006) 99 TTJ 358, ITAT**, Mumbai Bench and **CIT vs. Kamal Wahal (2013) 351 ITR 4 (Del.)**,

Thus based on the above decisions, it seems clear that mere inclusion of family member's name in the purchase deed does not disentitle the assessee from claiming exemption u/s. 54F. Exemption would be available to the assessee whose funds have been used for the purpose of investment.

### 4.3 Can consideration arising out of sale of multiple assets be invested in a single asset for the purpose of Section 54F?

Kindly consider the following situation. Mr. X has earned Long Term Capital Gains of Rs. 2 cr., 3Cr. And 1 cr. For the AY 2010-11, 2011-12 and 2012-13 respectively. However, he invests a sum of Rs. 8 crore for purchase a single flat in AY 2011-12 and claims exemption from the Capital Gains earned for all three AY i.e. 2010-11, 2011-12 and 2012-13. Can he do so?

Section 54F allows the assessee exemption from long term capital gains provided he purchases a residential house one year before or two years after the date of transfer of the asset.

The Mumbai Bench of ITAT has in the case of **Smt. Anagha Ajit Patnekar V. ITO (2006) 9 SOT 685 (Mum.)** held that from the language of this section, legislature has provided leverage to the assessee for claiming deduction under Section 54F in the sense that assessee can buy the property first and claim deduction later on i.e., within one year or can have capital gain first and can claim deduction within two years by purchasing the residential flat.

Therefore, in respect of residential **property till cost of purchase of flat is exhausted by the claim of the capital gain deduction cannot be denied**. Sub-section (4) has been inserted with a view to facilitate the assessee to claim the capital gain exemption when assessee opts for purchase of flat after arising of the capital gain and deposit the sale consideration in the bank account till such appropriation.

The assessee cannot be expected to appropriate the sale consideration in respect of the already purchased flat. If such interpretation is accepted, it will frustrate the object of the provisions of s. 54F and lead to absurdity.

Thus, from the aforesaid judgment of the Mumbai ITAT it can be stated that there is no bar in Section 54F for claiming deduction second or third time for the same property, if the capital gain which has arisen in the case of taxpayer is within the cost of the property.

## 5. Capital Gain on Retirement of Partners

### 5.1 Whether cash received by partners on retirement is taxable u/s. 45(4) particularly when partners had brought cash at the time of admission, which is used by the Firm to purchase a property?

There may arise a situation when at the time of retirement, the retiring partner is paid cash equivalent of his share in the partnership firm. The question that arises is whether in such a situation, section 45(4) can be invoked or not?

It has now been well settled that section 45(4) would be applicable in case of dissolution of the firm as well as at the time of retirement of the partner from the firm.

Following conditions are required to attract Section 45(4)

- There should be a distribution of capital assets of a firm
- Such distribution should result in transfer of a capital asset by firm in favour of the partner
- on account of the transfer there should be a profit or gain derived by the firm
- such distribution should be on dissolution of the firm or otherwise

When the firm gives money equivalent of his share to the partner on retirement, the firm does not transfer any property. Thus section 45(4) is not attracted at all. This has been held in the case of **CIT V. Riyaz A. Sheikh (ITA No. 1969 of 2011) (Bom.)**

Further, there may be a situation in which the old partner who had brought property at the time of admission to the firm retires after introduction of new partners and takes the money value of his share in the firm. In such a case it cannot be said that the said transaction is a device adopted to transfer the immovable property to the new partners. The property belongs to the partnership firm and not to the partners. The partners only have a share in the partnership asset. When they retire they are not relinquishing their interest in the immovable property of the firm. What they relinquish is their share in the partnership. Therefore, there is no transfer of a capital asset and no capital gains or profit arises. The said view also finds support from the decisions rendered in the case of **ITO Vs. M/s. Dynamic Enterprises, (ITA No. 1414/2006 Kar. HC)**

## 6. Conclusion

The subject of Capital Gains is never ending and illimitable. The authors hope that the views discussed above shall help the readers in handling the problems and issues arising during the course of assessment.

❊ ❊ ❊

# Glimpses of Supreme Court Rulings

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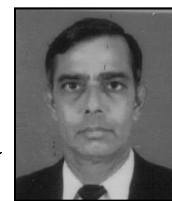

## 27 Negotiable Instruments Act, 1981- Offence of cheque dishonor

Section 138 of NI Act r.w.s. 177 of CrPC leaves no manner of doubt that the return of the cheque unpaid by the drawee bank alone constitutes the commission of the offence of cheque dishonor and indicates the place where the offence is committed. The Parliament in its wisdom considered it just and proper to give to the drawer of a dishonoured cheque an opportunity to pay up the amount before permitting his prosecution, no matter the offence is complete the moment the cheque was dishonoured.

A coordinate Bench is bound to follow the previously published view; it is certainly competent to add to the precedent to make it logically and dialectically compelling. However, once a decision of a larger Bench has been delivered it is that decision which mandatorily has to be applied; whereas a coordinate Bench,, in the event that it finds itself unable to agree with an existing ratio, is competent to recommend the precedent for reconsideration by referring the case to the Chief Justice for constitution of a larger Bench.

***Dashrath Rupsingh Rathod vs. ST. Of Maharashtra (2014) (9 SCC 129)***

## 28 ESI Act, 1948- Meaning of Shop, establishment

The term "shop", again, has not been defined in the ESI Act. Therefore, the meaning assigned to this word in dictionaries may be noticed. It can be said that a "shop" is a business establishment where a systematic or organized commercial activity takes place with regard to the sale or purchase of goods or services, and includes an establishment that facilitates the above transaction as well.

"Entertainment" is an activity that provides with amusement or gratification. Further, it would include public performances, including games and sports. Therefore, it can be said that horse racing is indeed a form of entertainment.

Every word of a language is flexible to connote different meanings when used in different contexts. That is why it is said that words are not static, but dynamic and the court should adopt the dynamic meaning which upholds the validity or scheme of any legislation.

***Bangalore Turf Club Limited vs. Regional Dir. ESIC (2014) (9 SCC 657)***

## 29 Courts, Tribunals and Judiciary- Judicial Process-Recusal by Judge.

A Judge is to decide every dispute in consonance with law. If one is not free to decide in consonance with his will, but must decide in consonance with law, the concept of a Judge being individual possessing power and authority is but a delusion.

Correction of a wrong order would never put anyone to shame. Recognition of a mistake, and its rectification, would certainly not put the present Bench to shame. The embarrassment would only arise when the order assailed is actuated by personal and/or extraneous considerations, and the pleadings record such an accusation.

The oath of office of the Supreme Court requires the Bench to discharge its obligations, without fear or favour. The Supreme Court therefore also commends to all courts, to similarly repulse all baseless an unfounded insinuations [of bias], unless of course, they should not be hearing a particular matter, for reasons of their direct or indirect involvement. The benchmark that justice must not only be done but should also appear to be done, has to be preserved at all costs.

What is a Judge is taught during his arduous and onerous journey to the Supreme Court is, that his calling is based on the faith and confidence reposed

**contd. on page no. 520**

# From the Courts

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## 57 CBDT Circulars : Time limit for selecting cases for Scrutiny assessment. Amal kumar Ghosh v/s. Asst. C.I.T. (2014) 361 ITR 458(Cal).

**Issue:**

Whether circulars are binding to Department?

**Held:**

CBDT issued circulars No.9 and 10, i.e. for Corporate/Non Corporate assesses for scrutiny selection.

**Circular No. 9 reads as under:-**

"The process of selection of cases for scrutiny of returns filed up to March 31, 2004 must be completed by October 15, 2004. For returns filed during the current financial year 2004-2005, the selection of cases for scrutiny will have to be completed within three months of the date of filing of the Return."

When Return was filed on October 29, 2004 and the case was selected for scrutiny on July 6, 2005, on challenge by the assessee, High Court has held as under:

(i) Even assuming that the intention of the CBDT was to restrict the time for selection of the case for scrutiny to a period of three months, it could not be said that the selection in the case of the assessee was made within the period. The return was filed on October 29, 2004 and the case was selected for scrutiny on July 6, 2005. By any process of reasoning, it was not open to Tribunal to come to a finding that the Department acted within the four corners of Circular No.9 & 10 issued by the CBDT. The circulars were evidently violated. The circulars were binding upon the Department u/s. 119.

(ii) That even assuming that the circulars were not meant for the purpose of permitting unscrupulous assessees from evading tax, it could not be said that the Department which is a State, can be permitted to selectively apply standards set by itself for its own conduct. When the Department has set down a standard for itself the Department is bound by that standard and cannot act with discrimination. If it does then the act of the Department is bound to be struck under Article 14 of the Constitution. In the facts of the case, it was not necessary to decide whether the intention of the CBDT was to restrict the period of issuance of notice from the date of filing the return laid down u/s. 143(2). Thus, the notice u/s. 143(2) was not in legal exercise of jurisdiction.

## 58 Section 271 (1) (c) Explanation 1 : Requirements - CIT v/s. Manjunatha Cotton & Ginning Factory (2013) 263 CTR 153 ( Kar): (2013) 359 ITR 565 (Karn)

**Issue:**

What are the requirements for levy of penalty u/s. 271 (1) (c)?

**Held :**

After insertion of Explanation 1 to Section 271(1) (c), the law on concealment and penalty has become stiffer. The explanation as it stands now is a complete code having the following features:

(1) Every difference between reported and assessed income needs an explanation.

(2) If no explanation is offered, levy of penalty may be justified.

(3) If explanation is offered but is found to be false, penalty will be exigible.

(4) If explanation is offered and it is not found to be false, penalty may not be leviable. - if

(a) Such explanation is bonafide,

(b) The assessee has made available to the A.O. all the facts and materials necessary in computation of income.

Therefore the Explanation I, understood in the proper context in particular, Clause (c) of Sub. Sec. (1) of Sec. 271 makes the intention of the legislature manifest. It clearly sets out when penalty is leviable and when penalty is not leviable. The condition precedent for levying the penalty is the satisfaction of the authority that there is concealment of particulars of the income or inaccurate particulars are furnished to avoid payment of tax.

## 59 Burden on assessee and burden on Department: Income Tax Act. Sec.68 - C.I.T. v/s. Smt. Sanghamitra Bharali (2014) 361 ITR 481 (Gauhati) [This decision does not appear in CTR DVD]

**Issue :**

In Income-tax Act, for taxing Income what is the burden on Assessee and on Department?

**Held :**

In all cases in which receipt is sought to the taxed as income, the burden lies on the Revenue to prove that it is within the taxing provision; but once that burden is discharged, the burden of proving that it is not taxable, because it falls within exemption provision under the I.T. Act. 1961, lies on the assessee. If the explanation offered by the assessee about the nature and source thereof, is, in the opinion of the A.O. not satisfactory and there are evidences and circumstances pointing out to the effect that what has been shown was not real and if the assessee fails to contradict such facts and circumstances, then such acts and circumstances can certainly be used against the assessee to hold that the receipt was in the nature of income.

In order to establish the receipt of cash credit as required u/s. 68, the assessee must satisfy three important conditions:

(i) The identity of the creditor;

(ii) The genuineness of the transaction and,

(iii) The financial capability of the person giving the cash credit to the assessee i.e. the creditworthiness of the creditor.

However, the onus of the assessee is limited to the extent of proving the source from which he received the cash credit. The creditworthiness of the creditor is to be judged vis-à-vis the transaction which had taken place between the assessee and the creditor, and it is not the burden of the assessee to find out the source or creditworthy capacity in order to prove genuineness of transaction.

## 60 Capital Gain of depreciable assets and Section 54 EC. - C.I.T. v/s. Aditya Medisales Ltd. (2014) 266 CTR 98 (Guj) [This decision does not appear in CTR DVD]

**Issue :**

Whether relief of investment u/s. 54 EC is available for short term capital gain of long term depreciable capital asset?

**Held :**

Capital gain of depreciable capital asset if invested in specified asset, exemption u/s. 54 EC cannot be denied only on account of the fact that deeming fiction is created u/s. 50 of the I.T. Act. Legal fiction created under u/s. 50 is though restricted to computation of capital gains, such deeming fiction cannot restrict application of Sec. 54 EC which allows exemption of capital gain, if assessee makes investment in specified assets. Thus, the assessee cannot be charged to capital gains when short term gain of long term capital assets get invested, in the assets specified under the law.

## 61 Waiver of loan amount by Bank: Section 41(1) does not apply - C.I.T. v/s. Dholgiri Industries Pvt. Ltd. (2014) 266 CTR 111 (MP)

**Issue :**

When Bank has waived loan taken, whether provision of Sec. 41(1) would apply for taxing that amount?

**Held :**

The A.O. has committed error in treating the amount waived by the bank to be amount earned by the assessee. The principle amount of loan being never claimed by the assessee as its expenditure, its waiver will not amount to income of the assessee and as such there is no infirmity in the orders passed by CIT (A) and I.T.A.T. in considering the amount as non-taxable and hence addition is not proper.

## 62 Section 14 A and availability of interest free funds - C.I.T. v/s. Gujarat Narmada Valley Fertilizer Co. Ltd. (2014) 221 Taxman 479 (Guj)

**Issue :**

Whether when interest free funds are available for investment in shares and UTI from which dividend is received, application of Sec. 14 A is proper?

**Held :**

The A.O. disallowed the interest expenditure on the ground that as per the provisions of Sec. 14A the expenditure in terms of investment which pertained to the exempt income from interest bearing funds was not allowable.

On appeal the CIT (Appeals) held that the dividend income was earned out of the investment made in the earlier years. The assessee company had huge share capital and reserves and surplus, which did not carry any interest. No disallowance was made on the interest expenditure made in past and the A.O. could not establish any nexus between interest bearing borrowing and investment from which exempt income was earned. He, therefore, deleted the disallowance made by the A. O.

On second appeal the Tribunal held that no fresh investment was made by the assessee during the year under consideration. As per the Balance Sheet of the assessee huge interest free funds in the form of capital, reserves and surplus to the tune of Rs.84.45 Lakhs were available. Whereas investment was made only to the extent of Rs.22.70 Lakhs. It therefore, upheld order of CIT (Appeal).

High Court held that both the authorities below had correctly approached the issue by setting aside the order of disallowance under Sec. 14A of the Act, in respect of interest expenditure. When the very basis for employing Sec. 14-A of the Act. on factual matrix is lacking, the disallowance to the extent of 10% of dividend income was not permissible.

## 63 Taxability: Lack of taxable event - Chimanlal and Sons v/s. C.I.T. (2013) 353 ITR 344 (Guj) : (2014) 221 Taxman 174 (Guj.) (Mag.)

**Issue:**

Subsidy received long back by the firm, which is transferred to partners accounts can be taxable?

**Held :**

Assessee received subsidy from State Government in the year 1995. Since then such subsidy had been reflected in firm's Balance Sheet in subsidy account. During I.T.A.Y. 2004-05 such amount was transferred to partners' capital accounts making reserve and subsidy nil and correspondingly, partners' capital was increased by such amount. Consequently, assessment was sought to be reopened to examine taxability of such receipt. Since no taxable event did arise during the year under consideration, mainly because assessee changed nature of treatment for accounting purpose, it would not permit revenue to examine taxability of such receipt in I.T. A.Y. 2004-05 and thus reassessment lacked validity.

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# Tribunal News

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### 49 M.Dinshaw & Co. (P.) Ltd. v. DCIT 150 ITD 342 (Mum.) Assessment year: 2004-05 Order Dated: 14th July, 2014

**Basic Facts**

The assessee paid vehicle tax on purchase of vehicle under Bombay Motor Vehicles Tax Act, 1958. Vide an amendment to the said act, effective 1995, the annual tax was converted into a one-time tax, so that it was required to be paid once during the life time of a vehicle, at the time of its purchase. The assessee's contention was that the amendment would, however, not alter its character. The vehicle tax under the pre-amended Act was being continuously and undisputedly allowed as revenue expenditure. The same would continue to be so in-as-much as a lump sum levy, for administrative reasons, would not change the nature of the expenditure from revenue to capital. The revenue authorities rejected assessee's explanation and concluded that payment is a part of cost of the vehicle to the assessee, a capital asset in its hands, and would accordingly form part of its cost.

**Issue**

**Whether one time vehicle tax paid by assessee is capital expenditure exigible to depreciation as against being revenue expenditure deductible u/s 37?**

**Held**

The matter that the motor car on which the impugned tax stands paid are capital assets in assessee's hands intended for primary use if not wholly, in Maharashtra, is not in dispute. It is amply clear that the tax is under law applicable on motor cars or omnibuses registered in the State of Maharashtra, as one time tax for the life of vehicle. Further, the tax is for user, active or passive of the motor vehicle in the territory to which the jurisdiction of the said Act extends i.e. the state of Maharashtra. The Tribunal held that Section 43(1) which defines the term 'actual cost', does not define it negatively, i.e., emphasizing the elements which would not form a part thereof, so that the principles of commercial accounting shall apply in determining the actual cost. The same is even otherwise trite law, so that in the absence of a statutory definition or mandate, the accounting prescription shall prevail. It is only where the law specifically provides for a particular course of action, inconsistent with the accounting mandate, that the same shall prevail and override the latter, viz., section 43B. The Accounting Standard (AS) in respect of accounting for fixed assets, i.e., AS-10, issued by the Institute of Chartered Accountants of India, defines 'fixed asset', also laying down the principles for its valuation (cost) or determining its cost. Therefore, the payment of tax which enables the vehicle being put to its intended use represents a condition thereof and accordingly shall form a part of its cost. The misconception arises as the assessee, in its mind, and without basis, links the provisions of the said Act as it stood prior to the amendment of 1995 with that as amended. There is nothing in law, as it stands, to suggest that the levy is in lieu of a series of annual payments. In fact, the amendment/s has the effect of altering the nature of the levy in-as-much as the pre-amended tax could be regarded as an annual charge for the user of the vehicle for one year at a time.In view of the above the tribunal held that the tax levied by the said act would form part of actual cost of the motor cars.

### 50 JSW Energy Ltd. v. ACIT 140 ITD 406(Mum) Assessment Year: 2005-06Order dated: 30th April, 2013

**Basic Facts**

In the instant case, the assessee had set aside out of the profits Debenture Redemption Reserve and claimed the same as deduction while computing

profits u/s 115JB of the Act. The revenue held the same to be reserve as appropriation of profits and not 'provision' for meeting liability while computing the profits u/s 115JB.

**Issue**

**Whether amount set aside as 'Debenture Redemption Reserve' is deductible while computing book profits under MAT?**

**Held**

Debenture is a loan liability i.e. borrowed capital of the entity raising funds through the issue of debentures. The said liability is classified as a secured loan in the balance-sheet prepared under Part I of Schedule VI to the Companies Act, 1956. As the debenture funds form part of the capital structure of the enterprise, the relevant provisions of the Companies Act provide that its profits are to that extent, and over the period of its currency, set aside for the purpose. This ensures, simultaneously, two things. Firstly, that the debentures are redeemed out of the profits of the enterprise and, two, that the profits are capitalized to that extent. The Companies (Acceptance of Deposit) Rules, 1975, as prescribed under section 58A of the Companies Act, also provide, similarly, for a set aside, over a period of time, i.e., the tenure of the public deposits, of the profits of the depositee-company, investing a part thereof in liquid government securities each year. This ensures that the terms of the redemption are met in a timely manner (out of the fund so created), and there are no defaults by the depositee-companies, as where the company invests its profits on expansion or in business or otherwise dissipates them, as by way of dividends, so that the liquid funds are not available for discharge of the loan liability at the relevant time, i.e., the time of redemption, but at hand through the sale/realization of the liquid securities. This can also be considered as a measure to protect investor's confidence as well as to promote investment climate and corporate discipline. The set aside of profits is, therefore, only a sinking fund to fund a capital liability (out of the profits).The set aside of profits, though for meeting a liability, is of one on capital account so that neither the assumption thereof (the liability) nor its liquidation (discharge) would impact the operating statement of the enterprises, i.e., the company's profit and loss account prepared /to be prepared under Parts II and III of Schedule VI to the Companies Act. The adjustments to the book profit under section 115JB are also consistent with the preparation of the profit and loss account under the Companies Act. The set side of the profits is not to meet a trading liability or a liability on revenue account, so as to form part of or get incorporated therein, i.e., the profit and loss account. As such a liability would itself be charged to the operating statement, reducing the profit to that extent. That is, even if not actually discharged out of the profits, as where the same stand locked up in an asset/s, the profits have been deemed to have been absorbed to that extent, so as to become the source of its discharge. Therefore, the revenue was not incorrect in stating that the said set aside of the profits is only an appropriation of profits, and would not amount to a provision, so as to qualify for deduction in the computation of the profit of the assessee-company. The issue, in fact, is not if it is a 'provision' against an ascertained liability or a 'reserve' per se, but whether it could be considered as deductible in computing the profit of the enterprise. In short, the liability, for the discharge of which the profits are being set aside, is in the capital field, so that neither the liability (on its assumption) nor the profit set aside (for its discharge) could be considered as a charge against the profits. This is precisely the reason that the same is not either claimed or allowed as deduction in the computation of income under the regular provisions of the Act.Accordingly, the adjustment made by the assessee in the computation of book profit under section 115JB gets validated.

**51**

**ACIT v. Hitachi Home and Life Solutions (India) Ltd. 150 ITD 454 (Ahd). - Assessment Year: 2000-01, 2001-02, 2003-04 and 2004-05 Order dated: 24th September, 2013**

**Basic Facts**

In the case, additions had been made by the TPO, after comparing the rate of royalty paid by other associate enterprises with the rate paid by the

assessee, using internal comparable uncontrolled transaction (CUP) method. In the TP analysis, the assessee did not benchmark this transaction and submitted that the royalty rate is comparable to the royalty payments in international market. It was further submitted that the payment is approved by the RBI. These arguments were rejected by the TPO.CIT(A)deleted the addition after observing that on the basis of the chart submitted by the assessee, the royalty paid by it was less than the payment made by the other associate enterprises.

**Issue**

**Whether where it is proved that effective rate of royalty was paid by assessee was less than royalty paid by other AEs would addition be justified?**

**Held**

The Tribunal held that only stated rate is not decisive and effective rate has to be considered and when the amount of royalty paid by the assessee is considered with ex-factory sale value, without deducting various expenses, such as dealer commission, special commission, warranty etc., then the effective rate worked out is only 2.3% on sale, as against 3% paid by other group entities. This finding given by the CIT(A) was not controverted by Department. Hence based on this aspect, the Tribunal upheld the order of the CIT(A).

## 52 Deraj Agrotech Ltd. Vs. ITO 164 TTJ 495(Mum) Assessment Year: 2007-08 Order dated: 29th January, 2014

**Basic Facts**

The assessee company filed its return of income at NIL after set off of brought forward losses. The AO finalized the assessment determining the income of the assessee at Rs.15.37 lakhs. During the assessment proceedings AO found that the assessee company had not disallowed the deferred tax, fringe benefit tax and prior year adjustment amounts debited to the Profit & Loss account. The AO disallowed the same and initiated penalty proceedings. In penalty proceedings the assessee stated that these amounts were not offered for tax through an inadvertent error. The AO held that the plea of the assessee that the default was committed through an inadvertent error was too general to be accepted as a reasonable and accordingly levied penalty under section 271(1)(c). On appeal, CIT(A) held that assessee had given a lame excuse for the mistakes committed by it. Taking of a wrong base could not be termed as an inadvertent mistake. Further, assessee had considered those very sums for calculation to be made under section 115JB, hence there was no reason why same was not done for computing taxable income. The wrong claim, so basic and fundamental, was not acceptable as a reasonable cause while deciding the cases of concealment penalty. Accordingly he upheld the order of the AO.

**Issue**

**Whether income not offered for tax through an inadvertent error would result in evasion of taxes and the provisions of section 271(1) (c) be attracted?**

**Held**

There is fundamental difference in a debatable claim and a patently wrong or false claim. There have to be diverse opinions of courts about the claims made under the first category and where assessee can adopt one of the views. In such circumstances, one can say that issue has not reached finality and if assessee has opted for one of the possible views, he should not be visited by penal provisions. But, the claims made under the second category have no legs of their own to stand. Clearly, such claims are not tenable legally or factually. If a claim of deduction put forward by the assessee is not legally valid and results in evasion of taxes, provisions of section 271(1)(c) comes in picture. So, it can be safely said that whenever any material fact for correct computation of incomeis not filed or if filed is inaccurate, then penalty has to be imposed. Further, it can be observed that while computing the tax liability under section 115JB the assessee had relied upon various judgments of the Tribunal and arrived at the conclusion that certain amounts were not to be considered while computing income under MAT provisions. It clearly shows and proves that the assessee company is well versed with the provisions and procedure of law. It is not a case of an assessee

who is a small time player and is ignorant of tax laws. A knowledgeable corporate-assessee cannot be allowed to take shelter of inadvertent mistake.Henceforth, the claim of deductions made by the assessee with regard to FBT and prior period expenses was not justified and claims fall in the category of false claim. However amount of deferred taxes was a deductible item at the time of assessment which became disallowable because of retrospective amendment and therefore the claim for deduction thereof made by the assessee was not a false claim and no penalty is leviable in respect of said claim.

## 53 GFA Anlagenbau GMBH vs. DDIT (International Taxation) 165 TTJ 126 (Hyd) Assessment Year: 2005-06 TO 2009-10 Order dated: 27th June, 2014

**Basic Facts**

The assessee was a foreign company incorporated in Germany. It was engaged in the activity of supervision, erection, commissioning of plant and machinery for steel and allied plants in India. During the year under consideration, the assessee had received contractual receipts from an Indian company for rendering technical and supervision services. The assessee had rendered services to the above mentioned resident company by engaging foreign technicians at the work sites in India and the total stay of technicians deputed by the assessee company on the projects exceeded 183 days .i.e. 220 days. On the basis of these particulars of stay, Assessing Officer concluded that the assessee was having Permanent Establishment within the meaning of article 5 of DTAA between India and Germany. The DRP held that the provisions of relevant contract agreement as well as the provisions of article 5 of DTAA between India and Germany clearly established that the assessee was having Permanent Establishment in India during the relevant period. Further with regard to the deduction of expenditure DRP held that the assessee was entitled to deduction of 50 per cent of gross receipts from all projects towards expenditure.

**Issue**

**Since technicians deployed by assessee merely rendered supervisory services at project sites of its clients and assessee did not by itself own or operates such sites independently, whether it can be concluded that assessee's supervisory services constituted a PE in India under article 5 of India Germany DTAA?**

**Held**

The term 'Permanent Establishment' is defined in section 92F (iiia) which includes a fixed place of business through which the business of the enterprise is wholly or partly carried on'. The supervisory activities do not constitute a fixed place of business in as much as the assessee rendered its services at the project sites of its clients and does not by itself own or operate such sites independently but rather provided under contract terms by its clients. In the instant case, assessee is clearly doing the supervision of project of the Indian company and has no fixed place of business. Only its technicians deputed to India in one project stayed in India for more than 180 days.Nothing was brought on record that the technicians are operating from a fixed place in the custody of assessee. As per the terms the stay and transportation are undertaken by Indian company. Applying the rationale of the Special Bench in case of Motorola Inc. v. Dy. CIT it cannot be said that the assessee has a fixed place of business for its supervisory activities.Further, Article 5(2) (i) talks about supervisory activities and in the instant case as assessee do not have any building site or construction site of its own. The activities being of a technical nature clearly fall under the Fees for Technical Service (FTS) i.e., Article 12 of the India-German DTAA and is taxable at the rates specified therein.

## 54 Aditi Technologies (P.) Ltd. V ITO 149 ITD 515 (Bang) Order dated 14th March 2014, Assessment Year 2008-09.

For the relevant assessment year, the assessee filed its return claiming deduction under section 10A in respect of profits derived from the business of manufacture and export of computer software. The CIT passed order under section 263 holding that the order of the AO was erroneous and prejudicial to the interest of the revenue, for the reasons that u/s 10A deduction was allowed for ten consecutive assessment years beginning from the assessment year

in which the assessee began to manufacture an article or thing. According to the CIT, the assessee began to manufacture article or thing from the assessment year 1995-96 and the period of ten years would expire in Assessment year 2004-05 and in such a situation the assessee was not entitled to claim exemption u/s 10A in the assessment year in question.

**Issue**

**Whether the assessee would be entitled to deduction u/s 10A and how to reckon the period of 10 consecutive assessment years in the case of the assessee?**

**Held**

The fact that the assessee began manufacturing in AY 1995-96 was not disputed. Accordingly the assessee was entitled to deduction u/s 10A from AY 1995-96. As per the law as it existed prior to substitution of section 10A by Finance Act 2001, the period was 5 consecutive assessment years falling within a period of 8 years from the assessment year in which the undertaking began to manufacture. As per the amended section the deduction was allowed for a period of 10 consecutive years from the year of manufacture. In this case, the assessee had not claimed deduction for AY 1995-96 to 1997-98. But the assessee claimed deduction u/s 10A for AY 1998-99 to 2001-02. The assessee opted out of the provisions of section 10A by virtue of the provisions of section 10A(8) which gives such opting out to an assessee for AY 2002-03 to 2004-05. In the case of the assessee the band of 10 years as per the amended law would be 1995-96 to 2004-05 only. Opting out of the provisions of section 10A will not have the effect of extending the band period of 10 years. The assessee could get the benefit of the amended law applicable from assessment year 2001-02 only for 2 more years viz., AY 2003-04 & 2004-05. The provision for opting out of the provisions of section 10A is intended to facilitate an assessee who can get more benefits under any other provisions of deduction under Chapter VIA. That provision cannot extend the period of benefit beyond 10 years from the previous year relevant to assessment year in which the assessee begins to manufacture or produce articles or things.

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contd. from page 512



in him to serve his country, its institutions and citizens. Each one of the above (the country, its institutions and citizens), needs to be preserved. Each of them grows to prosper, with the others' support. Each of them has duties, obligations and responsibilities and also rights, benefits and advantages. Their harmonious glory emerges from what is commonly understood as "the Rule of Law". The judiciary as an institution has extremely sacrosanct duties, obligations and responsibilities".

***Subrata Roy Sahara vs. UOI (2014) (8 SCC 470)***

**30 Recovery of tax-Membership card of Stock Exchange.**

A reading of rules 5 and 9 of the Rules, By-Laws and Regulations of BSE leads to the conclusion that a membership card is only a personal permission from the stock exchange to exercise the rights and privileges that may be given to subject to Rules. The moment a member is declared defaulter, his right of nomination seizes and vests in the exchange.

Government debts have precedents over unsecured creditors. The Income Tax Act, 1961 does not provide for any paramountcy of dues by way of income tax. The moment the stock exchange has a lien over the member's securities; it would have precedence over income tax dues. The lien possessed by SE makes it a secured creditor and whether it is a statutory lien arise out of agreement, does not make much of the difference as SE being a secured creditor would have priority over Government dues.

***Stock Exchange, Bomaby vs. Y.S. Khandalgaonkar (2014) (368 ITR 296)***

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# Unreported Judgements

**CA. Sanjay R. Shah**
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In this issue we are giving gist of an important decision of Hon'ble Ahmedabad Tribunal in the case of **Shri Kishore R. Pithva**, wherein an issue on which the appellant did not press his grounds before CIT(A) came to be agitated by assessee before Hon'ble Tribunal and the same was allowed by the Hon'ble Tribunal as the legal position was in favour of the assessee.

The Hon'ble Tribunal while deciding the matter reiterated old principle that there cannot be estopple against the law and that there cannot be concession in the matter of law. If the legal position is in favour of the assessee, the department has to grant relief to the assessee irrespective of the fact that the assessee may have waived his entitlement of the same. Present day, many a times, an assessee may be under certain compulsions made to withdraw his grounds as not pressed even if the legal position is in favour of the assessee. In that situation such decision could be helpful.

**In the Income Tax Appellate Tribunal at Ahmedabad**
**"D" Bench**
**Before S/Shri G.C. Gupta, Vice-President and N.S. Saini, Accountant Member**
**ITA No. 2931/Ahd/2010**
**[Asstt. Year : 2007-2008]**

**Shri Kishore R. Pithva v/s ITO, Ward-12(2)**
**Mathur Master Estate Ahmedabad**
**Opp: Babulal Zafarani Patti**
**Nagarwel Hanuman Road**
**Amraiwadi, Ahmedabad – 380 006**
**PAN : ACRPP 9292 L**

**(Appellant) (Respondent)**
**Assessee by ; Shri M.K. Patel**
**Revenue by : Smt. Sonia Kumar, Sr. DR**
**Date of Hearing : 8th September, 2014**
**Date of Pronouncement : 17/10/2014**

**Gist**

**Facts :**

The relevant grounds before Hon'ble Tribunal were as under :

*"2. The ground No.1 and 2 of the assessee are as under :*

*"1. The ld. CIT(A) has erred in deciding the ground of appeal 'a' as not pressed in respect of non deduction of TDS u/s 194C of the Act on expenses of Rs.7,97,850/- and Rs.1,75,000/- as not allowable u/s 40(a)(ia) when the provisions of deduction of TDS for an individual assessee were made applicable w.e.f. 01/06/2007 and also brought to the notice of CIT(A) vide submission dated 25/03/2010 that it were not applicable during previous year 2006-07. The learned CIT(A) ought to have deleted the expenses disallowance as not consistent with legal provisions.*

*2. The ld. CIT(A) has erred in rejecting the ground number 'a' of the ground of appeal before him as not pressed vide order sheet entry dated 06/09/2010 in as much as the AR was not empowered to do so but as explained to appellant he was forced to do so to avoid adverse consequences thereof. The acceptance of the AR for not pressing the ground number 'a' be held to be illegal and bad in law and also as not in conformity with the authority granted to AR."*

**Rival Contentions :**

The Counsel for the assessee submitted that issue of disallowance of expenses amounting to Rs.7,97,850/- and Rs.1,75,000/- u/s 40(a)(ia) of the Act was not pressed by the Chartered Accountant of the assessee before CIT(A). It is submitted that provisions of TDS u/s 194C for an individual assessee were made applicable w.e.f. 01/06/2007 and therefore were not applicable for the relevant assessment year 2007-08 and therefore the concession made by C.A. of the assessee was under

misconception of the law. He submitted that issue being legal in nature, Revenue authorities should have decided the same in accordance with the law. He relied on the decisions of Hon'ble Apex Court in CIT v/s Shelly Products and Another, 261 ITR 367 (SC) and the decisions of the Hon'ble Gujarat High Court in P.V. Doshi v/s CIT, 113 ITR 22 (Guj.) and S.R. Koshti v/s CIT, 276 ITR 165 (Guj.).

On the other hand DR opposed the submission of the assessee and submitted that since the C.A. of the assessee had conceded the issue before CIT(A), the assessee should not be allowed to re-agitate the same now before the Tribunal.

**Held**

The Hon'ble Tribunal on consideration of the facts and legal position held as under:

"5. *We have considered rival submissions and have perused the orders of theAO and the CIT(A), and also decisions of various courts relied upon on behalfof the assessee. We find that the assessee has admitted that its Chartered Accountant has "not pressed" the issue before the CIT(A). However, we findthat there could not legally be no estoppel against the law. The disallowancewas made for non-deduction of tax on expenses under section 40(a)(ia) of theAct, although, the TDS provision under section 194C on an individual assesseewas not applicable during the relevant period to the case of the assessee, beingan individual, as this provision of TDS was made applicable w.e.f. 1-6-2007 incase of an individual. We find that there could not be any valid agreement ofthe assessee with the department in contravention of the statute. It is not thecase of the department that the TDS provisionunder section 194C were in factapplicable to the facts of the case of the assessee during the relevant period.The only reasoning of the Revenue authorities was that since the assessee'srepresentative has conceded the issue before the CIT(A), the addition should beupheld. Such an interpretation of law, in our considered opinion, shall lead toanomalies and also not sustainable in law. We are of the view that it is theresponsibility of the Revenue authorities to compute the taxable income of theassessee correctly in accordance with the provision of law applicable to the caseof the assessee. If the assessee under some misconception of the correct legalprovision applicable to the relevant period, make a concession and agreed to getthe amount taxed, which was otherwise not taxable as per the scheme of theAct, the taxing authorities should refrain themselves from taxing such amount. The taxing authorities have an equal responsibility of assessing the correctincome of the assessee. However, in case the assessee concedes certain amountand agrees that the same may be taxed on the basis of pure factual position ofthe issue, the assessee may be bound by such concession made by himvoluntarily and with his free will. In CIT Vs. Shelly Products and Another(supra), the Hon'ble Apex Court held that excess tax paid by assessee out ofabundant caution or owing to error or non-taxability, the same has to berefunded to the assessee. In P.V. Doshi Vs. CIT (supra), the Hon'ble GujaratHigh Court held that as a jurisdictional provision which was mandatory andenacted in public interest could never be waived and the want of jurisdictionwas discovered by the AAC, there was no question of waiver by the assessee.In S.R.Koshti Vs. CIT, wherein there was a over assessment due to mistake ofassessee in failure to claim exemption on voluntary retirement compensationand the mistake was rectified by the AO, it is held by the Hon'ble High GujaratCourt that the order of the AO was not prejudicial to the interest of the Revenue.In view of the various judicial pronouncements and the settled legal position, asdetailed above, we are of the considered view that the amount in question couldnot be disallowed under section 40(a)(ia) of the Act merely because the assesseehas conceded the same through its Chartered Accountant before the CIT(A).We find that the CIT(A) has not considered the issue before him on merits, andaccordingly, we hold that it shall be in the interest of justice to restore the issuein ground no.1 and 2 before us to the file of the CIT(A) with direction to decidethe same de novo in accordance with law after providing reasonable opportunityto both the parties. We direct accordingly.*

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# Controversies

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**Issue:**

Can the Opening Stock be disturbed when value of Closing Stock is changed due to a change in valuation method or due to any other reason?

**Proposition:**

Whenever the method of valuation of closing stock is changed and is for bona fide purpose, the method of valuation of opening stock is not required to be changed.

**Relevant Provisions of the Act:**

Section 145 of the Act "Method of Accounting" is as under :

(1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(2) The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assessee's or in respect of any class of income.

(3) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) or accounting standards as notified under sub-section (2), have not been regularly followed by the assessee, the Assessing Officer may make an assessment in the manner provided in section 144.

"Method of Accounting in certain cases"- Section 145A of the Act reads as under :

Notwithstanding anything to the contrary contained in section 145,—

(a) The valuation of purchase and sale of goods and inventory for the purposes of determining the income chargeable under the head "Profits and gains of business or profession" shall be—

   (i) In accordance with the method of accounting regularly employed by the assessee; and

   (ii) further adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

Explanation.—For the purposes of this section, any tax, duty, cess or fee (by whatever name called) under any law for the time being in force, shall include all such payment notwithstanding any right arising as a consequence to such payment;

**View Against the proposition:**

In the case of *CIT vs.The Ahmedabad New Cotton Mills Co. [1929] 4 ITC 245 (PC),* the closing stock was undervalued by the assessee. Assessee claimed that it was also undervalued at the beginning of the year. The commissioner rectified the value of the stock at the end of the year by substituting the true value of the stock as at that date, but he declined to make the corresponding alteration as regards to the stock at the opening of the year, stating a well-known principle of accountancy that the opening value must be taken at precisely the same figure as shown in the closing books of accounts of the previous year.

The Bombay High court observed that there is a fallacy in adopting that as a universal rule it is

incapable of any alteration. It also went on to note that the method proposed by the Commissioner will result in a fictitious profit and that it will not be a true profit for the particular year in question.

Finally it concluded that a wrong valuation was put on the stock at the beginning of the year as well as at the end of the year. Then both the errors should be corrected and not merely one.

However, the court guarded itself by commenting that nothing is to be taken to lead any one to believe that it is open to an assessee to adopt any arbitrary method of valuation he may like, and still lest that he may take any course which will tend to defraud the revenue.

Supreme Court's judgement in the case of *Commissioner of Income-tax Vs. British Paints India Ltd.[1991] 188 ITR 44 (SC)* is also worth mentioning. Assessee was engaged in business of manufacture and sale of paints. It had valued its work in process and finished goods solely at cost of raw materials. It has totally excluded the allocation of overhead expenditure in the stock. This had been the regular practice adopted by the assessee.

The Apex Court observed that "any system of accounting which excludes, for the valuation of the stock-in- trade, all costs other than the cost of raw material for the goods in process and finished products, is likely to result in a distorted picture of the true state of the business for the purpose of computing the chargeable income. Such a system may produce a comparatively lower valuation of the opening stock and the closing stock, thus, showing a comparatively low difference between the two."

The Supreme Court, thus, directed the ITO to recalculate the figures of both the Opening Stock as well as the Closing Stock after adding the overhead expenditures.

In the case of *CIT Vs Mahavir Alluminium Ltd.[2008] 297 ITR 77 (Delhi High Court)* in itsclosingstockfortherelevantpreviousyearthe assessee had charged MODVAT credit on certain inputs. While doing so, the assessee also made an adjustment in the opening stock. The Assessing Officer was of the opinion that section 145A of the Act did not permit the assessee to make a change in the valuation of the opening stock although it permitted a change in the closing stock. He, therefore, did not allow the adjustment made by the assessee. On appeal, the Commissioner (Appeals) upheld the order of the Assessing Officer. On further appeal, the Tribunal, relying upon the CBDT's Circular as well as the Guidance Note issued by the Institute of Chartered Accountants of India, held that the adjustment on account of MODVAT credit can be made in the opening stock also; and that the assessee did not commit any error in doing so. The Delhi High Court also took the same view and decided in the favour of the assessee.

**View in Favour of the proposition:**

The case of *Melmould Corporation v. CIT [1993] 202 ITR 789 (Bombay High Court)* is worth noting regarding the issue. During the relevant previous year, the assessee had valued its opening stock on the basis of costs plus overheads which was the method adopted by the assessee in the years prior thereto. However, the assessee decided to change its method of valuation by valuing the stock at cost price only excluding the overheads. The assessee accordingly valued its closing stock for the assessment year in question at cost price. The Income-tax Officer increased the gross profit rate in view of the difference in the method of valuation of opening stock and closing stock.

The assessee challenged the action of ITO in Tribunal, which held that the correct profit can only be arrived at by valuing the opening stock and closing stock at cost price excluding overhead expenses. ITO was directed to re-determine the value of the opening stock at cost price after excluding all overheads.

The matter was further taken up to High Court. The High Court barred itself from commenting upon whether the method adopted for valuing the closing

stock was in accordance with law and/or accounting practice. But it noted that the change has to be effected by adopting the new method for valuing the closing stock which will, in its turn, become the value of the opening stock of the next year. If, instead, a procedure is adopted for changing the value of the opening stock, it will lead to a chain reactionofchangesforallthepreviousyears.The court held that the direction of Tribunal was, thus, not justified.

The decision of *Andhra Pradesh High Court* in the case of *CIT Vs. Mopeds India Ltd.[1988] 173 ITR 347* is also relevant to the issue. The assessee was valuing its closing stock, in the past years, by what is known as the "total cost" method. In this method, proportionate overheads for administrative expenses, selling expenses and interest in stock valuation were taken into account.

While valuing the closing stock for the assessment year under consideration, the assessee found the earlier system to be somewhat unscientific and problematic and, therefore, switched on to what is recognised as the "works cost" system where administrative overheads are not taken into account. The assessee explained that the change was made for bona fide purposes and it was to replace a somewhat unscientific method of valuation by a more scientific and recognised method of closing stock valuation. The ITO did not accept the explanation of the assessee. He valued the closing stock on the basis adopted in the past year and made an addition of the difference in the value of the closing stock.

The High Court noted that "In the face of the finding that the change adopted by the assessee was for bona fide purpose and was not actuated by consideration to reduce income for the income-tax purpose, the revenue has no right to interfere with the change in the method of valuation of the closing stock." There was no suggestion made to change the opening stock accordingly.

Where a particular method is consistently followed, it is necessarily to be accepted as held in *Wallace Flour Mills Co. Ltd v. Collector of Central Excise [1990] 186 ITR 441 (SC)*. Similar view has been taken for Income Tax purpose in *CaprihansIndial Ltdv. Prakash Chandra [2002] 256 ITR 721(Bombay)* following the decision in *Hindustan Lever Ltd. V. V.K.Pamdey, ft. CIT [2001] 251 ITR 209 (Bombay)* and C*IT v. Sant Ram Mangat Ram [2005] 275 ITR 312 (P&H)*. It However, does not mean that there cannot be any change in the method so as to adopt this method, because the change to such method, if consistently followed thereafter, should be acceptable as decided in *CIT v. Amrithalakshmi [2008] 300 ITR 78*.

Let me refer to the principles laid down in the case of *CIT vs. ChainrupSampatram's24 ITR 481 (SC)*:

"If the Assessing Officer is of the view that the profit could not be properly deducted from the accounts maintained, he can apply the provisions of section 145 of the Act. In the present case, the method adopted by the assessee is to value the closing stock at the market value irrespective of the fact whether the market value of stock at the relevant time is more than the cost value of the stock, which necessarily results in imaginary or notional profits to the assessee which he has not actually received. In fact such notional imaginary profits cannot be taxed. It is a well settled principle as held in *Sir Kikabhai*

*Premchand v. CIT [1953] 24 ITR 506 (SC),* the Constitution Bench Judgement that the firm cannot make a profit out of itself. The transaction which is not a business transaction and does not derive immediate pecuniary gain is not subject to tax. In the present case by showing the market value of closing stock the assessee has earned potential profits out of itself in as much as the stock-in-trade remained with the assessee at the closing of the accounting year. Secondly, putting the stock at the market value does not and cannot bring any real profit which is necessary for taxing the income under the Act as is held in *ChainrupSampatram v. CIT [1953] 24 ITR 481 (SC)* and *CIT v. Hind Constructions Ltd. [1972] 83 ITR 211 (SC)*. Thirdly, it is a settled principle to income-tax law that it is the real income, which is taxable under the Act.

This proposition was enunciated in *CIT v. Birla Gwalior (P.) Ltd [1973] 89 ITR 266 (SC)*, which was pronounced in *CIT v. ShoorjiVallabhdas and Co. [1962] 46 ITR 144 (SC).*"

**Summation:**

It can be well established that there is no need to change the valuation of opening stock for the year when there is change in value of closing stock due to a change in the method of valuation.

However, when there is a mistake in valuing the opening and closing stock, both the values need to be recomputed and not only one. It also remains a fact that when any adjustment is required to be made by a statute (as for example section 145A of the Act), effect to the same should be given irrespective of any consequences on the computation of income for tax purposes.

The High Court in the case of *Melmould Corporation v. CIT [1993] 202 ITR 789 (Bombay High Court)*relied upon the booklet titled Valuation of Stock and Work-in-Progress- Normally Accepted Accounting Principles brought out by the Indian Merchant's Chamber Economic Research and Training Foundation, which may usefully be attracted here:

"2. Where change from one valid basis to another valid as is accepted, certain consequences normally follow. The opening stock of base year of change is valued on same basis as the closing stock. Whether the change is to a higher level or to a lower level, the Revenue normally does not seek to revise the valuation of earlier years. It neither seeks to raise additional assessments, nor does it admit relief under the "error or mistake" provision.

3. It is not possible to define with precision what amounts to a change of basis. It is a convenience, both to tax payers and to the Revenue, not to regard every change in the valuation as a change of basis. In particular, the Revenue encourages the view that change involves no more than a greater degree of accuracy, or a refinement, should not be treated as a change of basis, whether change results in a higher or lower valuation. In such cases the new change valuation is applied at the end of the year without amendment of the opening value."

The recent decision of the *High Court in CIT v. Modern Terry Towels Ltd. [2013] 357 ITR 750 (Bombay)* recognizes the principle repeatedly laid down by the Courts as to why there should be no difficulty in accepting the opening stock figure as an anchor for future computation not only on principle, but also on practical consideration. The extract at Page 757-759 of this judgement reads as under :

"Re Question (c): The respondent assessee has been regularly following a method of valuing its closing stock on the basis of net realizable value. However, during the period relevant to the assessment year 1997-98, the respondent changed the method of valuation of its closing stock form net realizable value to the cost or market value, whichever is lower. As a consequence of the change in the method of valuating closing stock the valuation of closing stock went down by Rs. 6.147 Crores. The Assessing Officer did not accept the explanation offered by the respondent assessee for change in the method of valuing the Closing Stoc, viz., accounting standard AS-2 required the closing stock to be valued at cost or market value, whichever is lower. However, the Assessing Officer held that the change in method of valuation has been effected with an intention to evade tax and approximately Rs. 6.17 crores was added back to the declared income of the respondent assessee.

The CIT (Appeals) allowed the respondent assessee's appeal. It was held that the change in the method of valuing closing stock was not done to undervalue the profit and there was no mala fide intention on the part of the respondent assessee. Consequently, the Assessing Officer was directed to delete the addition of Rs. 6.17 Crores on account of valuation of closing stock.

The Tribunal upheld the finding the Commissioner (Appeals). The Tribunal held that in view of the provisions of the Companies Act the respondent assessee is obliged to comply with the accounting standards issued by the Institute of Chartered Accountants Of India. The accounting standard issued by the Institute of Chartered Accountants Of India made it mandatory that the inventories should be valued at lower of costs or net realizable value. The Tribunal also recorded the fact that for the earlier assessment year 1996-97 the auditors had mentioned the fact that the respondent assessee had not followed the accounting standard AS-2. In the circumstances, the change in the method of valuation of stock was because of a statutory requirement and could not be branded mala fide. The contention of the Revenue that the change in the method of valuation of closing stock would result in distortion of the profit earned as the opening stock has not been disturbed was also negatived by the Tribunal in view of the fact that there was a bona fide reason for change in the valuation of closing stock."

Let me now refer to the decision of their lordships of Madras High Court in the case of *CIT vs. Carborandum Universal*. The Madras High Court held as under:

"The main contention if the Revenue in this case is that the change in the method of valuation of the stock should be applied both to the opening stock as well as closing stock, which alone will indicate the true or real profits as has been held in *CIT vs. The Ahmedabad New Cotton Mills Co. [1929] 4 ITC 245 (PC),* and that is not open to the assessee to apply the new method to the closing stock alone without reference to the opening stock. Thus, according to the learned counsel for the Revenue, whatever be the method of valuation adopted by the assessee it should be applied to both the opening and closing stock, as otherwise it will give a distorted picture of the assessee's income. The Tribunal's reasoning for rejection the contention of the Revenue is that so far as the first year when the changes introduced is concerned, there is bound to be a slight distortion in the profits but that will get adjusted in course of time as the new method of valuation of stock is going to be applied on a permanent basis year after year."

Before concluding, it would be useful to refer to the Compendium of Opinion of ICAI Vo. XXI, wherein the issue as to whether opening inventories and closing inventories should be valued on the same basis as was considered by the expert advisory committee. In its opinion quoted at page no. , the committee has stated as follows:

"15. On the basis of the above, the committee is of the following opinion on the issue raised:

(a) Under the facts and circumstances of the query, the value of the opening inventories is not required to be changed. However, since the value of closing inventories should include the amount of provision for excise duty, the opening and closing inventories would not be valued on the same basis for the purpose of quantifying the impact of the profit\loss for the year. Since the value of the opening inventories is not required to be changed, the question of disclosure as a prior period item or change in accounting policy with regard to such inventories does not arise."

Finally it is submitted that whenever change in the method of valuation of closing stock is made by the assesse which is bona fide and which is to be applied in future as well, the method of valuation of closing stock is not required to be changed.

However, when method of valuation of closing stock is imposed on assesse as was done in the case of *Commissioner of Income-tax Vs. British Paints India Ltd.[1991] 188 ITR 44,* then method of valuation of opening stock is required to be changed.

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# Judicial Analysis

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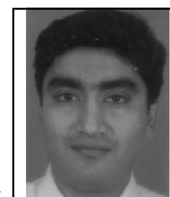

**Recent decisions on interpretation of provisions of S.45(4) of the Income Tax Act, 1961.**

**ACIT vs. Arbuda Estate Corporation (Tax Appeal No. 1152 of 2010) (Gujarat High Court)**

1.0 The revenue has filed this appeal challenging the judgment of the Tribunal dated 20.11.2009 raising following question for consideration.

"Whether on the facts and in the circumstances of the case, the tribunal was right in law in deleting the addition of Rs.1,79,49,012/- made by the A.O. being long term capital gain u/s. 45 of the I.T. Act, even though the assessee's case clearly falls within the ambit of provisions of section 45(4) of the Income Tax Act, since the assessee firm has distributed the revaluation reserve to the existing and retiring partners during the year under consideration?"

2.0 The facts of the case in brief are stated as follow:

2.1 The assessee is a partnership firm. During the previous year relevant to assessment year 1998-99, the assessee had revalued its capital assets and the total amount of Rs. 1,79, 49, 012/-. On the basis of such revaluation, the assets was taken in the revaluation reserved account and it was distributed amongst partners in the following manner.

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2.2 The assessing officer was of the opinion that in view of the provisions contained in section 45 read with section 2(47) of the Income Tax Act, the assessee firm had to pay tax on the said amount of Rs.1,79,49,012/- by way of capital gains. The assessee approached CIT (Appeals). The CIT (Appeals) deleted the additions made by the assessing officer. The revenue therefore approached the tribunal. The Tribunal confirmed the order passed by the CIT (Appeals). Hence, the present appeal.

3.0 The Tribunal in its judgment noted that sub-section (4) of section 45 refers to 'capital assets' and not to the appreciated market value of the capital assets which is taken to revaluation reserved account. The Tribunal observed that there has to be distribution of the 'capital assets' in specie in order to attract the said sub-section. In the present case, there was no distribution of capital assets. The Tribunal further observed that the land and building continued to remain with the firm even after the crediting of the revaluation reserve to the capital accounts of the partners. There was thus no distribution of any capital assets. It is only that appreciation in the market value of the land and building otherwise created to a revaluation reserve account and was then transferred to the partners' capital account. The Tribunal, therefore, concluded as under:

"What actually happens when an asset is revalued on the basis of the current market value is that the asset account is debited with the increase in the value and the revaluation reserve account is credited. The asset as well as the appreciation in its market value belong to the partners since under the law of partnership the firm is only a compendious name to describe the partners and they are the real owners of the assets belonging to the firm. When the appreciated value of the asset is credited to the account of the partner he only gets his share in the assets which he is entitled to in law. The position however would be different under section 45(4) when a capital asset in specie is given to the partner by7 way of distribution on dissolution or otherwise because the Act treats the firm and the partners as different taxable entities."

4.0 Having heard learned counsel for the revenue and having perused the documents on record, we are of the opinion that the Tribunal committed no error. Section 45(4) of the Act which reads as under:

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5.0 What sub-section (4) of Section 45 seeks to bring within the tax net in the form of capital gain is the profit or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals or otherwise. In the present case, there was neither dissolution of the firm nor there was any distribution of capital assets on such dissolution or otherwise. The Tribunal correctly examined the position by holding that all that was done was that the assets were revalued on the current market value and the resultant increase was brought in the revaluation reserve account of the partnership. Since the partners held the property jointly in specified shares, in proportion to the shares the revalued assets and the value thereof was distributed in the different accounts.

6.0 We are in agreement with the Tribunal that in such circumstances there was no applicability of sub-section (4) of section 45 of the Income Tax Act, 1961.

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**CIT *vs*. Karnataka Agro Chemicals [49 taxmann.com 324 (Karnataka)]**

**xxx…**

**2.** In the course of assessment proceedings, the assessing Officer noticed that the assessee firm had created and self-generated assets in the form of goodwill of business to an extent of Rs.7,59,28,000/- and transferred it to the current accounts of the four partners proportionately consequent to re constitution of assessee firm. The assessing authority felt that this good-will is chargeable to tax under the head “capital gains” and accordingly, brought it to tax as “long term capital gains”.

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Insofar as goodwill is concerned, the remand report showed that there is no transfer involved within the terms of Section 45 and Section 2(47) of the Income Tax Act. It is the case of revaluation of assests and the goodwill was carried in the balance sheet of the firm. There were no transfer of any assets by the firm to the retiring partners. No assets were allotted to the retiring partners. The accounts of the retiring partners were settled by actual payment of sums due to them. Therefore, it held that there is no transfer and in view of Circular of CBDT notional transfer cannot be subjected to taxation and therefore an order for deduction of Rs.7,59,28,000/- was made and accordingly, the appeal was allowed. Aggrieved by the said order, the revenue preferred an appeal to the Tribunal.

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Insofar as addition on account of goodwill is concerned, when the Appellate Authority accepted the contention of the assessee during the remand proceedings that there was no transfer of goodwill, Section 45(4) is not attracted and accordingly, it found no ground to entertain the appeal. Aggrieved by the said order, the present appeal is filed.

**3.** The learned Senior Counsel appearing for revenue assailing the impugned order fairly conceded that the finding of the Appellate Authority insofar as unexplained cash credit of Rs.40,00,000/- is reflected in the accounts and properly explained and no grievance can be had on that account. Insofar as the transfer of goodwill which resulted in capital gains is concerned, he submitted once the goodwill is valued and it is proportionately distributed to four partners, when two partners paid the consideration while the other two partners walked out of the partnership firm after taking. the consideration for the goodwill which was credited to their account, it constitutes a transfer. He relied on the judgment of the Bombay High Court wherein while interpreting Section 45(4) of the Act it has

explained the meaning of the word "otherwise". Therefore, he submits that it falls under the category of "otherwise" and the appellate authorities were not justified in interfering with the order passed by the assessing authority.

**4.** Per contra, the learned counsel appearing for the assessee submitted that the condition precedent for attracting Section 45 is there should be transfer of asset. In the instant case, admittedly the retiring partners took money and walked out of the partnership firm. No asset much less capital asset was transferred in their favour. Therefore, Section 45 is not at all attracted much less Section 45(4) of the Act. Therefore, he submits that the order passed by the authorities, cannot be found fault with.

**5.** From the aforesaid facts and the rival contentions, it is clear that the assets of the partnership was revalued and for the first time they valued the goodwill at Rs.7,59,28,000/-. Thereafter it was credited to the four partners in accordance with the profit sharing ratio. Two of the partners retired. They have been paid actual amount due to them in the books of the partnership firm. The goodwill continued with the firm. No portion of the goodwill is transferred to the retiring partners. Therefore, rightly in the remand report it had been stated that there is no transfer of the capital asset. If there is no transfer of capital asset, Section 45(4) is not attracted. In fact the Full Bench of this Court while interpreting Section 45(4) of the Act after reviewing the case law on the point has held as under:—

"Sub-Section (4) of Section 45 deals with a distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals or otherwise. If in the course of such distribution of capital asset there is a transfer of a capital asset by the firm in favour of a person and it results in profits or gains to the firm, then the said profit or gains shall be chargeable to tax as income of the firm and again for computing such income, Section 48 is attracted. In other words, in the process of a dissolution of a firm, if a capital assets is transferred to a partner which results in profits or gains, then that income is chargeable at the hands of the firm under this provision. In order to attract sub-section (4) of section 45, the condition precedent is,

(1) there should be a distribution of capital assets of a firm;

(2) such distribution should result in transfer of a capital asset by firm in favour of the partner;

(3) on account of the transfer there should be a profit or gain derived by the firm; and

(4) such distribution should be on dissolution of the firm or otherwise."

Thereafter, it has proceeded to hold that to attract Section 45(4) there should be transfer of capital asset from the firm to the retiring partners, by which the firm ceases to have any right in the property which is so transferred. In other words, the right to property should stand extinguished and the retiring partners should acquire absolute title to the property.

**6.** In the instant case, the partnership firm did not transfer any right in the capital asset much less the goodwill in favour of the retiring partners. The partnership firm did not cease to hold the property. Consequently, its right to the property is not extinguished. On the other hand, the retiring partners did not acquire any right in the property as no property was transferred in their favour. In that view of the matter, we do not see any merit in this appeal. No substantial questions of law do arise for consideration in this appeal.

**xxx…**

**CIT *vs.* Dynamic Enterprises [359 ITR 83 (Karnataka)(FB)]**

**xxx…**

**23.** Sub-section (4) of Section 45 deals with a distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals or otherwise. If in the course of such distribution of capital asset there is a transfer of a capital asset by the firm in favour of a person and it results in profits or gains to the firm, then the said profits or gains shall be chargeable to tax as income of the firm and again for computing such income, Section 48 is attracted. In other words, in the process of a dissolution of a firm, if a capital asset is transferred to a partner which results in profits or gains, then that income is chargeable at the hands of the firm under this provision. In order to attract sub-section (4) of Section 45, the condition precedent is

(1) There should be a distribution of capital assets of a firm;

(2) Such distribution should result in transfer of a capital asset by firm in favour of the partner; and

(3) On account of the transfer there should be a profit or gain derived by the firm.

(4) Such distribution should be on dissolution of the firm or otherwise.

**24.** Therefore, in order to attract Section 45(4) of the Act, the capital asset of the firm should be transferred in favour of a partner, resulting in firm ceasing to have any interest in the capital asset transferred and the partners should acquire exclusive interest in the capital asset. In other words, the interest the firm has in the capital asset should be extinguished and the partners in whose favour the transfer is made should acquire that interest. Then only the profits or gains arising from such transfer is liable to tax under Section 45(4) of the Act.

**25.** In the instant case, the partnership firm had purchased the property under a registered sale deed in the name of the firm. The property did not stand in the name of any individual partners. No individual partners brought that capital asset as capital contribution into the firm. Five partners brought in cash by way of capital when the firm was reconstituted on 28.04.1993. Nearly a year thereafter on 01.04.1994 by way of retirement, the erstwhile three partners took their share in the partnership asset and went out of the partnership. After the retirement of three partners, the partnership continued to exist and the business was carried on by the remaining five partners. There was no dissolution of the firm or at any rate there was no distribution of capital asset on 01.04.1994 when three partners retired from the partnership firm. What was given to the retiring partners is cash representing the value of their share in the partnership. No capital asset was transferred on the date of retirement under the deed of retirement deed dated 01.04.1994. In the absence of distribution of capital asset and in the absence of transfer of capital asset in favour of the retiring partners, no profit or gain arose in the hands of the partnership firm. Therefore, the question of the firm being assessed under Section 45 (4) and charging them tax for the profits or gains which did not accrue to them would not arise.

**26.** It was contended on behalf of the revenue that five incoming partners brought money into the firm. Three erstwhile partners who retired from the partners on 01.04.1994 took money and left the property to the incoming partners. It is a device adopted by these partners in order to evade payment of profits or gains. As rightly held by this Court in *Gurunaths Talkies'* case (*supra*) it is taxable. This argument proceeds on the premise that the immovable property belongs to the erstwhile partners and that after the retirement the erstwhile partners have taken cash and given the property to the incoming partners. The property belongs to the partnership firm. It did not belong to the partners. The partners only had a share in the partnership asset. When the five partners came into the partnership and brought cash by way of capital contribution to the extent of their contribution, they were entitled to the

proportionate share in the interest in the partnership firm. When the retiring partners took cash and retired, they were not relinquishing their interest in the immovable property. What they relinquished is their share in the partnership. Therefore, there is no transfer of a capital asset, as such, no capital gains or profit arises in the facts of this case. In that view of the matter, Section 45(4) has no application to the facts of this case.

**27.** In *Gurunath Talkies'* case (*supra*), the Division Bench of this Court followed the judgment of the Bombay High Court in the case *CIT* v. *A.N. Naik Associates* [2004] 265 ITR 346/136 Taxman 107 (Bom.). In *A.N. Naik Associates'* case (*supra*), the asset of the partnership firm was transferred to a retiring partner by way of a deed of retirement. A memorandum of family settlement was entered into and the business of those firms as set out therein was distributed in terms of the family settlement as the party desired that various matters consisting the business and assets thereto be divided separately and partitioned. The term has also provided that such of those assets or liabilities belonging to or due from any of the firms allotted, the parties thereto in the schedule annexed shall be transferred or assigned irrevocably and possession made over and all such documents, deeds, declarations, affidavits, petitions, letters and alike as are reasonably required by the party entitled to such transfer would be effected. It is based on this document and subsequent deeds of retirement of partnership that the order of assessment was made holding that the assessees are liable for tax on capital gains..

**28.** In that context, the Bombay High Court held that when the assets of the partnership is transferred to a retiring partner, the partnership which is assessable to tax ceases to have a right or its right in the property stands extinguished in favour of the partner to whom it is transferred. If so read, it will further the object and the purpose and intent of the amendment of Section 45. Once that be the case, the transfer of assets of the partnership to the retiring partners would amount to the transfer of capital assets in the nature of capital gains and business profits which is chargeable to tax under Section 45(4) of the Income Tax Act. In that context, it was held the word "otherwise" takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of a retiring partner. It is in this context the Bombay High Court held that Section 45(4) was attracted. Therefore, to attract Section 45(4) there should be a transfer of a capital asset from the firm to the retiring partners, by which the firms ceases to have any right in the property which is so transferred. In other words, its right to the property should stand extinguished and the retiring partners acquires absolute title to the property.

**29.** In the instant case, the partnership firm did not transfer any right in the capital asset in favour of the retiring partner. The partnership firm did not cease to hold the property and consequently, its right to the property is not extinguished. Conversely, the retiring partner did not acquire any right in the property as no property was transferred in their favour. The Division Bench in *Gurunath Talkies'* case (*supra*) did not appreciate this distinguishing factor and by wrong application of the law laid down by the Bombay High Court held the assessee in that case is also liable to pay capital gains tax under Section 45(4). Therefore, the said judgment does not lay down the correct law.

**30.** We would like to add that several other aspects of Section 45(4) was addressed in the course of the arguments by both sides which are not relevant to adjudicate the present issue, as in the present case there is no distribution of assets and hence, one of the condition precedent for invoking Section 45(4) does not exist and hence Section 45(4) is not attracted to the facts of this case.

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# Transfer Pricing Implications on issue of shares to Associated Enterprises

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The issue of Equity Shares to non-resident parent company has always been a hotbed for controversy under Indian transfer pricing (TP) regulations. The scope of international transaction as widened by the Finance Act, 2012 w.r.e.f. 01.04.02 includes even capital financing and business restructuring or re-organisation.

Since then the transfer pricing provisions have remained a lucrative area to increase the tax revenues for the Government. There have been instances where the tax authorities have adopted aggressive approach and this has led to determination of huge transfer pricing adjustments.As per the annual report and statistics released by Ministry of Finance recently, TP adjustments in cases which underwent TP audits increased exponentially in last two years i.e. INR 700 billion in FY 2012-13 and INR 596 billion in FY 2013-14 from INR 445 billion in FY 2011-12.

A drastic increase in the amount of TP adjustments is attributable to TP disputes related to pricing of transactions involving share capital infusion.

Recently, Bombay High Court in the case of Vodafone India Services Private Limited has provided relief to the taxpayer. Further as per media reports the Attorney General of India has also advised the government not to file Special Leave Petition ('SLP') in the Hon'ble Apex Court against the order of the Hon'ble Bombay High Court. This has led to the hopes that the long lasting controversy will now end soon.

It is clear from the judgment that the judiciary system is unhappy and disappointed at the approach of the Income Tax Department at an attempt to tax a perceived short fall in capital receipt which itself is not taxable under the Act.

In the present article, we have analysed the recent judgment of Hon'ble Bombay High Court in the case of **Vodafone India Services Private Ltd**[1] (also known as Vodafone IV), which has dealt withthe implications of issuing shares to the AE under Indian transfer pricing provisions. The ruling surely comes as a morale booster for investors' confidence; and also improving the overall image of the Indian tax system.

**Background**

Vodafone India Services Private Limited ("VISPL"), a wholly owned subsidiaryof Vodafone Tele-Services (India) Holdings Ltd. ("Vodafone Mauritius"), issued 289,224 equity shares of face value of INR 10 each ata premium of INR 8,509 per share in August 2008. The FMV of the issueof equity shares was determinedby VISPL in accordance with the methodology prescribed for capital issues by the Central Government under FEMA and was also reported in the 3CEB as an international transaction. Further, Form 3CEB also contained a note stating that thistransaction was only reported as a matter of abundant caution and did not affect the income of VISPL.

Strictly speaking, TP provisions ought not to apply on transactions involving capital receipt and which don't have a bearing on the taxable income of a taxpayer. The Indian Income tax laws defines the term'international transaction' as a transaction between two or more AEs, either or both ofwhom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on theprofits, income, losses or assets of such enterprises. Thus, a transaction having a bearing on the profits,income, losses or assets is an important pre-condition for attracting the application of TP provisions.

Since the transaction involving issuance of shares by an Indian subsidiary to its foreign shareholder on account of capital infusion does not give rise to any income in the hands of the Indian subsidiary, the same ought not be subject to TP provisions, as the entire exercise of determination of the arm's length price in such case would be an academic exercise only.

However, the transfer pricing officer ('TPO') issued a show–cause notice to VISPL as to why considerationfor such issue of shares should not be computed having regard tothe Arm's Length Price('ALP'). VISPL contendedin all its responses that the IndianTP provisions are not applicable to the issue of equity shares and the notice was without jurisdiction of the TPO.

**Issue**

The TPO proceeded to compute the ALP ofthe share issue transaction statingthat the Assessing Officer ('AO') would determine whether any income had arisen or been affected by the international transaction and accordingly, enhanced the value of each share to INR 53,775. The TPO treated the difference in the value of shares as income of VISPL. Further, the TPO made a "secondary adjustment" by treating the short receipt of consideration for issue of shares as a deemed loan by the Tax payer to its AE and charged a notional interest of 13.5% for six months. Accordingly, a TP adjustment of INR 13.97 billion (approx. US$ 232.88 million) was determined. The AO confirmed the position adopted by the TPO in its draft assessment order without dealing with the Tax payer's principal contention that the Indian TP provisions would not apply to issues of equity shares to AEs.

VISPL further filed an appeal before the Dispute Resolution Panel ('DRP'). However, the DRP upheld the adjustment determined by the Tax Authorities and held that the short-fall in thereceipt of the premium is income arising from issue of sharesand also held that the AO has jurisdiction to invoke Indian TP provisions. The Taxpayer filed awrit petition with the Bombay HC challenging the TP adjustment.

**Arguments of the Assessee**

(i) Chapter X of the Act will not apply as the issue of equity shares by the Petitioner to its holding company does not give rise to any income;

(ii) Chapter X of the Act will not apply as no expenditure is incurred that impacts computation of the taxable income;

(iii) Chapter X of the Act will not apply as issue of shares is transaction on capital account and thus does not impact computation of income; and

(iv) Other issues raised were with regard to no jurisdiction to split a single transaction of issue of shares into issue of shares and grant of financial accommodation. This re-characterizing/re-classifying a business transaction is not permitted.

**Contentions of the Tax Authorities**

(i) Chapter X of the Act is a separate code by itself and the difference in valuation between ALP and the contract/transaction price would give rise to income;

(ii) Income as defined in Section 2(24) of the Act is inclusive definition and it does not prohibit taxing capital receipts as income;

(iii) The forgoing of premium on the part of the assessee amounts to extinguishment/ relinquishment of a right to receive fair market value. Therefore, the issue of shares is a transfer within the meaning of Section 2(47) of the Act; and

(iv) The meaning of International Transaction as given in clauses (c) and (e) of the Explanation (i) to Section 92B of the Act would include within its scope even capital account transaction.

### Ruling of the Bombay High Court

- Interpretation of the term “income” and applicability of TP provisions

  The HC held that “income” arising from an international transactionis a condition precedent for application of TP provisions. While interpreting the term “income,” the HC held that the Act defines the term “‘income” in an inclusive manner. Income, in its normal meaning, will not include capital receipts unless it is so specified. The amounts received on issue of share capital including the premium are oncapital account.

  In this case, what is being sought to be taxed is capital not received from a non-resident i.e., premium allegedly not received on application of ALP. Therefore, due to the absent express legislation, no amount received, accrued or arisingon capital account transactions canbe subjected to tax as “income.”

  The HC further held that the transaction on capital account or on account of restructuring would become taxable to the extent itimpacts income i.e., under reporting of interest received or over reporting of interest paid or claiming of depreciation. It is that income which is to be determined having regard to the ALP and it is not a tax on the capital receipts. In any case,the entire exercise of taxing the amounts allegedly not received as share premium fails, as no tax is charged on the amount received asshare premium. The TP provisions are invoked to ensure that the transaction is taxed only on working out the income after arriving at theALP of the transaction. This is only toensure that there is no manipulation of prices/ consideration between AEs. Hence, the entire consideration received would not be a subject matter of taxation.

  In view of the above, the HC found substance in VISPL’s case that neither the capital receipts received by the assessee on issue of equity shares to its AE nor the shortfall between the alleged FMV of its equity shares and the issue price ofthe equity shares can be considered as income within the meaning of the expression as defined in the Act and hence not subject to TP provisions in India. The HC also held that the reasoning that if the ALP were received, the assessee would be able to invest the same and earn income, proceeds on a meresurmise/ assumption and that this cannot be the basis of taxation.

- Interpretation of Section 92(2)

  Section 92(2) of the Act deals with a situation where two or more AEs enter into an arrangement whereby they are to receive any benefit, service or facility then the allocation, apportionment or contribution of the corresponding cost or expenditure is to be determined for each AE based on ALP. It is generally understood that this section is meant to cover cases of cost sharing arrangements and/ or cost contribution arrangements. The Income Tax Department relied on this section of the code to argue that differences between the ALP andthe price charged for issue ofshares is the benefit conferred upon the holding company. Thus, the passing of the benefit to theholding company is the cost to the Taxpayer, which should be taxed.

  The HC rejected the submission of the Tax Authorities and held that ignoring words in a statute to achieve a predetermined objective is not permissible and the same would amount to re drafting the legislation, which is beyond the jurisdiction of the Courts.

  Section 92(2) would have no application in cases like the presentone, where there is no occasion to allocate, apportion or contribute any cost and/or expenses between the assessee and its AE.

- Interpretation of TP provisions

The HC rejected the contention of the Tax Authorities that in view of the TP provisions, notional income is to be taxed and real income isnot relevant. The HC held that the entire exercise of determining the ALP is only to arrive at the real income earned. The HC held that the TP provisions laid out in the Act are in the nature of machinery or computational provisions to arrive at the ALP of a transaction between AEs. Even income arising from international transactions between AEs must satisfy the test of "income" under the Act andmust find its home under one ofthe charging provisions. It is a re-computation exercise to be carried out only when income arises in case of an international transaction between AEs. It does not warrant re-computation of a consideration received/given on capital account except in cases of interest paid/received on loans taken/given, depreciation taken on machinery, etc.

Thus, in theabsence of a charging provision to tax issue of shares at a premiumto a non-resident, the occasion to invoke the computational TP provisions does not arise. Further, given the inclusion of issue of shares, by a company to another resident, at a price in excess of FMV in the definition of "income" under the Act, the HC noted that, there is conscious intention of the Parliament to not tax amounts received from a non-resident for issue of shares, as it would discourage capital inflow from abroad.

For all the above reasons, the HC held that in the present facts, issue of shares at a premium by the Tax payer to its non-resident AE does not give rise to any income from an admitted international transaction and thus, Indian TP provisions are not applicable in such a case.

- Vodafone IV followed in various cases

o Shell India Markets Private Limited[2]

Hon'ble Bombay HC in the case of **Shell India Markets Private Limited** on the similar issue of taxability of the receipt of the amounts on issue of share capital along with the share premium followed the ratio laid down in Vodafone IV. The Hon'ble HC dismissed the contention of the Department holding that the issue on merits stands covered by the decision of Vodafone IV and is binding on all the authorities within the State till the Hon'ble Apex Court takes a different view on this issue.

Further, the counsel for the Revenue placed an argument that since the assessee has not disclosed the above transaction in Form 3CEB, and hence the amount received on issue of share capital needs to be taxed.The Hon'ble HC turned down the contention of the counsel of the Revenue and held that mere non filing of Form 3CEB would not give jurisdiction to the Revenue to tax amount for which it does not have jurisdiction to tax.

o Conversion of CCD into equity shares-Equinox Business Parks Private Limited[3]

The assessee in this case issued equity shares and compulsory convertible debentures ('CCD') to its non-resident AEs. The DRP held that the shortfall on the issue of equity shares as well as the issue of CCDs should be taxed in the hands of the assessee considering as the receipt in the hands of the assessee. Further, the revenue went a step further and held that CCDs issued by the assessee will be converted into four equity shares being available to the holders and hence the CCDs are also in the nature of equity shares and accordingly the issue of CCDs also needs to be benchmarked to determine the ALP. The assessee filed a writ petition before the Hon'ble Bombay HC challenging the order of the DRP. The Hon'ble HC allowed the petition of the assessee holding that the decision of Vodafone IV squarely applies in this case and held that issue of equity shares and CCDs cannot be considered as an international transaction.

- o Conversion of Preference Shares into equity shares-Leighton India Contractors Pvt. Ltd.[4]

  The assessee in this case issued equity shares and convertible preference shares to its non-resident AEs. The TPO while passing the draft assessment order held that the shortfall on the issue of equity shares as well as the issue of convertible preference shares should be taxed in the hands of the assessee considering as the receipt in the hands of the assessee. The assessee filed objection before the DRP against the draft order and also filed a writ petition before the Hon'ble Bombay HC against the action of the TPO. The Hon'ble Bombay HC held that the issue is squarely covered by the ruling of Vodafone IV and accordingly no income would arise in respect of issue of equityshares to non-resident share holder and the conversion of preference shares into equity shares held by the non-resident AEs.

**Implications**

The long lasting controversy regarding the transfer pricing implications of issue of shares to the AEs has now come to a rest.

The approach of the Tax Authorities in making TP adjustments on transactions involving issue of shares to AEs hasbeen one of the concerns expressed by several foreign investors.

In general, Indian TP provisions apply to income arising from an international transaction. Even if allotment of shares is regarded as an international transaction, as consideration received is not regarded as income subject to tax,TP provisions may not apply to such transactions.

Further, the HC ruling acknowledges that mere reporting of an international transaction on abundant caution would not make the same taxable as thereis no "income" arising from such international transaction. The HC's ruling upholding this view may be welcomed by foreign investors as it is expected to address one of the TP challenges they were facing in India in recent times.

This decision couldn't have been timelier than anticipated in light of the major national initiative Make in India, launched by the Hon'ble Prime Minister Narendra Modi recently. 'Make in India'initiative, which aims to transform India into a global manufacturing hub, requires significant FDI inbuilding up best-in-class manufacturing infrastructure in the country. An investor friendly tax environment and certainty around the administration of tax laws of country is critical for attracting billions of dollars of FDI in the country. This decision reinforces the independence of the Indian judiciary and sends a positive message to investors around the globe. The ruling will benefit multinationals which are facing similar transfer pricing adjustments.

Further, the Attorney General's advice (based on media reports) to the Government for not challenging the decision of Hon'ble Bombay HC before the Hon'ble Apex Court signifies that this controversy will now come to an end. One can only hope that wiser counsel will prevail and the department as also the Government will accept the decision, issue a circular clarifying that except for specific charging provisions capital receipts are not taxable and generally, use this as an opportunity to win/regain the faith of Foreign and Indian taxpayers and investors.

**Footnotes:**

[1] Vodafone India Services Private Ltd. v. Union of India (50 taxmann.com 300)

[2] Shell India Markets (P.) Ltd. v. ACIT, LTU (51 taxmann.com 519)

[3] Equinox Business Parks Pvt. Ltd. v. Union of India &Ors. (W.P. 1273 of 2014)

[4] Leighton India Contractors Pvt. Ltd. v. Union of India &Ors. (W.P. 732 of 2014)

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# Returnee NRI - FEMA & Tax :

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At long last take off the shoes ; hang the coat and relax in a rocking arm-chair - back in your home town in India is almost every Non Resident Indian's [NRI s]longcherisheddreamwhichmoreoften remains a dream only . It's seldom that NRIs leave their comfort zones of friends , neighbors and foreign land to settle back in India. However developments in Infotech sector back home hasbeeninstrumentalforgreatmanyNRI-techies to take up assignments in Indian subsidiaries or otherIndiancompaniesandreturntoIndiawhile few courageous ones indeed retire in India.

Provisions of Foreign Exchange Management Act, 1999 [FEMA] and Income tax Act, 1961 effect Indian as also overseas assets and also taxability of incomes of these returning NRIs which are discussed herein.

I. 1 **Residential Status Under FEMA :** The Residential Status under FEMA is the governing factor for NRIs as also returning NRIs.

2 Under FEMA, which has replaced the Foreign Exchange Regulation Act, 1973 [FERA] with effect from 1st June, 2000, an Indian citizen or a person of Indian origin is defined as "a person Resident outside India"[ PROI], popularly known as a "Non-Resident Indian".[NRI] when such person leaves India or is permanently residingoutside India for purpose of employment,profession, vocation, business or any other reasons. [ Section 2(v) r.t.w. Section 2(w) of FEMA '99 ]

3 An overseas resident Indian / NRI is said to be "a person Resident in India" [ PRII ] when such NRI returns to India for permanent settlement, i.e. for taking up employment or to commence business, profession, vocation or any other reason including retirement which indicates his intention of settlement in India.

.02 The definition incorporates a condition for such returnee NRI to be covered by the definition of a Resident in a financial year provided his stay in preceding financial year exceeds 182 days. However these part of definition is in contradiction of most of the requirements for a returnee NRI's NRE/NRO bank accounts ; Life policies ; investment in Firms and Companies to name a few and hence to avoid ambiguity it is advisable to treat a person who has returned for settlement as a "Resident " under FEMA since the date of his return to India.[ Section 2(w) r.t.w. Section 2(v) of FEMA '99 ]

.03 As FEMA regulations require a Returnee NRI to redesignate NRE account as resident account or transfer balance to Resident Foreign Currency Account [RFC) immediately upon return to India for settlement. Hence if the NRE accounts are redesignated as Resident accounts, the interest will of course be liable to tax in India.

.04 However if erroneously the returnee NRI has continued to hold NRE account intact not redesignating the same as Resident account technically he can claim exemption of interest of such NRE account as in all probability his stay in year preceding the year of return would be less than 181 days whereby he would not be covered by the strict definition of PRII and as such will continue to be defined as PROI / NRI. But taking misadvantage of

technicality can for sure create heat and dust during assessment and hence should not be followed.

4 "A person of Indian origin" is defined as:"a citizen of any country other than Pakistan or Bangladesh, who, at any time, -

01. has held an Indian passport, or

02. himself or either of his parents or any of his grandparents have been citizens of India or

03. is a spouse of an Indian citizen or is a spouse of a person covered in 01 & 02 above.

[Regulation-2(xii) of Foreign Exchange Management (Deposit)Regulations, 2000]

5. It may be noted that a returnee NRI will be covered by the definition of Person Resident in India [PRII] and will be treated as a Resident irrespective of his citizenship or continued overseas residency status or rights.

.02 As such if a US citizen or Green Card Holder returns to India for taking up employment or commence business he will be a PRII / Resident under FEMA irrespective of the fact of his US Citizenship or continuation of Green Card / US Residency.

## II. Residential Status under I.T. Act :

1. Under the Income-tax Act, 1961 [I.T.Act], an individual's Residential Status is determined by the number of days of his stay in India or otherwise.

02. A person is "Resident" in a financial year commencing from 1st April and ending on 31st March, if such person's stay in India :

(i) totals to 182 days or more in the financial year **or**

(ii) totals to 60 days or more in the financial year wedded with stay of 365 days or more in 4 years immediately preceding that financial year. [Sec. 6(1) of I.T.Act ]

2. In case of an NRI i.e. an overseas Indian this number of 60 days is substituted by 182 days and hence in case of an NRI only deciding factor is stay of 182 days or more in a given financial year. [ Exp. (b) to 1 to Sec. 6 of I.T.Act]

3. A person who is a Resident is further defined to be "Resident but Not Ordinarily Resident - [ R but NOR] " in a financial year if -

(i) he has been "Non-Resident" in 9 out of 10 financial years immediately preceding the relevant/current financial year, **or**

(ii) his stay in India totals to 729 days or less in 7 years immediately preceding the relevant/current financial year. [ Sec. 6(6) of I.T.Act]

4. THEREFORE a person defined as " Resident " in a financial year will further be defined as " Resident & Ordinarily Resident -( R & OR ) " if :

01. he is not " Non Resident " in 9 out of 10 financial years immediately preceding that financial year, **and also**

02. his stay in India totals to 730 days or more in 7 years immediately preceding that financial year. [ Sec. 6(6) of I.T.Act]

5. .02 NOW THEREFORE a returnee NRI not being covered by Exp. (b) to Sec. 6(1) of the I.T.Act both the conditions of Sec. 6(1) for determining residential status will apply and need examination.Quite often professionals examine returnee NRI's stay exceeding 181 days in year of return only and determine the status which is erroneous. If such returnee NRI's stay exceeds 59 days in the year of return and 364 days in immediately preceding 4 years he would be a Resident under the I.T.Act in the year of return and will be subject to further scrutiny of stay of preceding 7 and

10 years to determine his status as RbutNOR or R&OR.

**III. ScopeofIncome&Taxability :**

1. Now, based on the residential status, the scope of tax and total income of a given financial year , i.e. a year commencing on 1st April and ending on 31st March is determined as under :

   .01 Resident

   (i) all incomes arising or accruing in India.

   (ii) all incomes received in India, and

   (iii) all incomes arising or accruing outside India i.e. global income.

   .02 Non Resident :Subject to exemptions and concessions provided in I.T.Act) :

   (i) all incomes arising or accruing in India, and

   (ii) all incomes received in India.

   .03 R but NOR :(Subject to exemptions and concessions provided in I.T..Act) :

   (i) all incomes arising or accruing in India, and

   (ii) all incomes received in India.

2. Normally returnee NRIs are having following kinds of income in INDIA.

   - Interest income from bank deposits. i.e. NRE/FCNR/NRO/Residentaccountetc.
   - Dividend income of shares and mutual funds.
   - Capital gains from shares, debentures, securities and mutual funds.
   - Income from house property. i.e. Rent Income
   - Income from post office schemes and RBI Bonds investment being made while the NRIs were eligible to subscribe.
   - Salary income from employment undertaken in India.
   - Profits or gains of business of profession commenced in India.

**IV. Filing Income Tax Return :**

1. Permanent Account Number [PAN] :

   .02 If a returnee NRI's total income during a financial year exceeds the maximum amountwhichisnotchargeabletoIncome Tax or if he is required to file tax return on account of overseas assets he has to apply for Permanent Account Number to the Income Tax Office. If the returnee NRI is an Indian citizen application is in form No. 49A whereas in case of a foreign citizen Form 49AA will apply even though such returnee Foreign citizen is a Resident.

2. Filing of Income-Tax Return :

   .02 If a returnee NRI's total income during a financial year exceeds the maximum amount which is not chargeable to Income Tax then he has to file his return of Income before due date .

   .03 If the returnee NRI is defined as Resident he will be eligible for benefits of senior citizen.And if Resident he will be required to file tax return and disclose overseas assets even if he doesnot have taxable income in India .

**V. Tax Free Income :**

1. A returnee NRI like all resident tax-payers and in some cases like NRIs can earn certain incomes free of tax in India under the I.T.Act being :

   01. Interest on continued FCNR and RFC deposit so long as returnee NRI's residential status is determined as "Non Resident" or "Resident but Not Ordinarily Resident" under I.T. Act.

   02. Dividend earned from shares of Indian Companies.

03. Dividend earned from units of Indian Mutual Funds.

04. Interest earned on PPF accounts.

05. Long Term Capital Gain on Sale of equity shares of Company provided security transactions tax is applicable and paid.

06. Long term Capital Gains on sale of Equity Schemes of Indian Mutual Funds provided security transactions tax is applicable and paid.

07. Overseas income so long as returnee NRI's residential status is determined as "Non Resident" or "Resident but Not Ordinarily Resident" under the I.T. Act.

**VI. FEMA : Returnee NRI's Bank A/cs in India:**

1. Non Resident (External) Rupee Account [NRE] :

1.1 Upon return to India for settlement , a returnee NRI is required immediately upon return, to transfer the balance in NRE account to:

.01 Resident Foreign Currency (RFC) Account or

.02 designate the account as Resident Rupee Account.

1.2 As Banks software normally doesnot facilitate conversion of NRI's accounts as Resident account NRE account is to be closed and balance is to be transferred to newly opened Resident bank account.This regulation also compels foreclosure of NRE deposits which quite often results in loss of interest .[Para 7 of Sch.1 of Foreign Exchange Management (Deposit) Regulations,2000]

2. Foreign Currency Non Resident (B) Account [ FCNR ] :

.01 can be continued until maturity as such and

.02 upon maturity, the balance may be transferred to a Resident Rupee Account orsaidFCNRaccountmaybedesignated as an RFC account

[Para 10 of Sch.2 of Foreign Exchange Management(Deposit)Regulations,2000]

3. Resident Foreign Currency Account (RFC Account) :

.01 A Returning NRI upon return to India for settlement can maintain Resident Foreign Currency account [RFC] in India for an indefinite period.

.02 Such accounts could be maintained as current, savings or term deposit accounts.

.03 Presently RFC can be maintained in US$, GBP,Euro or JY.

[Reg. 5 of Foreign Exchange Management (Foreign Currency Accounts by PersonResident in India)Regulations, 2000]

4. Non Resident (Ordinary) Account [ NRO ] :

.01 Upon return for permanent settlement, NRO account is to be redesignated as Resident Account.

[Para 8 of Sch.3 of Foreign Exchange Management (Deposit) Regulations, 2000]

1. Interest earned on NRE Account designated as Resident Rupee Account is liable to tax in India from the date of return to India and even if an NRE account is continued by mistake, interest earned since the date of return will be taxable as interest from NRE account is exempt only in case of an individual who is "person residing outside India" PROI as defined in Sec 2(v) r.t.w. Sec 2(w) of FEMA[ Sec 10(4)(ii) of I.T. Act ]

2. Interest on continued FCNR deposit isexempt from tax in India so long as

returnee NRI's residential status is determined as "Non Resident" or "Resident but Not Ordinarily Resident" under the I.T. Act. [ Sec. 10(15)(iv)(fa) of I.T.Act ]

3. Interest earned on RFC deposit is exempt from tax in India so long as returnee NRI's residential status is determined as "Non Resident" or "Resident but Not Ordinarily Resident" under the I.T. Act. [Sec 10(15)(iv)(fa) of I.T.Act ]

**VII. Continuity of Concessional Tax Rate :**

1. A returnee-NRI is eligible for concessional tax rate of 20% on the income arising from following assets held up till maturity:-

01. Deposits with Indian Public Company. It may be noted that Indian Banks are covered by the definition of Indian Companies ;

02. Debentures of Indian Public Company;

03. Central Government Securities. [Sec 115H of I.T.Act]

[Section 115H of the IT Act - Annex.5 ]

**VIII. Necessary Procedures Upon Return :**

1. Upon return for settlement a returnee NRI should :

01. apply and obtain Permanent Account Number [PAN].

02. examine the applicability of income-tax and if income exceeds maximum amount not chargeable to tax than examine applicability of advance-tax rules, and if so, pay advance-tax in specified equal installments.

03. fileIncome-TaxReturninthe prescribed form together with proof of payment of applicable tax within specified time after the year end.

04. file tax return even if income in India is below taxable limits if he is Resident and has overseas assets.

05. examine the applicability of wealth-tax and if market value of taxable wealth exceeds maximum amount not chargeable to tax than file Wealth-Tax Return in the prescribed form together with proof of payment of applicable tax within specified time after the year end.

06. inform banks about change of residential status and opt for necessary change in NRE and NRO a/c. and FCNR accounts upon maturity.

07. inform Insurance Companies, Depository Participant providing Demat account facility or Companies wherein shares are held, Mutual Funds, Partnership Firms wherein investments are held and other Institutions re: change of residential status and about return to India for settlement.

**IX. Clubbing Provisions :**

1. In the Middle East NRIs enjoy tax free incomes while in USA husband and wife often file joint tax returns.

2. As such segregation of personal wealth or capital is not necessary so long as they are abroad .

3. But in India income arising out of gifts or amounts transferred by husband to wife or vice versa is clubbed into the income of the Donor.[Section 64(1)(iv) of the I.T.Act] And income by way of Salary, Commission or Fees etc. paid in cash or kind to spouse, from a concern in which such individual has a substantial interest is also to be clubbed in the income of the payer except in cases where spouse possesses technical or professional qualification.[ Sec 64(1)(ii) of the IT Act ]

4. .02 Therefore it would be necessary for Non Resident Indians(NRIs) to segregate and identify each returning NRI husband and

wife's personal assets independently.It would be appropriate to segregate and maintain separate Bank accounts and holding of all investments whereby for husband's assets he is first holder and wife may be a joint holder in wife's assets wife is first holder and husband is a second holder.

5. Investment income of minor children (not being a minor child suffering from any severe disability) other than income earned through manual efforts or personal skills and talent is also to be clubbed into the income of the parent who has higher / more income.

02. Therefore if children have passive income in India or abroad the same be included appropriately.

**X. Global Income and Double Tax Treaties :**

1. A returning NRIs global income is not liable to tax in India as long as residential status under the I.T. Act is determined as " Non Resident " (NR) or " Resident but Not Ordinarily Resident " (R but NOR).

2. Upon the residential status under the I.T. Act being determined as " R and OR", returning NRI's entire global income will be liable to tax in India.

3. However, if a Double Tax Treaty exists between India and the country wherefrom the NRI is returning, the provisions of such Double Tax Treaty will apply if the same are more beneficial and if the tax payer so chooses.

4. Normally, Double Tax Treaties have three alternative methods of taxation namely:

   01. Tax and withholding tax of specified percentage by the country of origin and balance tax to be charged by India. For example, Indo-USA Tax Treaty provides for withholding tax @ 15% in USA on the interest payable by a Company in USA to a resident of India.

   011.In said case, upon being determined as R&OR , while computing returnee NRI's interest income in India, interest earned in USA will be included being global income taxable in India and credit will be provided for the tax of 15% withheld / paid in USA.

   02. Total tax being charged by either of the country, for example, pension paid by Government of USA is liable to tax in USA alone in case of returning NRI who is a USA citizen residing in India.

   03. Incomes which are not specifically covered by the Double Tax Treaty are liable to tax as per the provisions of tax laws of respective countries. In such case, question of possibility of double taxation arises.

   031.In case of dual taxation, normally, credit is granted for tax payable in one country wherein the tax payer is tax resident for tax paid in another country on incomes which are subject matter of taxation in both the countries.

**XI. Wealth Tax :**

1. The most common fallacy amongst NRIs and returnee NRIs is that they are exempt from almost all taxes in India and in particular Wealth Tax. Often professionals as also tax authorities are casual about wealth tax liability of NRI's taxable assets in India.

   .02 The reality is that NRIs and returnee NRIs both are at par with residents and are to pay Wealth Tax on chargeable assets in India i.e. immovable properties, jeweler and vehicles on its market value as on 31st March as much as residents are to.

   .03 Returnee NRI who are Indian citizens will also be subject to wealth tax for taxable overseas assets while Foreign citizens enjoy exemption therefrom.

2. Taxable Assets in India :

At the cost of repetition it may be worthwhile to view taxable Assets for residents as also NRIs, which are :

01. Buildings or land apparent there to other than, one house property or plot of land having area of 500 square meters or less.

02. Value of personal vehicles i.e. motor cars, boats, air crafts,

03. Jeweler, i.e. ornaments made of gold, silver, platinum, or any other precious metal and bullion including utensils and furniture made of gold, silver or other precious metals.

04. Cash on hand in excess of Rs. 50,000/-.

05. Urban land that is land situated :

(i) within the Jurisdiction of Municipality and having population of 10,000 and more or

(ii) in any area within 8 kilometers from the local limits of municipality.

.02 However taxable wealth does not include :

01. One house meant exclusively for residential purposes or plot of land adm. not more than 500 square meters;

02. Any house for residential or commercial purposes which forms part of stock-in-trade;

03. any house which is occupied by the owner for the purposes of any business or profession carried on by him ;

04. any residential property that has been let-out for a minimum period of three hundred days in the financial year ;

05. Any property in the nature of commercial establishments or complexes ;

06. Motor cars used by the assessee in the business of running them on hire or as stock in trade. ;

07. Yachts, boats & aircrafts used by the assessee for commercial purpose ;

08. Urban Land, if

(i) construction of building is not permissible

(ii) construction of building can be made only subject to special approval of appropriate authority.

(iii) It is unused land held for industrial purpose for two years.

(iv) forms part of stock in trade for a period of 10 years.

.03 Import of gold & silver :

NRIs being granted concessional import duty and permission to import gold & silver often import large quantity of gold / silver. If the market value of such gold / silver exceeds Rs.3 mn together with the market value of other taxable wealth & the same is held in India as on 31st March, such returnee NRI is liable to pay wealth tax @ 1% on such value exceeding Rs. 3 mn & file wealth tax return.

3. Wealth Tax Exemptions

In case of returnee NRI special wealth tax exemption is granted for :

01. money and the value of the assets brought by him into India upon return &

02. value of assets purchased by him out of funds remitted from abroad or balances held in NRE/FCNR account within 1 year before return to India for settlement or at any time within seven years after return.

Such exemption is available for a period of 7 years from the date of return.

[Sec 5(1)(v) of the W.T.Act ]

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# FEMA Updates

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## 41 Export of Goods / Software / Services – Period of Realisation and Repatriation of Export Proceeds – For exporters including Units in SEZs, Status Holder Exporters, EOUs, Units in EHTPs, STPs and BTPs

A.P. (DIR Series) Circular No. 52 dated November 20, 2012 extended the enhanced period for realization and repatriation to India, of the amount representing the full value of exports, from six months to twelve months from the date of export. This relaxation was available up to March 31, 2013. Thereafter, in terms of A.P. (DIR Series) Circular No. 105 dated May 20, 2013, this period was brought down from twelve months to nine months from the date of export, valid till September 30, 2013. Further, in terms of A.P. (DIR Series) Circular No. 35 dated April 01, 2002, A.P. (DIR Series) Circular No. 25 dated November 01, 2004 and A.P. (DIR Series) Circular No. 108 dated June 11, 2013, the Units located in SEZs, Status Holder Exporters, EOUs, Units in EHTPs, STPs & BTPs shall realize and repatriate full value of goods/software/services, to India within a period of twelve months from the date of export.

It has been decided, in consultation with the Government of India, that henceforth the period of realization and repatriation of export proceeds shall be nine months from the date of export for all exporters including Units in SEZs, Status Holder Exporters, EOUs, Units in EHTPs, STPs & BTPs until further notice. The provisions regarding the period of realization and repatriation to India of the full exports made to warehouses established outside India remain unchanged.

For Full Text refer to A.P. (DIR Series) Circular No. 37

http://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=9342&Mode=0

## 42 Acquisition/Transfer of Immovable property – Payment of taxes

In accordance to Foreign Exchange Management (Acquisition and Transfer of immovable property in India) Regulations, 2000 notified vide Notification No. FEMA 21 /2000-RB dated 3rd May 2000 as amended from time to time, observations show that doubts persist in the members of public regarding requirement of payment of taxes while undertaking property transactions under these regulations.

It is clarified that transactions involving acquisition of immovable property under these regulations shall be subject to the applicable tax laws in India.Reserve Bank has since amended the Principal Regulations through the Foreign Exchange Management (Acquisition and Transfer of immovable property in India) (Amendment) Regulations, 2014 notified vide Notification No. FEMA.321/2014-RB dated September 26, 2014 c.f. G.S.R. No.733€dated October 17, 2014.

For Full Text refer to A.P. (DIR Series) Circular No. 38

http://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=9345&Mode=0

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# Service Tax Decoded

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## Safety Nets Against Contravention of Service Tax Law

People contravene a law either knowingly or unknowingly. Those, who contravene the law unknowingly should be given chance to rectify their mistake without imposition of penalties. They should not be treated at par with the person who contravenes the law knowingly. Even, people who contravene the law knowingly may be forced by the circumstances to contravene the law against their willingness to follow the law. Even, person who contravenes the law willfully should be given a chance to rectify his wrong deeds and join the main stream of the genuine tax payers. Such a chance given to him might be given with some penalties but not with too harsh penalties which discourage him to rectify his wrong deeds.

Service tax law also recognises this principle and has incorporated certain provisions in the Chapter V of the Finance Act, 1994 (the Act) which provide some safety nets to such assessees. These provisions don't only give a chance to the tax payers but also helps department to reduce or avoid administration and cost of litigation. Assessee can walk away safely without imposition of penalties or with lesser penalties.

Different provisions are provided for different situations and different stages of investigation, adjudication or litigation. These provisions are discussed herein below.

### I. Section 73(3) of the Finance Act, 1994

It may happen that service tax is not paid due to *bona fide* belief that it is not payable or not paid due to any other unintentional reason. In such situation, assessee is ready to pay service tax but worries about penalties like penalty under section 76 which may be imposed for delay in payment of service tax even for a day that too without intention to evade service tax. Section 73(3) provides immunity from proceedings and penalties with following conditions and for following circumstances.

1. As provided in Section 73(4), benefit of section 73(3) is not available if service tax is not paid by the reason of fraud, collusion, wilful mis-statement, suppression or facts or contravention of law with intent to evade service tax. Thus, benefit of section 73(3) can be availed only in normal circumstances.
2. Tax payer has to pay service tax.
3. Such a payment may be on the basis of own ascertainment of tax payer or on the basis of tax ascertained by Central Excise Officer.
4. Such payment should be made before service of notice under section 73(1) of the Act (i.e. Show Cause Notice).
5. It may not be pre-condition to pay interest before service of notice interest due under section 75 of the Act is required to be paid.
6. Central Excise Officer shall be informed about such payment in writing.
7. Once such intimation is given to the Central Excise Officer, such officer shall not serve any Show Cause Notice to the tax payer in respect of amount so paid. Meaning thereby proceeding to recover penalties can't be even initiated by the department.
8. It is also clarified that no penalty under any of the provision of the Act or rules made thereunder shall be imposed in respect of payment of tax and interest made under section 73(3) of the Act.
9. It is worth noting that immunity is granted only for the amount already paid. If any service tax is still payable in opinion of the Central Excise Officer, proceeding to recover such tax may be initiated.

## II. Section 73(4A) of the Finance Act, 1994

During audit, investigation or verification it may be found that service tax is not paid. In such situation it may be argued that unless such audit, investigation or verification has been conducted, such non-payment would have never unearthed and hence department may charge assessee with intention to evade service tax. In such situation higher penalties may be imposed. In such situation safety net has been provided under Section 73(4A). Benefit available under this provision is subject to following conditions and circumstances as follows.

1. Non-payment of tax is to be found during any audit, investigation or verification.
2. True and complete details of transaction are available in specified record. In terms of explanation to Section 73(4A) specified records means records including computerized data, as required to be maintained by the assessee in accordance with any law for the time being in force or where there is no such requirement, the invoices recorded by the assessee in the books of accounts.
3. Tax payer may accept the tax liability and pay the same along with interest.
4. He is also required to pay reduced penalty equal to 1% of tax, each month, for the period of delay, up to a maximum of 25% of tax.
5. Above payment of tax and penalty shall be made before service of notice.
6. It seems that unlike section 73(3), interest is also required to be paid before issuance of notice to avail the benefit under this section.
7. Tax payer shall inform the Central Excise Officer in writing about the payment made.
8. On above mentioned payment and intimation, no notice shall be served by the department. However, in opinion Central Excise Officer if any service tax remains to be paid, he shall proceed to recover the same.
9. It is not necessary that assessee shall accept all service tax being payable in view of audit party or other officers. Assessee may agree to certain issue/s and may opt for benefit granted under the Section 73(4A) for that particular issue/s.
10. It can be seen from the provision of Section 73(4A) that safety net has been provided to the assessee who is ready to pay service tax, along with interest found to be unpaid during the audit, investigation or verification. He may agree to pay the service tax either on acceptance of liability or to buy peace of mind and does not want to face the music of litigation due to amount involved or any other reason.
11. It may be noted that penalty prescribed under Section 73(4A) is not mandatory but an option given to the assessee.
12. Once such payment of service tax, interest and penalty has been paid, Central Excise Officer can't even serve notice for such service tax and propose to impose various penalties. Thus, litigation can't be even initiated by the department at all. Further, proceeding in respect of service tax paid is deemed to have been concluded and hence department can't further compel the assessee to comply with other provisions say for example furnish the return along with payment late fees.
13. Unlike Section 73(3), benefit of this section is available irrespective of the fact that non-payment was intentional or not.

## III. Second proviso to Section 78(1) of the Finance Act, 1994

It may happen that assessee has not agreed or accepted any liability during initial stage and Show Cause Notice has been issued and adjudicated and demand has been confirmed on the assessee. He may prefer not to stretch the litigation further. In this case he is given a further safety net as follows.

1. At this stage, he has been given benefit of reduced penalty of 25% of service tax as compared to 50% of service tax as imposable under first proviso to Section 78(1).

2. Benefit of reduced penalty under this Section is available if service tax along with interest is paid within 30 days from the date of communication of order of Central Excise Officer determining such service tax.
3. Penalty as stated above is also required to be paid within 30 days from the date of communication of order.
4. Unlike section 73(3), interest is also required to be paid within 30 days to avail the benefit under this proviso.
5. In case small service provider (whose turnover of taxable service does not exceed Rs. 60 lakhs), period of 90 days has been granted instead of 30 days as stated above.
6. Normally, penalty under Section 78 is 100% of service tax. However, if true and complete details of transaction are recorded in specified records, amount of penalty shall be reduced to 50%. Benefit of 25% penalty, as granted under Second Proviso to Section 78(1) is available only if true and complete details of transaction are recorded in specified records and not in the case where penalty is imposable at 100% of service tax.
7. It is to be noted that benefit granted under this proviso is limited to penalty payable under Section 78 only. No immunity has been granted against any other penalty. Assessee is required to pay penalties under other section of the Act imposed in the order. It is worth noting that penalty under Section 76 is not payable if penalty under Section 78 is payable.
8. Opting of reduce penalty under this proviso does not mean that assessee surrenders his right to appeal further. To avoid higher penalty in future, he may opt to pay reduced penalty under this proviso and go for appeal against the order determining liability.

**IV. Waiver of penalties under Section 80 of the Finance Act, 1994**

Certain penalties are to be imposed irrespective of intention on the part of the assessee. This may result in imposition of penalty even in the cases where contravention was unavoidable by the assessee. In such situation, safety net is provided under Section 80 of the Act for genuine tax payers who have contravened provision of the law due to reasonable cause. Section 80 of the Act provides that if any failure referred to in Section 76 or 77 in the said provisions but there was reasonable cause for the failure, no penalty shall be imposable on the assessee. Although, discussion in this regard was written in the last article, at cost of repetition, it is reproduced below for justification to the subject of the article.

1. Term "reasonable cause" is not defined in the Act. It is a question of fact and may be decided in case to case basis. Question of interpretation of law, newly implemented/ amended law, different opinion by various courts, revenue neutrality, facts known to the department, proper disclosure to department, illness of proprietor or key management personnel, *bona fide* belief, misguiding opinion by consultants etc. may be considered a reasonable cause.
2. Though "reasonable cause" is very subjective word, but once it is established that there was a reasonable cause, no penalties under section 76 and 77 shall be imposed.
3. It is worth noting that benefit of Section 80 is available only for the penalties imposable under section 76 and 77 and not for the penalty imposable under Section 78 of the Act. In any case penalty under section 78 is imposable only if there was evasion (i.e. intentional non-payment) of service tax and it is hard to envisage existence of reasonable cause along with intention to evade tax.
4. Burden of proof is on the assessee to establish that there was a reasonable cause for the contravention.

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# Service Tax - Recent Judgements

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## 36 Vishal Packaging vs. CCE, Raipur 2014 36 STR 465 , Tribunal , Delhi.

**Manufacture of corrugated boxes from craft paper on job work basis, whether amounts to manufacture?**

**Facts :-**

Assessee manufacturing corrugated boxes from craft paper on job work basis. Department argued that the said activity does not amount to manufacture and will be liable to service tax under the category of business auxiliary.

**Held:-**

It was held by tribunal that process of making of corrugated boxes from craft paper on job work basis amounts to manufacture and therefore not liable to service tax under Business Auxiliary Service.

## 37 Commissioner of Central Excise v. Shri Shanker Engineering Works , [2014] 47 taxmann.com 153 , CESTAT, New Delhi.

**Fabrication of storage tanks and structures amounts to manufacture and their erection and installation is, therefore, not covered by Business Auxiliary Service**

**Facts:-**

Assessee was engaged in fabrication of steel storage tanks, dozers, settlers, steel structures, platforms, railing, foundation frames etc. and their erection and installation in factory. Department alleged that since steel items after being erected and installed become embedded to earth and become non-excisable goods, hence, activity of assessee would be Business Auxiliary Service.

**Held:-**

It was not specified by Department as to which sub-clause of definition of Business Auxiliary Service covers this activity. Probably department wants to cover this activity under 'Production or processing of goods for or on behalf of a client, which does not amount to manufacture'. But fabrication of steel storage tanks and steel structures would amount to manufacture and their erection and installation would certainly not be covered by Business Auxiliary Service.

## 38 M.R. Patel & Sons v. Commissioner of Service Tax, Ahmedabad [ 2014 ] 41 taxmann.com 344 (Ahmedabad - CESTAT)

**Merely supervising loading of coal and co-coordinating with railway authorities without any supervision work being carried out at coal mines does not amount to 'clearing' and/or 'forwarding' of coal and is, therefore, not liable to service tax under Clearing and Forwarding Agent's Services.**

**Facts:-**

Under terms of contract with Gujarat Electricity Board, assessee was required to : (a) make pre-payment of railway freight, (b) remain vigilant about route where coal is moved, (c) co-ordinate with railway authorities and (d) supervise loading of coal into rakes. Department sought levy of service tax under Clearing and Forwarding Agent's services on ground that assessee had received goods/coal from premises of supplier and made suitable arrangement for dispatch of said coal as per direction of Gujarat Electricity Board by engaging railway wagon. Assessee argued that it had not carried out any clearing activity.

**Held:-**

It was held that assessee had not done any activity of clearing coal from mines; assessee was only supervising loading of coal in railway yard and was not doing supervision at mines end. In order to get covered under Clearing & Forwarding Agent services, assessee must have 'cleared' as well as 'forwarded' goods. In this case, both clearing and forwarding activities were absence and, prima facie, therefore, assessee had made out a case for full waiver of pre-deposit .

## 39 Commissioner of Service Tax v. Shah Coal (P.) Ltd [2014] 44 taxmann.com 269 ( Mumbai – CESTAT)

**Activity of supervision and loading of coal does not come under category of 'Clearing and Forwarding Agent's Service'.**

**Facts:-**

Assessee entered into a contract with M/s. Ambuja Cement for movement of client's coal from various collieries to its plants involving : (a) supervision of coal loading at collieries; and (b) transportation of coal by rail or road to client's plant/factory. Department classified said services under 'Clearing & Forwarding Agent's Services'

**Held:-**

It was held that since assessee's activities did not fall under any of categories specified in said Circular, activity of supervision and loading of coal does not come under category of 'Clearing and Forwarding Agent's Service'. Circular No. B-43/7/97-TRU, dated 11-7-1997 issued by Board at time of inception of levy needs to be given due weightage, following principles of 'administrative construction' of statutes.

## 40 Manav Sansadhan Vikas Ani Sanodhan Manch vs. CCE (2014) 35 STR 385 (Tribunal- Mumbai)

**Trust engaged in treatment of ailments by combination of Yoga and Medicine.**

**Facts:-**

Assessee Trust registered under Maharastra state was engaged in treatment of ailments by combination of yoga and medicine. Department held that the assessee is liable for service tax under the category of 'Health & Fitness Service'.

**Held:-**

It was held that appellant is trust registered to teach yoga and yoga is therapeutic and restorative and hence services provided by them are covered under the category of Health & Fitness Service.

## 41 CCE vs. Surenderkumar (2014) 36 STR 327 ( Tribunal – Delhi)

**Loading and unloading of sugar bags from one place to another place , whether liable to service tax under the category of 'Cargo Handling Service'.**

**Facts:-**

Assessee engaged in business of shifting of sugar bags from floor to mill house to godown and from one godown to another.

**Held:-**

It was held by the tribunal that the said activities of loading, unloading and shifting of sugar bags from floor to mill house to godown and from one godown to another would not be liable for service tax under the category of 'cargo handling service '.

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# VAT - Recent Judgements and Updates

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## Statute Updates

[I] **Important Notifications / Circulars :**

Vide notification dated 23.09.2014 tax credit available on the taxable turnover of purchases is to be reduced by 1% instead of 2%, if the goods are sold/resold in the course of inter state trade and commerce or the goods are used as inputs in the manufacturing of taxable goods which are sold in the courts of inter state trade or commerce.

**Description of Goods:**

a) The description of the goods from which input tax credit is to be reduced by 1% are all goods of Schedule II of the Act except Bullion, Gold, Silver, Cotton, whether ginned or unginned, baled, pressed or otherwise Isabgul, Jira, Variali, Methid, Ajma, Asalia, Kalingda seeds, khas khas, Dhana, Dhana Dal and Pepper, all seds of all types and Bidi Leaves.

b) The Part II of the Notification prescribes that the Tax Credit @ 2% is to be reduced in case of following goods :

Crude Oil, Furnace Oil, Aviation Turbine fuel, High Speed Diesel Oil, Light Diesel Oil, Solvent, Petrol, Lower Sulphur heavy stock, Linear Alkyl Benzene, Bitumen, Liquified Petroleum Gas and other Petroleum Products and Natural Gas.

[II] **Important Judgments:**

[1] **Judgment delivered by the Hon. Allahabad High Court in case of Laxmi Doors.**

**Issue:**

**The Registration Number of the dealer is cancelled ab-initio and the dealer has not paid the tax collected on its sales, under the circumstances no tax credit can be denied in the case of purchaser and the tax is to be collected from the seller.**

**Facts:**

In this case, the dealer has purchased the Timber from registered dealers including one viz. M/s. Heena Timbers. The seller has issued the Tax Invoice. The registration certificate of M/s. Heena Timbers has been cancelled ab-initio and the department has disallowed the tax credit of Laxmi Doors. The purchaser has preferred appeal at various stages and lastly Hon. Allahabad High Court has set aside the order of Tribunal stating that is absolutely illegal. As the different view is taken by the Hon. Allahabad High Court, as compared to Hon. Gujarat High Court, in the case of Madhav Steel, therefore this judgment is important.

The judgment is very important and therefore total judgment is reproduced hereunder for the benefit of the readers as there is a burning issue in the State of Gujarat for ab-initio cancellation.

The appellant is aggrieved by the order of the Trade Tax Tribunal dated 12.9.2013.

Briefly stated that the facts of the case are that the appellant is a registered dealer having a TIN No. 09552300340 and he is carrying on the business from Village Semara, Chinhat, Lucknow. During the year 2008-09 the Firm has made certain purchases of raw material namely timber from registered dealers including one M/s. Heena Timbers, Bahraich having TIN No. 09555700834. For these purchases tax invoices, 9R's as well as gate passes of the Mandi Samiti were also issued. M/s. Heena Timbers was also a registered dealer and its registration certificate continued up to 23.12.2009 but thereafter the registration was cancelled by the department. On 23.12.2009 a first information report was also lodged against M/s. Heena Timbers under sections 420, 424, 467, 468 and 120B I.P.C. by the Asst. Commissioner, Tax, Bahraich in Police Station Kesarganj, Dist. Bahraich. The grievance of the appellant is that while making assessment

for tax for the year 2008-09, the claim of the Appellant Firm for credit of input tax was disallowed by the Assessing Authority and the Tax Invoice, 9R's and gate passes issued by M/s. Heena Timbers were not accepted and assessment of tax was thereafter made on the basis of best judgment assessment.

Aggrieved by the order of the Assessing Officer, the Appellant Firm preferred an appeal before the Addl. Commissioner (Appeals), Commercial Tax, Lucknow which was also dismissed.

The aggrieved appellant firm preferred an appeal before the Commercial Tax Tribunal, Lucknow which has also been rejected, on the ground that the tax invoices issued by M/s. Heena Timbers are forged and that the said firm has not deposited the VAT collected by it.

In the present revision the grievance of the appellant is that the tax invoices showing payment of tax by M/s. Heena Timbers was issued to the revisionist Firm along with Mandi Samiti gate passes and there was no reason for the appellant Firm to disbelieve the said documents or to believe that M/s. Heena Timbers had evaded the payment of tax. If in the assessment proceedings against M/s. Heena Timbers it came to light before the Taxing Authorities that M/s. Heena Timbers was guilty of evasion of tax, the said liability could not have been fastened upon the appellant Firm and if at all any tax allegedly evaded was required to be recovered the same should have been recovered from M/s. Heena Timbers in proceedings to that effect.

Learned counsel for the appellant further submitted that the mere fact that certain consignment of timber has been purchased from M/s. Heena Timbers in cash and the sale had not been shown by M/s. Heena Timbers in their registers or cash book it cannot lead to a presumption that there was a fraudulent sale with the intention to evade tax so far as the Appellant Firm was concerned and therefore the findings of the Tribunal to that effect was absolutely illegal and arbitrary. In addition to the assessment made by the Assessing Authority, the Tribunal has also held the Appellant Firm liable to payment of penalty u/s. 54(1)(19) of the U.P. VAT Act, 2008. Section 54(1)(19) of the U.P. VAT Act provides for imposition of penalty of a sum equal to five times of the amount of the input tax credit where a dealer or any other person falsely or fraudulently claims an amount of input tax credit. So far as the books and registers of the Appellant Firm are concerned, the entries therein have not been doubted and it is not the case of the Revenue that the entries made therein did not tally with the invoices.

The submission is that once the tax invoices have been duly issued by M/s. Heena Timbers, the Tribunal ought to have recorded a finding as to whether the said invoices were actually issued by M/s. Heena Timbers or not and in the absence of any such finding recorded by the Tribunal. The Tribunal could not have come to a conclusion that the said documents were false or fraudulent for the purposes of imposition of penalty against the appellant firm under section 54(1)(19) of the U. P. VAT Act.

The learned counsel for the appellant was placed reliance upon a judgment of this court in case of M/s. Waterflow Industries Gaur Kender Mathura vs. The Commissioner of Commercial Tax U.P. Lucknow MANU/UP/3395/2010: 2010 NTN (VOL.44) – 324 wherein the claim of revenue that since the assessee has claimed benefit of set off the burden lies upon the assessee to prove the genuineness of the invoices has been rejected by the Court.

In the present case also there is no finding recorded by the Tribunal that the Tax Invoices for claiming benefit of input tax credit was not genuine and in the absence of such an exercise no liability to tax or penalty could have been imposed against the revisionist firm.

For the reasons aforesaid, the order of the Tribunal is absolutely illegal and arbitrary and is accordingly set aside and the matter is remitted to the Tribunal for reconsideration in the light of the observations made therein above.

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# Business Valuation

**Approaches to Valuation**

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## The Income Approach (DCF - Discounted Cash Flow Method)

Last time we have gone through the basics of Discounted Cash Flow (DCF) Method. As mentioned in that column, business valuation through DCF is an estimation job and uncertainty is invariably attached with estimation. So, the appraiser should concentrate on building the best models they can with as much information as they can legally access, trying to make their best estimates of business specific components and being as neutral as they can on economic variables like rate of interest or growth rate etc. As new information comes in, they should update their valuations to reflect the new information. There is no place for false pride in this process.

Using this method, we can derive value of equity holders by (i) choosing present value of free cash available to equity holders and (ii) choosing present value of the cash flow available to firm and subtracting the present value of debts there from.

The fundamentals to estimate value under this technique are cash flows and discounting rate. We have briefly gone through fundamental of designing the cash flow. Now, we will see the importance of discount rate in this article:

**Estimation of Discount Rates**

Having projected the firm's free cash flow for the next "n" years, we will need to figure out what these cash flows are worth today. That means coming up with an appropriate discount rate which we can use to calculate the net present value (NPV) of the cash flows. So, what should be this discount rate? That's a crucial question, because a difference of just one or two percentage points in discounting rate can make a big difference in firm's fair value. This discounting rate is the most critical item of DCF valuation. In order to find a present value of periodic cash flow to firm, we need to discount it by an appropriate rate. The cost of capital is an estimate of the rate of return an investor (this may be owner or financer to business) demands to invest in business or in asset or, said differently, an investor's opportunity cost. As such, the cost of capital is the proper rate for discounting future cash flows to a present value. Most companies finance their operations largely through debt and equity. Estimating the cost of equity is more challenging. Unlike debt's explicit cost, the cost of equity is implicit. The cost of equity is higher than the cost of debt because equity's claim is junior. But no simple method exists to estimate the cost of equity.

Cost of Capital rate is normally derived by determining the cost of each component forming part of invested capital and taking the weighted average of that. The discount rate so arrived is termed as Weighted Average cost of Capital (WACC). The WACC reflects the business as well as financial risk of the enterprise. The discounting rate to be applied with free cash flow to equity is the expected rate of return on equity (%cost of equity) only.

The weighted average cost of capital (WACC) is a weighting of a firm's cost of equity and costs of debt. The general principle when developing the WACC is that it must be consistent with the overall valuation approach. To be consistent with the free cash flow approach, the estimate of cost of capital must comprise a weighted average of the costs of all sources of capital, meaning long term debt, short term debt, equity etcetera, since the free cash flow represents cash available to all providers of capital within the firm. It must be computed after taxes since the free cash flow is stated after taxes. The discount rate will change with time as interest rates, inflation, and other factors affecting the environment the company operates in, are changing. Therefore, the assumption that it will remain the same for the entire forecasting period is not realistic.

Each component of WACC is discussed in detail in the following paragraphs.

**Cost of Equity**

Unlike debt, which the company must pay at a set rate of interest, equity does not have a concrete price that the company must pay. But that doesn't mean that there is no cost of equity. Equity shareholders expect to obtain a certain return on their equity investment in a company. From the company's perspective, the equity holders' required rate of return is a cost, because if the company does not deliver this expected return, shareholders will simply sell their shares, causing the price to drop. Therefore, the cost of equity is basically what it costs the company to maintain a share price that is satisfactory (at least in theory) to investors.

The cost of equity can be derived either by the risk and return approach or by dividend expectation approach. Free cash flow to equity is not just the dividend pay outs by the enterprise but it is free cash flow available to equity holders for distribution. Considering this, generally the risk return approach is used to work out the cost of equity. The most common approach to estimating the cost of equity is the capital asset pricing model (CAPM). The CAPM says a company's cost of equity equals the risk-free rate plus the product of the equity risk premium and beta.

The CAPM is the most widely accepted method of estimating the cost of equity capital.

Under CAPM, the cost of equity is defined as under:

Cost of equity = Risk Free Return + [Beta * Equity Risk Premium]

Cost of Equity (Re) = Rf + Beta (Rm-Rf).

Where,

**Risk Free Return** is the return expected by equity holder where default risk is zero. Government issued securities or RBI bonds generally provide a good proxy for the risk-free rate. Estimates for the equity risk premium and beta prove more challenging.

**Beta** is the sensitivity of a particular stock vis a vis Market or Index. Arithmetically, beta can be calculated as: **Beta = Covariance (X,Y) / Variance (X)**

Beta attempts to reflect the sensitivity of a stock's price movement relative to the broader market. A beta of 1.0 means the stock tends to move in line with the market. A beta below 1.0 suggests a stock moves less than the market, while a beta above 1.0 implies moves greater than the market. All things equal, finance theory associates a higher beta with higher risk and reward.

Equity Risk Premium = return generated by the market - risk free return

**Equity Risk Premium** is the return above and beyond the risk-free rate an investor expects to earn as compensation for assuming greater risk. Like beta, the equity risk premium is ideally a forward-looking estimate. Most analysts rely on past equity risk premiums, which, depending on the time frame, may not give a reasonable sense of the return outlook. Most of the problems with the cost of capital come from stale inputs for beta and the equity risk premium.

Once the cost of equity is calculated, adjustments can be made to take account of risk factors specific to the company, which may increase or decrease the risk profile of the company. Such factors include the size of the company, pending lawsuits, concentration of customer base and dependence on key employees. Adjustments are entirely a matter of investor judgment and they vary from company to company.

**Cost of Debt**

Cost of Debt is the long-term cost of debt of a business. Cost of debt for each of the long term debt forming part of invested capital is to be derived separately and those will form the part of calculating WACC. Cost of Debt Compared to cost of equity, cost of debt is fairly straightforward to calculate. The rate applied to determine the cost of debt (Rd) should be the current market rate the company is paying on its debt. If the company is not paying market rates, an appropriate market rate payable by the company should be estimated.

As companies benefit from the tax deductions available on interest paid, the net cost of the debt is actually the interest paid less the tax savings resulting from the tax-deductible interest payment. Therefore, the after-tax cost of debt is Rd (1 - corporate tax rate).

**Cost of Preference Shares**

Cost of preference shares is the dividend rate of the preference share. The dividend distribution tax being part of cost of shares here it will be added to arrive cost of preference shares.

**Weighted Average Cost of Capital (WACC)**

The Weighted Average Cost of Capital is the weighted average of the costs of the different components of financing used by an enterprise.

Arithmetically, WACC is calculated as follows:

WACC= [(Cost of Equity*Weightage) + (Cost of Debt 1*Weightage) + (Cost of Debt 1*Weightage) + (Cost of Preference Shares*Weightage)]/ [Weightage of Equity + Weightage of Debts + Weightage of Preference Shares]

The weighted average Cost of Capital so derived will be used as denominator or a discounting rate to arrive at the present value of free cash flow to firm.

**Note :** One should remember that "Never mix and match cash flows and discount rates". Means FCFF should be used with WACC and FCFE should be used with Cost of equity only. Using FCFF with cost of equity will not give the correct estimation of value.

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# Corporate Law Update

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**(A) MCA Updates:**

1. **The Company Law Board (Fees on Applications and Petitions) Amendment Rules, 2014**

Following shall be inserted after the Sr. No. 33, in the Schedule of the Company Law Board (Fees on Applications and Petitions) Rules, 1991:

| Sr. No. | Relevant Section No. of Companies Act, 2013 | Particulars | Amount (In Rs.) |
|---|---|---|---|
| **34** | 2 (41) | Allowing any period other than April to March as Financial Year. | 5000/- |
| **35** | 58 & 59 | Rectification of Register of Members. | 500/- |
| **36** | 73 (4) read with section 76 | Directing the company to pay the sum due or for any loss or damage incurred as a result of such non-payment. | 100/- |
| **37** | 74 (21) | Allow further time as considered reasonable to the Company to repay the deposit. | 5000/- |

**[F. No. 1/19/2014-CL-V dated 03/11/2014]**

2. **Clarification on matters relating to Companies [Cost Record and Audit] Rules, 2014:**

MCA has clarified in the matter of Rule 5(1) and 6(2) of the Companies (Cost Records and Audit) Rules, 2014 regarding maintenance of Cost Records and filing of notice of appointment of the Cost Auditor in the form CRA-2 in the electronic mode.

- The date of filing of the said Form CRA-2 has been extended without any late fee/ penalty up to 31st January, 2015. CRA-2 will be made available on the MCA website soon.
- Those Companies who have filed Form-23AC for appointment of Cost Auditor for the year 2014-15 need not file the Form CRA-2 afresh for the year 2014-15.

**[General Circular No. 42/2014 dated 12/11/ 2014]**

3. **Issue of Foreign Currency Convertible Bonds (FCCBs and Foreign Currency Bonds (FCBs) – Clarification regarding applicability of provisions of Chapter III of the Companies Act, 2013:**

In the matter of the applicability of provisions of Chapter III of the Companies Act, 2013 (Act) to the issue of Foreign Currency Convertible Bonds (FCCBS) and Foreign Currency Bonds (FCBs) by Indian companies exclusively to persons resident outside India in accordance with applicable sectoral regulatory provisions, the MCA has clarified that unless otherwise provided in the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipts Mechanism) Scheme, 1993 and Reserve Bank of India through its various directions/regulations, provisions of Chapter III of the Act shall not apply to an issue of a FCCB or FCB made exclusively to persons

resident outside India in accordance with the above mentioned regulations.

**[General Circular No. 43/2014 dated 13/11/2014]**

**4. Extension of Company Law Settlement Scheme, 2014 (CLSS-2O14)**

In continuation to the Ministry's General Circular No. 34/2014 dated 12/08/2014 and 40/2014 dated 15/10/2014, the ministry has extended the company law settlement scheme (CLSS-2014) up to 31st December, 2014.

**[General Circular No. 44/2014 dated 14/11/2014]**

**5. Extension of time for holding Annual General Meeting (AGM) under section 96(1) of the Companies Act, 2013- Companies registered in State of Jammu and Kashmir:**

Looking to the unprecedented floods in the State of Jammu and Kashmir the MCA has advised to the Registrar of Companies, Jammu and Kashmir, to exercise powers conferred on him under the third proviso to section 96(1) of the Companies Act, 2013 to grant extension of time up to 31/12/2014 to those companies registered in the State of Jammu and Kashmir, who could not hold their AGMS (other than first AGM) for the financial year 2013-14 within the stipulated time

**[General Circular No. 45/2014 dated 18/11/2014]**

## (B) LATEST JUDGMENTS:

**1. Shri Ashlesh Gunvantbhai Shah, Ahmedabad Vs. SEBI [Appeal No. 271 of 2014]:**

The appellant had disposed 74,547 shares of the "Target Company", which represented 6.2% of the total shareholding of the target company. Since that disposal of shares was in excess of the limit prescribed under regulation 13(3) of PIT Regulations, 1992 and regulation 29(2) of SAST Regulations, 2011, it was obligatory on part of the appellant to make disclosures of sale to the target company. Since disclosures were not made, show-cause notice was issued, and by the impugned order, a penalty of Rs. 5 lac was imposed upon the appellant.

It was concluded that appellant being a person dealing in securities ought to have known his rights and obligations. Therefore, in the facts of present case, no fault can be found with the decision of SEBI in imposing nominal penalty upon the appellant.

In other words, irrespective of disclosures made by the Company, obligation on part of appellant to make disclosures under the respective regulations being mandatory, appellant cannot escape penal liability on account of failure to make requisite disclosures under the SAST Regulations, 2011 and PIT Regulations, 1992 on ground that the failure was unintentional, technical and inadvertent.

**2. Golden Tobacco Ltd. and GHCL Limited, Gujarat Vs. SEBI [Appeal No. 181 and 183 of 2013]**

The matter in dispute was that "Whether a listed Company under the format annexed to clause 35 of the Listing Agreement is required to disclose to the Stock Exchange, details of 'OTHERWISE ENCUMBERED' shares of that listed Company held by the promoter/ promoter group, even though there is no obligation cast upon the promoter/ promoter group to make such disclosures to the listed Company?

It was held that impugned decisions of the Adjudicating Officer of SEBI in holding that in view of the words 'shares pledged or otherwise encumbered' in the format annexed to clause 35 of the Listing Agreement (as amended), appellants were obliged to disclose to the Stock Exchanges details of shares which are otherwise encumbered by the promoter/ promoter group and since the appellants have

**contd. on page no. 562**

# From Published Accounts

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## AS 22– Accounting for Taxes on Income

**Significant Accounting Policies and Notes on Accounts for the year ended 31st March, 2014**

### Petronet LNG Limited

Provision is made for deferred tax for all timing differences arising between taxable incomes and accounting income at currently enacted or substantially enacted tax rates.

Deferred tax assets are recognized, only if there is reasonable / virtual certainty that they will be realized and are reviewed for the appropriateness of their respective carrying values at each Balance Sheet date.

### Bajaj Corp Limited

Tax expense comprises of current and deferred tax. Current income tax is measured at the amount expected to be paid to the tax authorities in accordance with the Income-tax Act, 1961 enacted in India. Deferred income taxes reflects the impact of current year timing differences between taxable income and accounting income for the year and reversal of timing differences of earlier years.

Deferred tax is measured based on the tax rates and the tax laws enacted or substantively enacted at the balance sheet date. Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and deferred tax liabilities relate to the taxes on income levied by the same governing taxation laws. Deferred tax assets is reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realized. In situations where the company has unabsorbed depreciation or carry forward tax losses, all deferred tax assets are recognized only if there is virtual certainty supported by convincing evidence that can be realized against future taxable profits.

In the situations where the Company is entitled to a tax holiday under the Income-tax Act, 1961 enacted in India or tax laws prevailing in the respective tax jurisdictions where it operates, no deferred tax (asset or liability) is recognized in respect of timing differences which reverse during the tax holiday period, to the extent the company's gross total income is subject to the deduction during the tax holiday period. Deferred tax in respect of timing differences which reverse after the tax holiday period is recognized in the year in which the timing differences originate.

The carrying amount of deferred tax assets are reviewed at each balance sheet date. The company writes-down the carrying amount of a deferred tax asset to extent that it is no longer reasonably certain or virtually certain, as the case may be, that sufficient future taxable income will be available which deferred tax asset can be realized.

### Take Solutions Limited

Tax expense comprising of both current tax and deferred tax are included in determining the net results for the period.

**Deferred tax** reflects the effect of timing differences between the assets and liabilities recognized for financial reporting purposes and the amounts that are recognized for current tax purposes. As a matter of prudence deferred tax assets are recognized and carried forward only to the extent, there is reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realized.

**Current tax** is determined based on the provisions of the Income Tax Act of the respective countries.

### KPR Mill Limited

Current tax is the amount of tax payable on the taxable income for the year as determined in accordance with the provisions of the Income tax Act, 1961.

Minimum Alternate Tax (MAT) paid in accordance with the tax laws, which gives future economic benefits in the form of adjustment to future income tax liability, is considered as asset if there is convincing evidence that the Company will pay normal income tax. Accordingly, MAT is recognized as an asset in the Balance sheet when it is highly probable that future economic benefit associated with it will flow to the Company.

Deferred tax is recognized on timing differences, being the differences between the taxable income and the accounting income that originate in one period and are capable of reversal in one or more subsequent periods. Deferred tax is measured using the tax rates and the tax laws enacted or substantively enacted as at the reporting date. Deferred tax liabilities are recognized for all timing differences. Deferred tax assets are recognized for timing differences of items other than unabsorbed depreciation and carry forward losses only to the extent the reasonable certainty exists that sufficient future taxable income will be available against which these can be realized. However, if there are unabsorbed depreciation and carry forward of losses, deferred tax assets are recognized only if there is virtual certainty that there will be sufficient future taxable income available to realize the assets. Deferred tax assets and liabilities are offset if such items relate to taxes on income levied by the same governing tax laws and the Company has a legally enforceable right for such set off. Deferred tax assets are reviewed at each balance sheet date for their realisability.

Current and deferred tax relating to items directly recognised in reserves are recognised in reserves and not in the Statement of Profit and Loss.

**Manugraph India Limited**

Tax expense comprises of current and deferred taxes.

Current income tax is measured at the amount expected to be paid to the authorities in accordance with the Indian Income Tax Act, 1961.

Deferred income taxes reflects the impact of current year timing differences between taxable income and accounting income for the year and reversal of timing differences of earlier years. Deferred tax is measured based on the tax rates and the tax laws enacted or substantively enacted at the balance sheet date. Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set-off current tax assets against current tax liabilities and the deferred tax assets and the deferred tax liabilities related to the taxes on income levied by same governing taxation laws. Deferred tax assets are recognised only to the extent that there is reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realized. In situations where the company has unabsorbed depreciation or carry forward tax losses, all deferred tax assets are recognised only if there is virtual certainty supported by convincing evidence that they can be realized against future taxable profits. The carrying amount of deferred tax assets are reviewed at each balance sheet date. The Company writes down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain, as the case may be, that sufficient future taxable income will be available against which deferred tax asset can be realized. Any such write-down is reversed to the extent that it becomes reasonably certain or virtually certain, as the case may be, that sufficient future taxable income will be available.

**KNR Constructions Limited**

Provision for current tax is made based on the liability computed in accordance with the relevant tax rates and tax laws applicable. Provision for deferred tax is made for timing differences arising between taxable income and accounting income using the tax laws and tax rates enacted or subsequently enacted as of the balance sheet date. Deferred Tax Assets are recognized only if there is a virtual certainty that there will be sufficient taxable income in future.

During the year under consideration, we have arrived at the net tax payable after claiming deduction of profits under section 80IA of the Income Tax Act., on eligible projects taking into account, the decisions of Tribunal, in cases of various asessees. As a result the taxable income is reduced by Rs. 52,99,08,798/-as per the Income Tax Act., and provision for tax has been calculated accordingly.

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# From the Government

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## Income Tax

1) **Notification regarding Bank Term Deposit Scheme,2006**

   In pursuance of section 80C of the Income tax Act, 1961 (43 of 1961), the Central Government hereby makes the following amendments to the Bank Term Deposit Scheme, 2006, namely:-

   (1) This scheme may be called the Bank Term Deposit (Amendment) Scheme, 2014.

   (2) It shall come into force on the date of its publication in the Official Gazette.

2) In the Bank Term Deposit Scheme, 2006, in para 3, in clause (1), for the words "one lakh rupees , the words one hundred and fifty thousand rupees shall be substituted.

   **[Notification No.63/2014, dtd 13/11/2014]**

2) **Notification regarding amendment in income-tax rules relating to advance ruling and insertion of form 34DA**

   a) **CBDT hereby substitutes sub-rule (1) of rule 44E of the Income Tax Rules, which is as under:-**

   - An application for obtaining an advance ruling under sub-section (1) of section 245Q shall be made in quadruplicate,
   - in Form No. 34C in respect of a non-resident applicant referred to in subclause (i) of clause (a) of section 245N,
   - in Form No. 34D in respect of a resident applicant referred to in sub-clause (ii) of clause (a) of section 245N seeking advance ruling in relation to a transaction undertaken or proposed to be undertaken by him with a nonresident,
   - **in Form No. 34DA in respect of a resident applicant referred to in subclause (iia) of clause (a) of section 245N falling within any such class or category of person as notified by the Central Government in exercise of the powers conferred by sub-clause (iia) of clause (b) of that section, ( newly inserted)**
   - in Form No. 34E in respect of a resident falling within any such class or category of person as notified by the Central Government in exercise of the powers conferred by sub-clause (iii) of clause (b) of section 245N,
   - in Form No. 34EA, in respect of an applicant referred to in sub-clause (iiia) of clause (b) of section 245N of the Act and shall be verified in the manner indicated therein."**b) CBDT hereby inserts sub-rule (3) and (4) after sub-rule (2).**

   **Sub-rule-3** – Every application the in the form as applicable shall be accompanied by the proof of payment of fees as specified in sub-rule(4),
   **Sub-rule 4** – Chart of fees payable along with the application for advance ruling.
   **(For full text and new form 34DA refer notification no.74 dated 28/11/2014.The above notification shall come into force on the date of its publication in the Official Gazette)**

3) In pursuance of Chapter XIX-B ( Advance Ruling) , CBDT hereby vide notification no 73, dated 28/11/2014 specifies a resident, in relation to his tax liability arising out of one or more transactions valuing rupees one hundred crore or more in total which has been undertaken or proposed to be undertaken, being such class of persons as application for the purpose of advance ruling. The said notification shall come into force on the date of its publication in the Official Gazette.

## Service Tax

1) **Notification regarding amendment in rule 5A ( Access to a registered premises) of the Service Tax Rules, 1994.**

CBDT hereby substitutes sub-rule (2) of rule 5A , which reads as under:-

Every assessee, shall, on demand make available to the officer empowered under sub-rule (1) or the audit party deputed by the Commissioner or the Comptroller and Auditor General of India, or a cost accountant or chartered accountant nominated under section 72A of the Finance Act, 1994,-

(i) the records maintained or prepared by him in terms of sub-rule (2) of rule 5;

(ii) the cost audit reports, if any, under section 148 of the Companies Act, 2013 (18 of 2013); and

(iii) the income-tax audit report, if any, under section 44AB of the Income-tax Act, 1961 (43 of 1961),

for the scrutiny of the officer or the audit party, or the cost accountant or chartered accountant, within the time limit specified by the said officer or the audit party or the cost accountant or chartered accountant, as the case may be.

***(Notification No. 23, dtd. 5th December, 2014)***

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contd. from page 558



failed to make such disclosures, appellants have violated clause 35 of the Listing Agreement as well as PFUTP Regulations is unjustified, because:,

- Firstly, neither any regulation framed by SEBI nor clause 35 of the Listing Agreement cast an obligation on the promoter/promoter group to make such disclosures to the listed Company, and in the absence of such disclosure made by promoter/ promoter group, SEBI is not justified in directing the listed Company to disclose to the Stock Exchanges details of shares which are 'otherwise encumbered' by the promoter/ promoter group.
- Secondly, as per the press release issued by SEBI on January 21, 2009, clause 35 of the Listing Agreement was to be amended so that details of pledged shares and release/sale of shares are first made by promoter/ promoter group to the listed Company and in turn, the listed Company would disclose the same to the public through the Stock Exchanges. Since the promoter/ promoter group are not obliged to disclose to the listed Company details of shares that are otherwise encumbered by them, SEBI is not justified in directing the listed Company to disclose to the Stock Exchange details of 'otherwise encumbered' shares which are not furnished to it by the promoter/promoter group.
- Thirdly, when an Adjudicating Officer of SEBI has already construed the words 'shares pledged or otherwise encumbered' and held that the said words would cover particulars relating to pledged shares only, the Adjudicating Officer in the present case is not justified in taking a contrary view that too without assigning any reasons. Such a conduct on part of the Adjudicating Officer is highly objectionable. It was advised that the officers of SEBI shall henceforth ensure that no orders are passed by them which are mutually contradictory to each other.

For the reasons stated hereinabove, the Bench set aside the penalty of Rs.1crore and Rs. 1.25 crore imposed on each appellant by SEBI on ground that the appellants have failed to disclose to the Stock Exchanges, fact that the shares of the appellant Company held by the respective promoter/promoter group have been encumbered pursuant to an order passed by the arbitrator in the arbitration proceedings between the promoter/promoter group and some third party.

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# Association News

**CA. Abhishek J. Jain**
Hon. Secretary

**CA. Nirav R. Choksi**
Hon. Secretary

**Forthcoming Programmes**

| Date/Day | Time | Programmes | Speaker | Venue |
|---|---|---|---|---|
| 20.12.2014 Saturday | 8.00 a.m. to 1.00 p.m. | Cricket Match - President XI Vs. Secretary XI | - | Sardar Patel Stadium, Navrangpura, Ahmedabad |
| 03.01.2015 Saturday | 9.00 a.m. to 12.30 p.m. | Controversial Issues under the Income Tax Act | Shri Tushar Hemani, Advocate | ATMA Hall, Opp. Citi Gold, Ashram Road, Ahmedabad. |
| 04.01.2015 Sunday | 8.00 a.m. to 1.00 p.m. | Cricket Match - CAA Ahmedabad Vs. Baroda Branch of WIRC of ICAI | - | Motera Stadium, Ground -B, Motera, Ahmedabad. |
| 01.02.2015 Sunday | 8.00 a.m. to 1.00 p.m. | Cricket Match - CAA Ahmedabad Vs. IT Bar Association Ahmedabad | - | Sardar Patel Stadium, Navrangpura, Ahmedabad |

**Glimpses of events gone by:**

1. "**Intensive Study on Income Tax Assessment Proceedings"** on 10th, 12th, 14th and on 16th of November 2014 at the office of the Association.

2. On 1st December 2014, 6th Study Circle Meeting was held on the topic of "**Important Amendments and Issues under GVAT"** at K. V. Patel Hall, Ahmedabad Branch of WIRC of ICAI, Ahmedabad.

(L to R CA. Abhishek J. Jain, CA. Naishal H. Shah, CA. Shailesh C. Shah, Speaker CA. Priyam R. Shah, CA. Mehul S. Shah)

Participants at Study Circle Meeting

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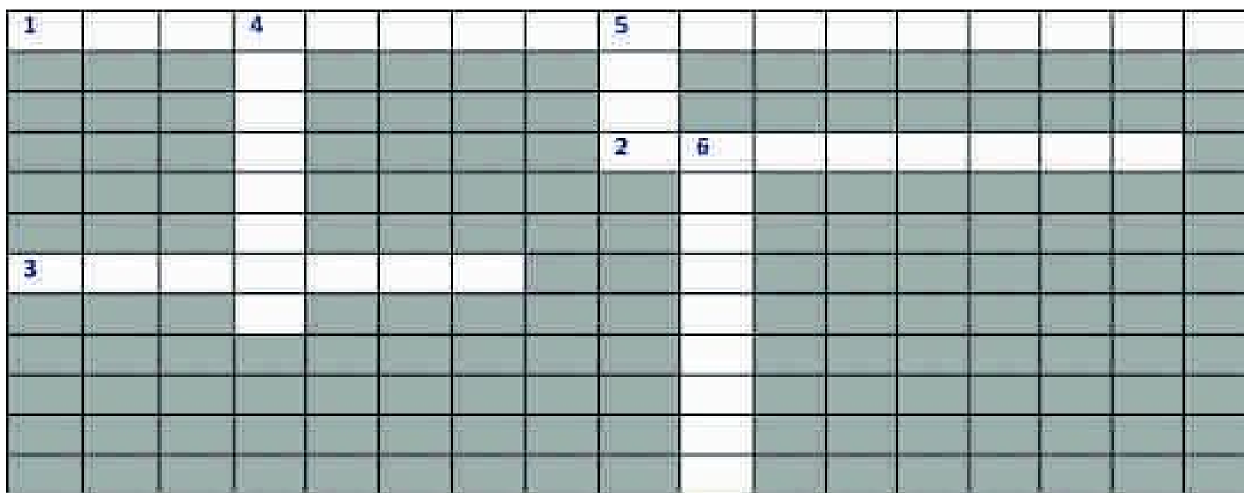
# ACAJ Crossword Contest # 8

**Across**

1. One of the qualities of a devotee, "Purity of Mind or Heart" ___________________.
2. Penalty u/s 272 B is linked vis-à-vis ___________ and not with number of defaults.
3. Law without _______ is a toothless tiger.

**Down**

4. The cash flow for life span of business includes growth period cash flow and ________ value.
5. I will not let anyone walk through my ____ with their dirty feet.
6. All keymen insurance policies are now taxable in the hands of _______ on receipt of sum even after assignment of such policy.



**Notes:**

1. The Crossword puzzle is based on previous issue of ACA Journal.
2. Three lucky winners on the basis of a draw will be awarded prizes.
3. The contest is open only for the members of Chartered Accountants Association and no member is allowed to submit more than one entry.
4. Members may submit their reply either physically at the office of the Association or by email at caaahmedabad@gmail.com on or before 31/12/2014.
5. The decision of Journal Committee shall be final and binding.

| Winners of ACAJ Crossword Contest # 7 | |
|---|---|
| 1. | CA. Jainee Shah |
| 2. | CA. Kush Desai |
| 3. | CA. Rinkesh Shah |

**ACAJ Crossword Contest # 7 - Solution**

**Across**

1. Religions
2. Cenvat
3. Seller

**Down**

4. Oil and Gas
5. Temple
6. Fraud