**Responses and discussion:**

**These responses are the personal views of the author and not that of any firm/organization. This is only aimed at knowledge sharing and no responsibility is accepted for correctness of any views.**

1. **Expenditure in relation to exempt income (section 14A read with Rule 8D)**

Given below in seriatim, are the responses to the posers:

1. The invocation of sections 14A(2)/(3) read with Rule 8D is conditional upon the objective satisfaction of the AO about the correctness of the assessee’s claim, having regard to the accounts of the assessee. The AO has to arrive at the decision in good faith and on relevant considerations. If the AO is not satisfied with the correctness of the assessee’s claim, he must record the reasons for his conclusion. Resort cannot be had to the provisions of Rule 8D in the absence of such finding:

* + *Godrej & Boyce Mfg. Co. Ltd. (2010)(328 ITR 81)(Bom HC)*
  + *Maxopp Investment Ltd. (2012)(347 ITR 272)(Delhi HC)*
  + *Taikisha Engineering India Ltd (2015)(370 ITR 338)(Delhi HC)*

Further, based on the assessee’s facts and in case of apparent incongruity on mechanical application of Rule 8D, an amount lower than the computation as per Rule 8D can be disallowed:

* *Ramkumar Venugopal Investments Pvt. Ltd. (2014)(ITA No. 6324/Mum/ 2012)(Mum ITAT)*
* *Damani Estates & Finance Pvt Ltd (2013)(ITA No. 3029/Mum/2012)(Mum ITAT)*
* *Oriental Structural Engineers (P) Ltd (2013)(216 Taxman 92)(Del HC) –* the Delhi HC upheld the ITAT’s decision restricting disallowance to 2% of the dividend income, in disregard of Rule 8D

In view thereof, the AO cannot disregard the voluntary disallowance and proceed to mechanically apply Rule 8D. He would first have to record a finding on why he is not satisfied with Mr.X’s working of disallowance.

2. Vide notification No.SO1949(E)[F.NO.370142/7/2016-TPL] dated 2 June 2016, the method prescribed under Rule 8D has been slightly simplified in line with some of the recommendations made by the Justice Easwar Committee. Based on the ratio of the decision of the jurisdictional High Court in the case of *Godrej Boyce Mfg. Co. Ltd.(2010)(328 ITR 81)(Bom HC),* it may be contended that the amended Rule would have prospective operation and will apply to assessment years commencing from AY 2017-18.

However, as stated above, based on the assessee’s facts and in case of apparent incongruity on mechanical application of Rule 8D, application of ‘any other method’ has been allowed. Accordingly, taxpayers who may benefit as a result of the amended Rule could argue that the method prescribed under the amended Rule would constitute ‘any other method’ vis-à-vis the old Rule.

It could be further argued that the amendment was aimed at removing difficulties. In the context of beneficial legislation intended to remove difficulties, it is useful to make reference to the decision in the case of *Allied Motors (1997)(224 ITR 677)(SC)* wherein the Supreme Court has held that a proviso which is inserted to remedy unintended consequences and to make the provision workable requires to be treated as retrospective in operation.

However, the claim for retrospective application of the amended Rule 8D could meet with litigation.However one can keep one’s options open and prefer a claim that it is retrospective based on the precedents after making the necessary disclosures and reliance on precedents.

3. The amended Rule 8D clearly caps the disallowance at total expenditure claimed by the taxpayer. Even before the amended Rule, the position has been judicially upheld:

* *Gillette Group India (P) Ltd (2012)(51 SOT 221)(Del ITAT)*
* *Iqbal M. Chagala (2014)(67 SOT 123)(Mum ITAT)*
* *Manugraph India Ltd (2015)(ITA No.4761/Mum/2013)(Mum. ITAT)*

Hence any further disallowance by the AO cannot exceed Rs.5,50,000.

4. Disallowance u/s 14A should be restricted to the income claimed as exempt:

* *Joint Investments Pvt. Ltd. (2015)(372 ITR 694)(Del. HC)*
* *Sahara India Financial Corpn. Ltd.(2014)(148 ITD 336) (Del. ITAT)*
* *Daga Global Chemicals P. Ltd. (2015)(ITA No. 5592/Mum/2012)(Mum ITAT)*
* *Kumaran Systems (P.) Ltd (2016)(66 taxmann.com 75)(Chenn ITAT)*

A contrary view has however been expressed in *SanchayitaMercantile(25 SOT 57)(Mum ITAT)*

Reliance can also be placed on the favourable HC rulings [interaliaCheminvest Del HC &DeliteBom HC] holding that disallowance u/s 14A will not apply if no exempt income is received or receivable during the year.

However, as stated in question 3, the further disallowance by the AO cannot exceed Rs.5,50,000. Thus the total disallowance u/s 14A would work out to Rs.9,50,000 (4,00,000 voluntary + 5,50,000 by the AO).

As the amount of dividend is Rs.35,00,000 which is far greater than the disallowance of Rs.9,50,000, the question of whether the disallowance can exceed the dividend income does not arise in Mr. X’s case.

5. It can be argued that as the interest has been disallowed u/s 36(1)(iii), the same should not be considered for section 14A disallowance as it would result in double disallowance. A similar proposition has been accepted by the Kolkata Tribunal in the case of *Snowtex Investment Ltd (2015)(174 TTJ 875)(Kol ITAT).*

6. A new section 115BBDA has been introduced from 1 April 2017 (i.e. financial year 2016-17) to provide for an additional tax @ 10% on dividends exceeding Rs.10,00,000 received by resident individuals/HUF. Hence, to the extent such dividend is taxed, it is not exempt u/s 10(34).

Assuming that Mr. X receives the same amount of dividend i.e. Rs.35,00,000 next year, he will have to pay additional tax on dividend of Rs.25,00,000 (35,00,000 -10,00,000). Having been so taxed, dividend of Rs.25,00,000 would not be exempt u/s 10(34) i.e. ‘it would form part of total income’ and hence the provisions of section 14A would not apply. Accordingly, if such dividend arises on investments which are few in number, it can be argued that the same investment has yielded both taxable (Rs.25,00,000) as well as tax-free (Rs.10,00,000) income (Scenario 1). Whereas if the dividend arises on many investments, then a difficulty would arise in bifurcating which of the investments can be considered as yielding the tax-free dividend of Rs.10,00,000 and which are related to the taxable dividend of Rs.25,00,000 (Scenario 2). Since the amended Rule 8D provides for a 1% adhoc disallowance based on the average of the monthly average value of the investments, it would be interesting to see how the Rule would be applied in the above two scenarios.

The better view would be that that Rule 8D would not apply at all under Scenario 1 since the investment has also yielded taxable dividend. Under Scenario 2, with a view to keeping the quantum of disallowance low, Mr. X could contend that the taxable income has arisen on investments having high value and the tax-free dividend relates to investments with lower value.

The other point which came up for discussion was the treatment of income which is partly exempt and partly taxable. It can be argued is that there should be only proportionate disallowance as there are two streams of income viz taxable income and income which is exempt. In the context of shares held as stock in trade, the Mumbai Tribunal has held that a proportionate amount should be disallowed ( DCIT vi Damani Estates& Finance Limited)( 41 Taxmann.com 262). This approach could therefore be followed.

1. **Expenditure on Corporate Social Responsibility (CSR)(sections 37(1), 30 to 36, 80G)**

Section 135 of the Companies Act, 2013 has made it mandatory for certain companies (having yearly net worth of Rs.500 crore or more, or turnover of Rs.1000 crore or more, or a net profit of Rs.5 crore or more) to spend specified percentage of their profit on activities relating to CSR.

With effect from 1 April 2015 (AY 2015-16), the Finance (No. 2) Act, 2014 has inserted Explanation 2 to section 37(1) to provide that the CSR spends u/s 135 of the Companies Act, 2013 shall not be regarded as an expense incurred for business purpose.

The Memorandum to the Finance Bill explains the intent of the Explanation as under:

“CSR expenditure, being an application of income, is not incurred wholly and exclusively for the purposes of carrying on business. As the application of income is not allowed as deduction for the purposes of computing taxable income of a company, amount spent on CSR cannot be allowed as deduction for computing the taxable income of the company. Moreover, the objective of CSR is to share burden of the Government in providing social services by companies having net worth/turnover/profit above a threshold. If such expenses are allowed as tax deduction, this would result in subsidizing of around one-third of such expenses by the Government by way of tax expenditure…. As the CSR expenditure (being an application of income) is not incurred for the purposes of carrying on business, such expenditures cannot be allowed under the existing provisions of section 37 of the Income-tax Act….. However, the CSR expenditure which is of the nature described in section 30 to section 36 of the Act shall be allowed deduction under those sections subject to fulfilment of conditions, if any, specified therein…”

In a recent decision in the case of ***Jindal Power Ltd [2016](70 taxmann.com 389)(Raip ITAT)****,* the Raipur Tribunal held as under with respect to the above Explanation 2 to section 37(1):

* The Explanation being disadvantageous to the assessee, cannot apply retrospectively to years prior to AY 2015-16.
* The disallowance under the said Explanation will be restricted to statutory obligation u/s 135 of the Companies Act, 2013 and would not apply to amounts spent voluntarily on CSR.
* So long as the expenses are incurred for business purpose, merely because some of it is voluntary i.e. without any legal or contractual obligation to incur the same or merely because it benefited the public, would not mean that the expenses cease to be deductible in nature.
* As the Explanation 2 to section 37(1) was not applicable to the year before the ITAT (i.e. AY 2008-09, the CSR expenses satisfied the business purpose test and were hence deductible u/s 37(1). In so holding, the ITAT relied on the ruling in *Madras Refineries Ltd (266 ITR 170)(Mad).*

In viewof the above and on the basis that the expenses incurred have nexus with the CSR policy of ABC Ltd and can be substantiated with proper evidences, the answers to the posers are as under:

* Based on the ruling in the case of Jindal Power (supra), Explanation 2 to section 37(1) would not apply to AY 2014-15. Hence it is possible to claim that the expenses would be deductible u/s 37(1). In any case, as stated in the Memorandum to the Finance Bill, CSR expenditure which is of the nature described in sections 30 to 36 of the Act shall be deductible under those sections subject to fulfilment of any specified conditions. Accordingly, ABC Ltd may examine whether claim for deduction u/s 35AC can be made in respect of the expenses on village development, healthcare & drinking water, pollution control and temple renovation. Depreciation can be claimed on the expansion of school building.
* In view of Explanation 2, deduction u/s section 37(1) will not be available for AY 2015-16. However, claim for deduction u/s 35AC, 32 may be examined.
* Also based on the logic of the Raipur bench, all those expenses which are not considered as CSR under section 135 should be allowed. For some expenses like those on the temple and other expenses, at times the claim for deduction as staff welfare expenses or advertisement expenses where there is advertisement along with CSR could be examined.

**3. Sale of shares – capital gains or business profit (section 45 vs. section 28)**

Based on judicial precedents & past circulars, key elements such as (i) frequency of transactions (ii)period of holding (iii) sources of funds (iv)object clause of the investing entity (v)motive at the time of purchase, were held to be relevant for determining the character of income arising on sale of shares and securities. However, the determination being largely fact-specific, much was left to the discretion of the AO, leading to proliferated litigation.

In line with some of the recommendations made by the Justice Easwar Committee, the CBDT has issued two Circulars, No.6/2016 dated 29 February 2016 (covering listed shares and securities) and F No.225/12/2016 dated 2 May 2016 (covering unlisted shares) with a view to bring in the much needed clarity and to curb protracted litigation. While acknowledging that no universal principle in absolute terms can be laid down to decide the character of income, the CBDT has provided the following guidelines:

|  |  |
| --- | --- |
| Listed shares and securities | Unlisted shares |
| 1. Irrespective of the holding period, where the assessee itself opts to treat the shares/securities as stock-in-trade, the income from transfer of such shares/ securities would be treated as business income. | 1. Income arising from transfer of unlisted shares would be considered under the head 'Capital Gain', irrespective of the period of holding. |
| 2. In case of listed shares/ securities held for more than 12 months immediately prior to its transfer, if the assessee treats the income arising on transfer as ‘Capital gains’, the same shall not be disputed by the AO. However, once this stand is taken in a particular AY, the same shall apply in subsequent AYs also and the assessee shall not be allowed to adopt contrary/ differing stands in subsequent years. | 2. The above would not be necessarily applied in situations where:   * The genuineness of the transaction itself is questionable * The transfer relates to an issue pertaining to lifting of corporate veil * The transfer is made along with the control and management of underlying business   The AO would take appropriate view in such situations. |
| 3. The above shall not apply where the genuineness of the transaction itself is questionable such as bogus claims of Long term capital Gain/ Short Term Capital Loss or any other sham transactions. |  |

Income arising on securities not covered under the above Circulars will be characterized based on the guidelines provided in the past circulars.

These recent Circulars have greatly reduced the scope for subjectivity, litigation and have provided the much needed clarity atleast in relation to the specific situations covered therein.Genuineness of the transaction or lifting of the corporate veil is already covered under GAAR which applies from 1 April 2017. Hence there doesn’t appear a necessity to specifically carve this out in the Circulars. Further, Circular dated 2 May 2016 has a carve out in cases where the transfer of unlisted shares is made along with the control & management of underlying business. However, as the definition of “capital asset” specifically includes management & control rights qua an Indian company, the purpose of this carve out is also unclear and could lead to unnecessary litigation. It would also have helped if as in the case of listed shares, the Circular dated 29 February 2016 would have provided an option to the assessee, to treat the income as business income on a consistent basis in cases where the unlisted shares are held as stock-in-trade.

The other point to note is that these circulars must be treated as providing a benefit to the taxpayer to avoid litigation and may not always lay down the rule. There could be situations where the facts and circumstances would lead to a portfolio being considered as investment or stock in trade based on the various conditions laid down in the Circular In such a case a taxpayer would be entitled to claim that the circular does not bind him.

To summarize, the earlier circulars which were framed on judicial precedents continue to hold the field, but where the taxpayer fulfils the conditions as laid down in the Circulars of 2016, he can claim that those should apply without an examination of facts and thus avoid litigation.

In the above background and on the basis that the transactions undertaken by XYZ Pvt Ltd are genuine and do not pertain to lifting of corporate veil or transfer of underlying business, the income characterization under the 2 scenarios would be as follows:

***Scenario 1 – Where XYZ Pvt Ltd is a dealer in securities:***

\* Income from sale of listed shares, debentures, bonds would be treated as business income. XYZ Ltd would have to consistently follow the position and cannot take a different stand in subsequent years.

\* Income from sale of unlisted shares will be treated as Capital gains irrespective of the holding period. Circular dated 29 February 2016 does not provide an option to treat the income as business income on a consistent basis in cases where the unlisted shares are held as stock-in-trade.

If a taxpayer is holding unlisted shares as stock in trade, there will be a heavy onus placed on him to show that his conduct justifies that it be treated as stock in trade given the Circular and the restriction on transferability . As mentioned earlier, he will then have to argue that the Circular does not lay down the law and provides a concession to taxpayers who fulfil the conditions.

\* Income from sale of unlisted debentures, bonds will have to be characterized based on past circulars & judicial precedents as the Circular dated 2 May 2016 only applies to unlisted shares.

***Scenario 2 – Where XYZ Pvt Ltd is an investor:***

\* Income from sale of listed shares, debentures and bonds held for more than 12 months immediately prior to the sale, can be treated as Capital gains. However, XYZ Ltd would have to consistently follow the position and cannot take a different stand in subsequent years.

\* Income from sale of listed shares, debentures and bonds held for less than 12 months shall have to be characterized based on past circulars & judicial precedents as stated in the Circular dated 29 February 2016.

\* Income from sale of unlisted shares will be treated as Capital gains irrespective of the holding period.

\* Income from sale of unlisted debentures, bonds will have to be characterized based on past circulars & judicial precedents as the Circular dated 2 May 2016 only applies to unlisted shares.

**4. Taxability of share premium charged by eligible startups (sections 56(2)(viib), 68)**

Section 56(2)(viib) was introduced by the Finance Act, 2012, as an anti-abuse provision to tax monies received while issuing shares, in excess of fair market value (FMV as computed under Rules 11U, 11UA) of the shares. The provision applies only to closely held companies and taxes the excess consideration (over and above the FMV) received by such issuing companies from resident persons, as ‘Income from other sources’ of these companies. As a result, the provisions of this section pose a challenge where resident investors are willing to invest in domestic ventures especially when participation by domestic investors in the investment space is witnessing a decline. In fact recent press reports suggested that the tax department was contemplating a move to impose tax on startups which had received funds in excess of FMV of their shares.

However, section 56(2)(viib) does not applyinteraliawhere the consideration for issue of shares is received by a company from a ‘class or classes of persons’ as may be notified by the Central Government in this behalf. Hence with a view to address the anxiety triggered by the above referred press reports, the Central Government has vide CBDT Notification no. 45/2016 dated 14 June 2016 notified the ‘classes of persons’ to include a resident person who makes any consideration exceeding the FMV for issue of shares of a ‘startup company’.

In other words, a ‘startup’ company receiving consideration for issue of shares in excess of FMV, would be relieved from taxation u/s 56(2)(viib) of the Act. The term ‘startup’ has been defined to mean a closely held company which fulfills the conditions specified in the notification issued by the Ministry of Commerce and Industry, Department of Industrial Policy and Promotion (‘DIPP’), number G.S.R.I 80(E) dated February 17, 2016 (published on February 18, 2016). The conditions include:

* Operative for not more than 5 years from the date of its incorporation / registration;
* Turnover not exceeding INR 25 crores for any of the financial years;
* Engaged in a business which involves innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property;
* Obtains a certificate of eligible business from Inter-Ministerial Board of Certification; and
* Is not formed by split up or reconstruction of an existing business.

Thus, on the basis that Realtime Solutions Pvt Ltd would constitute an ‘eligible startup’ in terms of the discussion above, the share premium that it may earn on the proposed issue of shares during the ongoing financial year, will not attract taxation u/s 56(2)(viib) of the Act. However, should it fail to qualify as an ‘eligible startup’, the premium that would be received on the proposed issue of shares would need to comply with the valuation norms prescribed under section 56(2)(viib) read with Rules 11U, 11UA.

Another provision that needs to be looked at is section 68 which deals with unexplained cash credits. The said section was amended by the Finance Act 2012 to provide that any sum credited in the books of a closely held company on account of share application, share capital, share premium or any such amount shall be treated as ‘unexplained cash credits’ and will be taxable in the hands of the company, if the source of such investment made by a resident is not substantiated.

Prior to the introduction of section 56(2) (viib), the issue of shares at a premium could not lead to income as held the Bombay High Court in the case of Vodafone (368 ITR 1 ). However unexplained share capital can be taxed under section 68 and it has been held by the Kolkatta Tribunal in M/s. SubhalakshmiVanijya Pvt. Ltd. Vs CIT (ITAT Kolkata)Appeal Number : ITA No. 1104/KOL/2014 – that the provisions of section 68 could be treated as retrospective in nature as it is only of a clarificatory nature.

**5. Tax collection at source on motor vehicles, goods, services (TCS)(amended section 206C)**

In order to reduce the cash transactions in sale of goods and services, Finance Act, 2016 has expanded the scope of section 206C (1D) to provide that the seller shall collect tax @ 1% from the purchaser on sale in cash of any goods (other than bullion and jewellery) or providing of any services (other than payment on which tax is deducted at source under Chapter XVII-B) exceeding 2 lakh rupees. Further, with a view to bring high value transactions within the tax net, it has been provided in sub-section (1F) of section 206C that a seller who receives consideration for sale of a motor vehicle exceeding 10 lakh rupees, shall collect 1% of the sale consideration as tax from the buyer.

Subsequent to the amendments made by the Finance Act, 2016, the CBDT has issued two Circulars, No.22/2016 dated 8 June 2016 and No.23/2016 dated 24 June 2016, clarifying applicability of TCS in illustrative situations. The posers and their responses are based on these Circulars read with the bare provisions. The responses to the posers are as under:

**a).** TCS will only cover transactions of retail sales and will not apply on sale by manufacturers to dealers/distributors – Circular 22, Question 1.

**b).** TCS will apply on sale of any motor vehicle of the value exceeding Rs.10 lakhs – Circular 22, Question 2.

Accordingly, as trucks, buses, two wheelers, etc. will also constitute motor vehicle, TCS would apply if the value exceeds Rs.10 lakhs.

**c).** The definition of "Seller" as given in clause (*c*) of the Explanation below sub-section (11) of section 206C shall be applicable in the case of sale of motor vehicles also. Accordingly, an individual who is liable to tax audit u/s 44AB during the financial year immediately preceding the financial year in which the motor vehicle is sold shall be liable for collection of tax at source on sale of motor vehicle by him. – Circular 22, Question 5.

Seller as defined in clause (c) of the Explanation applies only to sale of goods & provision of services u/s 206C(1D). For the purpose of TCS on motor vehicles u/s 206C(1F), Circular 22 has sought to widen the scope of the term ‘seller’ by clarifying that seller will include individuals liable to tax audit. It however needs to be examined whether Circulars which only supplement law, can have the effect of enlarging the scope of the bare provision.

**d).** TCS applicability is not dependent on the mode of payment i.e. any sale of motor vehicle exceeding Rs.10 lakhs would attract TCS – Circular 22, Question 6.

**e).** TCS will apply on sale of motor vehicles irrespective of the payment mode. Thus if the value of motor vehicle is Rs.20 lakh, out of which Rs.5 lakh has been paid in cash and balance by cheque, the tax shall be collected at source @ 1% on total sale consideration of 20 lakh rupees only under sub-section (1F) of section 206C. However, if a vehicle is sold for Rs. 8 lakh and the consideration is paid in cash, tax shall be collected at source @ 1% on Rs.8 lakh as per sub-section (1D) of section 206C – Circular 22, Question 7.

However, it may be noted that while section 206C(1F) requires ‘value’ of the motor vehicles to exceed Rs.10 lakhs, in the Circular, the terms ‘value’ and ‘sales consideration’ have been used interchangeably. A clarification to this effect would hence be useful.

**f).**TCS will not apply on sale of motor vehicle or goods or provision of services to Government Departments, Embassies, Consulates and United Nation Institutions – Circular 22, Question 3.

**g).** It is applicable to each sale and not to aggregate value of sale made during the year. Example: Motor vehicle worth 20 lakhs is sold and for which payments are made in instalments, one at the time of booking and the other at the time of delivery. At the time of booking, Rs.5 lakh are paid and Rs.15 lakh are paid at the time of delivery. Tax @ 1% on Rs.5 lakhs at the time of booking and @ 1% on remaining Rs.15 lakhs at the time of delivery shall be collected at source.

Similar will be the position with regard to TCS on sale of goods and provision of services u/s 206(1D) – Circular 22, Question 4.

**h).** TCS will not be levied if the cash receipt does not exceed Rs.2 lakhs, even if the sale consideration exceeds Rs.2 lakhs. Example: Goods worth Rs. 5 lakhs are sold for which the consideration amounting to Rs. 4 lakhs has been received by cheque and Rs. l lakh has been received in cash. As the cash receipt does not exceed Rs. 2 lakhs, no tax is required to be collected at source as per section 206C(1D) – Circular 23, Question 1.

**i).** U/s 206C(1D), tax is required to be collected at source on the cash component of the sales consideration and not on the whole of sales consideration. Example: Goods worth Rs. 5 lakhs are sold for which the consideration amounting to Rs. 2 lakhs has been received by cheque and Rs. 3 lakhs has been received in cash. TCS u/s 206C(1D)will apply only on cash receipt of Rs. 3 lakhs and not on the whole of sales consideration of Rs. 5 lakhs – Circular 23, Question 2.

Lastly, newly inserted sub-section (1E) provides that certain classes of buyers may be exempt from TCS u/s 206C(1D), subject to fulfilment of conditions. Hence it is possible that the CBDT may also notify such exempt class of buyers.

**6. Stay of demand upto the CIT(A) stage (section 220(6))**

The CBDT had earlier issued an Instruction No. 1914 dated 21-3-1996 providing guidelines regarding procedure to be followed for recovery of outstanding demand, including procedure for grant of stay of demand. The Instruction prescribes that a demand will be stayed only if there are valid reasons for doing so and that mere filing of an appeal against the assessment order will not be a sufficient reason to stay the recovery of demand. It further states that while granting stay, the AO may require the assessee to offer a suitable security (bank guarantee, etc.) and/ or to pay a reasonable amount in lump sum or in instalments.

Based on the above Instruction, AOs often insist on payment of a very high proportion of the disputed demand before granting stay of the balance demand. This often results in hardship for the taxpayers seeking stay of demand.

Thus, in order to streamline the process of grant of stay and to standardize the quantum of lump sum payment required to be made by the assessee as a pre-condition for stay of demand disputed before CIT(A), an office memorandum [F.NO.404/72/93-ITCC] dated 29 February 2016 has been issued notifying following guidelines in partial modification of Instruction No. 1914:

|  |  |  |
| --- | --- | --- |
| (A) |  | In a case where the outstanding demand is disputed before CIT(A), the AO shall grant stay of demand till disposal of first appeal on payment of 15% of the disputed demand, unless the case falls in the category discussed in para (B) hereunder. |
| (B) |  | In a situation where, |
| (*a*) |  | the AO is of the view that the nature of addition resulting in the disputed demand is such that payment of a lump sum amount higher than 15% is warranted (e.g. in a case where addition on the same issue has been confirmed by appellate authorities in earlier years or the decision of the Supreme Court or jurisdictional High Court is in favour of Revenue or addition is based on credible evidence collected in a search or survey operation, etc.) or, | |
| (*b*) |  | the AO is of the view that the nature of addition resulting in the disputed demand is such that payment of a lump sum amount lower than 15% is warranted (e.g. in a case where addition on the same issue has been deleted by appellate authorities in earlier years or the decision of the Supreme Court or jurisdictional High Court is in favour of the assessee, etc.), the AO shall refer the matter to the administrative Pr. CIT/CIT, who after considering all relevant facts shall decide the quantum/proportion of demand to be paid by the assessee as lump sum payment for granting a stay of the balance demand. | |
| (C) |  | In a case where stay of demand is granted by the AO on payment of 15% of the disputed demand and the assessee is still aggrieved, he may approach the jurisdictional administrative Pr. CIT/CIT for a review of the AO’s decision. | |
| (D) |  | The AO shall dispose of a stay petition within 2 weeks of filing of the petition. If a reference has been made to Pr. CIT/CIT under para (B) above or a review petition has been filed by the assessee under para (C) above, the same shall also be disposed of by the Pr. CIT/CIT within 2 weeks of the AO’s reference/ assessee’s review request. | |
| (E) |  | In granting stay, the AO may impose such conditions as he may think fit, inter alia,- | |
| (*i*) |  | require an undertaking from the assessee that he will cooperate in the early disposal of appeal failing which the stay order will be cancelled; | | |
| (*ii*) |  | reserve the right to review the order passed after expiry of reasonable period (say 6 months) or if the assessee has not co-operated in the early disposal of appeal, or where a subsequent pronouncement by a higher appellate authority or court alters the above situations; | | |
| (*iii*) |  | reserve the right to adjust refunds arising, if any, against the demand, to the extent of the amount required for granting stay and subject to the provisions of section 245.  To summarize, if the issue in appeal is covered by the appellate orders in earlier years, the payment of demand cannot be insisted upon as the Commissioner and Chief CIT would have to take note of the circular. Though the circular talks of a review by these authorities the fact that they would need to consider all relevant facts indicates that they will be bound/expected to agree to stay of demand in cases where there are favourable rulings of earlier years. | | |

Based on the above guidelines, Trident Corporation has the following options:

**Option 1** - As the issue under dispute (provision for warranties) has been decided in favour by the CIT(A) in the past years, the Company can file an application before the AO requesting stay of the entire demand or atleasta major portion (substantially more than 85%) thereof.

If the AO rejects the request, the Company can file a review petition before the Pr.CIT/CIT.

If the AO agrees with the Company’s request, he would have to refer the matter to the Pr. CIT/CIT.

**Option 2** – The CIT(A) also has inherent powers to stay a demand arising out of an appeal pending before him. Hence, after the Company files an appeal against the impugned order dated 10 July 2016 before the CIT(A) and given that the issue has been favourably decided by the CIT(A) in the past years, the Company can also approach the CIT(A) for a stay, should the AO reject the request.

However, the option to approach the Pr.CIT/CIT or the CIT(A) is mutually exclusive i.e. both the authorities cannot be approached. Further, if the Pr.CIT/CIT or the CIT(A) rejects the stay request, then there is no remedial action under the Act and hence the only option would be a Writ Petition against the rejection order issued by the Pr.CIT/CIT or the CIT(A).

**7. ‘Carry backward of loss’ vis-à-vis MAT computation (section 115JB)**

This issue has been a very contentious issue. A similar argument was placed before the Mumbai Tribunal recently in the case of ***SBI DFHI Ltd (71 taxmann.com 178)(Mum ITAT).***The Tribunal held as under:

* If book loss for an immediately preceding year was Rs. 20, and brought forward balance in the profit and loss account was a profit of Rs. 120, then the balance in the profit and loss account, as per the balance sheet as at the end of such year (or at the beginning of the current year) would be Rs. 100. However, going by the taxpayer’s argument, there would be two sets of figures of profit (or loss) brought forward, i.e., profit of Rs. 120 and a loss of Rs. 20 for the current year, as per the books of account.
* Reference to either profit and loss account or balance sheet was only for the purpose of ascertaining the loss, if any, brought forward as per the books of account, and thus there had to be one figure (of unabsorbed losses or depreciation) as per the books of account.
* A loss (for a particular year) would only go to add to the amount of loss, if any, being carried forward in the books of account or to reduce the profit, likewise, being carried forward. When the loss was so adjusted, there was no carry backward of loss. In fact, such loss only contributed to the general pool of profit/ loss, yielding a figure of cumulative profit/ loss as per the books of account, which was carried forward to the following period and, likewise, from year to year.
* Thus all that one needed to look at was the cumulative balance of Profit and Loss account – if positive would mean NIL unabsorbed depreciation/ book loss; and if negative, the amount of unabsorbed depreciation had to be segregated so that both, unabsorbed depreciation and the balance loss were separately known, and the lower of the two was set-off while computing book profit u/s 115JB of the Act.
* No ambiguity existed, and the clear language of clause (iii) of Explanation 1 to section 115JB did not, at any rate, admit of the interpretation sought to be provided to it by the taxpayer.

The Tribunal thus rejected the argument on the basis that where a statutory provision was otherwise clear, no benefit of doubt could be extended to the assessee.

However, clause (iii) to Explanation 1 of Section 115JB of the Act has always been open to interpretation.

In some earlier cases [Chennai Tribunal ruling in the case of *M/s PrithviSofitech Limited (ITA no 797/2010) and Delhi High Court ruling in the case of M/s. Sumi MothersonInnovative Energy Limited (195 Taxmann 353)*], Courts have held that a figure which may be available in the books of account may not be apparently visible in the profit and loss account or balance sheet, due to disclosure in a summarised manner. Further the terms, “loss brought forward” and “debit balance of profit and loss account” are different, and do not convey the same meaning. Clause (iii) to Explanation 1 of Section 115JB of the Act requires working out separate amount of losses and unabsorbed depreciation in each year from the books of account, and their set off, if any, against subsequent years’ profits to determine the quantum of unabsorbed depreciation/ book loss to be carried forward.

**Further, in a very recent decision in the case of *Surat Textile Mills Ltd (70 taxmann.com 158),* the Ahmedabad Tribunal held that unabsorbed depreciation adjusted from capital receipts under rehabilitation scheme of sick company would not extinguish such depreciation from accounts in actual terms; the same would be available as deductible expenditure to calculate book profits.**

Thus all the above decisions have held that the manner in which the accounts have been drawn up may not be determinative of whether loss or unabsorbed depreciation is available for set off.However, these decisions have not been considered by the Mumbai Tribunal while adopting a contrary view in theSBI DHFI ruling.

Circular no 495 dated 22.9.1987 also seems to support a computation under section 115JB independent of the figures of the profit and loss account as per the accounts.

Given these conflicting rulings and in the absence of a Supreme Court ruling on this aspect, the issue remains contentious and litigative in nature.

**8. Tax withholding in the case of non-residents not holding a PAN (amended section 206AA)**

The pre-amended provisions of section 206AA *inter alia*, provided that any person who is entitled to receive any amount on which tax is deductible at source, shall furnish his PAN to the deductor, failing which a higher withholding tax rate will be applicable.

In order to reduce compliance burden, the Finance Act, 2016 amended the provisions of section 206AA w.e.f. June 1, 2016 to provide relaxation from higher withholding tax rate while making payment to non-resident deductees in the absence of PAN, subject to fulfillment of prescribed conditions.

For this purpose, the CBDT has notified a new Rule 37BC vide Notification No. 53 /2016, F.No.370 142/16/ 2016-TPL dated 24 June 2016 to specify the conditions to avail the aforesaid relaxation. The new Rule provides that the provisions of section 206AA of the Act shall not apply on following payments made to non-resident deductees who do not have PAN in India:

1) Interest;

2) Royalty;

3) Fee for Technical Services; and

4) Payments on transfer of any capital asset

In respect of the above specified payments, the non-resident deductee shall be required to furnish following details and documents:

1) Name, e-mail id, contact number;

2) Address in the country of residence;

3) Tax Residency Certificate (TRC), if the law of country of residence provides for such certificate; and

4) Tax Identification Number (TIN) in the country of residence. Where TIN is not available, a unique identification number is required to be furnished through which the deductee is identified in the country of residence.

To capture and report the details specified in the notification, corresponding changes have also been made in the quarterly withholding tax return (i.e. Form 27Q) applicable for reporting withholding tax on payments made to non-resident deductees.

The prescribed conditions are in line with the expectations, and do not impose any additional burdensome requirements. Most of the details required are already being furnished by non-resident deductees in TRC/ Form 10F, which is a pre-requisite to avail beneficial treaty provisions.

The notification provides much relief to non-resident recipients and will encourage them to undertake transactions in India without the hassle of higher withholding tax or provision of cumbersome information, particularly for one-off transactions.

**9. Attributes for AOP characterization in case of EPC/ turnkey contracts**

In case of large Infrastructure/ EPC/ Turnkey Contracts, it is a common practice to form a consortium of contractors to bid for and execute the contracts. As the Act does not define an Association of persons (AOP), except for judicial precedents\*\*, there is no statutory guidance on what constitutes an AOP. Consequently, taxation of the consortium as a separate taxable entity in the form of AOP has been prone to litigation.

With a view to avoid tax disputes, and to have consistency in approach, the CBDT has specified that a consortium arrangement for executing EPC/ turnkey contracts that has the following *four* attributes will not be treated as AOP:

1. Each member is independently responsible for executing its part of the work, through its own resources, and also bears the risk of its scope of work, i.e. there is a clear demarcation in the work and costs between the consortium members, and each member incurs expenditure only in its specified area of work;

2. Each member earns profit or incurs losses based on performance of the contract falling strictly within its scope of work. However, consortium members may share contract price at gross level only to facilitate convenience in billing;

3. The resources (men and materials) used for any area of work are under the risk and control of respective consortium members; and

4. The control and management of the consortium is not unified, and common management is only for the *inter se* coordination between the consortium members for administrative convenience.

The Circular also states that there may be additional factors, depending upon specific facts of a particular case, which will need to be considered while taking a view in the matter. It has been further clarified that the Circular would not be applicable to cases where all or some of the consortium members are Associate Enterprises (AEs) as per Indian Transfer Pricing regulations.

Such cases will be decided by the AO in view of relevant provisions of the Domestic tax laws and judicial precedents in this regard.

Thus while the Circular does provide clarity and broad guidance, it has left a window open for AOs to examine further criteria, by stating that there may be additional factors, depending upon specific facts of a particular case, which will need to be considered while taking a view in the matter.

\*\*  *Van Oord ACZ.BV (248 ITR 399), Linde AG [2014] 365 ITR 1 (Delhi HC), Hyundai Rotem Co., Korea/ Mitsubishi Co., Japan,[2010] 323 ITR 277 (AAR)], Hyosung Corporation [2009] 314 ITR 343 (AAR) read with IndraBalkrishnan [1960] 39 ITR 546 (SC), B. N. Elias[1935] 3 ITR 408 (Cal), LaxmidasDevidas [1937] 5 ITR 584 (Bombay), N. V. Shanmugham& Co. [1970] 2 SCC 139 (SC), G. Murugesan& Bros. [1973] 4 SCC 211 (SC)*

**10. New penalty provisions – under-reporting or misreporting of income (sections 270A, 270AA)**

The levy of penalty u/s 271(1)(c) for concealment or furnishing of inaccurate particulars of income has been a matter of perennial litigation between the revenue and the taxpayers. The discretion regarding quantum of penalty led to corruption. The AO almost always levied penalty in respect of every addition or disallowance made in the assessment/reassessment order, even where there was no prima facie case for penalty. With a view to reduce the litigation and the discretion of the tax authority, the Finance Act, 2016 has completely revamped the penalty procedure by replacing section 271(1)(c) with two new sections 270A and 270AA.

The existing section 271(1)(c) will continue to apply upto AY 2016-17 and the new provisions will take effect from AY 2017-18 onwards. The new scheme however excludes search & seizure cases u/s 132, which will continue to be governed by section 271AAB.

**Salient features of the new penalty scheme:**

1. Penalty levy will be proposed under two situations:

(a) Under-reporting of income

(b) Misreporting of income

2. The scope of under-reportedincome shall be as follows:

|  |  |
| --- | --- |
| **Under-reported income** | |
| **Covers** | **Excludes** |
| Income assessed > income u/s 143(1)(a) | Income for which bonafide explanation and material facts are furnished |
| Income assessed > maximum amountnot chargeable to tax, where no return is filed | Income based on an estimate of life, if the accounts are correct and complete but the method employed is such that the income cannot be properly deduced |
| Income reassessed > income assessed/ reassessed immediately before such reassessment | Income based on an estimate, where the taxpayer has estimated a lower amount and included such amount in his income computation |
| Deemed total income assessed/reassessed u/s 115JB or 115JC> deemed total income u/s 143(1)(a) | Income representing transfer pricing addition for which proper documents are maintained and material facts are disclosed |
| Deemed total incomeassessed u/s 115JB or 115JC > maximum amountnot chargeable to tax, where no return is filed | Undisclosed income on account of search where penalty is leviable under other provisions |
| Deemed total income reassessed u/s 115JB or 115JC >deemed total income assessed/reassessed u/s 115JB or 115JC immediately before such reassessment |  |
| Income assessed/reassessed which results in reducing the loss or converting the loss into income |  |

3. Misreporting shall cover:

* Misrepresentation or suppression offacts
* Non-recording of investments in thebooks of account
* Claiming of expenditure notsubstantiated by evidence
* Recording of false entry in the books ofaccount
* Failure to record any receipt in the books of account having a bearing ontotal income
* Failure to report any transaction to which the transfer pricing provisions apply

4. The penalty would be 50% of the tax payable on under-reported income and 200% of the tax payable on misreported income.

5. The amount of under-reported income shall be:

(a) *Return furnished:* Income assessed (-) Income determined u/s 143(1)(a)

(b) *Return not furnished:* Income assessed [in the case of company, firm, etc.] or income assessed (-) maximum amount not chargeable to tax

(c) *In any other case*: Income reassessed (-) income assessed/ reassessed in a preceding order

In cases where the under-reported income arises out of determination of deemed total income under section 115JB /115JC, the same shall be computed as (A – B)+(C – D); where

A = the total income assessed as per the general provisions of the ITA;

B = the total income that would have been chargeable had the total income assessed as per the general provisions been reduced by the amount of under-reported income;

C = the total income assessed as per the provisions of section 115JB /115JC;

D = the total income that would have been chargeable if the total income chargeable under section 115JB /115JC would be reduced by the amount of under-reported income.

In cases where the under-reported income on any issue is considered, both under the provisions of section 115JB/115JC and under the general provisions, such amount shall not be reduced from total income assessed while determining the amount under item D.

7. The tax payable on the under-reported income shall be as follows:

1. *Return not furnished:* Where return of income has not been furnished and the income has been assessed for the first time, the tax shall be calculated on underreported income as increased by maximum amount not chargeable to tax.
2. *In case of loss:* Where the total income assessed or re-assessed is a loss, the tax shall be calculated on underreported income as if it was the total income.
3. *In any other case:* Tax on underreported income as increased by income assessed or re-assessed originally *less* tax on income assessed or re-assessed originally.

8. An addition or disallowance for which penalty has already been levied for the same or another assessment year, shall not be subjected to penalty again.

9. Prosecution u/s 276C will also apply.

*Immunity from penalty and prosecution:*

New section 270AA grants immunity from imposition of penalty and initiation of prosecution if an application is made to the AO within one month from the end of the month in which the assessment/reassessment order is received. Such immunity will be granted provided the assessed demand is paid within the period specified in the notice of demand and the taxpayer does not appeal against the assessment/ reassessment.

Immunity is however not available in cases of misreporting.

Thus the new provisions attempt to spell out instances to help differentiate between the two scenarios of under-reporting and misreporting. However, given the subjective nature of some of these instances and the steep difference in the penalty rates (50% vs. 200%), dispute around categorization is very likely under the new Scheme.

**Responses to the posers:**

*Scenario 1:*

Based on the details provided during the assessment proceedings, the assessee can argue that it has disclosed all the material facts and offered bonafide explanation. Accordingly, the addition made u/s 68 would not constitute under-reported income as its case is covered under the exclusion provided in clause (a) of section 270A(6). However, some litigation cannot be ruled out as the AO may not be satisfied with the explanation of the assessee. The appellate authorities are more likely to accept the assessee’s case.

*Scenario 2:*

The enhanced disallowance u/s 14A should not constitute under-reported income as it could be argued that the assessee’s case is covered both by clauses (b) and (c) of section 270A(6).

*Scenario 3:*

Disallowance made on account of bogus entries found in the books of account would amount to rejection of books by the AO. The assessee’s case would hence not fall under the exclusion in clause (b) of section 270A(6) in respect of under-reported income. The AO may in fact allege that it is a case of misreporting of income in terms of clause (d) of section 270A(9).

*Scenario 4:*

As the firm has not filed a return, the entire amount of Rs. 52,00,000 will be treated as under-reported income as per section 270A(3). The tax payable on such assessed income will be Rs. 15,60,000 on which a penalty of Rs. 7,80,000 will be imposed even though the entire tax is already paid. On the contrary, had the firm filed a return, the under reported income would be only Rs. 2,00,000(52,00,000 – 50,00,000) on which tax payable would be Rs. 60,000 and penalty would be only Rs. 30,000.

Thus the provisions are a little harsh as non-filing of a return would cost the assessee Rs.7,80,000 in penalty as against a Rs.30,000 penalty had the return been filed. Thus the higher penalty is more for non-filing of return than for under-reported income.

However, the assessee can avoid the higher penalty by applying for immunity in terms of section 270AA, for which it would have to pay up the assessed demand (which would only be on Rs.2,00,000 as TDS & advance tax has been paid on Rs.50,00,000) within the stipulated time and waive off its right to appeal against the assessment.

**11. Tax implications of pre-possession or pre-EMI interest borne by the builder under a subvention scheme (sections 56, 194-IA)**

Subvention schemes are launched by builders and real estate developers to woo buyers. In view of tight liquidity, with banks not willing to lend directly to developers, such schemes provide builders access to funds, and that too at a relatively low cost. It also helps buyers, who do not want to commit a big sum upfront as project delays are nowadays common.

Earlier, developers used to get the entire sanctioned loan from the bank upfront and bear the interest cost till possession. But in this system, the risk was on the buyer, he being the borrower on the bank’s record. Also, once the developer got all the money straightaway, he had little incentive to finish the project on time and often diverted the funds to other projects/purposes. In case of any delay/default in project completion or payment of interest by the builder, it was the buyer who got into trouble. To reduce these risks, the RBI directed lenders to disburse loans according to construction milestones.

The scheme under discussion is an interest subvention scheme, whereunder the developer agrees to bear the interest on loan either till possession or for a fixed period mentioned in the agreement.

A lot would depend on the form of the agreements entered into between the buyer and the builder and the agreement to bear or reimburse interest. The agreement could at times be structured as a discount. Thus while the exact response would depend on the nature of the agreement and documentation, a few possible responses are listed:

The responses to the specific queries are as under:

**A. Whether interest?**

*Arguments against:*

(i) Section 2(28A) of the Act defines interest as “"interest"means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilised.”

The above definition and the principles laid down in court rulings (interalia the ***Cal HC*** in ***M.K.J Enterprises Ltd (228 Taxman 61)***) suggest that to qualify as ‘interest’, the payment should relate to a pre-existing debt which indicates a debtor-creditor relationship.

Further, the definition in section 2(28A) provides that “*interest means interest payable in any manner…*.” Thus, while clarifying that the payment should relate to a borrowing, debt, etc., the definition states that the term interest would mean “interest payable”. Accordingly, interest payable would have to be understood in its ordinary sense.

In general sense, ‘interest’ means cost for borrowing the principal or cost for an original debt. Thus, interest would be compensation ‘in excess of’ or ‘over and above’ the principal. If looked at from this perspective, it could be argued that the sum of Rs.5 lacs borne by the builder is not interest as it is not a cost or compensation in relation to a pre-existing debt or obligation, but the obligation itself.

(ii) Further, even in plain terms, as the Buyer is the borrower on the Bank’s record, the payment by the Builder to the Bank would not constitute ‘interest’ for the Builder.

*Argument in support:*

The payment would be in the nature of ‘interest’ as the arrangement would make available funds to the Builder which he would otherwise have to borrow at a cost. Thus, in substance, the transaction could be characterized as interest as the obligation to the Buyer is merely a substitute for a potential direct borrowing cost which the Builder would otherwise incur.

However, to provide some form to the above argument, the subvention-related clauses of the sale agreement between the Buyer and the Builder, may be suitably worded.

**TDS applicability on interest:**

On the basis that the sum borne by the Builder represents ‘interest’, the provisions of section 194A would have to be examined to ascertain TDS applicability in relation to the amount. Section 194A of the Act provides for TDS @ 10% on payment of interest other than interest on securities. However, clause (iii)(a) of sub-section (3) of section 194A states that TDS would not apply to interest paid/ credited to a banking company governed by the Banking Regulation Act, 1949.

Thus an exemption from TDS has been provided in relation to interest payment to Banks. Further, an individual payer would be liable for TDS compliance only if such individual is subject to tax audit.

**B. Whether discount?**

*Meaning of discount as laid down in court rulings:*

***Ahmedabad Stamp Vendors Association (257 ITR 202)(Guj HC)*** *as affirmed by* ***SC in (348 ITR 378)*** *–* Black’s Law dictionary explains ‘discount’ as “In a general sense, an allowance or deduction made from a gross sum on any account whatever.”

***Harihar Cotton Pressing Factory (39 ITR 594)(Bom HC)****-* Rebate is a remission or a payment back and of the nature of a deduction from the gross amount. It is sometimes spoken of as a discount or a drawback. The dictionary meaning of the term includes a refund to the purchaser of a thing or commodity, of a portion of the price paid by him. It is not confined to a transaction of sale and includes any deduction or discount from a stipulated payment, charge or rate.

As the Buyer would be paying Rs. 45 lacs against the agreed sale price of Rs.50 lacs, it could be argued that Rs.5 lacs would represent an allowance or deduction made from the gross amount and should hence be characterized as a ‘discount’.

**TDS applicability on discount:**

The ***Bombay HC*** has held in ***Intervet (India) Pvt Ltd (364 ITR 238)*** that as the distributor/stockists to whom the product was sold were the customers of the assessee, no services were offered by the assessee and what was offered was a discount under the product distribution scheme or product campaign scheme to buy the assessee's product. Accordingly, TDS u/s 194H would not apply.

***Singapore Airlines Ltd (319 ITR 29)(Del HC) -*** Assessee-airlines issued tickets to its travel agents at a concessional price, transaction between assessee and travel agents was that of principal-to-principal and difference in price was discount and therefore, such transaction would not fall with ambit of section 194H.

***Kerala Stamp Vendors Association (282 ITR 7)(Ker) -*** Discount granted to licensed stamp vendors on sale of stamp paper, by treasury cannot be termed as `commission or brokerage’ to attract TDS under section 194H.

***SRL Ranbaxy Ltd (50 SOT 173)(Del ITAT)* -** Where assessee laboratory was rendering services of testing samples to collection centres/franchisees, TDS u/s 194H was not required in respect of discount offered by assessee to said collection centres/ franchisees.

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Based on the above decisions, it can be argued that TDS u/s 194H will not apply.

**C. Whether marketing and sales promotion expenses?**

As the subvention scheme is with a view to attract prospective buyers and promote sales, the sum borne by the Builder could be characterized as sales promotion expenses.

**TDS applicability on sales promotion expenses:**

As no services or work is involved, the provisions of section 194C, 194J would not apply. Further, as discussed in the decisions above, in the absence of a principal – agent relationship, section 194H will also not apply.

**D. Whether TDS would apply at all?**

As may be noted from the discussion above, except where the payment is characterized as interest, TDS may not apply.

However, when examining TDS applicability, what would matter is the income characterization in the hands of the recipient and not the nature of payment for the payer. As discussed in subsequent para E, the sum of Rs.5 lacs is a benefit that the Buyer receives and would hence be taxable as income from other sources in the Buyer’s hands.

However, unlike section 195 which covers any sum chargeable to tax in the hands of a non-resident recipient, there is no specific provision for TDS on the above type of miscellaneous income arising to a resident recipient.

**E. Tax implications for the Buyer:**

As the amount represents discharge of the Buyer’s liability to the Bank by the Builder,it would be a benefit received by the Buyer. Accordingly, the Buyer’s total income for the year should include the said amount of Rs.5 lacs as his income from other sources u/s 56 of the Act.

Further, section 24(b) allows deduction of pre-construction interest equally over a period of five years commencing from the year in which the construction is completed. However, as interest of Rs.5 lacs has not been borne by the Buyer, it would be difficult for him to avail a deduction in respect of the same.

**F. Entry in books of account:**

Based on the discussion above, the accounting entry would be:

Bank (i.e. money received from the Buyer’s Bank) ………………………… Debit 35

Interest/ Sales discount/ Sales Promotion expenses…….. Debit 5

To Sales………………. Credit 40

The above entry is a simplified total effect of the transaction. As the construction and consequently the disbursement by the Bank is certain to spread over more than one financial year, the total effect of the entries in the Builder’s books of account for all the concerned financial years should sum up to the above.

**G. Whether TDS u/s 194-IA would apply?**

Section 194-IA provides for TDS by the purchaser of an immovable property at the time of credit or payment of consideration to a resident transferor. Sub-section (2) of the said section provides that TDS shall not apply where the consideration for transfer is less than Rs.50 lacs.

In the instant case, the agreed sale price is Rs.50 lacs. However, as Rs.5 lacs is borne by the Builder, the Buyer would be paying only Rs.45 lacs. Thus as the consideration paid by the Buyer is less than Rs.50 lacs, TDS will not apply in terms of section 194-IA(2).

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