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A Monthly Journal of
The Chamber of
Tax Consultants

THE CHAMBER'S JOURNAL

Vol. VII | No. 7 April 2019

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

Shares Vs Debentures

Shares and Securities

PART I

Other Contents

- Direct Taxes
- Other Laws
- Best of the Rest
- Indirect Taxes
- International Taxation
- Corporate Laws
- The Chamber News

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Felicitation by President CA Hinesh Doshi of Ms. Priti Savla - Chairperson of WIRC, Prafulla Chajjed - President ICAI and Mr. Atul Gupta, Vice President, ICAI at WIRC Annual Function on 13th March, 2019 in Yogi Hall, Dadar, Mumbai

Corporate Connect Committee

Lecture Meeting on "Current Economic Scenario and Ease of Doing Business in India" was held on 12th March, 2019 at Babubhai Committee Hall, IMC, Churchgate

CA Hinesh Doshi (President) giving his opening remarks. Seen from L to R: CA Vitang Shah (Convenor), Mr. H. P. Ranina (Speaker), Mr. Mehool Bhuva (President – Indo-Japanese Association) and CA Paras K. Savla (Chairman)

Mr. H. P. Ranina addressing the delegates

Mr. Rishabh Shroff addressing the delegates

Lecture Meeting on "Banning of Unregulated Deposit Scheme Ordinance" was held on 14th March, 2019 at Jai Hind College Auditorium, Churchgate

Dignitaries on Dais - Seen from L to R: CA Vitang Shah (Convenor), CA Hinesh Doshi (President), Mr. Sharad Abhyankar (Advocate) and CA Paras K. Savla (Chairman)

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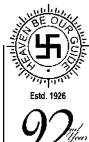

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Editorial

Dear Friends,

The new Financial Year has started. I wish you all a very active and professionally engaging fiscal year, 2019-20. By the time this issue reaches, the campaign for the general elections for the 17th Lok Sabha will be at its peak. Our country will be celebrating this festival of democracy with full fanfare. I request you all to participate in this by casting your vote. When we won our freedom in the year 1947, there were many pessimists and naysayers who never believed that we will survive as a nation and a democracy. I am reminded of the statement of General Sir Claude Auchinleck ex- Indian Army C-in-C in 1948 who stated that "The Sikhs may try to set up a separate regime. I think they probably will and that will be only a start of a general decentralisation and break-up of the idea that India is a country, whereas it is a subcontinent as varied as Europe. The Punjabi is as different from a *Madrassi* as a Scot is from an Italian. The British tried to consolidate it but achieved nothing permanent. No one can make a nation out of a continent of many nations." This view we have negated several times and positively 16 times by voting in the Parliamentary elections. We will do the same again for the 17th time. It is interesting to note that well known historian and columnist Ramchandra Guha in his book *"India after Gandhi"* in the Epilogue: Why India survives, poses the question "Is India a democracy? The answer is well, *phipty-phipty.* It mostly is when it comes to holding elections and permitting freedom of movement and expression. It mostly is not when it comes to the functioning of politicians and political institutions. However, that India is even a 50 per cent democracy flies in the face of tradition, history and the conventional wisdom. Indeed, by its own experience, it is rewriting that history and that wisdom. Thus Sunil Khilnani remarked of the 2004 polls that they represented the largest democratic election, ever and anywhere, in human history. Clearly, the idea of democracy, brought into being on an Athenian hillside some 2,500 years ago, has travelled far – and today describes a disparate array of political projects and experiences. The peripatetic life of the democratic idea has ensured that the history of western political ideas can no longer be written coherently from within the terms of the west's own historical experience." [Pages 749 to 750 of *India after Gandhi* – The History of the World's largest Democracy).

The above mentioned book was published in the year 2007. I personally feel it only gives a glimpse of past. After 2014 there is a paradigm shift in the thought process of society and the nation. The litmus test for a democracy is how seamlessly it absorbs change. I personally feel that we as a society are capable of such change and the same is happening. Thus, we professionals who are the conscience keepers of society and the nation should not only exercise our franchise and wherever possible should motivate others also to do it diligently.

The special story for this month is on Shares and Securities. Due to the number of issues and topics covered, we are forced to publish it in two part editions. Eminent professionals have contributed to the same. I thank all the professionals who have contributed to the Chamber's Journal April, 2019 issue for sparing their valuable time.

K. GOPAL
Editor

v

From the President

Самая большая опасность для всех нас заключается не в том, чтобы установить свою цель слишком высоко и не достичь её, а в том, чтобы установить её слишком низко и достичь своей отметки

… is a **Russian quote** which says – ***'The greatest danger for most of us is not that our aim is too high and we miss it, but that is it too low and we reach it'.*** We have covered following world languages in our series till date namely Sanskrit, Latin, Chinese, Greek, Japanese, Hebrew, Korean, Turkish, Arabic.

In Mr. N. R. Narayana Murthy's words – 'Leadership is all about dreaming big!' If philanthropic leaders, and entrepreneurs like Jamsetji Tata, Ratan Tata, Dhirubhai Ambani, Azim Premji, N. R. Narayana Murthy would have limited their goals, they would have feared to go against the world or sail their ship in safe waters, would companies like Tata, Reliance, Wipro, Infosys be where they are today?

Dreaming big is no harm, and merely a fear to fail shouldn't limit our vision and hunger to grow, learn and dream big. We, at The Chamber too believe in dreaming big, setting new goals every time we achieve one, and never settling for less. We believe in exploring new areas, touch new horizons and achieve what might be believed to be unachievable. We don't worry about the results, but what we worry about more is – Trying new things for our members!

In Shri Harivansh Rai Bachchan's words –
'Kuch kiye bina jai-jai kaar nahi hoti………………… Koshish karne waalo ki kabhi haar nahi hoti!'

So, I would like to convey this message to everyone far and wide – Dream big, keep learning, keep growing, and keep trying! Try, fall, learn, rise and repeat!

"We learn something from everyone who passes through our lives…..some lessons are painful, some are painless, but all are priceless."

To make this dream come true, we have been given one powerful tool by our Constitution – the Right to vote. As this month will stage one of the largest

shows on this earth where a hundred and twenty crore Indians will vote for five hundred and forty three Lok Sabha seats, let us vow to not waste this powerful tool. So let us bring that change we wish to see and shape our nation, the way we've dreamt it to be!. I request all members of CTC to please cast their votes and also educate your friends, colleagues and relatives to refrain from taking holiday on this day.

CTC News and Events

The Chamber organized **3rd Y.P. Trivedi National Tax Moot Competition** in association with Government Law College on 29th and 30th March. Eighteen law colleges from all over India participated on Moot problem was based on Benami Law and Income-tax Act. The preliminary and Quarter rounds were judged by senior professionals, semi-final round by four ITAT Tribunal members and final round by two sitting Hon'ble High Court judges – Justice Shri M. S. Sonak and Justice Shri D. S. Naidu. My deep gratitude to Mr. Ashwani Taneja for helping us draft the Moot problem and also Bench Memorial for Judges. Appreciate efforts by Nishtha, Niyati, Ajay Singh, K. Gopal, Hiro Rai, Vipul Joshi, Charmi, Rahul, Paras, Mallika, MCA members and many other to make this event turn around in just 30 days from date of announcement. The Students had opportunity to argue quarter final and semi final round in ITAT Court rooms and Hi Tea meeting was attended by Hon'ble President ITAT, Justice P. P. Bhatt, Vice Presidents Hon'ble Shri G. S. Pannu and Shri G. D. Agrawal and all Tribunal Members. We appreciate contribution and support of respected Dr. Y. P. Trivedi for this event.

The month of April and coming months will see The Chamber holding **numerous events jointly with Reserve Bank of India.** A half-day seminar on ***Recent Developments in Compounding of Offences under FEMA*** is scheduled to be held on the 24th April at IMC, Churchgate while a two-day ***Conference on FEMA*** is scheduled to be held on 3rd and 4th May at India International Centre, New Delhi.

To spread our wings, The Chamber organises several programmes outside Mumbai with local associations and organisations. We have planned programmes at Amravati, Vadodara, Raipur, Ahmedabad, Nashik etc. in next 2 to 3 months.

Every member should try to learn some foreign language to increase his business and expand his work area. The Chamber has also joined hands with Indo-Japanese Association to provide ***Japanese Language Conversation Course*** at the CTC Conference Room every Friday from 6-8 pm and every Saturday from 9.30-11.30 am.

The Chamber has planned ***Industrial visit to CTRL's Data Center*** – The largest in Asia and India's only Tier-4 Data Center at Navi Mumbai.

Right to Information (RTI) codifies the fundamental rights of the citizen and no public authority can deny providing information. RTI is useful in various

ways and provides transparency in the system of the country. This lecture meeting, scheduled on 30th April at IMC, Churchgate is aimed at making the professionals aware about the nuances of RTI.

We have received highest enrolments in the history of CTC for both RRCs' at Hyderabad and Lucknow. We shall repeat the same performance for our 13th RRC on International Taxation at Surat. Please enrol before 30th April for early bird discount. Galaxy of 17 speakers with inaugural address by Hon'ble Justice P. P. Bhatt, President ITAT has been planned.

Representations and Writ Petition

The Chamber filed ***writ petition*** and Hon'ble Bombay High Court passed Interim Order on the petition filed by us on CBDT's proposal, where CIT-A would now be incentivised on passing 'quality' orders. As this would be detrimental to the interest of taxpayers, the Hon'ble Bombay High Court has directed the CBDT to reconsider the norms. The matter has been fixed for next hearing on 11th April, 2019.

The CBDT has well appreciated The Chamber's efforts as a major stake holder, in submitting representation on ***Tax Litigation Management*** and we received appreciation letter from Mr. P. K. Dash, Member, CBDT for sending constructive proposal and suggestions.

The Chamber also represented before ***Task Force for Reforms in Maharashtra Public Trust Act*** and submitted our suggestions, corrections and views to improve the effectiveness and remove anomalies of the MPT Act.

With the number of representations and events increasing every month, I hope this trend keeps seeing an upward graph.

Special Story on "Shares and Securities" is designed to cover entire gamut of the subject and is split into two parts. I thank Mr. Bhadresh Doshi and Mr. Paras K. Savla for preparing the design and structure of this special story, which is very exhaustive, detailed and covers all practical aspects. I also thank all authors who have spared their time and made timely contribution.

благодарю вас

Hinesh R. Doshi
President

CA Kalpesh Katira & CA Prathmesh Pokharankar

Speculative Transactions

Meaning and Taxation of Speculative Transactions

Profits from purchase and sale of i.e. Dealing in shares can result either in "Business income" (chargeable as Profits & Gains of Business or Profession chargeable under section 28 of the Income-tax Act, 1961) or "Capital Gains" (chargeable under section 45 of the Act). Thus, dealings in shares could either be in the course of business – resulting in gains chargeable as Business Income, OR when these are for the purpose of investment result in gains - chargeable as Capital Gains. Classification into Business Income or Capital Gains depends on facts & circumstances of each case. However, as a very broad guideline, as held in many cases, it can be said that - ordinarily, the purchase and sale of shares with the motive of earning a profit, would result in transaction being in the nature of trade, but where the object of investment in shares of a company is to derive income by way of dividend etc., then the profit accruing by sale of shares will yield capital gains and not revenue gains (business income).

Trading in shares can be of two types namely

A) Delivery based trading

B) Non-delivery based (also called intra-day trading)

A) Delivery based trading

Under this type of trading, the share transaction is said to be complete only when there is actual delivery of shares/securities upon the settlement of transaction i.e., in other words, when shares are purchased/sold on delivery basis, then those shares will be transferred to/from Demat account of the buyers/sellers. The buyer of the share will have to pay the full value of share and the share will become his asset with that either he can trade in his business or hold for investment.

B) Non-delivery based (also called intra-day trading)

Intra-day trading by the name itself one can get a view that it refers to the trading system where the traders have to square-off their trade on the same day. Squaring off the trade means that the traders have to do the buy and sell or sell and buy transaction on the same day before the market close. In other words in this type of trading, shares are not actually transferred to the demat account of the buyer instead they have

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to square off their position before the market close on same day by selling the same number of shares. The buyer of the shares will not pay the full value of shares instead he will pay only the difference margin arising on account of such buy/sell transaction.

Having understood the meaning of Speculative Transaction in general, let us try to understand the legal definition of the term 'Speculative Transaction' as provided in section 43(5) of the Act.

The provisions of section 43(5) provides as under.

"Section 43(5): "Speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips."

From the above definition of ''speculative transaction", it means a transaction in which a contract for the purchase or sales of any commodity including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips.

The important term is "periodically or ultimately settled otherwise than by the actual delivery". It means physical delivery has not been made. Therefore, the settlement (periodic or ultimate) of contract for the purchase or sale of any commodity, stock and shares in which physical or actual delivery is not made or required may be regarded as Speculative Transaction.

In intra-day trading in shares, there is no actual delivery as the shares enter and exit from the trading account on the same day and it does not enter the demat account at all.

The 1st proviso to section 43(5) provides for list of certain transactions which are not regarded as Speculative Transactions. In other words, the below transactions may not be deemed to be Speculative Transactions for the purpose of section 43(5) of the Act.

a) **Hedging contract in respect of raw materials or merchandise** : A contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him.

b) **Hedging contract in respect of stocks and shares** : A contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations.

c) **Forward contract** : A contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member;

d) **Trading in derivatives** : An eligible transaction in respect of trading in derivatives referred to in clause (ac) of section 2 of the Securities Contracts (Regulation) Act, 1956 carried out in a recognised stock exchange.

e) **Trading in commodity derivatives** : An eligible transaction in respect of trading in commodity derivatives carried out in a recognised association, which is chargeable to commodities transaction tax under Chapter VII of the Finance Act, 2013

The above transactions are although settled otherwise than by actual delivery but for the purpose of section 43(5) of the Act, the same are not regarded as Speculative Transaction.

Every transaction where delivery is not taken does not automatically tantamount to speculative transaction. For e.g., if purchase order is placed and later cancelled due to business expediency does not amount to speculation transaction since actual delivery is not taken. In this connection, reference may be made to the decision of Madras High Court in the case of *CIT vs. Sri Ramalinga Choodambigai Mills Ltd.*[1] wherein it was observed as under.

> *"The contracts were entered into in the ordinary course of business of running a textile mill and had been entered into bona fide to secure the supply of the raw materials required by it. The contracts were later cancelled only because that raw material was no longer fit for the assessee's use, having regard to the fact that a different variety of cotton was required for the manufacture of higher count of yarn. If all such contracts were excluded from the definition of speculative transaction, entering into such contracts, and settling the same by paying damages did not amount to carrying on speculative business for the purpose of Explanation 2 to section 28."*

The Finance Act, 2018 has inserted the 2nd proviso to section 43(5) whereby the clause (e) of 1st proviso to section 43(5) is amended to provide that the requirement of charging of Commodity Transaction Tax (CTT) as provided in clause (e) is not applicable to trading in agricultural commodity derivatives. In other words, the trading in agricultural commodity derivatives will not be regarded as Speculative Transaction whether or not CTT on the same has been paid. The above amendment is applicable from the assessment year 2019-20 onwards. Therefore, prior to assessment year 2019-20, the trading in agricultural commodity derivatives was not regarded as Speculative Transaction only if CTT on the said derivative transaction is paid.

Further, the Explanations (1) and (2) provides for the meaning of the term 'eligible transaction', 'recognised stock exchange', 'recognised association' and 'commodity derivative'.

The next question arising for consideration is whether the Speculative Transaction can be regarded as Business and therefore, income therefrom, taxable under the head of 'Profits & Gains from Business or Profession'.

In the context of the term 'Speculative Transaction', the Explanation 2 to section 28 provides as under.

"Explanation 2: Where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business (hereinafter referred to as "speculation business") shall be deemed to be distinct and separate from any other business."

The Explanation 2 provides that if the Speculative Transaction constitutes the business activities, the said business shall be regarded as distinct and separate from any other business. In other words, the speculative transactions should constitute the business of the assessee. Consequently, the income / loss from such speculative business shall be treated separately from any other business.

In view of the above, income from intra-day trading is considered as speculation income chargeable under the head Business Income and is taxed at the normal rates.

Set-off of loss

As mentioned above, the income / loss from speculative business is taxed separately from any other business. Accordingly, the provisions of section 73 provides that the loss in respect of speculative business cannot be set off against any other heads of income i.e., it can be set off only against other speculative incomes if any in that year.

If there is any such loss which is not set off, such losses are eligible to be carried forward and set off only against speculative incomes

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for a period of only 4 subsequent assessment years.

The Explanation to section 73 provides that where any portion of the business of a company consists in the purchase and sale of the shares of other companies, such a company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares. However, the explanation provides for two exceptions to certain classes of taxpayers to whom the provisions of section 73 does not apply and accordingly, their business activities will not be constituted as speculation business.

- A company whose gross total income consists of mainly income chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources".
- A company the principal business of which is –
  - (a) the business of trading in shares; or
  - (b) the business of banking; or
  - (c) the granting of loans and advances.

From the above, it may be observed that the Explanation to section 73 is deeming fiction in respect of some of the companies whose business consists of the purchase and sale of shares. It may be noted that the deeming fiction applies only to loss arising from the purchase and sale of shares and not to the profit arising from such activities. In other words, the profit arising from purchase and sale of shares would not constitute Speculation Profit; rather it would be taxed as business profit. In this connection, the reference may be relied upon the decision of Mumbai Tribunal in the case of *Samba Trading & Investment (P.) Ltd. vs. ACIT*[2]. The Mumbai Tribunal has upheld the observation of the Commissioner of Income-tax as under.

> *"The Explanation to section 73 is a deeming provision and is not simply clarificatory. A specified business conducted by a specified company is deemed under the terms of the Explanation to be speculation business. The Explanation does not speak about either the profit or loss arising from business deemed as speculation business. In other words, the deeming provision covers both the contingencies, that is, profit or loss that may arise from that business. The Explanation is, of course, limited for the purpose of the section. The section talks of set off and carried forward and set off of losses in speculation business. According to the Commissioner, if there was a loss in the business deemed to be speculation business in terms of the Explanation, such loss could be set off against the profit from another speculation business.* ***In the reverse situation, that is, where there is a loss in another speculation business, it could not be set off against the profit derived from the business deemed to be speculation business in terms of the Explanation.****"*

For determining whether the gross total income of the assessee comprises of Income from Other Sources as provided in Explanation to section 73, the reference may be made to the decision of Mumbai Tribunal in the case of *Rajan Enterprises (P.) Ltd. vs. ITO*[3] wherein it was held as under.

> *"In order to determine whether an assessee was an investment company or not, one had to determine what was its gross total income, i.e., total income of an assessee, as computed without allowing Chapter VIA deductions. In other words, the income is computed as per the provisions of the Act before Chapter VIA deductions. There is no indication in the provision of section 73 or section 109 as to whether the loss incurred by an assessee on the share dealings was to be deducted or kept out*

2 58 ITD 360

3 41 ITD 469

of consideration in computing the gross total income."

Further, as mentioned above, the two exceptions are provided in the Explanation to section 73 as under.

- The company whose gross total income consists of mainly income chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources".
- A company the principal business of which is –
  - (a) the business of trading in shares; or
  - (b) the business of banking; or
  - (c) the granting of loans and advances.

Both the above exceptions are independent and are not required to be applied together. In this connection, the reference may be made to the Special Bench decision of the Mumbai Tribunal in the case of *ACIT vs. Concord Commercials (P.) Ltd.*[4] wherein the Tribunal observed as under.

> "The two kinds of exceptions provided in Explanation to section 73 are based on two independent tests laid down in the Explanation itself. ***The test to be applied on the first category of company is the character of its gross total income. The test laid down in the case of the second category of company is the nature of the principal business carried on by it.*** In the first category, where the test is that of the character of gross total income, the other test relating to the nature of principal business carried on by it does not apply. Likewise in the second category of company where the test is the nature of the principal business carried on by it, the test of the gross total income does not apply. The two exceptions provided in Explanation to section 73 are governed by two different tests laid down in the said Explanation itself. Therefore, the examination of the exceptions provided in Explanation to section 73 is to be done strictly in accordance with the tests laid down in the Explanation."

Conclusion

The meaning of Speculative Transaction in general means the intra-day trading in the context of shares and any transaction of contract of purchase and sell which is settled otherwise than by delivery. The income arising from speculative transaction is taxed under the head 'Profits and gains from business or profession' and thereby, taxed at the rates applicable to the assessee after allowing all the expenses / deduction available while computing the income under this head. The Speculation business is considered as different from other business activities. Further, the loss arising from the speculation business can be set-off only against the income arising from speculation business and not from any other business activities or any other head of income. The Explanation to section 73 provides for exception to certain classes of taxpayers to whom the provisions of section 73 does not apply.

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4 95 ITD 117

Nobody will come to help you if you put yourself forward as a leader ... Kill self first if you want to succeed.

— *Swami Vivekananda*

Dharan Gandhi, *Advocate*

Impact of ICDS

It is fairly settled that income tax is fairly unsettled. Income tax and complications go hand in hand. To add one more layer of complication, the Government had come out with 'Income Computation and Disclosure Standards' ('ICDS') *vide* Notification No. 87/2016. With ICDS, the Government tried to tweak the provisions governing the computation of income in as much as the ICDS indirectly provided for the point of time when a particular income would be taxed and also the allowability of certain expenses/losses.

The Chamber of Tax Consultants had challenged the provision of ICDS and was successful in mitigating its threats to a large extent by getting a favourable judgment from the Hon'ble Delhi High Court *[Chamber of Tax Consultant vs. UOI – 400 ITR 178(Del)]*. Thereafter, the Government brought about amendments by Finance Act, 2018 to undo what was done by the Hon'ble Delhi High Court in the said judgment.

As a result of the above, today, we have to go through the ICDS, said judgment of the Hon'ble Delhi High Court and the provisions of the Income-tax Act, 1961 ('Act') as amended by Finance Act, 2018, to understand the tax treatment in respect of any particular issue governed by the existing 10 ICDS. One of the issues, for which the above analysis is required is the impact of ICDS on shares and securities as we have many provisions in the ICDS touching upon, either directly or indirectly, the tax treatment of securities. In the present article, I shall be dealing with the same.

First and foremost, the ICDS have been issued u/s. 145 of the Act, which section deals with method of accounting to be followed by a person for computing income from business or income from other sources. Thus, the ICDS would not have any impact while computing capital gains. Also, the same would not be applicable if one follows cash system of Accounting.

ICDS-8

Firstly, we shall deal with ICDS-8, which is a specific ICDS that deals with valuation of securities held by a person as stock-in-trade. It has been divided into 2 parts. Part A deals with entities other than scheduled banks and public financial institutions whereas Part B deals with scheduled banks and public financial institutions.

In so far as Part B is concerned, it states that securities shall be classified, recognised and measured in accordance with the extant guidelines issued by the Reserve Bank of India.

Part A of the ICDS-8 does not apply to certain persons like insurance companies, mutual funds, venture capital funds apart from banks and public financial institutions.

The term securities is defined under Part A of ICDS-8 as under:

"Securities shall have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and shall include share of a company in which public are not substantially interested but shall not include derivatives referred to in sub-clause (ia) of that clause (h)."

There are three parts of the definition viz:

1. Securities shall have the same meaning as assigned in section 2(h) of the Securities Contracts (Regulation) Act, 1956 ('SCRA').
2. The term 'securities' shall include shares of a company in which public are not substantially interested, and
3. The term 'securities' shall not include derivatives referred to in section 2(h)(ia) of the SCRA.

The meaning of the term securities under the SCRA is very wide and it includes shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities, derivatives, units of mutual fund, government securities and rights or interests in securities. Since, the shares of a company in which public are not substantially interested are not marketable, therefore, they are outside the definition of the term 'securities' as defined under SCRA. As a result, ICDS-8 specifically includes the same within its definition.

Part A of the ICDS-8 deals with recognition and initial measurement of securities and subsequent measurement of securities. More or less the provisions of ICDS-8 are similar to the AS 13 issued by Institute of Chartered Accountants of India, except for certain issues which are dealt with hereunder.

Bucket approach of valuation

Para 10 of Part A of ICDS-8 states that, at the year end, the securities are to be valued at cost or net realisable value whichever is lower, however, such comparison has to be made category wise. Four broad categories of securities are laid down in para 10 and it states that an overall cost of the entire category will be compared to the net realisable value of the entire category and the lower figure will be taken as the closing stock value of the said category. Illustration is given in Q.19 of the CBDT Circular No. 10/2017. Such bucket system is in variance with the method prescribed by ICAI under AS 13. There the comparison has to be made individual security wise instead of bucket approach.

The above para of the ICDS-8 was struck down by the Hon'ble Delhi High Court on the ground that this change is not possible to be effectuated without a corresponding amendment to the Act and accordingly, the Court declared such para of Part A of ICDS-8 as *ultra vires*. Corresponding clarifications in the Circular was also struck down.

The above finding of the High Court was annulled by the amendment made by Finance Act, 2018, by amending section 145A of the Act. As per section 145A, clause (iv), inventory being securities listed in recognised stock exchange and quoted from time-to-time has to be valued at lower of actual cost or net realisable value in accordance with the ICDS notified u/s. 145(2). As per second proviso to section 145A such comparison of actual cost and net realisable value has to be made category wise.

It is interesting to note that second proviso to section 145A, though it states that the comparison is to be made category wise, it does not specify the categories nor does it make reference to para 10 of ICDS-8. This coupled with the fact that para 10 of ICDS-8 has been struck down by the Court and neither is there a new notification issued by the Government nor is the judgment of the Delhi High Court reversed by the Apex Court. One view is that, though the provision of amended section 145A states that the comparison is to be made category wise, no category is prescribed either in the Act or in the ICDS. Further, para 10 of ICDS 8 is struck down and it does not come back to life automatically unless so brought back expressly. Therefore, without there being any category, one can value the securities by comparing the actual cost and the net realisable value of individual securities instead of the categories. The other view would be that by virtue of amendment in section 145A, para 10 of ICDS-8 has come back to

life and therefore, one has to value the securities under bucket approach. I am more inclined to take the first view, though the same may lead to litigation.

Valuation of derivatives

The next important issue is about valuation of derivatives not being derivatives governed by ICDS-6. This issue is also affected by the provisions of ICDS-1 and ICDS-2 as well as provisions of new section 145A of the Act.

The position prior to introduction of ICDS was that the marked-to-market loss in respect of derivatives was held to be allowable by various judgments.

As already stated earlier, ICDS-8 specifically excludes derivatives from the ambit of the term securities for the purpose of ICDS-8. Thus, the valuation of derivatives would be governed by other ICDS. In this regard, attention is invited to Q.10 of the Circular No. 10/2017. In this question, it was asked as to which ICDS would govern derivative instruments? The reply received was that ICDS-6 (subject to para 3 of ICDS-8) provides guidance on accounting for derivative contracts such as forward contracts and other similar contracts. For derivatives, not within the scope of ICDS-6, provisions of ICDS-I would apply.

Thus, as per the Board, ICDS-1 applies to derivative contract. As per ICDS-1 (prior to the judgment of the Delhi High Court), para 4(ii), marked-to-market loss and expected losses were not to be recognised. Entire ICDS-1 was struck down by the Court. As a result, amendment was made in section 36(1), whereby clause (xviii) was inserted. As per the said clause, marked-to- market loss and other expected loss as computed in accordance with the ICDS notified u/s. 145(2) is to be allowed while computing business income. Further, section 40A(13) was inserted to provide that no deduction or allowance shall be allowed in respect of any marked-to-market loss or other expected loss, except as allowable u/s. 36(1)(xviii). Thus, the effect of para 4(ii) of ICDS-1 was restored by the said amendments.

Derivatives other than those covered by ICDS-6, are not governed by any other ICDS and there is no provision in the ICDS allowing any adjustment *qua* marked-to-market loss in respect of the same. Therefore, one may conclude that marked-to-market loss is not allowable in respect of such derivative instruments. The Board has also clarified in reply to Q.8 of Circular 10/2017, that even marked-to-market gains need not be recognised.

However, the above is only one side of the story. There is the other view to which I subscribe. The other side of the story stems from some of the judgments rendered by the Tribunal in case of *Edelweiss Capital Ltd. vs. ITO (ITA No. 5324/M/2007); DCIT vs. Kotak Mahindra Investment Ltd. [59 SOT 4(Mum)] and Darashaw & Company Pvt. Ltd. vs. DCIT [36 CCH 147(Mum)].* In the said judgments, the Tribunal has held that derivative contracts are stock-in-trade of the assessees, and accordingly the marked-to-market losses on such contracts are allowable based on the principle; stocks are to be valued at cost or market value whichever is lower.

The same principle can be extended in post ICDS era also. Further, as already stated earlier, section 145A has been amended by Finance Act, 2018 and as per section 145A(iv), securities other than the ones not listed on a recognised stock exchange, or listed but not quoted on a recognised stock exchange with regularity from time-to-time, have to be valued at lower of actual cost or net realisable value. The term 'securities' has not been defined for the purposes of section 145A. Accordingly, one may rely on the meaning provided in section 2(h) of the SCRA, which would include derivatives also. Further, such derivatives are listed on recognised stock exchange and quoted from time to time. This, in effect means that the marked- to-market loss on derivative contract held for trading purposes would be allowed u/s. 145A(iv), however, there would be no need to recognise marked to market gains.

Derivative contracts covered by ICDS-6

ICDS-6 deals with the treatment of forward exchange contracts. As per para 8(1) of ICDS 6, marked-to- market loss/ gain on forward exchange contract has to be recognised. However, the same principle is not to be applied in case such forward exchange contracts are intended for trading or speculation purposes. In respect of such contracts, everything has to be recognised at the time of settlement as per para 8(5) of ICDS-6. This was not accepted by the Delhi High Court, as it held that such treatment was running contrary to the judgment of the Supreme Court in case of *Sutlej Cotton Mills Limited vs. CIT (1979) 116 ITR 1 (SC)* and *Woodward Governor India P. Ltd. [312 ITR 254(SC)].* Accordingly, entire ICDS-6 was struck down.

To overcome the said decision, the Legislature inserted section 43AA in the Act. Section 43AA states that subject to the provisions of section 43A, any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss, as the case may be, and such gain or loss shall be computed in accordance with the ICDS notified u/s. 145(2). Section 43AA(1) is in the nature of charging provision. Further, the gain or loss u/s. 43AA would have to be computed in accordance with the ICDS notified u/s. 145(2). It should be noted that only the computation part has been delegated u/s. 145(2). Further, section 43AA(2) defines foreign currency transaction to include forward exchange contracts.

In my opinion, therefore, marked-to-market loss/gain in case of foreign currency derivatives held for trading or speculation purposes is to be recognised as per section 43AA as gain or loss, since the same arises out of foreign currency transaction. Even if the ICDS notified u/s. 145(2) states that no such loss or gains should be recognised, the same shall run the risk of being contrary to section 43AA as the only thing which the ICDS can provide is the computation of such loss/gain.

Now, we come to some of the incidental aspects in respect of securities viz., interest income on such securities in respect of investor in such securities and interest expense on such securities in respect of issuer of securities.

Interest income on securities

As per para 8(1) of ICDS-4, interest shall accrue on the time basis determined by the amount outstanding and the rate applicable. One need not take into consideration reasonable certainty of ultimate collection of such interest income while recognising it. This has been held to be perfectly valid by the Delhi High Court as necessary amendments were made in section 36(1)(vii) of the Act in as much as one can claim deduction u/s. 36(1)(vii) of the Act read with second proviso to section 36(1)(vii). In such cases, where reasonable certainty of ultimate collection is missing, one is advised to book the interest income in their books of account and then correspondingly claim deduction u/s. 36(1)(vii) read with the second proviso. This would make the treatment of the assessee full proof.

However, an interesting consequence as a result of upholding the constitutional validity of para 8(1) of ICDS 4 would be treatment of broken period interest. As per para 8(1) of the ICDS 4, interest is required to be recognised on accrual basis determined by the amount outstanding and the rate applicable. Let us examine this issue with an example. Take a case of an owner of a security of value of ₹ 10 lakh (interest rate 10%), where the due date for interest payment is 1st July and 1st January. Owner transfers the security on 1st June, 2019. As on 31st March, 2019, interest of 3 months has accrued to such owner. Such interest has accrued to him but is not due. As per ICDS-4, para 8(1), owner would be required to recognise interest of 3 months as on 31st March, 2019. Further, he shall also be required to recognise interest for two months i.e., April and May 2019. Now, when the owner transfers the security, he shall receive the consideration which shall be inclusive of interest for 5 months. If we go by the ICDS, then such interest is already offered to tax. On transfer, such interest amount cannot be reduced from the full value of consideration

as the definition of full value of consideration is very clear under the Act. Thus, such interest would be taxed twice. In this regard, reply to Q.18 of the Circular 10/2017, states that the amount already taxed as interest income on accrual basis shall not be taken into account for computation of income arising from sale of securities. Thus, the clarification removes the chance of double taxation. Though there is a clarification from the Board, but the same is not in accordance with law and therefore, the validity of the same is doubtful.

In this regard, if we keep the ICDS aside, i.e., if we look at the pre ICDS era, then there are judgments of the Court to the effect that interest which has accrued but is not due should not be charged to tax *[E.D. Sasson & Co. Ltd. & Ors. vs. CIT - 26 ITR 27(SC); DIT vs. Credit Suisse First Boston (Cyprus) Ltd. - 351 ITR 323 (Bom), CIT vs. Karnataka Bank Ltd. - 226 Taxman 187 (Kar)]*. Thus, the judgments state that such interest would not be required to be taxed until it becomes due. Further, on transfer, the interest amount which comes with the sale consideration would be taxed as capital gains and that such interest cannot be separated from the total consideration.

Thus, the treatment as per the ICDS is different from what is settled by the Courts. Though, para 8(1) has been upheld by the Court, the same was in one context of reasonable certainty of ultimate collection. At the same time, the Court also held that the ICDS would not override the judgments of the Court and therefore, one can take a view that, in so far as interest accrued but not due is concerned, the tax treatment will still be governed by the judgments and not the ICDS or the Circular.

Interest expense on securities

ICDS-9 deals with borrowing costs. Borrowing costs has been defined in para 2(1)(a) of such ICDS as under:

"Borrowing costs are interest and other costs incurred by a person in connection with the borrowing of funds and include:

(i) commitment charges on borrowings;

(ii) amortised amount of discounts or premiums relating to borrowings;

(iii) amortised amount of ancillary costs incurred in connection with the arrangement of borrowings;

(iv) finance charges in respect of assets acquired under finance leases or under other similar arrangements."

Thus, such ICDS covers the interest expense as well as incidental expenses.

Such borrowing costs are allowable as per the provision of the Act which includes section 36(1)(iii) and section 43B of the Act. ICDS-9 mainly provides for capitalisation of such borrowing cost in certain cases. As per para 3 of ICDS-9, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset and the amount of such borrowing cost to be capitalised would be computed in accordance with ICDS-9.

If the securities are issued and the funds are specifically received for the purposes of acquisition, construction or production of a qualifying asset, then the amount of borrowing costs to be capitalised on that asset shall be the actual borrowing costs incurred during the period on the funds so borrowed. Such borrowing cost is to be capitalised till the time the asset is first put to use or when the inventory is complete for its intended sale.

If the funds received on issue of securities are not specifically received for the purposes of acquisition, construction or production of a qualifying asset then as per para 6 of the ICDS-9, the interest to be capitalised has to be computed in accordance with the formula prescribed.

In this article, I have tried to highlight some of the material impacts which the ICDS will have on taxation of issues in respect of shares and securities.

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SS-VII-10

CA Umesh K. Gala and CA Anuj Shah

Taxation of ESOPs

1. Background

Human Resources or Human Capital is well recognised as a key resource enabling a business to create value. Incentivising such Human Resources through employee ownership plans has become very popular over the last few decades. Such plans are considered vital in enabling a business to attract, retain, motivate and reward human resources. Incentives through ownership plans create linkages with the overall performance of the business thereby aligning the interests of the employees with the shareholders thereby creating a win-win situation.

Before dealing with the taxation of employee stock ownership plans (ESOPs), it might not be out of place to have a very brief overview of a few important ESOPs.

1. Employee Stock Option Scheme (ESOS)

Under an ESOS, a company grants options (right without any obligation) to acquire a certain number of shares in the company or its holding / subsidiary company generally at a pre-determined price (exercise price) within a pre-determined period (exercise period) to its employees. The option to acquire shares can be exercised once the conditions are fulfilled, referred to as 'vesting conditions'. Such vesting conditions may be continued employment for a defined time or performance based or both. Upon vesting, the employee gets an unfettered right to 'exercise' the vested options by payment of the exercise price. On exercise, the shares are allotted / transferred to the employees who may sell them subject to lock-in period, if any, specified under the scheme.

2. Employee Share Purchase Scheme (ESPS)

In an ESPS, employees are granted right to acquire shares at a price lower than the prevailing market price. The shares issued under an ESPS are subject to lock-in restrictions during which the employees are required to hold onto the shares and / or continue employment with the Company.

3. Phantom Equity Plan (PEP) or Stock Appreciation Right Scheme (SAR)

PEP or SAR provide employees with ghost / simulated ownership. In a PEP / SAR, an employee is given notional units / shares at a benchmark price with a right to exit at a future formula based price of the phantom unit or market price / formula-based price of the SAR.

On exercise, PEP / SAR can be settled either by payment of cash (cash settled PEP / SAR) or issue of shares also (equity settled PEP/SAR).

4. Restricted Stock Units (RSUs)

RSUs involve grant of shares (usually without any exercise price) to the employees upon completion of vesting conditions.

In practice there can be multiple variants of the above ESOPs with complex features / conditions attached. In many cases these ESOPs are rolled out through employee ownership trusts settled exclusively for the benefit of employees.

The Companies Act, 2013 read with Rule 12 of Companies (Share Capital and Debentures) Rules, 2014 provides the regulatory framework for granting stock options to employees etc. Listed companies are further governed by the Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014 (SEBI SBEB Regulations) which has superseded the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 (SEBI ESOP Guidelines). The SEBI SBEB Regulations are much broader in nature and cover many variants of ESOPs. The SEBI SBEB Regulations are to be read along with SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Taxation of ESOPs has evolved over the last 2 decades. The phases cover uncodified tax provisions where such benefits were taxable on first principles, gradually moving to a period during which ESOPs were incentivized (subject to conditions) and taxed only at the time of final exit / sale, then to an intermediate stage when ESOPs were subject to levy of fringe benefit tax and finally to the present provisions (from 1-4-2010).

Taxation of ESOPs will vary depending on the type of ESOPs. Plans that result in allotment or transfer of shares to the employees are taxed differently than those that result in payment of cash pursuant to PEP / SAR. The analysis of the taxation provisions of ESOPs under the Income-tax Act, 1961 (the Act) are presented in a question answer format to make them more reader friendly. A few contentious issues are discussed at the end. In this article references to sections unless otherwise stated are sections of the Act.

2. Basic framework for taxation of ESOPs

Q.1 Whether benefit under an ESOP is taxable as income?

A.1 Income in money's worth or equivalent of cash is also income. However, a contingent gain cannot be taxed as income. A right to receive shares of a company at a price lower than its market price could at most be regarded as a benefit / perquisite or a concession not in the nature of income as commonly understood. This is more so when such right is not immediately exercisable as it may be subject to fulfilment of certain vesting conditions. Under the Act, income is defined u/s. 2(24) to include a benefit or perquisite or concession in certain situations. Accordingly, a benefit / perquisite arising in the course of employment is taxable under the head 'Salaries' while the same arising from the exercise of a business or profession is taxable as business income. As per section 2(24)(iv), a benefit or perquisite obtained from a company by a director or relative of director is also included as income.

Q.2 How is the benefit obtained under ESOS taxable in the hands of an employee?

A.2 Benefit received under an ESOS is taxed as a perquisite according to the provisions of section 17(2)(vi) of the Act.

Section 17(2)(vi) provides that the **value** of any **specified security or sweat equity shares allotted or transferred**, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee shall be treated as perquisite.

Thus, taxation arises at the time when the specified security is allotted or transferred to the employee.

The important aspects of section 17(2)(vi) are briefly analysed as under:

- ***Value*** means the fair market value (FMV) of specified securities on the exercise date less any amount actually paid or recovered from the employee for such specified securities. The mechanism for determining FMV has been prescribed under Rule 3(8) & 3(9) of the Income-tax Rules, 1962 (the Rules) (discussed in Q4 below).

- ***Specified security*** means securities as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956 (SCRA). Where stock options are granted under any plan or scheme, then the securities offered under such plan or scheme i.e. the resultant securities arising on exercise of such options is included therein. The resultant securities could be shares, debentures or any other securities.

- ***Allotted or transferred*** – Specified security must be allotted or transferred. Allotment signifies primary issue by the Company while transfer would include secondary transaction by way of purchase from the Trust / other entity.

- ***Directly or indirectly*** – wide enough to cover options granted through a trust especially when the trust is settled or controlled by the Company.

- ***By the employer or former employer*** – For ESOPs to be taxed, the grant / benefit should flow from the employer or former employer. Interesting issue arises where the ESOPs are granted by the holding company or by a promoter. This is discussed in Q 11.

Q.3 How does the taxation of ESPS take place?

A.3 In case of an ESPS, once the employee exercises the rights granted thereunder, the shares are allotted or transferred to him. Unlike ESOS where the options are exercised at a future date usually beyond one year from the date of grant, the allotment or transfer of shares in case of ESPS takes place immediately. Hence, the underlying perquisite becomes taxable immediately upon such exercise u/s. 17(2)(vi). The perquisite will be the difference between the FMV on the exercise date as determined under Rule 3(8) and the price paid for such shares. It may be mentioned that in terms of section 17(2)(vi), the FMV to be considered is as on the date on which **the 'option' is exercised**. In case of ESPS no option is granted but nevertheless the employee gets a right to purchase the shares. This right will be considered as an 'option' for the above purpose.

In case of ESPS, the shares allotted are subject to lock-in period (minimum 1 year prescribed under SEBI SBEB Regulations). Few issues about taxability of ESPS which are subject to lock-in restrictions are discussed at greater length in while discussing a few issues in Q.11.

Q.4 What is the valuation mechanism to determine the FMV as per the Rules?

A.4 Rule 3(8) & 3(9) – Determination of FMV

In case of equity shares-

- If it is listed on any recognised stock exchange on the date of exercise, the FMV shall be average of the opening and the closing price.

- If it is listed on more than one stock exchange on the date of exercise, the FMV shall be the average of the opening and the closing price on the recognised stock exchange with the highest trading volume.

- In considering both the opening or the closing price, the first settlement or the

last settlement respectively on such exchange shall be considered. Where both 'buy' and 'sell' quotes are available, the sell quotes shall be considered.

- Where there is no trading recorded on a particular day, the FMV shall be closing price on the recognised stock exchange or recognised stock exchange with highest trading volume on the closest date immediately preceding the date of exercise. It may be noted that here only the closing price is to be considered as opposed to average of opening and closing price for considered for regularly traded shares.
- Recognised stock exchange shall have the meaning as per section 2(f) of the SCRA which refers to the stock exchange as recognised by the Central Government under section 4 of the SCRA. Thus, if equity shares are listed on a stock exchange outside India then such equity shares shall not be considered as listed on a recognised stock exchange. Accordingly, such equity shares are considered as unlisted shares for the purpose of this Rule.

In case of unlisted equity shares or securities other than equity shares

The FMV shall be the value as determined by Category-1 Merchant Banker (registered with SEBI). The FMV shall be determined either on the exercise date or any earlier date not more than 180 days prior to the exercise date. The date of report of the merchant banker is not relevant but what is relevant is the valuation date **as of which** the merchant banker determines the underlying valuation of the share. Thus, a valuation report once obtained will be valid for 180 days.

Q.5 How does the taxation take place in case of PEP or SAR?

A.5 Cash settled PEP / SARs

On exercise of the PEP / SAR, the Company will be obligated to pay cash based on the valuation formula specified for the PEP/ SAR. Since this is paid in cash, it is taxable as normal salary. The Tribunal (Special Bench)[1] has held that the benefit on account of SAR shall be assessable as salary in the year of redemption.

Equity settled PEP / SAR

Where shares are allotted to settle the difference payable to an employee under SARs or PEPs, the perquisite on allotment or transfer of such shares will taxable in accordance with section 17(2)(vi) based on the FMV of the shares determined as per Rule 3(8).

Q.6 How are gains arising on subsequent sale of shares taxed?

A.6 Gains arising on subsequent sale of shares shall be taxable as 'capital gains' - long term or short-term, depending upon the period of holding of such shares. The period of holding shall be computed from the date of allotment of such shares as per section 2(42A). As per section 49(2AA), the FMV as per Rule 3(8) considered for determining the perquisite value u/s 17(2)(vi) shall be taken as cost of acquisition. This ensures that the employee does not suffer double taxation on the perquisite value already taxed as salaries.

Q.7 Whether benefit of grandfathering of cost will be available for shares of a listed company acquired on exercise of ESOPs?

A.7 Where the exercise of ESOPs and allotment of the shares is done prior to 31-1-2018 and the Company was listed as on 31-1-2018, the benefit of grandfathering of

1 Sumit Bhattacharya v. ACIT [2008] 112 ITD 1 (Mum)(SB)

cost on the basis of FMV as on 31-3-2018 in accordance with the provisions of section 55(2)(ac) r.w.s. 112A will be available. It may be mentioned that section 112A provides that long term capital gains resulting from sale of equity shares which are subjected to securities transaction tax ('STT') both at the time of acquisition as well as transfer shall be subjected to tax @ 10% without availing the benefit of indexation. The Central Government has issued a Notification[2] which *inter alia* specifies that shares acquired pursuant to ESOS or ESPS framed under the SEBI ESOP Guidelines shall be covered by section 112A even though no STT is paid on them at the time of acquisition. This is a beneficial notification. However, the notification gives reference to the SEBI ESOP Guidelines despite the same being already superseded by SEBI SBEB Regulations even prior to the issue of the aforesaid notification. This seems a unintended lapse. Hence, despite the anomaly, shares acquired under ESOPs framed both under SEBI ESOP Guidelines and SEBI SBEB Regulations are eligible for the benefit under the said notification.

Q.8 How are sweat equity shares to be taxed?

A.8 Sweat equity shares are defined to mean equity shares issued by a company to employees or directors at a discount or for non-cash consideration for know-how / IP / value addition provided by such employees / directors. The issue of such sweat equity shares will have to comply with the provisions of the Companies Act, 2013 for the unlisted companies or the SEBI (Issue of Sweat Equity) Regulations, 2002 for the listed companies. Section 17(2)(vi) also covers issue of sweat equity shares within its fold and hence, the value of perquisite shall be determined with reference to as FMV as per Rule 3(8) & 3(9) less the price paid for such shares, if any.

Q.9 How are ESOPs offered to consultants or advisors to be taxed?

A.9 The Indian regulations viz. the Companies Act, 2013 and the SEBI SBEB Regulations do not permit ESOPs to be offered to non-employees. However, in case equity shares are allotted or transferred to consultants or advisors who are engaged in business or profession, then the perquisite element, if any, will be taxed in accordance with section 28(iv) as profits and gains of business or profession.

Q.10 What is the taxation of ESOPs given to directors who are not employees?

A.10 The Companies Act, 2013 and the SEBI SBEB Regulations do not permit issue of ESOPs to independent directors. However, non – independent directors who are not in an executive capacity may also be given ESOPs. If these directors receive such ESOPs as part of their business or profession, then they will be taxed u/s. 28(iv). In other cases, the value of benefit or perquisite obtained by a director from a company is deemed as income u/s 2(24)(iv) and taxed as 'income from other sources'. However, no valuation guidelines are prescribed under the Act or the Rules for such cases. Whether the perquisite is to be valued in accordance with Rule 3(8) or Rule 11UA read with section 50CA or Section 56(2)(x) seems an open question. Under Rule 3(8), the valuation of the underlying unlisted share would be the FMV determined by a merchant banker whereas under Rule 11UA, the FMV will be the book value of the share as adjusted for certain assets as prescribed therein.

If the perquisite element is taxed, a collateral issue will be whether at the time of sale of the shares, the FMV so considered for taxing the perquisite element will be available as cost. Section 49(2AA) provides adjustment for cost of acquisition only where the perquisite is taxed

2 Notification No. 60/2018/F. No. 370142/9/2017-TPL dated 1-10-2018

u/s. 17(2)(vi). It might be a good case to argue that the FMV considered for perquisite taxation ought to be available as cost basis existing jurisprudence as otherwise it will result in double taxation.

Q.11 Are ESOPs offered by Holding Co. to the employees of Subsidiary Co. taxable as salary?

A11 In the case of Microsoft Corporation USA[3], the Authority for Advance Rulings ('AAR') held that the benefit arising to the employee of Indian subsidiary from stock option granted by its US parent company was taxable in the hands of Indian employee as 'salary'. The AAR, by lifting the corporate veil, held that *'the parent company has made such offer to the employees of the subsidiary company only because it regards its subsidiary and itself as the same concern'*. In another decision, the Tribunal (Special Bench – Mumbai)[4] relying on the decision of the Supreme Court[5] held that employer-employee relationship is not necessary for an income to be taxed under the head 'Salaries'. It is enough if the sum earned is a reward for services rendered by the employee. Similar view has also been taken in other cases[6]. In most such cases, the parent company may be recovering the benefit so provided by way of cross charge from the subsidiary. Further the obligation to deduct rightful taxes on the salaries paid to employees will be on the employer company. Keeping all these aspects in mind, in most cases, the benefit received is accordingly treated as taxable under the head 'salaries' and appropriate TDS is being done. Even if the same is not taxable under the head 'salaries', it may be taxable under 'income from other sources'.

Q.12 What will be the tax treatment in case shares allotted under ESOPs are bought back by the Company?

A.12 Section 46A specifically deals with the tax implications in case of buyback by a company of its own shares or specified securities. Hence, in case where shares are listed, buyback of shares allotted under ESOPs would be subject to provisions of section 46A and taxed accordingly. In doing so, the cost will be determined in accordance with section 49(2AA).

However, in case of buyback of shares of an unlisted company, section 115QA applies. As per section 115QA, the 'distributed income' paid to the shareholder is charged to tax @ 20% plus applicable surcharge and cess. 'Distributed income' has been defined as buyback price minus the 'amount received by the company' for issue of shares. As per rule 40BB of the Rules, the 'amount received by the company' in case of shares issued under stock option plan shall be the FMV determined by the merchant banker for taxation of perquisite under Rule 3(8) **to the extent credited to the share capital and share premium account.**

Let us consider an example, shares of face value of ₹ 10 having FMV on date of grant of ₹ 100 are granted at ₹ 80. The Company can account for ₹20 as discount to be amortised over the vesting period. Assume the FMV at the time of exercise for determining the perquisite is ₹ 400. As per the generally accepted accounting practice, the amount received at the time of exercise (₹ 80) plus the discount of ₹ 20 will be credited to the share capital and share premium account in aggregate. The difference of ₹ 300 out of ₹ 320 on which the employee has paid the perquisite tax will again suffer buy back

3 (P. No. 15 of 1998) [1999] 235 ITR 565 (AAR)

4 Sumit Bhattacharya vs. ACIT [2008] 112 ITD 1 (Mum)(SB)

5 Justice Deoki Nandan Agarwal vs. Union of India [1997] 237 ITR 872 (SC)

6 ACIT vs. Chittaranjan A. Dasannacharya [2014] 64 SOT 226 (Bangalore - Trib.)

tax u/s. 115QA since the entire value on which perquisite tax is paid is not credited to the share capital or share premium account. Once the employee has been taxed on the perquisite based on the FMV, the further requirement of the same being credited to share capital or share premium seems out of place and inequitable.

Q.13 It is quite common for companies to set up a Trust exclusively for implementing ESOPs? What are the tax implications in such cases?

A.13 Generally, in an ESOP Trust, the beneficiaries are identified by a class and their individual interest would be indeterminate. Such ESOP Trusts set up by the Company will be governed by proviso (iv) to section 164 and accordingly, they will not be taxed at maximum marginal rate but as per the rates applicable to an AOP i.e. as individuals.

Q.14 Is the Employer Company required to withhold any taxes on account of perquisite element under an ESOP?

A.14 The employer shall be liable to deduct taxes at source on the perquisite under an ESOP. The perquisite u/s. 17(2)(vi) is taxable at the time when the shares are allotted or transferred. Under Rule 3(8), the underlying FMV of the shares is to be determined as on the date of exercise. Nevertheless, the perquisite arises only at the time of allotment or transfer of shares and hence, the TDS obligation will also arise at the time of such allotment or transfer and not on the date of exercise[7].

Q.15 How are ESOPs taxed in case of a cross border situations?

A.15 In the present era, employees are mobile and are internationally engaged. Further, the life cycle of an ESOP from grant – vesting - exercise - sale is spread over many years. It may be possible that employees would have moved to many countries during this period. Taxation of the employees in such cases can be complicated as each of the countries in which the employee may have worked during the entire life cycle of an ESOP may tax ESOPs in differing manner. There can be situations of either double taxation or double non taxation. Credit for taxes withheld can also pose some challenges. The topic is worthy of a separate article and is therefore, not addressed here.

3 Issues

Some of the key issues in ESOP taxation are briefly discussed here.

I.1 In case of ESPS the shares allotted or transferred are subject to lock-in. How is the FMV determined under 3(8) to be adjusted for such lock-in conditions.

A.1 In case of ESPS, the lock-in conditions can be of 2 types - a) where the employee is precluded from selling the shares during the lock-in period or b) where the employee is compelled to retransfer the shares if conditions like continued employment are not fulfilled during the lock-in period.

If there is merely a restriction on sale during the lock-in period, the benefit will nevertheless be taxable by virtue of section 17(2)(vi). However, such lock-in restrictions ought to be suitably factored while determining the taxable value. For listed shares, unfortunately, the FMV is the quoted price and hence, the lock-in restriction cannot be factored in the valuation. However, in case of unlisted shares, the merchant banker may suitably factor in the lock-in restrictions while valuing the shares considering the duration of the lock-in period.

In some cases of lock-in resrictions, the shares received under an ESPS are to be compulsorily re-transferred, at the issue price, in case of failure to comply with the conditions of continued employment or other conditions during the lock-in period. Thus, unless the

7 Bharat Financial Inclusion Ltd. vs. DCIT (TDS) [2018] 172 ITD 198 (Hyderabad-Trib.)

conditions are fully complied with, there is no benefit arising to the employee. The Supreme Court in case of Infosys Technologies Ltd.[8] had ruled that where shares are re-transferrable on account of resignation etc. during the lock-in period, the shares have no realisable value and hence, there is no perquisite in the hands of the employee. However, this decision was rendered before the provisions of section 17(2)(vi) were brought on the statute. One may also want to press the real income theory and other case laws which have upheld such a position. However, due to express provisions of section 17(2)(vi) read with Rule 3(8), this may be subject to litigation.

I.2 What is the taxability of stock options exercised by the legal heirs in case of death of the employee?

A.2 As per the Companies Act, 2013 as well as the SEBI SBEB Regulations, 2014, upon the death of an employee, all options granted, shall vest and such vested options, may be exercised by the legal heirs or nominees, as the case may be. In the context of gratuity payment, the CBDT[9] has clarified that lumpsum gratuity paid to legal heirs of deceased employees is not taxable. Similarly, exemption is available in case of leave encashment paid to legal heirs of deceased employees[10]. It may also be pointed out that there are several judicial precedents which have held that amount received by legal heirs of deceased person amounts to a capital receipt not chargeable to tax. It can also be contended that in absence of any employer-employee relationship, the same should not be taxable as perquisite u/s. 17(2)(vi). Hence it seems to be a very good case to argue that no amount will be taxable in the hands of the legal heirs on exercise of the vested options.

However, where such shares are allotted or transferred at a price which is lower than the FMV under Rule 11UA, whether the difference can be brought to tax u/s. 56(2)(x) is a matter of debate. Exceptions to applicability of section 56(2)(x) do not provide for any carve out in respect of any property received on exercise of options by legal heirs. The carve out for property received under inheritance or will may not apply in this case as the shares will be received from the Company and not from the deceased employee. It may be argued that the right to exercise the vested options devolves upon the legal heirs pursuant to the contract of the Company with the deceased employee and hence, the benefit is flowing on account of inheritance or will and should be covered by the carve out u/s. 56(2)(x).

I.3 What is the taxability in cases where the individual promoter of a company makes a grant to employees of the company of which he is a promoter. Such grants may be either directly or through an employee welfare trust set up for benefit of the employees?

A.3 Where the grant of shares is made directly to the employees as a gratuitous act for years of association with the company in which the promoter is interested and it is one-time in nature, then one may argue that it is a capital receipt. In such cases, the application u/s. 56(2)(x) may pose a challenge. However, where the grant to the employees is linked to continued employment or other performance linked conditions or where the grants are recurring in nature, then they may partake the character of 'Salaries'.

Where such shares are granted through the employee welfare trusts, it may still be a capital receipt. Such distribution is made to the employees as beneficiaries of the employee welfare trust. Hence, it may be argued that the distribution is in the capacity as a beneficiary and therefore, there is adequate consideration for the same so as not to be taxable u/s. 56(2)

8 [2008] 297 ITR 167 (SC)

9 *Vide* Circular No. 573 dated 21.8.1990

10 *Vide* Circular No. 309 dated 3.7.1981

(x). The issue is debatable and not free from litigation.

I.4 In case of an amalgamation or demerger, if the ESOPs of the amalgamating company or demerged company are substituted with similar ESOPs of the amalgamated company or the resulting company, would any taxability arise in the hands of the employees?

A.4 It is common that vested or unvested ESOPs of an amalgamating company or demerged company are substituted for similar ESOPs from the amalgamated company or the resulting company on an equitable basis. Section 47(vii) and section 47(vid) provide exemption only to shareholders of the amalgamating company or demerged company. There is no specific exemption for ESOP holders. Since capital gains arise only upon transfer of a capital asset, it is necessary to examine whether ESOPs are a capital asset. Further, ESOPs by their very nature are non-transferable and hence, their realizable value is Nil. It will be a good case to argue that receipt of ESOPs from the amalgamated company or the resulting company cannot be taxed as capital gains as ESOPs are only notional in nature and benefit, if any, crystallises only upon exercise. In any case, on exercise, the perquisite element will be taxed in the hands of the employees as per section 17(2)(vi) read with Rule 3(8). Hence, the taxability of capital gains ought not to take place.

I.5 In case an employee surrenders his right under the ESOP and receives a cash payout, whether the same will be taxed as salary or capital gains?

A.5 In case of corporate actions, it is quite common that the acquirer may insist that all outstanding ESOPs be settled before the acquisition is completed. In such cases, the compensation committee administering the ESOP may decide to pay in cash the fair value of the shares less exercise price to the employees for the vested / unvested options. Taxability u/s. 17(2)(vi) arises only when the shares are allotted or transferred upon exercise of ESOPs. Hence, if the ESOPs are surrendered, the same will not come within the purview of section 17(2)(vi) of the Act.

As per section 2(14) of the Act, a capital asset is defined to include "property, of any kind, whether or not connected with his business or profession'. The judicial authorities[11] have held that the definition of property is wide enough to cover even rights to subscribe to the shares of the company. Accordingly, rights granted under ESOPs should also be treated as capital assets. Where such rights are surrendered to the Company / third party, the income arising therefrom may be taxed under the head 'capital gains' and not as 'income from salary'[12] and the period of holding shall be reckoned from the date of grant of the option.

4. Conclusion

The taxation provisions relating to ESOPs have evolved over the years. ESOPs are given by both listed and unlisted companies including start-ups. At a practical level, the biggest constraint faced by employees, especially in case of unlisted companies, is that the perquisite is taxed at the time of exercise. There may be no exit or liquidity available at the time of such exercise and hence, tax on such perquisite in most cases will have to borne by the employees out-of-their pocket. This makes ESOPs a bit unattractive and in many cases, employees are unable to exercise their vested options. The uncertainty surrounding timing of eventual exit and valuation issues further aggravate the problem. At a time when the government is keen to promote start-ups, there is strong merit to postpone the taxability of ESOPs till it is either freely encashable or upon its ultimate realisation.

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11 Hari Brothers (P.) Ltd. vs. ITO [1964] 52 ITR 399 (Punjab & Haryana); Kamlesh Bahedia vs. ACIT [2014] 151 ITD 495 (Delhi - Trib.); Giridhar Krishna M. v. ACIT [2008] 117 TTJ 965 (Bang.)

12 N. R. Ravikrishnan vs. ACIT [2019] 175 ITD 355 (Bangalore - Trib.)

CA Paras K. Savla

Valuation of Shares – Rule 11UA

1. Background

1.1 Section 56(2)(viib) of the Income-tax Act 1961 (the 'Act') provides that where a company (other than the company in which the public are substantially interested), receives any consideration from any resident person for issue of shares which exceed the face value of such shares, shall be considered as income, if the aggregate consideration received for such shares is in excess of the fair market value of the shares.

1.2 Section 56(2)(x)(c) of the Act provides tax treatment where any person receives any property other than immovable property, from any person on or after April 1, 2017 without any consideration or with consideration which is lower than fair market value.

- In case consideration is NIL, the aggregate fair market value of which exceeds ₹ 50,000, the whole of the aggregate fair market value of such property shall be considered as income; and
- In case consideration is less than aggregate fair market value of the property by an amount exceeding ₹ 50,000, the aggregate fair market of such property exceeding such consideration, shall be considered as income.

Sections 56(2)(viib)/56(2)(x)(c) of the Act are a deeming provisions to bring notional income to tax and hence has to be strictly interpreted. While giving effect to such legal fictions all facts and circumstances incidental thereto and inevitable corollaries thereof have to be assumed[1]. Legal fictions are created only for a definite purpose and they are limited to the purpose for which they are created and should not be extended beyond the legitimate field. But the legal fiction has to be carried to its logical conclusion within the framework of the purpose for which it is created[2].

1.3 Rule 11UA of the Income-tax Rules 1962 (the 'Rules') prescribes the mechanism for determination of the fair market value of any property. Rule 11UA(1)(c) and 11UA(2) provides for the mechanism for determination of value of quoted and unquoted shares as referred in sections 56(2)(x)(c) and 56(2)(viib) respectively. The rule 11UAA provides that valuation mechanism provided under rule 11UA(1)(c)(b)&(c) is also applicable for determination fair market value in respect of unquoted shares u/s 50CA.

1 Vaani Estates (P.) Ltd. v. ITO [2018] 98 taxmann.com 92 (Chennai - Trib.)

2 M.D. Jindal v. CIT [1986] 164 ITR 28

2. Fair Market Value of shares and securities

2.1 Where a method has been prescribed by the legislature, that method alone shall be followed for computation of the fair market value. The legislature in its wisdom has also given a formulae for computation of the fair market value which cannot be ignored by the authorities below. The tax officer has to compute the fair market value in accordance with the prescribed method and he cannot adopt the market value as fair market value[3].

2.2 Fair Market Value of shares and securities u/s 56(2)(x)(c)

2.2.1 Quoted Shares

2.2.1.1 The fair market value of quoted shares and securities is determined as under[4]:

- if the quoted shares and securities are received by way of transaction carried out through any recognised stock exchange, the fair market value of such shares and securities shall be the transaction value as recorded in such stock exchange;
- if such quoted shares and securities are received by way of transaction carried out other than through any recognised stock exchange, the fair market value of such shares and securities shall be:
  - o shares and securities quoted on any recognised stock exchange on the valuation date – the lowest quoted price, and
  - o shares and securities are not quoted on any recognised stock exchange on the valuation date – the lowest price of such shares and securities on any recognised stock exchange on a date immediately preceding the valuation date when such shares and securities were traded on such stock exchange

2.2.1.2 The 'quoted shares or securities" in relation to share or securities means a share or security quoted on any recognised stock exchange with regularity from time-to-time, where the quotations of such shares or securities are based on current transaction made in the ordinary course of business. The regularity of the trading/quoting has not been defined. However as per the SEBI Regulation shares are 'frequently traded shares" if the traded turnover of such shares or securities on any stock exchange during the last twelve calendar months is at least ten per cent of the total number of shares of such class.

2.2.2 Unquoted shares – Equity Shares

2.2.2.1 The fair market value of unquoted equity shares shall be the value, on the valuation date, of such unquoted equity shares as determined by following formula (A+B+C+D - L)× (PV)/(PE)[5]

- A= book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) in the balance-sheet as reduced by following amounts:
  - o any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any; and
  - o any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;
- B = the price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer;

3 Medplus Health Services (P.) Ltd. v. ITO [2016] 68 taxmann.com 29/158 ITD 105 (Hyd. - Trib.)
4 Rule 11UA(1)(c)(a)
5 Rule 11UA(1)(c)(b)

- C = fair market value of shares and securities as determined in the manner provided in this rule;
- D = the value adopted or assessed or assessable by any authority of the Government for the purpose of payment of stamp duty in respect of the immovable property;
- L = book value of liabilities shown in the balance sheet, but excluding the following amounts:—
  - o the paid-up capital in respect of equity shares;
  - o the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
  - o reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
  - o any amount representing provision for taxation, other than amount of income-tax paid, if any, less the amount of income-tax claimed as refund, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;
  - o any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
  - o any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;
- PV= the paid up value of such equity shares;
- PE = total amount of paid up equity share capital as shown in the balance-sheet;

2.2.2.2 Prescribed methodology required the valuation to be carried based on adjusted value of specified assets viz. Jewellery and artistic work, shares and securities immovable property and book value of other assets as shown in balance sheet. For the purpose of this rule balance sheet is required to be drawn up on the valuation date and "valuation date" means the date on which the property or consideration, as the case may be, is received by the assessee. When the transaction is happening during the year other than on year end, it is difficult for the shareholder to obtain audited balance sheet as on the valuation date. Shareholder has no authority demand the same from the company. This is more difficult in case shareholder is minority shareholder or where he is not in good terms with the company.

2.2.3 Unquoted shares other than equity shares

2.2.3.1 The fair market value of unquoted shares and securities other than equity shares in a company which are not listed in any recognized stock exchange shall be estimated to be price it would fetch if sold in the open market on the valuation date and the assessee may obtain a report from a merchant banker or an accountant in respect of which such valuation.

2.2.3.2 The equity shares and preference shares stand on different footings. The method "book value" of shares would value only "Equity shares" and not "Preference shares"[6]. The preference shares can also be issued at premium. While valuing, discounting factor cannot be considered in arbitrary manner. It need to be based on proper comparable for bench marking. Further income-tax also has to be factored while determining the net rate of return on investments[7].

6 ACIT vs. Golden Line Studio (P.) Ltd. [2018] 98 taxmann.com 299 / 173 ITD 200 (Mumbai - Trib.)

7 Microfirm Capital (P.) Ltd. vs. DCIT [2018] 89 taxmann.com 23 / 168 ITD 301 (Kolkata - Trib.)

2.3 Fair Market Value of shares when issued at price exceeding face value u/s. 56(2)(viib)

2.3.1 The fair market value of unquoted equity shares when issued at price exceeding face value shall be determined = [(A–L)/ (PE)] × (PV),[8]

- A = book value of the assets in the balance-sheet as reduced by any amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act and any amount shown in the balance-sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;
- L = book value of liabilities shown in the balance-sheet, but not including the following amounts:
  - o the paid-up capital in respect of equity shares;
  - o the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
  - o reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
  - o any amount representing provision for taxation, other than amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;
  - o any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
  - o any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;
- PE = total amount of paid up equity share capital as shown in the balance-sheet;
- PV = the paid up value of such equity shares;

2.3.2 It also provides an option to determine fair market value of the unquoted equity shares using the Discounted Free Cash Flow (DCF) method. However in such event w.e.f. 24-5-2018, valuation exercise shall be carried by a merchant banker only.

2.3.3 The Section 56(2)(viib) of the Act applies to all types of shares i.e. equity and preference. The assessee has all the right to choose a method i.e. NAV Method (Book Value) or DCF Method which, cannot be changed by the tax officer. The method adopted for the purpose of valuation should be based on relevant materials and if based on relevant material even the Court will not interfere with such a finding of fact[9]. The tax officer is undoubtedly entitled to scrutinise the valuation report. The Tax Officer has not only a right but he is also duty bound to examine the valuation report evaluate it and record his findings on the same. Such finding should be based on relevant material and rational view taken in a judicious manner[10]. He may determine a fresh valuation either by himself or by calling for a final determination from an independent valuer to confront the petitioner. However, the basis has to be the same method and it is not open to him to change the method of valuation which has been opted for by the

8 11UA(2)
9 Duncans Industries Ltd. vs. State of U.P [CA No. 5929 of 1997] (SC)
10 Microfirm Capital (P.) Ltd. vs. DCIT [2018] 89 taxmann.com 23 / 168 ITD 301 (Kolkata - Trib.)

Assessee[11] and to modify the figures as per his own whims and fancies. In any case, the tax officer cannot ask assessee to prepare the valuation report based on actuals which is not contemplated in Rule 11UA(2)(b[12].

2.3.4 The rules prescribe that while valuing the shares the book value of the assets and liabilities declared by the company should be taken into consideration. Unlike rule 11UA(1)(c)(b) there is no whisper to refer the fair market value of the specified assets, while valuing under rule 11UA(2). Therefore, while valuing no adjustment is required to be made with respect to market value or fair value of any assets[13]. However this inconsistency between the rules 11UA(1)(c)(b) and rule 11UA(2) in valuation of FMV of unquoted equity shares may lead to two different valuation from the perspective of company issuing shares and from the perspective of the recipient of such shares.

2.3.5 The Chennai ITAT[14] after analysing various legal principles held that provisions of Section 56(2)(viib) of the Act, cannot be invoked in the case of the assessee company because by virtue of cash being brought into the assessee company by 'S' for allotment of equity shares with unrealistic premium the benefit has only passed on to her daughter 'S' and there is no scope in the Act to tax when cash or asset is transferred by a mother to her daughter.

2.3.6 Any of the method prescribed does not considers adjustment for specific situation e.g. when equity shares are issued with differential voting rights. Further same transaction of issue of shares may require valuation to be carried by more than one valuer. e.g. under the Companies Act, 2013 valuation for the purpose of issue of shares is required to be carried by the registered valuer. In case, shares are valued using DCF method then under the income tax provisions such report is required to be issued by merchant banker. This is against the principle of ease of doing business.

3. Exemption to startups for the purpose of clause (viib) of sub-section (2) of section 56 of the Act

3.1 The Notification NO. GSR 127 (E) [F.NO.5 (4)/2018-SI], Dated 19-2-2019 had been issue to provide relaxation u/s. 56(2)(viib) for the startup. An entity shall be considered as a Startup:

- Upto a period of ten years from the date of incorporation/ registration, if it is incorporated as a private limited company or registered as a partnership firm or a limited liability partnership in India.
- Turnover of the entity for any of the financial years since incorporation/ registration has not exceeded one hundred crore rupees.
- Entity is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation.

3.2 A Startup shall be eligible for notification under clause (ii) of the proviso to clause (viib) of sub-section (2) of section 56 of the Act and consequent exemption from the provisions of that clause, if it fulfils the following conditions:

- it has been recognised by Department for Promotion of Industry and Internal Trade (DPIIT)
- aggregate amount of paid up share capital and share premium of the startup after issue or proposed issue of share, if any, does not exceed, ₹ 25 crore. However in computing the aggregate amount of paid up share capital, the amount of paid up share capital and share premium of ₹ 25 crore, shares issued to a non-resident or a venture capital company or a venture capital fund or specified company shall not be included.
  - o "specified company" means a company whose shares are frequently traded within the meaning of Securities and

11 Vodafone M-Pesa Ltd. vs. Pr. CIT [2018] 92 taxmann.com 73 (Bombay)

12 Rameshwaram Strong Glass (P.) Ltd. vs. ITO [2018] 96 taxmann.com 542/172 ITD 571 (Jaipur - Trib.)

13 Minda S M Technocast (P.) Ltd v. ACIT [2018] 92 taxmann.com 29 (Delhi - Trib.)

14 Vaani Estates (P.) Ltd. v. ITO [2018] 98 taxmann.com 92 (Chennai - Trib.)

Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and whose net worth on the last date of financial year preceding the year in which shares are issued exceeds one hundred crore rupees or turnover for the financial year preceding the year in which shares are issued exceeds two hundred fifty crore rupees.

- It has not invested in any of the following assets,–
  - o building or land appurtenant thereto, being a residential house, other than that used by the Startup for the purposes of renting or held by it as stock-in-trade, in the ordinary course of business;
  - o land or building, or both, not being a residential house, other than that occupied by the Startup for its business or used by it for purposes of renting or held by it as stock-in trade, in the ordinary course of business;
  - o loans and advances, other than loans or advances extended in the ordinary course of business by the Startup where the lending of money is substantial part of its business;
  - o capital contribution made to any other entity;
  - o shares and securities;
  - o a motor vehicle, aircraft, yacht or any other mode of transport, the actual cost of which exceeds ten lakh rupees, other than that held by the Startup for the purpose of plying, hiring, leasing or as stock-in-trade, in the ordinary course of business;
  - o jewellery other than that held by the Startup as stock-in-trade in the ordinary course of business;
  - o any other asset viz. archaeological collections, drawings, paintings, sculptures, any work of art, bullion, whether in the nature of capital asset or otherwise.
  - o The Startup shall not invest in any of the above specified assets for the period of seven years from the end of the latest financial year in which shares are issued at premium;

4. Share premium S. 56(2)(viib) vs. S. 68

4.1 Any premium received by a Company on sale of shares, in excess of its face value, if the Company is not one in which the public has substantial interest, would be treated as income from other sources, as seen from Section 56(2)(viib) of the Act, which cannot be controlled by the provisions of section 68 of the Act. Section 68 on the other hand, as substituted with the provisos, treats any credit in the books of account, even by way of allotment of shares; for which no satisfactory explanation is offered, to be liable to income-tax. Clause (viib) of Section 56(2) is triggered at the stage of computation of income itself when the share application money received, from a resident, by a Company, in which the public are not substantially interested; is above the face value. Then the aggregate consideration received for the shares as exceeds the fair market value will be included as income from other sources. However, when the resident investor is not able to explain the nature and source for the credit seen in the books of accounts of the Company or the explanation offered is not satisfactory then the entire credit would be charged to income tax for that previous year. That is the entire amounts credited in the books of accounts, styled as, for allotment of shares or application money, including the fair market value determined will be charged to tax. However if an explanation is offered and if it is satisfactory in the case of a Company in which the public are not substantially interested, then the charge to tax will only be to that portion exceeding the fair market value determined; which anyway has to occur under Section 56(2)(viib)[15].

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15 Sunrise Academy of Medical Specialities (India) (P.) Ltd. v. ITO [2018] 96 taxmann.com 43 / 409 ITR 109 (Kerala)

CA Rima Gandhi & CA Anand Bathiya

Taxation of Debt Instruments

Investing in a debt instrument is similar to giving a loan to the issuing entity in a manner wherein each holders' component is separable from the others and also marketable in accordance with the terms of the issuance. The basic reason behind investing in a debt instrument is to earn interest income and capital appreciation. The issuer pre-decides the interest rate you will earn as well as maturity period. That's why they are also called 'fixed-income' securities because you know what you're going to get out of them. Pooled vehicles or funds that invest in debt instruments are also known as debt funds. A debt fund invests in fixed-interest generating securities like corporate bonds, government securities, treasury bills, commercial paper and other money market instruments.

Some of the important and widely used debt instruments are Non-Convertible Debentures, Zero Coupon Bonds, Redeemable Preference Shares, Deep Discount Bonds, Units of Debt Oriented Mutual Funds, Units of Real Estate Investment Trusts, Units of Infrastructure Investment Trusts, etc.

A. Tax treatment of Debt Instruments– from Issuer's perspective

As per the provisions of the Income-tax Act, 1961 ('ITA'), under Section 36(1)(iii) – amounts paid as interest on borrowings and debt, in general, qualify for tax deduction as long as it is on account of capital borrowed for the purpose of a business or profession.

Further, section 37 of the ITA provides that any expenditure (not being capital or personal in nature), incurred wholly and exclusively for the purposes of the business, would qualify as an allowable expenditure to be taken into account while computing taxable business or professional income.

The issuer of a debt instrument would need to consider appropriate tax withholding at source ('WHT') on interest payments to claim interest as a tax-deductible expense. Failure to deduct WHT could result in tax, interest and penal consequences.

a. Meaning of "debt" and "interest" under the ITA

ITA does not specifically define the terms "debt" or "loan". In the ordinary sense, it means something that is owed and creates an obligation to pay, generally money or money's worth. In terms of financing, it connotes a temporary provision of money usually with interest payable on the amount. For a loan there has to be a positive act of lending money coupled with its acceptance[1] and a corresponding obligation of repayment.

1 CEPT vs. Bhartia Electric Steel Co. Ltd (1954) 25 ITR 192 (Cal.).

Therefore, equity contributions without any provision of repayment cannot be classified as a loan.

The term "interest", however, has been defined under Section 2(28A) in the ITA to mean:

"interest means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized."

The above definition is inclusive in nature and does not provide specific guidance as to the essential attributes of "debt" or "interest". Judicial authorities have interpreted the above-mentioned terms in a broad fashion and have held interest to include any amount payable as compensation towards any debt incurred, money borrowed, deposit, claim or any other similar right or obligation. However, for purposes of tax deduction, interest needs to be distinguished from payments which are in the form of application of profits, since deduction is only permissible with respect to interest on borrowings. In this context "interest" is understood as an outgoing expenditure that is taken into account to arrive at the taxable profit as compared to any payment which is an application of profit (which would not qualify as a deductible expenditure).

The issuance of preference shares is generally not considered a loan,[2] even if it has been issued on a redeemable basis. Hence, payment of interest/dividend on redeemable preference shares is not deductible as interest on borrowed capital under normal taxation provisions of ITA. It is worthwhile to note that under the provisions of IND-AS redeemable preference shares are classified as liability and accordingly payment due thereon as finance expenses.

b. Certain issues in deductibility of interest payments

The ITA provides for a residual clause in Section 37, under which any expenditure incurred wholly and exclusively for the purposes of a business, not being capital in nature, can be allowed as a tax deductible expense. Accordingly, claims of deduction for interest expenditure on items like trade payables, brokerage or commission paid to an agent to procure a loan have been allowed under this residuary clause. However, Interest paid on borrowings made for the purpose of paying statutory dues has been held to be not eligible for tax deduction.[3]

Further, as per the provisions of the ITA, a deduction of interest on borrowings is allowable only if it is paid or incurred on account of capital borrowed for business purposes. The interpretation of "business purpose" is largely a question of fact whereby the borrowed funds should be utilised for the purposes of the existing business and not a new project or independent venture which is unconnected with the business.[4] In order to be allowable as a tax deduction, interest should be paid in respect of a business which is already set up and running.[5] Further, the Indian courts have held that in cases where an entity has borrowed money on interest and subsequently advanced interest free loans to its sister concerns, that interest expenditure on such borrowing cannot be said to be for business purposes and is hence disallowable.[6]

2 Kirloskar Electric Co. Ltd vs. CIT (1997) 228 ITR 674 (Karn.).

3 Thapar (LM) vs. CIT (1988) 173 ITR 577 (Cal.).

4 Dey's Medical Stores Mfg (P) Ltd. vs. CIT (1986) 162 ITR 630 (Cal.).

5 Ritz Continental Hotels Ltd. vs. CIT (1978) 114 ITR 554 (Cal.).

6 Triveni Engg Works Ltd. vs. CIT (1987) 167 ITR 742 (All.).

In situations where money has been borrowed from -

(a) a related party, as defined under the ITA, or

(b) enterprises which for the purposes of transfer pricing are associated enterprises,

the amount of interest eligible for tax deduction is computed (a) to ensure that the amount is not excessive and unreasonable and (b) on an arm's length basis.[7]

The judicial trend, has been to ascertain the reasonableness of the expenditure having regard to first, the fair market value of the goods, services or facilities for which the payment is made,[8] secondly, the legitimate needs of the business or profession, and lastly, the benefit derived by or accruing to the taxpayer from the expenditure.[9] Furthermore, a duty is cast on the Revenue Authorities to establish that the payment is excessive or unreasonable; evidence for this has to be placed on record and the disallowance cannot proceed merely on the basis of surmises and conjectures.

Further, deduction for expense incurred in relation to convertible instruments has been the subject matter of conflicting judicial opinion. In the case of *Banco Products (India) Ltd. vs. CIT*[10] it was observed that since convertible debentures have the characteristics of equity shares, the convertible portion of such debentures cannot be termed as debt and, therefore, any expenditure to enhance the equity base of the company has to be treated as capital expenditure. However, a contrary view was taken in *CIT vs. Secure Meters Ltd.*[11] in which case it was held that debentures issued are loans and, thus, that expenditure incurred in issuing and raising loans by debentures is admissible, notwithstanding the fact that they are convertible or non-convertible.

If interest payments are made contingent on earning profits or on the value of publicly traded property or the value of a stock or commodities index, a question may arise whether the amount paid by way of interest is tax deductible. Such loan/interest arrangements are not widely prevalent in India and the ITA does not provide any separate provisions for the deduction of interest in such situations and such issues remain largely untested by the Revenue Authorities.

B. Tax treatment of Debt – from investor's perspective

With respect to the income earned by subscribing or holding to a debt instrument, is normally classified as interest income and taxed as such. Upon sale of the debt instrument the gains arising, if any, are classified as capital gains and are taxed as such.

a. Taxability of interest income

As per Section 5 of the ITA, a tax resident of India is taxable on interest income accruing or arising from India or abroad as against a non-resident who is taxable only if the interest accrues or arises or is deemed to accrue or arise in India as per Section 9(1)(v).

Interest income payable in the following cases has been deemed to accrue or arise in India:

(a) interest payable by the Government of India; or

(b) an Indian tax resident, except where the interest is payable in relation to any debt incurred, or moneys borrowed and used, for the purposes of a business or

7 S. 92 of the ITA provides for determination of arm's length price in international transactions whereas s. 40A(2)(b) of the ITA provides for disallowance of any excessive expenditure incurred in favour of a related party.

8 Bharti Airtel Ltd v. Asstt. CIT (2010) 48 DTR 416 (Trib.)(Mum.).

9 Mittal Metal v. ITO, 2008 ITS 1465 ITAT; see also CBDT Circular no.6P (LXXVI-66) of 1968, dated 6th July 1968.

10 [1999] 63 Taxman 370 (Ahd.); see also Sona Steering Systems Ltd v. CIT [2003] 129 Taxman 152 (Mag.).

11 [2008] 175 Taxman 567.

profession carried on outside India or for the purposes of making or earning any income from any source outside India; or

(c) a person who is a non-resident for tax purposes, where the interest is payable in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India."

b. Sale, conversion and redemption debt instruments – important tax considerations

i. Sale of debt instruments

According to the Indian capital gains tax regime, where the holder of securities such as debentures, bonds, etc., receive any consideration for the sale of the securities, then subject to computation modes prescribed in the ITA, the difference between the value received by that person and the cost of acquisition is taxed as capital gains.

ii. Conversion of debt instruments

The ITA provides that any profits and gains arising from the transfer of a capital asset are chargeable to tax under the head capital gains.

"Transfer", in relation to a capital asset, has a wide connotation and is defined in Section 2(47) to include sale, exchange or relinquishment of an asset or the extinguishment of any rights in an asset.

However, under Section 47(x), (xa) and (xb) - the exemption clauses, any transfer involving the conversion of bonds or debentures, debenture stock or deposit certificates, preference shares of a company into shares or debentures of that company is exempt.

As a result, no capital gains will be liable to tax as section 47(x), (xa) and (xb) provides that the provisions of section 45 will not apply to any transfer by way of conversion of debentures, debenture-stock, bonds or deposit certificates, preference shares of a company into shares or debentures of that company.

iii. Redemption of debt instruments

In cases of redemption of debentures, the debenture holder would be exposed to tax on the capital gains accrued on the redemption of debentures. For instance, in the case of a foreign currency convertible bond (FCCB) it should be noted that for the purpose of taxation it is treated as a debt instrument until such time as it is converted into equity shares. Nonetheless, since it is considered a debt instrument it would qualify as a capital asset in the hands of a subscriber/purchaser of the FCCB.[12]

Further, in the case of redemption of FCCBs, it can be said that the redemption results in the relinquishment of rights in the capital asset (here, FCCB), and hence should give rise to capital gains. The Mumbai ITAT in case of *Mrs. Perviz Wang Chuk Basi vs. Joint Commissioner of Income-tax, Spl. Range 7 [2006] 102 ITD 123* held that "Thus after the date of redemption, there was an extinguishment of right by operation of contract and also a relinquishment of right in the asset in lieu of which, the assessee received cash from the competent authority. In either of the situations, the case is covered within the definition of Section 2(47) i.e., transfer".[13]

In the case of a zero coupon FCCB (bonds that are convertible into equity shares after a certain period but no interest is payable until the conversion), an option is provided to the bond holder to either convert the bond into equity shares or redeem it at a premium. Since there is only an extinguishment and relinquishment of rights in the capital asset, and not a payment representing interest, the same

12 This assumes that the debt instruments are not held as stock-in-trade in which case they would be treated as a revenue receipt. There are a number of judicial precedents stating that even a debt instrument such as a fixed deposit in a bank or foreign currency by itself should qualify as a capital asset.

13 See also M.P. Financial Corporation vs.. CIT [1981] 132 ITR 884.

should be regarded as capital gains. Further, the Central Board of Direct Taxes (CBDT) has issued Circular No. 2/2002, dated 15 February 2002 discussing the tax treatment of deep discount bonds where it is stated that any payment received on the maturity of such bonds must be treated as interest income. Deep discount bonds are sold at a discounted value and, on maturity, face value is paid to the investors. These are negotiable instruments which are transferable by endorsement and delivery by the transferor. The CBDT *vide* another Circular No. 3/2006 dated 27 February 2006, has further clarified that the previous circular is applicable in respect of zero coupon bonds issued by specified companies that are notified by the government.

c. Capital Gains

The incidence of tax on Capital Gains depends upon the length of the time period for which the capital asset was held before the transfer.

i. Classification of capital asset into short-term capital asset and long-term capital asset

In the case of capital assets being security[14] (other than a unit) listed on a recognised stock exchange in India, the asset is termed as short term if it is held for a period of not more than 12 months under Section 2(42A) and if held for more than 12 months are termed as long-term assets under Section 2(29A).

Units of debt-oriented mutual funds, REITs/InVITs are to be held for more than 36 months to qualify as long-term capital assets - Section 2(42A).

The following table summarises the minimum holding period for capital asset (other than equity shares) to qualify as long-term capital asset is as under:

Sr. No.	Capital Asset	Holding period to qualify as Long Term Capital Asset
1.	Listed Preference Shares of a company	More than 12 months
2.	Unlisted Preference Shares of a company	More than 24 months
3.	Securities (like debentures, bonds, Government Securities, derivatives, etc.) listed in a recognised stock exchange in India	More than 12 months
4.	Units of debt-oriented mutual funds (listed or unlisted)	More than 36 months
5.	Units of REITs/InVITs	More than 36 months
6.	Units of UTI (whether quoted or not)	More than 12 months
7.	Zero Coupon Bonds(listed or unlisted)	More than 12 months
8.	Any other asset	More than 36 months

14 The Securities Contracts (Regulations) Act, 1956 in Section 2(h) defines the term "security" to mean -

"(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate; (ia) derivative; (ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes; (ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; (id) units or any other such instrument issued to the investors under any mutual fund scheme; (ii) Government securities; (iia) such other instruments as may be declared by the Central Government to be securities; and (iii) rights or interest in securities".

For the sale of a security held in an unlisted company, the sale of debentures would be taxed at the rate of 10 per cent without indexation or 20 per cent with Indexation in the case of long-term capital gains (LTCG). Whereas, Short-term capital gains (STCG) arising from the sale of the same would be taxed at the rate of 30 per cent.

A large number of Foreign Institutional Investors (FIIs) invest in India *via* entities in Mauritius, Singapore, Cyprus, Netherlands or others for a variety of reasons including tax efficiency.[15] The issue of whether the income of FIIs from trading in securities is "capital gain" or "business income" has been long debated. The AAR in the ruling of *Fidelity Advisor Series VIII (Fidelity VIII) [271 ITR 1 (AAR)]* has held that such income would be business income keeping in view the intent of the investor and the frequency of transactions. On the other hand, the AAR in *Fidelity Northstar 288 ITR 641 (AAR)* held that such income would be capital gains in view of the regulatory norms that apply to such investors.

The CBDT had issued ***Circular No. 4 of 2007 dated 15th June 2007*** providing guidance in this regard stating the facts and circumstances that should be taken into account to determine whether the income is capital gain or business income. It should be noted that business income of non-residents would not ordinarily be taxable in India in the absence of a Permanent Establishment (PE). Permanent establishment is the threshold provided in the tax treaties as against the threshold of "business connection" provided in the ITA.

MAT regime taxation for Debt Instruments

The Finance Act, 2017 *inter alia* carried out amendments in Section 115JB of the Income tax Act, 1961 ("the Act") to accommodate the changes in calculation of 'book profits' pursuant to Ind-AS adoption by companies. Sub-section 2A principally provides for adjustments to be made to such book profits computed in accordance with the mechanics as stated before such amendment. Sub-section 2C provides for adjustments to be made to 'book profits' during the year of convergence for one fifth of the 'transition amount'. The aforesaid has been defined in clause (iii) to the Explanation to the sub-section. It effectively is defined as the amounts adjusted against 'other equity' as on the convergence date.

The impact of the above amendments on compound financial instruments, like Compulsorily Convertible Preference Shares, Optionally convertible debentures etc., under Ind-AS 32 regime, where these instruments are treated partly debt and partly equity based on the terms of issuance. After such bifurcation, the finance cost which accrues on the debt, as classified under the Ind-AS regime, is treated as an expense and is debited to the profit and loss account for future years.

MAT was introduced as concept to tax companies which due to excessive claims under various allowances under the IT Act were not paying any corporate tax at the time. To circumvent this strategy, 115J (as originally envisaged) was introduced to tax companies on their 'book profits'. It can be inferred from the judicial guidance available on the subject that capital receipts are not intended to come under the ambit of MAT. In other words, receipts not taxable at all, cannot be made taxable under the MAT regime. In this particular case, the amount forming part of 'Other Equity' forms part of the of the Transition amount subject to exceptions carved out in clause (iii) of explanation (2C) of Section 115JB. The impugned amounts do

15 Section 90(2) of the ITA provides that the provisions of the ITA or the tax treaty whichever are more beneficial apply to a taxpayer.

not form part of the distributable profits for the declaration of dividend. The premise of 115J was to tax only commercial profits. In the current transaction it's a pure capital receipt not chargeable under any provisions of the Act. In this light a view may be adopted that this amount cannot be taken to form 'profit' as per the 'Statement of Profit and Loss' as provided for under the provisions of the Companies Act, 2013.

The Memorandum explaining the Finance Bill, 2017 on page 27 states

"The adjustments arising on account of transition to Ind AS from existing Indian GAAP is required to be recorded directly in Other Equity at the date of transition to Ind AS. Several of these items would subsequently never be reclassified to the statement of profit and loss / included in the computation of book profits. Accordingly, the following treatment is proposed: (I) Those adjustments recorded in other comprehensive income and which would subsequently be reclassified to the profit and loss, shall be included in book profits in the year in which these are reclassified to the profit and loss;... (III) All other adjustments recorded in Reserves and Surplus (excluding Capital Reserve and Securities Premium Reserve) as referred to in Division II of Schedule III of Companies Act, 2013 and which would otherwise never subsequently be reclassified to the profit and loss account, shall be included in the book profits, equally over a period of five years starting from the year of first time adoption of Ind AS..."

It may be worth appreciating the reply of CBDT in Circular Number 24/2017 and in specific the Query Number 9 in this regard where the CBDT states that "equity component of financial instruments such as NCD's, interest free loans would be included in the transition amount" however this does not address the situation *qua* transition amount and distributable profit and therefore should not apply in the present case. This unsettles the view to make "capital" taxable instead of "income". Such a stand is fortified in view of Query Number 8 of the said circular that disallows amount of interest in relation to preference shares debited to P&L. As regards the amount charged to the P&L, the same is notional in nature and does not represent any 'real' expense. Hence, notional entries against income or expenditure are treated equally.

Ind-AS provisions merely seek to reclassify the financial instruments into equity and debt. No income accrues through this reclassification.

Section 43 of the Companies Act, 2013 further provides that this receipt was always recognised as a capital receipt.

As such, these provisions go well beyond the charging provisions of the IT Act and it may well be possible that they are challenged on their constitution *vires* being outside the scope of Entry 82, Schedule VII to the Constitution of India – Taxes on income other than agricultural income since it's a notional entry being capital receipt and does not partake the nature of 'income'.

While the Courts in the past *(Navinchandra Mafatlal vs. CIT)* have upheld the right of Parliament to tax capital receipts not forming part of income, however what seems to sway in favour of the taxpayer here is the fact that this 'income' is accruing only because of an accounting entry and in light of the ICDS decision of the Hon'ble High Court of Delhi it may be tenable to argue against its constitutionality.

Tax Overview of Different Debt Instruments

1. Deep Discount Bonds (DDBs), Zero-Coupon Bonds (ZCBs) and Discount Bonds (DBs)

Issuer	Usually financial institutions, infrastructure capital fund, Government undertakings, scheduled banks and large Indian companies including infrastructure capital companies.
Eligible foreign investors	FPIs NRIs
Exchange rate risk	Since the investment is in INR, the exchange rate risk is borne by the foreign investor.
Period of holding for classification as a long term capital asset – *Section 2(29A) and 2(42A)*	12 months or more for listed securities 36 months or more for unlisted securities
Taxation of capital gains under the Indian tax law*	DDBs (as per a clarification issued by the Government) • Transfer before maturity - difference between sale price and the cost of bond (value as on last valuation date) taxable as Short Term Capital Gains (STCG). ZCBs (as per the Indian tax law) • Transfer before maturity - difference between sale price and the cost of bond taxable as capital gains; • On maturity or redemption – difference between face value of bond and acquisition price taxable as capital gains. DBs • Transfer before maturity - difference between sale price and the cost of bond taxable as capital gains; • Where the DBs carry coupon which is commensurate with the market rate, redemption premium could be arguably, regarded as capital gains. FPIs: LTCG - 10%; and STCG - 30% NRIs: LTCG - 10%/20%; and STCG – 30%
Taxation of interest income under the Indian tax law*	DDBs (as per a clarification issued by the Government) Yearly accretion - Bonds to be marked to market at every year end; - Accretion (difference between bid price/cost and market value at the year end) generally taxable as interest income. On maturity or redemption - Difference between redemption price and value as on the last valuation date/cost is generally taxable as interest income.

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	Discount Bonds On maturity or redemption - Difference between face value of the bond and acquisition price is generally taxable as interest income. FPIs: 5%/20% Others: 20%/30%
Withholding tax rate on interest income in India	Income in respect of investment in ZCB is not subject to withholding tax rate. Interest in respect of investment in DDBs and DBs is subject to withholding tax at the rates mentioned below: • FPIs: 5%/ 20% • NRIs: 20%/30%
** Treaty provisions where beneficial may be applied*	

2. Listed Non-Convertible Debentures (NCDs)/Bonds (including Credit Enhanced Bonds)

Issuer	Indian companies
Eligible foreign investors	FPIs NRIs
Exchange rate risk	Since the investment is in INR, the exchange rate risk is borne by the foreign investor.
Period of holding for classification as a long term capital asset	12 months or more
Taxation of capital gains under the Indian tax law*	FPIs: LTCG - 10%; and STCG - 30% NRIs: LTCG - 10%/20%; and STCG – 30%
Taxation of interest income under the Indian tax law*	FPIs: 5%/ 20% NRIs: 20%/30%
Withholding tax rate on interest income in India	FPIs: 5%/ 20% NRIs: 20%/30%
** Treaty provisions where beneficial may be applied*	

3. Unlisted Corporate Debt Securities (Bonds and NCDs)

Issuer	Indian companies
Eligible foreign investors	FPIs NRIs
Exchange rate risk	Since the investment is in INR, the exchange rate risk is borne by the foreign investor.

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Period of holding for classification as a long term capital asset	36 months or more
Taxation of capital gains under the Indian tax law*	FPIs: LTCG - 10%; and STCG - 30% NRIs: LTCG - 10%; and STCG – 30%
Taxation of interest income under the Indian tax law*	FPIs: 5%/ 20% NRIs: 20%/30%
Withholding tax rate on interest income in India	FPIs: 5%/ 20% NRIs: 20%/30%
* Treaty provisions where beneficial may be applied	

4. Units of a Debt Oriented Mutual Fund

Issuer	Scheme of Debt Oriented Mutual Funds registered with SEBI
Eligible foreign investors	FPIs NRIs
Exchange rate risk	Since the investment is in INR, the exchange rate risk is borne by the foreign investor.
Period of holding for classification as a long term capital asset	36 months or more for listed or unlisted securities
Taxation of capital gains under the Indian tax law*	FPIs: LTCG - 10%; and STCG - 30% NRIs: LTCG - 10%/20%; and STCG – 30%
Taxation of dividend income under the Indian tax law*	Dividend income earned from units of a debt oriented mutual fund shall be exempt in the hands of the investor
Withholding tax rate on interest income in India	Not applicable
* Treaty provisions where beneficial may be applied	

5. Non-Convertible Redeemable Preference Share (NCRPS)

Issuer	Any "public company", PSU or statutory corporation can issue or propose to issue, or seek to list its NCRPS on a recognized stock exchange.
Eligible foreign investors	FPIs NRIs
Exchange rate risk	Since the investment is in INR, the exchange rate risk is borne by the foreign investor.

Returns	Dividends or redemption. Dividends must be paid out of distributable profits. Redemption may be out of distributable profits, proceeds of fresh issue of shares made for the purpose of redemption. Redemption premium shall be paid out of securities premium account.
Period of holding for classification as a long term capital asset	12 months or more for listed 24 months or more for unlisted
Tax Treatment for Issuer	Dividend or redemption will not be a tax deductible expense for the issuer.
Tax treatment on distribution of dividend	Subject to additional dividend distribution tax of 15%.
Tax treatment at the hands of investor under the Indian tax law*	Dividends are tax free in the hands of the recipient. Redemption premium classified as capital gains.
Deemed Dividend	Redemption premium cannot be classified as deemed dividend to the extent of accumulated profits. Provisions related to Deemed dividend under Section 2(22)(d) and section 2(22)(e) will not be applicable in the event of redemption of Preference shares.
Taxation of capital gains under the Indian tax law*	Listed: FPIs: LTCG - 10%; and STCG - 30% NRIs: LTCG - 10%/20%; and STCG – 30% Unlisted: FPIs: LTCG - 10%; and STCG - 30% NRIs: LTCG - 10%; and STCG – 30%
Withholding tax rate on interest income in India	
Liquidation Preference	Subordinated to NCDs, senior to equity.
** Treaty provisions where beneficial may be applied*	

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It is the patient up building of character, the intense struggle to realise the truth, which alone will tell in the future of hmanity.

— *Swami Vivekananda*

CA Vishesh Dhirendra Sangoi

Taxation of Mutual Fund Investments

Introduction

Mutual funds are a popular and easily understood investment vehicle for many investors. This investment vehicle offers investors the opportunity of parking money in various financial instruments by harnessing the skill and knowledge of trained and expert investment managers.

As per statistics provided by Association of Mutual Funds in India ('AMFI'), the assets under management of the Indian Mutual Fund Industry has grown from INR 5.09 trillion as on 28th February 2009 to INR 23.16 trillion as on 28th February 2019, more than 4 ½ fold increase in a span of 10 years. The total number of accounts (or folios as per mutual fund parlance) as on February 28, 2019 stood at INR 8.18 crore (INR 81.8 million), while the number of folios under Equity, ELSS and Balanced schemes, wherein the maximum investment is from retail segment stood at INR 6.87 crore (INR 68.7 million). This is 57th consecutive month witnessing a rise in the number of folios.

The best benefit of these investment vehicles is that these offer better returns compared to other traditional modes of investment such as fixed deposits, recurring deposits. To go with this, the prospect of high capital gains and dividends kindle one's desire to invest in mutual funds. But these gains are taxable as per the Income -tax Act ('ITA'). The amount which has to be paid as tax would depend on residential status of the investor, the type of mutual fund which one invests in and the duration which one stays invested in the funds.

Income from Mutual Fund investments can be divided into 2 parts - (1) Capital Gains and (2) Dividend that investors receive if they have opted for dividend plans. In this article, we look at the applicability of income tax on mutual fund investments.

Taxation of Mutual Fund Investments

Capital gain tax from mutual fund investments would depend upon 3 factors –

1	Residential Status of the investor
2	Type of fund invested in
3	Holding period

A. Residential Status

Section 6 of ITA provides that an individual is said to be non-resident in India if he is not a resident in India and an individual is deemed

to be resident in India in any previous year if he satisfies any of the following conditions —

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

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

As per section 6(2) of the ITA, a Hindu Undivided Family, firm or other association of persons is said to be resident in India in any previous year in every case except where during that year the control and management of its affairs is situated wholly outside India. As per section 6(3) of the ITA, a company is said to be a resident in India in any previous year, if (1) it is an Indian company; or (2) its place of effective management, in that year, is in India.

B. Types of Mutual Funds

From the taxation point of view, the mutual funds could be categorized into 2 buckets-

1) Equity based Funds
2) Non-Equity based Funds

Types of Equity based Funds	
Equity Funds	Explanation to s. 112A of the ITA defines Equity oriented fund as a fund- *i. which invests in the units of another fund which is traded on a recognised stock exchange—* *A. a minimum of ninety per cent of the total proceeds of such fund is invested in the units of such other fund; and* *B. such other fund also invests a minimum of ninety per cent of its total proceeds in the equity shares of domestic companies listed on a recognised stock exchange; and* *ii. in any other case, a minimum of sixty-five per cent of the total proceeds of such fund is invested in the equity shares of domestic companies listed on a recognised stock exchange* These are the funds that invest in equities (shares of a company) which can be actively or passively managed. The price of the equity fund is based on the fund's net asset value (NAV) less its liabilities. Equity funds have different key goals like capital appreciation, regular income etc.
ELSS	Equity-Linked Savings Scheme (ELSS) is an equity mutual fund investment that invests at least 80% of its assets in equity and equity-related instruments and hence qualifies as equity oriented funds by virtue of explanation to s. 112A. Investments in an ELSS qualify for tax deduction u/s. 80C of the ITA within the overall limit of INR 1.5 lakh. Investments in ELSS are subject to a three-year lock-in period.
Balanced Fund (Equity oriented)	A balanced fund combines equity stock component, a bond component and sometimes a money market component in a single portfolio. Balanced Funds are of 2 types - equity oriented and debt oriented. Equity oriented balanced funds invest 65% to 80% in equities and balance in debt instruments. Generally, these hybrid funds stick to a relatively fixed mix of stocks and bonds that reflects either a moderate, or higher equity, component, or conservative, or higher fixed-income, component orientation.

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Types of Non-Equity based Funds	
Debt Funds	A debt fund is a mutual fund scheme that invests in fixed income instruments, such as corporate and Government bonds, corporate debt securities, and money market instruments etc. that offer capital appreciation. Debt funds are also referred to as income funds or bond Funds. Debt funds have low risks compared to the equity funds. However, the expected returns while investing in debt funds are also lower.
Liquid Funds	Liquid Funds, as the name suggests, invest predominantly in highly liquid money market instruments and debt securities of very short tenure and hence provide high liquidity. They invest in very short-term instruments such as Treasury Bills (T-bills), Commercial Paper (CP), Certificates of Deposit (CD) and Collateralised Lending & Borrowing Obligations (CBLO) that have residual maturities of up to 91 days to generate optimal returns while maintaining safety and high liquidity.
Balanced Fund (Debt oriented)	Debt Oriented balanced funds invest around 70% to 80% in debt instruments and balance in equity and other instruments.
Exchange Traded Fund	An ETF, or exchange traded fund, is a marketable security that tracks an index, a commodity, bonds, or a basket of assets like an index fund. In the simple terms, ETFs are funds that track indexes such as CNX Nifty or BSE Sensex, etc. Unlike regular mutual funds, an ETF trades like a common stock on a stock exchange. The traded price of an ETF changes throughout the day like any other stock, as it is bought and sold on the stock exchange.
Fund of Funds	A 'Fund of Funds' (FOF) is an investment strategy of holding a portfolio of other investment funds rather than investing directly in stocks, bonds or other securities. An FOF Scheme primarily invests in the units of another Mutual Fund scheme. A FOF is treated as a non-Equity fund and consequently taxed accordingly.
Gold ETF	A Gold ETF is an exchange-traded fund (ETF) that aims to track the domestic physical gold price. They are passive investment instruments that are based on gold prices and invest in gold bullion. In short, Gold ETFs are units representing physical gold which may be in paper or dematerialised form. One Gold ETF unit is equal to 1 gram of gold and is backed by physical gold of very high purity. Gold ETFs can be bought on BSE/NSE through the broker using a demat account and trading account.
Fixed Maturity Plan	FMP is fixed tenure, debt-based scheme, which terminates on a pre-determined date. FMPs are ideal for those investors who wish to park their funds for a specific period. The return of these schemes is predictable as money is invested in fixed interest based securities maturing in the line with the maturity of the underline FMP.
Infrastructure Debt Fund	It is a scheme which invests primarily (min 90% of scheme assets) in debt securities or securitised debt instrument of infrastructure companies or infrastructure capital companies or infrastructure projects or special purpose vehicles, etc. or other permissible assets in accordance with these regulations or bank loans in respect of completed and revenue generating projects of infrastructure companies or projects or special purpose vehicles.

C. Categorisation of an investment into short-term and long-term based on the holding period

In the case of **equity-based mutual funds**, if the holding period is less than 12 months, then it is considered a short-term investment. Further, if the holding period is more than 12 months, then it is called a long-term investment.

In the case of **debt-based mutual funds**, if the holding period is less than 36 months, then it is considered a short-term investment. Further, if the holding period is more than 36 months, then it is called a long-term investment.

Funds	**Short-term**	**Long-term**
Equity funds	< 12 months	>= 12 months
Debt funds	<36 months	>= 36 months

Following chart depicts the classification of capital gains arising from transfer of a unit of an equity based and non-equity based mutual fund

Resident / Non-Resident Indian	
Equity Mutual Funds	Non-Equity Mutual Funds
LTCG: If holding period more than 12 months	LTCG: If holding period more than 36 months
STCG: If holding period less than 12 months	STCG: If holding period less than 36 months

Capital Gains Tax Rate

For Equity Funds			
	Resident Individual / HUF	**Domestic Company**	**Non-Resident**
LTCG on sale of equity fund on which STT has been paid *[section 112A of ITA]*	10% without indexation on capital gain exceeding INR 1,00,000*	10% without indexation on capital gain exceeding INR 1,00,000*	10% without indexation on capital gain exceeding INR 1,00,000*
STCG on sale of equity fund on which STT has been paid *[section 111A of ITA]*	15%	15%	15%

For Non-Equity Funds			
	Resident Individual/HUF	**Domestic Company**	**Non-Resident**
LTCG on sale of non-equity fund *[section 112 of ITA]*	20% after indexation	20% after indexation	Listed – 20% after indexation Unlisted – 10% without indexation
STCG on sale of non-equity fund	Based on slab rates	25% / 30%	Based on slab rate

** Upto AY 2018-19, LTCG arising from transfer of* ***a unit of equity oriented fund*** *was exempt from income-tax u/s. 10(38) of the ITA. The Finance Act, 2018 withdrew the exemption u/s. 10(38) by making this section non-operative with effect from AY 2019-20 and introduced a new section 112A in the ITA. The new section 112A provides that LTCG arising from transfer of a long term capital asset being an equity share in a company or* ***a unit of an equity oriented fund*** *shall be taxed at 10% of such capital gains exceeding INR 1,00,000. The new tax regime shall apply to sale of equity oriented mutual funds only on or after 1-4-2018 and only if STT has been paid on transfer / sale of equity oriented fund. This amendment was accompanied by the insertion of section 55(2)(ac) which provides for the value of gains earned up to January 31st, 2018 to be grandfathered. The indexation benefit will not be allowed while computing the tax liability as per section 112A.*

Grandfathering clause for gains up to January 31, 2018

The grandfathered concept implies that all the gains on equity oriented mutual funds until 31st January 2018 will be exempt from taxation. This means that income tax will not be levied with retrospective effect, but with prospective effect. The gains accruing as on 31st January 2018 have been grandfathered. This is done by introducing a deeming provision whereby cost of acquisition of the unit would be considered to be higher of the actual cost or the NAV of the unit on 31st January 2018. However, to avoid an arbitrary loss situation, if the actual sale consideration (NAV at the time of redemption) is lower than the NAV as on 31 January 2018, the cost of acquisition would be either the actual sale consideration or actual cost, whichever is higher.

To sum up, cost of acquisition of such units shall be deemed to be the **higher** of-

1. The **actual COA** of such investments; and
2. The **lower** of-
   - o **NAV** of unit as on 31st January 2018; and
   - o the **Full Value of Consideration** received or accruing as a result of the transfer of the unit i.e. the **Sale Price**

Illustrations

Scenario 1
• Purchase price (NAV) on 1st January 2013 – INR 100 • NAV on 31st January 2018 – INR 300 • Selling price NAV on 1st March 2018 – INR 350 (also subject to STT) • As this investment is long term in nature and is sold before 31st March 2018, there is no tax liability
Scenario 2
• Purchase price (NAV) on 1st January 2013 – INR 100 • NAV on 31st January 2018 – INR 300 • Selling price NAV on 1st June 2018 – INR 350 (also subject to STT) • As this investment is sold after 31st March 2018, tax liability will arise as per s. 112A. The deemed cost for tax calculation will be INR 300. LTCG = INR 50 (350 – 300)

Scenario 3

- Purchase price (NAV) on 1st January 2013 – INR 100
- NAV on 31st January 2018 – INR 50
- Selling price NAV on 1st June 2018 – INR 110 (also subject to STT)
- The NAV as on 31st January 2018 is below the original purchase NAV. Hence the tax liability will be computed taking the original purchase NAV as cost of acquisition. LTCG = INR 10 (110 – 100)

Scenario 4

- Purchase price (NAV) on 1st January 2013 – INR 100
- NAV on 31st January 2018 – INR 200
- Selling price NAV on 1st June 2018 – INR 150 (also subject to STT)
- In this case, deemed cost of acquisition will be INR 150. LTCG = NIL (150 – 150)

Scenario 5

- Purchase price (NAV) on 1st January 2013 – INR 100
- NAV on 31st January 2018 – INR 200
- Selling price NAV on 1st June 2018 – INR 50 (also subject to STT)
- In this case, the actual cost of acquisition is less than the NAV as on 31st January 2018. The sale value is less than the NAV as on 31st of January 2018 and also the actual cost of acquisition. Therefore, the actual cost of INR 100 will be taken as the cost of acquisition in this case. Hence, the long-term capital loss will be INR 50 (₹ 50 – ₹ 100) in this case.

The CBDT has issued the following FAQ's in the form of Circular No. 370149/20/2018-TPL dated 4th February 2018 in response to queries raised on various issues relating to the new tax regime for taxation of long-term capital gains.

Q.5 How do we determine the cost of acquisition for assets acquired on or before 31st January 2018?

Ans. 5 *The cost of acquisition for the long-term capital asset acquired on or before 31st of January 2018 will be the actual cost.*

However, if the actual cost is less than the fair market value of such asset as on 31st January 2018, the fair market value will be deemed to be the cost of acquisition.

Further, if the full value of consideration on transfer is less than the fair market value, then such full value of consideration or the actual cost, whichever is higher, will be deemed to be the cost of acquisition.

Q.6 How will the fair market value be determined?

Ans. 6 *In case of a listed equity share or unit, the fair market value means the highest price of such share or unit quoted on a recognized stock exchange on 31st January 2018.*

However, if there is no trading on 31st January 2018, the fair market value will be the highest price quoted on a date immediately preceding 31st of January 2018, on which it has been traded. In the

case of unlisted unit, the net asset value of such unit on 31st of January 2018 will be the fair market value.

Q.8 Whether the cost of acquisition will be inflation indexed?

Ans. 8 Sub-clause (5) of clause 31 of the Finance Bill, 2018, inter alia, provides that the long-term capital gains will be computed without giving effect to the provisions of the second provisos of section 48. Accordingly, it is clarified that the benefit of inflation indexation of the cost of acquisition would not be available for computing long-term capital gains under the new tax regime.

Systematic Investment Plan (SIP)

SIP is an investment plan offered by Mutual Funds wherein a person can invest a fixed amount in a mutual fund scheme periodically, at fixed intervals – say once a month, instead of making a lump-sum investment. SIP helps in Rupee Cost Averaging and also in investing in a disciplined manner without worrying about market volatility and timing the market. Investment in SIP can be done in equity based mutual funds as well as non-equity based funds.

Taxation of SIP

In case of SIP scheme, if a person redeems equity oriented MF units, the first-in-first-out rule is followed for computing tax liability. That is, it is assumed that the units bought first are the units that are sold first.

Firstly, based on the number of units sold, the investor needs to determine the equivalent number of purchase units and their corresponding dates. This equivalent number can originate from more than one purchase date. Next, for these purchase dates, the net asset value (NAV) needs to be taken. The holding period also needs to be calculated for each purchase date to determine if it's long-term or short-term.

Illustration – An investor has been investing with a monthly SIP of INR 20,000 in an equity fund and units are allotted as per the table below. For better understanding only three months considered.

Purchase date	Units	NAV (Rs)	SIP (INR)
01-05-2017	400	50	20,000
01-06-2017	444	45	20,000
01-07-2017	333	60	20,000

Total units accumulated equals to 1177 (fractional units ignored), NAV on 31st January 2018 is INR 70 and the NAV on 1st May 2018 is INR 75. Now, 500 units are to be redeemed on 1st May 2018. Then, 400 units purchased on 1st May 2017 and 100 units purchased on 1st June 2017 will be considered. As 400 units have completed 12 months, they will be subject to LTCG while the gains made on the balance 100 units will be short-term in nature, as they have been held for 11 months.

Sale date – 1st May 2018

	400 units	100 units
Holding period	12 months	11 months
Nature of Capital Gains	LTCG	STCG
Section applicable and tax rate	112A / 10%	111A / 15%
Sale value per unit	75	75
Cost of Acquisition per unit (higher of original cost and NAV on 31st January 2018)	70	45
Capital Gains per unit	5	30

Consolidation of mutual fund schemes

Transfer of units under consolidation of mutual fund schemes of two or more schemes of equity oriented fund or two or more schemes of a fund other than equity oriented fund in accordance with SEBI (Mutual Fund) Regulations, 1996 does not amount to 'transfer' by virtue of section 47(xviii) of the ITA and hence there is no capital gains tax liability in the hands of the investors owing to consolidation of the schemes.

Tax Deduction at Source

In case of payments made to residents in respect of capital gains arising on transfer of units, there is no withholding tax implications. However, under section 195 of the ITA, tax is required to be deducted at source on payments made to non-residents. Thus, the short term/long term capital gain tax will be deducted at the time of redemption of units in case of non-resident investors. Section 196D of the ITA specifically provides that no tax is required to be withheld for payment to a Foreign Institutional Investor ('FII') in respect of capital gains arising on transfer of units. The TDS rates in case of payments to non-residents would be applicable as follows:

Person	Short Term Capital Gains		Long term Capital Gains	
	Equity schemes	Debt schemes (including Infrastructure Debt Funds)	Equity schemes	Debt Schemes (including Infrastructure Debt Funds)
NRI	15%	30%	10% without indexation	Listed Units – 20% with indexation Unlisted Units- 10% (without indexation)
FII	Nil	Nil	Nil	Nil

As per provisions of section 206AA of the ITA, if there is default on the part of a non-resident investor (entitled to receive redemption proceeds from the Mutual Fund on which tax is deductible under Chapter XVII of the Act) to provide its Permanent Account Number ('PAN'), the tax shall be deducted at higher of the following rates: i) Rates specified in relevant provisions of the Act; or ii) Rate or rates in force; or iii) Rate of 20%. A non-resident taxpayer has an option to be governed by the provision of ITA or the provision of relevant DTAA, whichever is more beneficial. As per provision of ITA, submission of Tax Residency Certificate (TRC) along with Form No.10F will be necessary for granting DTAA benefits to non-residents investor and such other documents and information subsequently, as may be prescribed by The Indian Tax authorities, from time-to-time.

Dividend from Mutual Fund investments

The dividend received by a unit holder from a mutual fund scheme will be exempt in his hands under section 10(35) of the ITA. Taxability of dividend income in the hands of the investors-

Taxability of Dividend Income			
	Resident Individual / HUF	**Domestic Company**	**Non-Resident**
Equity Oriented Scheme	Exempt	Exempt	Exempt
Non Equity Fund Scheme	Exempt	Exempt	Exempt

Dividend Distribution Tax ('DDT')

Section 115R of the ITA provides that any amount of income (dividend, interest etc.) distributed by a mutual fund to its unit holders shall be chargeable to additional income tax and such mutual fund shall be liable to pay the said additional income tax on the distributed income. Rate of income tax on distributed income (payable by the Mutual fund scheme) –

Tax Rate			
	Resident Individual / HUF	**Domestic Company**	**Non-Resident**
Equity Oriented Scheme	10% + 12% Surcharge + 4% Cess = 11.648% *	10% + 12% Surcharge + 4% Cess = 11.648% *	10% + 12% Surcharge + 4% Cess = 11.648% *
Money market or Liquid schemes / debt schemes (other than infrastructure debt fund)	25% + 12% Surcharge + 4% Cess = 29.12%	30% + 12% Surcharge + 4% Cess = 34.944%	25% + 12% Surcharge + 4% Cess = 29.12%
Infrastructure Debt Fund	25% + 12% Surcharge + 4% Cess = 29.12%	30% + 12% Surcharge + 4% Cess = 34.944%	5% + 12% Surcharge + 4% Cess = 5.824%

*Section 115R has been amended with effect from 1st April 2018 to provide that where any income is distributed by an equity oriented fund, it shall be liable to pay additional income tax @10% on income so distributed. Prior to the amendment, any income distributed to a unit holder of equity oriented funds was not chargeable to DDT tax under the said section [clause (b) to second proviso to section 115R(2)].

Redemption/repurchase of units

CBDT has clarified that redemption of units or repurchase of units by the mutual fund scheme would not attract levy of DDT tax under section 115R(2) since such income is not of the nature of income "distributed" to the unit holders and bonus units at the time of issue would not be subject to additional DDT tax under section 115R since issue of bonus units is not akin to distribution of income by way of dividend. Thus, redemption/repurchase of units by an equity oriented mutual fund will not attract the income distribution tax.

Taxability of income from the units of open-ended equity oriented fund of the Unit Trust of India or of Mutual Funds

Section 115BBB provides that any income from units of an open-ended equity oriented fund of the Unit Trust of India or of a Mutual Fund shall be chargeable to tax at the rate of 10%.

A question arises whether dividend received from a mutual fund becomes a part of the ceiling limit of INR 10 lakh, over and above which is taxable u/s. 115BBDA of the ITA. Or whether the limit consists of only dividend from equity shares?

***115BBDA.** (1) Notwithstanding anything contained in this Act, where the total income of a specified assessee, resident in India, includes any income in aggregate exceeding ten lakh rupees, by way of dividends declared, distributed or paid by a domestic company or companies, the income-tax payable shall be the aggregate of—*

(a) the amount of income-tax calculated on the income by way of such dividends in aggregate exceeding ten lakh rupees, at the rate of ten per cent; and

(b) the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the amount of income by way of dividends.

[Explanation—For the purposes of this section,—

(a) "dividend" shall have the meaning assigned to it in clause (22) of section 2 but shall not include sub-clause (e) thereof;

Explanation to section 115BBDA of the ITA provides that "dividends" shall have the same meaning as given to "dividend" in section 2(22) but shall not include sub-clause (e) thereof. When reference is made to section 2(22) of the ITA, it implies equity shareholders only and provisions of sub-section (e) of section 2(22) dealing with deemed dividends are specifically excluded.

Mutual fund holders are not shareholders of the company, but they are creditors, they do not hold shares, but they hold units. Further, section 10(34) which deals with dividend from equity shares contains a specific reference to section 115BBDA. There is no such reference in section 10(35) which deals with income from mutual funds. Thus, the intention of the Legislature is very clear that it does not disturb the income received from mutual funds by including income from mutual funds in such ceiling of INR 10 lakh. The ceiling limit of INR 10 lakh is applicable only for dividend income from equity shares of domestic companies.

Dividend Stripping

Dividend stripping is an attempt to reduce the tax liability by buying units of mutual funds / equity shares, just before the declaration of dividend and then selling it off right after the receipt of dividend, when the NAV has fallen below the purchase price NAV. The strategy behind dividend stripping is a two way strategy wherein investor gets tax free dividend (i.e., exempted u/s. 10(34)/10(35)) and incurs short term capital loss (i.e., allowed to be set off and carry forward). Record date is the date fixed by a company or mutual funds for the purpose of entitlement of holders of securities or units to receive dividend or other income. In order to curb such a practice, section 94(7) had been inserted in the ITA.

Conditions to be satisfied to attract the provisions of section 94(7)-

Conditions	***Units***	***Securities***
Buying or Acquiring	Within a period of 3 months prior to the Record Date	Within a period of 3 months prior to the Record Date
Selling or Transferring	Within a period of 9 months after the Record Date	Within a period of 3 months after the Record date
Dividend or Income during the intervening period	Exempt	Exempt

If all the above mentioned conditions are met, then the short-term capital loss, if any, arising to the investor on purchase and sale of such units, not exceeding the amount of dividend or income received/receivable on such securities or units, shall not be considered while computing the total income chargeable to tax. Even u/s. 94(7) the short-term capital loss arising shall not be allowed to be set-off or carried forward to the extent of dividend or income received.

Illustration – Mr. Investor purchases 1,000 units of ABC fund at NAV of INR 60 per unit on April 15, 2018. ABC Fund declares dividend of INR 5 per share; record date being May 30, 2018. Mr. XYZ sold all his units in ABC fund on August 2, 2018 at NAV of INR 48. He would receive INR 5,000 as tax free income in the form of dividend. He has also incurred a short term capital loss of INR 12,000 (sales proceeds INR 48,000 less cost of acquisition of shares INR 60,000). However due to application of provisions of 94(7), the loss that can be set off is only INR 7,000 (short term capital loss less dividend received).

Bonus Stripping

Section 94(8) of the ITA, contains the provisions related to the Bonus stripping. This is applicable on Bonus units allotted by open as well as closed ended mutual funds. Bonus units means additional units allotted without any payment based on holding of original units. Generally, the Net Asset Value of the mutual fund units would fall after record date of Bonus unit distribution. Bonus stripping provides that the loss, if any, arising to an investor on account of purchase and sale of Original units shall be ignored for the purpose of computing his total income chargeable to tax, subject to the following conditions:

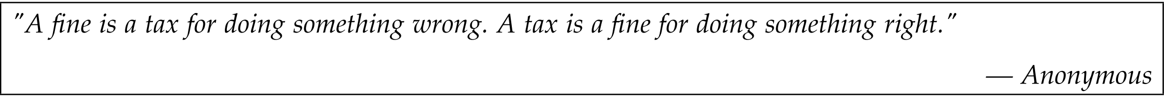
Conditions to be satisfied to attract the provisions of section 94(8) –

Conditions	**Units**
Buying or acquiring of Original Units	Within a period of 3 months prior to the Record Date
Allotment of Additional Units	Without any payment on such Record Date
Selling or transferring of Original Units	Within 9 months after the Record date
Holding at least one Bonus Unit	On the date of such sale or transfer of original units

If all the above conditions are met, then as per provisions of section 94(8) of the ITA, the loss arising on account of such sale or transfer of the original units shall be ignored for the purposes of computation of taxable income, and the amount of loss so ignored shall be deemed to be the cost of purchase or acquisition of such bonus units.

Takeaway

One can appreciate that while taking personal investment decisions, among other decisive factors like type of investment, rate of return, risk profile, time frame of investments, etc., the quantum of tax on purchase / redemption of such investments is also a key consideration, which needs to be factored in. It is not just about the amount of tax which the investor needs to pay out his pocket, but also the amount of tax which is paid before the investor gets his share of income.



"A fine is a tax for doing something wrong. A tax is a fine for doing something right."

— Anonymous

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CA Kiran Nisar

Capital Gains vs. Business Income

Shares and securities can either be held as capital asset or business asset and both will have different tax consequences. The dividing line between whether shares are held as a capital asset or business asset is very thin. Amongst various parameters, the intention at the time of acquisition plays critical role in deciding whether it is a capital asset or business asset. This makes the matter highly subjective and prone to litigation and we have numerous decisions on the subject, rendered in the context of different facts.

In this Chapter, I have been assigned the responsibility of dealing with the current status of some of the tax issues in shares and securities, like (i) tax issues pertaining to characterisation of profits/ loss from dealing in securities (capital gains vs. business income), (ii) tax issues pertaining to transactions under PMS Scheme, and (iii) tax issues on conversion of trading asset into investment and *vice versa.*

1. Capital Gains vs. Business Income

One of the common areas of dispute between tax payer and tax authority is whether the gain / loss from dealing in shares and securities is taxable under the head "Capital Gains" or "Business Income". The main reason for such dispute is the differential tax treatment, the capital gains is taxable at concessional or NIL rate, whereas business income is taxable at full rate. There is no specific guideline in the Income-tax Act with reference to characterisation of any particular investment as capital asset or stock-in-trade. Further even when taxpayer maintains on some logical basis, has two separate portfolios (trading portfolio and investment portfolio), the litigation still continues. Even the number of clarification / circulars issued by CBDT have not helped to reduce litigation surrounding the demonstration of intention at the time of acquisition of shares and securities. Hence finally with the object of reducing tax litigation and maintain consistency, the CBDT came out with masterpiece in the form of Circular No. 6/2016, followed by letter dated 2nd May 2016, which put at rest most of the controversy, particularly in regard to unlisted shares and brings certainty and consistency.

1.1 The various Circulars / clarifications/ guidance issued by the CBDT on this subject are briefly summarised hereunder:

- **CBDT's Instruction No. 1827 dated 31st August, 1989**
  This instruction initially brought the distinction between capital asset and trading asset. However, after discussing number of judicial precedence, the CBDT

had emphasised that "though the test laid down by Courts may help in determining the issue in particular cases, the decision will ultimately turn on facts of each case".

- **CBDT's office memorandum dated 13th December 2005**

  Vide this memorandum, CBDT has issued guidelines on test for distinction between shares held as stock-in-trade and shares held as investment

  "Circumstances to be considered by the Assessing Officers in determining whether a person is a trader or an investor in stocks:

  (i) Whether the purchase and sale of securities was allied to his usual trade or business/was incidental to it or was an occasional independent activity; (ii) Whether, the purchase is made solely with the intention of resale at a profit or for long-term appreciation and/or for earning dividends and interest. (iii) Whether scale of activity is substantial; (iv) Whether transaction were entered into continuously and regularly during the assessment year. (v) Whether purchases are made out of own funds or borrowings; (vi) The stated objects in the Memorandum and Articles of Association in the case of corporate assessee; (vii) Typical holding period for securities bought and sold; (viii) Ratio of sales to purchase and holding. (ix) The time devoted to the activity and the extent to which it is the means of livelihood. (x) The characterization of securities in the books of account and balance sheet as stock-in-trade or investment. (xi) Whether the securities purchased or sold are listed or unlisted. (xii) Whether investment is in sister/related concerns or independent companies. (xiii) Whether transaction is by promoters of the company. (xiv) Total number of stock dealt in (xv) Whether money has been paid or received or whether these are only book entries".

  The above Memorandum also advised the Assessing Officers that no single criteria listed would be decisive and that the total effect of all these parameters should be considered to determine the nature of an activity.

- **CBDT's Circular No. 4/2007, dated 15th June 2007**

  After discussing number of judicial pronouncements on the subject, it advised AO that where a taxpayer has two portfolios "the above principles should guide them in determining whether, in a given case, the shares are held by the assessees as investments (and, therefore, giving rise to capital gains) or as stock-in-trade (and, therefore, giving rise to business profits)". The Assessing Officers have been further advised that "no single principle would be decisive and that the total effect of all the principles should be considered to determine whether, in a given case, the shares are held by the assessee as investment or stock-in-trade."

- **CBDT's Circular No. 6/ 2016 dated 29th February 2016**

  A majority of transactions in shares and securities take place in respect of listed shares and securities. Therefore, CBDT has instructed the Assessing Officers, *vide* its Circular, to consider the following principles for determination whether the surplus generated from sale of listed shares or other securities would be treated as capital gains or business income:

  a. If the taxpayer himself opts to treat the listed shares or other securities as stock-in-trade, then irrespective of the period of holding of these listed shares and securities, the income arising from transfer of such shares/ securities would be treated as its business income.

b. In respect of listed shares and securities held for a period of more than 12 months immediately preceding the date of its transfer, if the taxpayer desires to treat the income arising from the transfer thereof as capital gain, the same shall not be put to dispute by the Assessing Officer. However, once this stand is taken by the taxpayer in a particular assessment year, then the taxpayer will be bound by the same stand in the subsequent assessment years also and the taxpayers will not be allowed to adopt a different/contrary stand in the subsequent years.

c. In all other cases, the nature of transaction (i.e., whether the same is in the nature of capital gains or business income) shall continue to be decided keeping in view the earlier circulars issued by the CBDT (Instruction No. 1827, dated August 31, 1989 and Circular No. 4 of 2007 dated June 15, 2007).

The Circular further clarifies that the above principles for categorisation will not apply for those transactions, where there is a question on the genuineness of the transaction, such as bogus claims of long term capital gain/short term capital loss or any other sham transactions.

- **CBDT's letter F.No. 225/12/2016/ITA II dated 2nd May 2016 – dealing with unlisted shares**

  The CBDT's letter further brings clarity towards assessment pertaining to income arising from transfer of unlisted shares and provides that income arising from transfer of unlisted shares would be considered under the head 'Capital Gains', irrespective of the period of holding to minimise disputes.

  The above assumption would however not apply to situations where:

  i. the genuineness of the sale of unlisted shares is questionable; or

  ii. the transfer is related to an issue pertaining to lifting of corporate veil; or

  iii. the transfer of unlisted shares is made along with the control and management of underlying business.

  The Assessing Officer in the aforesaid cases will take a view depending on the facts and circumstances of each case.

1.2 Conclusion

The various Circulars / clarification issued by CBDT, particularly the latest one with the object to reduce tax litigation on characterisation of income from shares and securities, are welcome steps. Such clarifications will bring certainty and will reduce tax litigation. Even though certain discretion has been granted to the Assessing Officers in certain situations, it is expected that in majority of security transactions, taxpayer will have clarity and certainty and the assessment would be simpler and non-contentious.

2. Taxation issues for Portfolio Management Scheme (PMS)

2.1 Background

The SEBI (Portfolio Managers) Regulations, 1993 define a portfolio manager as any person who, pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or the funds of the client, as the case may be. Clause 15(2) of the regulations clearly provides that the portfolio manager shall act in a fiduciary capacity with regard to the client's funds. Further clause 16(8) of the regulation provides that a

portfolio manager cannot hold securities in its own name. Portfolio manager cannot use amount received under PMS for its own use. If portfolio is discretionary, portfolio manager will not take any permission of the assessee. If it is non-discretionary, then portfolio manager will require permission from assessee.

Therefore, under general principles, the transactions in securities by portfolio manager are the transactions of the investor carried out through an agent, the income from such transactions is liable to tax as the income of the investor, and would take its colour from the circumstances surrounding the actions of the investor. Similarly dividends received or STT paid by the portfolio manager in his capacity as an agent of the investor, and accordingly investor would be able to claim the related benefit, exemption, rebate, deduction as the case may be.

2.2 Taxation on PMS transactions

Portfolio manager invests in securities on behalf of assessee. The relevant contract for purchase or sale of securities is also in the name of assessee. When portfolio manager sells any securities, the resultant gain/ loss will be treated as a capital gains or business income, depending upon whether the activity is treated as investment activity or business activity. Since portfolio manager is acting as an agent of the assessee, there is no material difference in tax treatment between activity done by the assessee on its own or through portfolio manager. In PMS, the assessee takes risk as portfolio manager is his agent. However all the efforts are taken by portfolio manager by using its infrastructure. Hence it would be difficult to contend that assessee is carrying on business through PMS operator, as assessee merely invests his money for capital appreciation. Though in law the portfolio manager is the agent of the investor, in practice the investor has no role in the actual execution of the transactions and is a passive party. Hence, the gains in PMS Scheme are more likely to be treated as capital gains rather than business income. Further the Courts have also held that the borrowing by taxpayer is not relevant for determining characteristic of income from transfer of securities. Some of the recent decisions on the subject where gains from PMS activities were treated as capital gains:

- *CIT vs. Kapur Investment Pvt. Ltd. [TS -318-HC-2015 (Kar.)]*
- *Radials International vs. ACIT [2014] 367 ITR 1 (Del.)*
- *Salil Shah Family P. Trust vs. ACIT [2013] 36 taxmann.com 543 (Mum.)*
- *Apoorva Patni vs. ACIT [2012] 24 taxmann.com 223 (Pune)*
- *Radials International vs. ACIT* – Delhi High Court wherein High Court has reversed the order of Delhi Tribunal and held the gains from PMS transactions are capital gains and not business income.

2.3 Deductibility of PMS fees

If the income from PMS activities is treated as business income, then PMS fees will be allowed as deduction under section 37. However, if the income from PMS activities is treated as capital gains, then the question is whether PMS fees can be considered as (i) expenses incurred in connection with transfer, or (ii) cost of acquisition / improvement? There are decisions on both the sides.

Irrespective of whether the fee charged is a flat fee, a percentage of the value of the portfolio, or a percentage of the appreciation, the portfolio management fees being charged are for purchase and sale of the shares, and it is only the manner of quantification of the fee that differs. As held by the Courts/ Tribunal, the expression "in connection with such transfer" has a wide meaning and all expenditure having a nexus with the transfer is allowable. Further, the payment of the fee to the portfolio manager is for the twin purposes of purchase of shares and sale of shares, which shows that the portfolio management fee has

a direct nexus with capital gains on transfer of shares. Also, for claiming deduction while computing capital gains, there is no requirement for bifurcation of the fee between purchase and sale because the part of the fee paid for purchase would form a part of cost of acquisition, while the portion paid for sale would be expenditure in connection with the transfer – in either case, it would be allowable.

Following is the illustrative list of decisions where ,based on the prevailing facts, the PMS fees were allowed as a deduction while computing capital gains:

- *KRA Holding & Trading Pvt. Ltd. vs. DCIT (2011) 46 SOT 19 Pune ITAT (25-7-2012) – Further appeal on this ground was not admitted by Bombay High Court*
- *Serum Institute of India Ltd. – ITA No. 1576/ PN/2012 and 1617/PN/2012) ITAT Pune dated 18-2-2015*
- *M/s Amrit Diamond Trade Centre Pvt. Ltd., ITA No. 2642/ Mumbai ITAT (date of Order 15-1-2016)*
- *Shri Nadir A Modi, Mumbai ITAT – ITA No. 2996/Mum/2010 & 4859/Mum/2012 Order dated 31-3-2017*
- *Joy Beauty Care P. Ltd. Kolkata ITAT – ITA No. 856/Kol/2007 – Order dated 5-9-2018*

However there are decisions on the other side also, where the deduction for PMS fees, while computing capital gains, were denied *[For e.g. Manteen Pyarali Dholkia vs. DCIT (2018) 171 ITD 294 (Mum.) (Trib.)]*

2.4 Conclusion

In number of recent Courts/ Tribunal decisions, two propositions emerge with reference to taxation of PMS transactions, (i) Courts/ Tribunal have taken a view that gains from PMS transactions should be taxed as capital gains and not business income, and (ii) PMS Fees is deductible while computing capital gains. Also it is settled proposition in law that where two interpretations are possible, the one which is beneficial to the taxpayer should be adopted. *[CIT vs. Vegetable Products Ltd. 88 ITR 192 (SC)]*

3. Conversion and Reconversion

There were some anomalies prevailing earlier with regards to taxation on conversion of capital assets in to stock-in-trade and *vice versa*. However, the legislators have made an attempt to put at rest most of these anomalies. Some of such issues faced earlier and the amendments in the Income-tax Act to address the same are dealt with hereunder.

3.1 Conversion of capital assets into stock-in-trade

As per the law prevailing prior to 1st April 1985, when capital assets was converted into stock-in-trade, the difference between the actual cost and the market value on the date of conversion was escaping tax altogether *[CIT vs. Bai Shirinbai K. Kooka, 46 ITR 86(SC)]*

To curb such loopholes, section 2(47) and 45 were amended effective from assessment year 1985-86. As a result, (a) The conversion of capital asset into or treatment of capital asset as stock-in-trade was included in the definition of 'transfer', (b) The difference between the actual cost and the fair market value on the date of such conversion was made taxable as a capital gains under section 45(2), and (c) Such incidence of tax is postponed to the year in which such stock-in-trade is sold. In other words, though the transfer is deemed to take place in the year of conversion, the taxation on such transfer is postponed to the year of actual sale. As a result the entire difference between original cost and sale price is now taxable in the year of actual sale, part of it as a capital gains and part of it as business income.

Even though such capital gains is taxed in the year of sale, the benefit of indexation will be restricted to the year of conversion, as conversion is deemed to be transfer. For period of holding to determine whether it is short-term or long-term,

as per one school of thought, the period for which such shares are held as capital assets only needs to be considered. Whereas, as per other school of thought, since section 2(47A) refers to period for which such assets are held by assessee, it is possible to consider even subsequent period when shares are held as stock-in-trade. However the latter view is not free from doubt and is prone to litigation as the same does not go with the intention of the legislator.

3.2 Conversion of stock-in-trade into investment

Till last year, anomaly was prevailing with reference to taxability on conversion of stock-in-trade into investment. Such conversion of stock-in-trade into investment may result into lower taxation, as capital gains is taxable at lower rate as compared to business income and there is also an advantage of indexation.

Illustrative list of tax issues arising on conversion of stock-in-trade into investment

- Whether conversion of inventory into a capital asset is permitted by law? Whether AO can dispute such conversion? *[CIT vs. Abhinandan Investment Ltd. (2016) 282 CTR 466 (Del.), Bombay High Court Mr. Kenneth D'Souza vs. Addl. CIT – ITA No.770/M/15 dated 24-1-2018 Bombay HC]*
- Whether such conversion gives rise to a taxable event?
- What is the sale consideration and when is the tax to be paid i.e., in the year in which there is sale of capital asset or in the year of conversion itself?
  - o The Calcutta High Court in the case of *Deeplok Financial Services Ltd. vs. CIT [2017] 80 taxmann.com 51 (Calcutta)*(decided on 4th April, 2017) based on the facts of the case, held that where assessee converts its stock-in-trade of shares into investments and sells the same at a later stage, profit arising from sale of such shares shall be deemed to be capital gains and not business income. It was held that as the shares were held as long-term capital asset, profit arising from sale of shares would be exempt from tax under section 10(38) of the Income-tax Act.
- What should be taken as the cost of acquisition of the capital asset post conversion and what will be the period of holding of the capital asset?
  - o In *Kalyani Export & Investments (P) Ltd. 78 ITD 95 (Pune Trib.) / Jannahvi Investment P. Ltd., 304 ITR 276 (Bom)*, the Tribunal/ Court has taken a view that indexation benefit should be available from the date of first acquisition and not from the date of conversion as there can be only one acquisition of an asset.
  - o In *CIT vs. Bright Star Investment P. Ltd. (2008) 24 SOT 288 (Mumbai)*, it was held that in absence of specific provision to deal with situation where stock-in-trade is converted into investment, the formula which is favourable to assessee should be accepted.
  - o In *Splendor Construction (P) Ltd. vs. ITO, (2009) 27 SOT 39,(Del. Trib.) & Deenson Trading Pvt. Ltd. (2017) 81 taxmann.com 71 (Chennai Trib.)* held that the holding period should be counted from the date of conversion and not from the date of acquisition. These decisions have distinguished the decision in the case of Jannahvi Investment Pvt. Ltd. (referred above) as the same was with reference to cost of acquisition and not period of holding.
- Supreme Court in *Sir Kikabhai Premchand vs. CIT, 24 ITR 256*, has held that no man can

be supposed to be trading with himself and that the withdrawal of inventory should be taken at cost. In that case, certain shares held as stock-in-trade, were withdrawn and endowed on certain trust. Following this decision, the Calcutta High Court in *CIT vs. Dhanuka & Sons, 124 ITR 24* held that loss on transfer of stock into investment at prevailing market price could not be computed as such conversion had to be recorded at cost. However, in *ALA Firm vs. CIT, 189 ITR 285*, the Supreme Court has taken a view that on dissolution of Firm, the value of closing stock which is taken over by the Partners, is to be taken at market value.

These are the few illustration of the anomalies prevailing on taxation with reference to conversion of stock in trade to capital asset.

3.3 Amendments brought in by Finance Act 2018

To address some of the anomalies with reference to taxation on conversion of stock-in-trade into capital assets, Finance Act 2018 has brought following amendments:

- Section 28 was amended (Clause (via) inserted) to provide that fair market value of inventory on the date of conversion or treatment shall be charged to tax as business income.
- Section 2(24) was amended (clause (xiia) was inserted) to include such fair market value in the definition of income.
- Section 49 was amended (sub-section (9) was introduced) to provide that such fair market value on the date of conversion shall be the cost of acquisition for the purpose of computation of capital gains in the event of sale of such capital asset.
- Section 2(42A) was amended to provide that period of holding of such capital assets should be reckoned from the date of conversion or treatment.

These amendments will take effect, from 1st April, 2019 and will, accordingly, apply in relation to the assessment year 2019-20 and subsequent assessment years.

3.4 Analysis of provisions brought in by Finance Act, 2018

- The newly inserted provisions erroneously levies tax on entire fair market value as against taxing only profits arising on conversion computed with reference to fair market value!!
    - o Section 2(24) says that fair market value is income. Now entire fair market value cannot be income, only profit arising on conversion, after reducing cost of inventory from fair market value should be treated as income.
    - o Similarly newly inserted clause (via) in section 28 considers fair market value as profits and gains from business or profession, as against considering only profits on conversion computed with reference to fair market value.

  This appears to be unintentional drafting error and possibly we may see suitable amendments in due course.
- The tax is payable in the year of conversion or treatment. It means the tax is payable on notional income, before income is actually earned. Whereas in case of conversion of capital asset into stock-in-trade, covered by section 45(2), the tax is payable when such inventory is actually sold.
- Further the income under the head "Profits and Gains from Business and Profession" is taxable on the basis of method of accounting regularly followed by the assessee. Hence if the assessee is following cash system of accounting, then the payment of tax can be deferred until the time the consideration is actually received.

- The issues faced earlier with reference to demonstration of conversion or treatment will continue. For the same, the due consideration should be given to the substance of the transaction rather than form. The treatment in the books of account can be one of the factors but shall not be the sole determining factor.

3.5 What if the stock-in-trade which was converted into investment is bonus share?

- The Supreme Court in the case of *Dalmia Investment Co. Ltd., 52 ITR 567 (SC)*, has held that if the bonus shares rank at *pari pasu* with the original shares, they had to be valued at the average of both the bonus and original shares.
- However, where shares are held as a capital assets, then as per section 55(2) the cost of bonus shares should be considered as NIL for computing capital gains.
- Now if the bonus shares held as stock-in-trade are converted into capital assets, then computation of capital gains pose some issue
- The business income under section 28 can be computed on the date of conversion of stock-in-trade into investment as a difference between cost (i.e., average cost as per *Dalmia Investment*) of bonus shares and fair market value on the date of conversion. However, the issue arises while computing capital gains on sale of bonus shares (as a capital asset).
- According to newly inserted sub-section (9) to section 49, in the case of conversion from stock-in-trade to investment, the fair market value on the date of conversion shall be the cost for computing capital gains in the event of sale of capital asset. Whereas as per section 55(2), for computing capital gains, the cost of bonus shares shall be NIL.
- It is settled proposition of the law that in the case of conflict between two provisions of the Act, the specific provisions will prevail over general. Accordingly, the provision of section 49(9), being more specific to compute capital gains on shares converted from stock-in-trade to investment, will prevail and hence capital gains should be computed after considering fair market value on the date of conversion.
- Further if such bonus shares are listed and the same are converted into investment prior to 31st January 2018, then the long-term capital gains on sale of such bonus shares needs to be split into two, (i) The portion of gains pertaining to period prior to 31st January 2018 (which is exempt), and (ii) The portion of gains pertaining to period after 31st January, 2018.
- According to the FAQs released by the department, the cost of acquisition of bonus shares and right shares acquired before 31st January 2018 will be the fair market value of such shares as on 31st January 2018. The FMV of the stock will be taken as the highest price quoted on a recognised stock exchange on January 31, 2018
- Now such clarification with reference to the computation of long-term capital gains under section 112A will support the proposition discussed above that the provision of section 49(9) will prevail and fair market value should be reduced while computing capital gains.

3.6 Conclusion

So in summary, these amendments do disregard some of the fundamental principles of income tax that "no man can trade with himself" or "no one can profit from oneself", "Government has no power to tax potential profits" etc. However, it puts at rest various controversies and brings clarity on what is taxable and when is it taxable.

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SS-VII-55

CA Ajay Agashe & CA Hemali Rajkotia

The Curious Case of Indirect Transfer Taxation in India

Background and legislative history

It is a well-established norm that when an asset situated in India is transferred by way of sale or otherwise, right to tax the gains on that asset lies with India, in common parlance we refer to it as the 'source taxation rule'. This rule applies to all assets located in India including shares of an Indian company.

However, adopting a source taxation rule becomes ambiguous when there is a transfer of interest in the shares of a foreign company that either directly or through a chain of subsidiaries has assets located in India and such foreign company derives significant value from assets located in India. In such a scenario, if one were to follow the source taxation rule, tax authorities would have to overstep their jurisdiction and look through the entire chain of holding and tax the ultimate non-resident sellers of the foreign company for transfer of foreign company shares on the premise that such a transfer entails a constructive sale of Indian assets.

Taxation of cross-border acquisitions involving the indirect transfer of Indian company shares has been subject to controversy over the last several years. There was considerable uncertainty regarding the taxation of a transaction where the indirect acquisition of the target is affected by acquiring the shares of the non-resident intermediate holding company.

The uncertainty was finally put to rest with the Supreme Court's decision in case of Vodafone International Holdings B.V. As is well recorded, the Vodafone case involved a contention by the Indian tax authorities that the acquisition of an entity located in Cayman Islands by Vodafone's Dutch subsidiary involved an indirect transfer of underlying assets situated in India. Consequently, the Indian tax authorities claimed that the gains arising on the transfer were liable to capital gains tax in India. The Supreme Court ruled in favour of Vodafone stating that Section 9(1)(i) (i.e., provisions dealing with 'Income deemed to accrue or arise in India') did not cover such transactions within its scope. But that's history, since then Finance Act 2012 introduced *Explanation 5* to Section 9(1)(i) clarifying that an offshore capital asset would be considered to have a situs in India if it substantially derives its value (directly or indirectly) from assets located in India. This amendment was frowned upon by the international investor community given that the amendment was made effective retrospectively.

Further, the situation was worsened due to the lack of clarity on the meaning of the term 'substantially' used in the amendment. In this regard, the Delhi High Court, in case of Copal Research Mauritius Limited weighed in to rule that the term 'substantially' should be interpreted to mean 'principally' or 'mainly' or at least 'majority' and concluded that the indirect transfer provisions shall apply when the offshore company derives at least '50%' of its value from assets located in India.

To put an end to the controversy, the Finance Act 2015 introduced *Explanation 6* to Section 9(1)(i) to clarify various aspects which were in line with some of the recommendations made by the Shome Committee such as the substantial threshold limit, small shareholder exemption, proportionate basis of taxation, specific exemption for overseas mergers and demergers, reporting obligations and related penalty consequences.

Having gained a reasonable insight of the context and framework of indirect transfer provisions under the Indian tax law, we now delve into the actual provisions.

I. Scope of indirect transfer provisions

Explanation 5 to Section 9(1)(i) provides that an asset or a capital asset in the nature of share or interest in an entity registered or incorporated outside India to be deemed to be situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India. On a broad basis, it covers the following:

- Share in a company incorporated outside India
- Share in a company registered outside India
- Interest in a company incorporated outside India
- Interest in a company registered outside India
- Share in an entity incorporated outside India
- Share in an entity registered outside India
- Interest in an entity incorporated outside India
- Interest in an entity registered outside India

Question arises on meaning of the term 'interest'. Stated alternatively, whether *Explanation 5* covers only 'shares' in a company and does not cover any other forms of 'interest' in a company / entity. In its recommendation, the Shome Committee suggested that reference to 'share or interest in a company or entity' in *Explanation 5* should mean and include only such share or interest which results in participation in ownership, capital, control or management. All other types including mere economic interest should not be contemplated within the ambit of *Explanation 5*. Section 9(1)(i) may get fairly restrictive if it covers only shares of foreign company / foreign entity even when the holder of interest has rights and obligations and economic benefits comparable to that of a shareholder. As a consequence, *Explanation 5* can cover interest in a foreign company / entity as well i.e., various forms of interest (otherwise than by way of shares) may also get covered. The term 'Interest' is likely to cover equity shares with differential voting or dividend rights, preference shares (irrespective of its coupon rate or premium or whether it is redeemable or irredeemable), compulsorily convertible debentures etc.

II. Threshold test for substantiality and valuation

A. Meaning of 'substantial'

Explanation 6 provided that the share or interest of a foreign company or entity shall be deemed to derive its value substantially from assets located in India, if on the specified date, the value of Indian assets (i) exceeds INR 100 million and (ii) represents at least 50% of the

value of all the assets owned by the company or entity. The value of the asset shall be the Fair Market Value ('FMV') of such asset without reduction of liabilities, if any, in respect of the asset. Whilst the manner of determination of FMV of assets has not been prescribed under the Act, CBDT notified rules[1] in this regard in June 2016.

B. Date for determining valuation

Explanation 6 further provides that the valuation needs to be carried out on the 'Specified Date'. Generally, the specified date is the date on which the preceding accounting period of foreign company / entity ends. The date shifts to the date of transfer only if the book value of assets of such foreign company / entity as on the date of transfer exceeds the book value as of the preceding accounting date by 15%.

Here again, the provisions lead to an ambiguity while computing the book value of assets in terms of whether liabilities need to be excluded for determining the book value of assets. Difficulty may also arise if shares / interest in the foreign company / entity are being transferred / gifted in first year of its existence in which case there is no previous balance sheet date.

Clarity is awaited from the CBDT to address such practical aspects of the computation methodology.

C. FMV determination

Explanation 6 provides that share / interest in a foreign company / entity would derive its value substantially from assets located in India if the value of such Indian assets represents at least 50% of the value of all assets of the foreign company / entity. The value of the asset shall be the FMV of such asset without reduction of liabilities, if any, in respect of the asset. The rules prescribed by CBDT in this regard contemplates two types of adjustments of liabilities in relation to different types of assets:

- Specific cases where there is add back of liabilities which are 'considered' by the valuer in determination of valuation – In such cases, one would need to determine the scope of 'liabilities considered by the valuer' particularly when the shares are valued under the discounted cash flow method or adopting any earning based method of valuation which do not adopt parameters as adopted for break-up value or liquidation valuation methodology. The determination of liabilities would accordingly depend on the method of accounting adopted by the valuer.
- Specific cases where there is add back of 'book value of liabilities' as reflected in 'balance sheet' – As per the prescribed rule, 'book value of liabilities' means the value of liabilities as shown in the balance sheet of the company or the entity excluding certain specified items which are not in the nature of 'liabilities' namely:
  - o Paid up capital in respect of equity shares or member's interest
  - o General reserves and surplus
  - o Security premium related to paid up capital

The above definition poses practical challenges as it does not explicitly exclude preference share capital, specific reserves, etc. A valuer may also have to grapple with the issue of whether to consider contingent liabilities appearing in the balance sheet while determining the book value of liabilities.

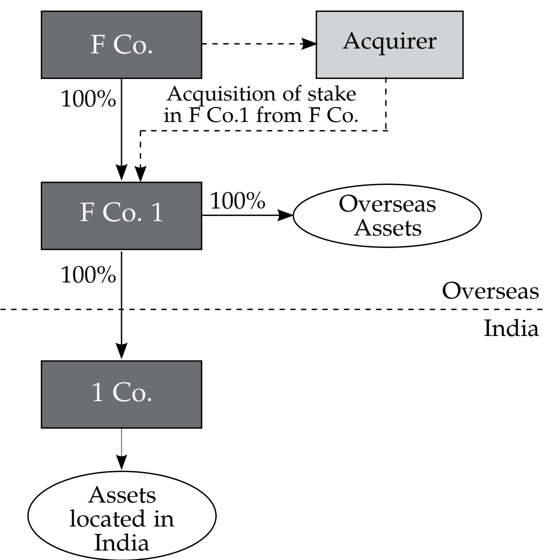
The other issue with respect to valuation may include whether the reference to "Balance sheet" in the prescribed rules is based on standalone or consolidated financial statements. While a general interpretation could be that the reference is to the standalone financial statements, it could give rise to another unique challenge.

1 Notification 55/2016 dated 28th June 2016

This approach is likely to give rise to distorted proportion in cases where the Indian company is a leverage entity. Because when liabilities of an Indian entity are added, the numerator will be the intrinsic value of Indian entity whereas the denominator (which represents the value of foreign entity) does not capture the same. Hence, adoption of standalone financial statements in such a fact pattern may likely create mismatch and result in giving far higher weightage to India as compared to the real economic contribution by India assets.

Whilst the overall intent of the rules seems to ensure that FMV of the Indian assets does not undergo any reduction due to increase in liabilities of the concerned entities, however, due to the separate rules and methods prescribed with respect to each asset class such as listed shares, unlisted shares, partnership interest and other capital assets both in India and abroad, the application of the rules becomes very cumbersome and complicated to comply with.

In order to appreciate the peculiarity of the Specified Date concept better, let us understand it by way of an illustration depicting the interplay between valuation as on accounting year end date and as on date of transfer:



Key assumptions

- Actual date of transfer of foreign entity – 24th February 2019
- Previous accounting year end date – 31st March 2018

Particulars	Situation 1	Situation 2	Situation 3	Situation 4
Book value of F Co 1 as on 31st March 2018	1000	1000	1000	1000
Book value of F Co 1 as on 24th February 2019	1100	300	1100	300
Whether exceeds 15% of book value as on 31st March 2018	No	No	No	No
Specified Date for 'substantiality' test	31st March 2018	31st March 2018	31st March 2018	31st March 2018
% of value derivation from Indian assets				
As of 31st March 2018 (Specified Date)	45%	55%	45%	100%
As of 24th February 2019	55%	45%	100%	Nil (no underlying India asset)
Whether the transaction is taxable?	No	Yes	No	This could be ambiguous

D. Apportionment of gains

Explanation 7 provides that the gains arising on transfer of a share or interest deriving, directly or indirectly, its value substantially from assets located in India shall be taxed on a proportionate

basis based on the assets located in India *vis-a-vis* global assets. The rules further prescribed the manner of computing the proportionate capital gains which was in line with the expectation by taking the ratio between India assets and global assets of the foreign company / entity. However, an interesting point to note here would be that the computation of proportion is based on FMVs of assets as on Specified Date instead of FMV on date of transfer. This can lead to unintended results and consequences especially in circumstances where India contribution as of the date of transfer is minimal / nil while as of the earlier accounting date (being the Specified Date), India contribution is more than 50%.

Continuing the example referred to in Pt. C above, proportion of taxable gains in India shall be as under:

Particulars	Situation 1	Situation 2	Situation 3	Situation 4
Whether the transaction is taxable?	No	Yes	No	This could be ambiguous
Specified Date for 'substantiality' test	31st March 2018	31st March 2018	31st March 2018	31st March 2018
As of 31st March 2018 (Specified Date)	45%	55%	45%	100%
As of 24th February 2019	55%	45%	100%	Nil (no underlying India asset)
Proportion of taxation	Nil	55%	Nil	Nil (no underlying India asset)

As can be seen above, in Situation 4, while there is no underlying Indian asset as on the date of transfer, however on application of the Specified Date provisions, there could be an unintended consequence of taxing proportionate Indian capital gains. This should ideally not be the intent of the legislation and a clarification from the authorities is awaited to put to rest such unintended consequences.

III. Exemptions

The indirect transfer provisions have been continuously evolving since it was first introduced in 2012. One of the key aspects which has undergone changes is the exemptions provided for various situations from the applicability of indirect transfer provisions based on the timely concerns raised by various stakeholders. An overview of the exemptions available is outlined hereunder:

i. Small Shareholder's exemption

The indirect transfer provisions have specifically provided a carve out for small shareholders who do not have a right to 'control and management' and hold less than 5% of the voting power/ share capital/ interest in the foreign company/ entity deriving substantial value from assets in India.

Accordingly, in case the transfer is of shares or interest in a foreign company/ entity which directly owns assets located in India, exemption from indirect transfer provision is available to the transferor if the transferor -

(a) neither holds the right of management or control in the direct holding company;

(b) nor holds voting power/ share capital/ interest exceeding 5% of the total voting power/ total share capital/ total interest of the direct holding company.

Further, in case the transfer is of shares or interest in a foreign company or foreign entity which indirectly owns assets located in India, then exemption from indirect transfer provision is available to the transferor if the transferor -

(a) neither holds the right of management or control in the indirect holding company;

(b) nor holds any right in or in relation to indirect holding company which would entitle him to right of management or control in the direct holding company;

(c) nor holds voting power/ share capital/ interest in the indirect holding company which results in holding of a voting power/ share capital/ interest exceeding 5% of the total voting power/ total share capital/ total interest of the direct holding company

ii. Overseas tax neutral corporate reorganisations such as amalgamation and demerger

In case of business reorganisations such as amalgamation and demerger, exemptions have been provided from the applicability of indirect transfer provisions. The conditions for claiming these exemptions are similar to the exemptions that are provided under the Income-tax Act to transactions of a similar nature.

However, it is pertinent to note that the above exemption from indirect transfer provisions is available only for the amalgamating company, and not to the shareholders of amalgamating company. Also, entities other than foreign companies (i.e., non-corporate bodies) have been left outside the ambit of this exemption.

iii. Dividend

A technical reading of the indirect transfer provisions resulted in the provisions being applicable even at the time of redemption of interest by way of distribution of dividend by a foreign company to its foreign shareholders. However, the applicability of the provisions to declaration of dividend was an unintended consequence of the language of the provisions.

Recognising the same, the CBDT clarified[2] that declaration of dividend outside India by a foreign company would not be taxable in India under the indirect transfer provisions.

iv. Exemption to Foreign Portfolio Investors

The indirect transfer provisions were introduced to bring to tax transfer of share or interest in a foreign company/ entity deriving substantial value from assets located in India. However, in case of multi-layered structures, where such transfer arises in case of upstreaming as a consequence of a direct redemption or sale of an investment in India which is chargeable to tax in India, application of indirect transfer provisions results in double taxation (or multiple taxation in case of multi-layered holding structures) of the same income, i.e., first on sale of Indian securities and thereafter, on upstreaming of the sale proceeds. A number of concerns were raised by stakeholders including Foreign Portfolio Investors ('FPI') and Private Equity ('PE')/ Venture Capital ('VC') investors in connection with redemption by offshore funds to distribute gains made from India.

To address the aforesaid issue, via the Finance Act 2017, investment held in Category I and II FPI were excluded from the ambit of indirect transfer provisions. However, Category III FPIs and PE / VC funds which tend to invest under the foreign direct investment (FDI) route and foreign venture capital investment ('FVCI') route continue to remain covered within the purview of these provisions. A clarification was anticipated by the industry in line with the Finance Minister's observations i.e., to not apply indirect transfer provisions to situations where the income is already undergoing a level of taxation in India.

v. Exemption on redemption of interest held directly in specified funds

In light of the concerns raised by the PE / VC funds regarding the applicability of indirect transfer provisions, especially to multi-layered investment structure, the CBDT issued Circular[3] to state that indirect transfer provisions shall not apply in respect of income accruing or arising to a non-resident on account of redemption or buy-back of its share or interest held indirectly

2 Circular 4 of 2015

3 Circular No. 28/2017, dated 7 November 2017

(i.e., through upstream entities registered or incorporated outside India) in a Venture Capital Fund or a Category-I Alternative Investment Fund or a Category-II Alternative Investment Fund (collectively referred as a "Specified Fund"). However, this exemption is subject to the following conditions:

(a) The income accrues or arises in consequence of transfer of shares or securities by the Specified Funds which is chargeable to tax in India

(b) The proceeds of redemption or buy-back arising to the non-resident do not exceed the pro- rata share of the non-resident in the total consideration realised by the Specified Funds from transfer of shares or securities in India

This exclusion provided much needed clarity to non-resident investors in Specified Funds who invested through multi-layered structures.

IV. Reporting requirements

There are various reporting requirements prescribed that are to be undertaken which includes electronically furnishing relevant information in prescribed from. Compliances have been prescribed for the seller (in Form 3CT) as well as the Indian company (Form 49D). In addition to this, the Rules also envisages maintenance of a host of documents by the Indian entity which includes details of the foreign company / entity which can prove to be quite cumbersome. It may be noted that while the reporting obligation is on the Indian entity, the onus of determining if such obligation is triggered will be on the transferor i.e., the foreign company / entity. Indian entity shall only be entitled to rely on the honest and *bona fide* judgment of the transferor to verify its own obligation, subject to reasonable care and diligence to be exercised on the part of the Indian entity on receipt of information from the foreign company/ entity.

Having said above, there is an anomaly on applicability of reporting requirement to exempt transfers. For example, say the income on transfer of foreign company / entity shares is deemed to accrue or arise in India but by virtue of exemption provided under Indian tax law (say small shareholder's exemption) or the income is not chargeable to tax under the treaty. Since the law is not clear on applicability of reporting requirements and plausible arguments exist on the issue, practically it may be a tedious exercise on the part of the Indian entity for maintaining such prescribed documents.

With the introduction of indirect transfer provisions and rules, parallely, penal provisions were also introduced to levy penalty on Indian entities upon failure to furnish relevant information. The quantum of penalty prescribed is 2% of the transaction value, where the transaction has an effect of directly or indirectly transferring right of management or control in relation to the Indian entity. In other cases, the penalty of INR 5 lakh is prescribed. However, there are no penal provisions prescribed for non-filing of Form 3CT by the foreign company / entity.

Conclusion

Though the law at present is relatively complex by nature, and these provisions have a material impact on foreign direct investment and corporate reorganisation, they should be clear, simple and easy to implement. Considering that indirect transfers are covered in the taxation ambit of various jurisdictions and these provisions are emerging as a law across the globe, it shall be interesting to have a consistent law to bring parity (for parameters such as viz., substantial threshold, reporting requirements, etc.), which is otherwise being witnessed with the introduction of Base Erosion Profit Shifting provisions as a global code.

Further, considering that the indirect transfer provisions are still evolving, necessary modifications / amendments to these provisions may prove to be a welcome move to fix the unintended consequences arising out of the existing law.

(Salonee Shah, Senior Tax Professional, Transaction Tax - EY has also contributed to the article)

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SS-VII-62

CA Gautam Nayak

New Taxation Regime – Section 112A

The New Regime

Long term capital gains (LTCG) on transfer of equity shares, units of an equity oriented mutual fund (EOMF) and units of a business trust (Real Estate Investment Trust or Infrastructure Investment Trust) were exempt till assessment year 2018-19, provided Securities Transaction Tax (STT) was paid on such transfer, and certain further conditions were satisfied. The Finance Act 2018 did away with such exemption with effect from Assessment Year 2019-20, bringing in a 10% tax on such transactions. A grandfathering of gains up to 31st January 2018 was also provided for.

There were four amendments carried out in relation to levy of such tax:

(i) A fourth proviso was inserted in s.10(38), providing that the section would not apply to transfers on or after 1st April 2018;

(ii) A third proviso was inserted in s.48, providing that the first and second provisos to that section (forex computation and cost indexation) would not apply to transfer of capital assets referred to in s.112A;

(iii) A new clause (ac) was inserted in section 55(2), providing for the cost of assets in cases referred to in s.112A, in order to give effect to the grandfathering of unrealized gains till 31st January 2018; and

(iv) S.112A was inserted, providing for the rate of tax of 10% on such gains exceeding ₹ 1,00,000.

Even before the Finance Bill was passed by Parliament, since various questions were raised on the computation of the gains and the tax, on account of the manner in which the law was drafted, the CBDT issued certain FAQs *vide* letter F. No. 370149/20/2018-TPL dated 4th February 2018.

Applicability

For the new scheme to apply, the following conditions need to be met:

1. Total income includes income chargeable under the head "Capital Gains";

2. Capital gains has arisen from the transfer of a long-term capital asset, being equity share in a company, unit of an EOMF, or unit of a business trust; and

3. STT has been paid, in case of equity shares, on acquisition and transfer of the shares, and in case of units of EOMF or business trust, on transfer of the units.

Effectively, on account of the requirement of payment of STT on transfer, it applies to transfer of equity shares of listed companies on recognised stock exchanges.

In case of equity shares, the Central Government can notify the nature of acquisition where the requirement of payment of STT on acquisition shall not apply. Accordingly, the CBDT has issued Notification No. SO 5054(E) [F.No. 60/2018 (F.No.370142/9/2017-TPL)], dated 1-10-2018, specifying such cases. This notification is almost identical to the notification under s.10(38), where there was a similar requirement.

The requirement of payment of STT on acquisition or transfer does not apply to a transfer undertaken on a recognised stock exchange located in any International Financial Services Centre, where the consideration for the transfer in received or receivable in foreign currency.

Deduction under Chapter VIA & Rebate u/s. 87A

S.112A(5) provides that deductions under Chapter VIA are allowable from the gross total income, after reduction of the LTCG taxable u/s. 112A, similar to the provisions of s.112(2).

Similarly, the rebate u/s. 87A cannot be reduced from the tax determined on the LTCG u/s. 112A, but can only be reduced from the tax on other income, by virtue of the provisions of s.112A(6). There is a similar provision in s.112(3), but the rebate in that case referred to is the rebate u/s. 88 (which was discontinued with effect from Assessment Year 2006-07), and not the rebate u/s. 87A.

Limit of ₹ 1 lakh

No tax is payable u/s. 112A on LTCG of up to ₹ 1 lakh. This limit of ₹ 1 lakh is an aggregate limit of all LTCG qualifying for the rate of tax u/s. 112A, which includes LTCG on equity shares of listed companies, units of EOMF and units of business trusts. The LTCG would be computed after setting off long term capital losses also falling u/s. 112A.

Can brought forward capital loss, or short term capital loss (STCL), or long term capital loss (LTCL) not falling u/s. 112A be set off against such LTCG u/s. 112A before computing the applicability of the limit u/s. 112A?

One view is that there is no change in the provisions relating to set off and carry forward of losses, there being no amendment of section 74. Therefore, any STCL or LTCL, current or brought forward, can be set off against such LTCG falling u/s. 112A by operation of the provisions of s.74, just as LTCL covered by s.112A can be set off against any other LTCG. The LTCG included in the total income to which s.112A is applicable, is to be finally determined after all such set off. It is only then that the tax computation provisions, including s.112A, come into play.

This has also been clarified, though not directly, in the CBDT FAQs of 4th February 2018, as under:

> *"Q 24. What will be the treatment of long-term capital loss arising from transfer made on or after 1st April, 2018?*
>
> *Ans 24. Long-term capital loss arising from transfer made on or after 1st April, 2018 will be allowed to be set-off and carried forward in accordance with existing provisions of the Act. Therefore, it can be set-off against any other long-term capital gains and unabsorbed loss can be carried forward to subsequent eight years for set-off against long-term capital gains."*

The CBDT has thus clarified that such LTCL falling under s.112A, where a 10% rate is applicable on the LTCG, can be set off against other LTCG, where the rate of tax applicable may be 20%.

Therefore, as per this view, while computing the tax on such LTCG, such LTCG is to be computed after set off of all eligible capital losses under section 74, and then tax on such LTCG in excess of ₹ 1 lakh is to be computed.

There is also a contrary view. As per this view, s.112A envisages the computation of tax liability in 2 buckets – tax on LTCG falling within s.112A, and tax on other income. These two incomes have to be computed separately, and the tax on each computed separately.

The first view appears to be the better view for the following reasons. Ultimately, tax is to be computed on the total income. In computing the total income, the effect of set off of losses has to be first given. Tax is to be computed only on the income remaining after such set off. Tax is therefore payable on the net gain after such set off. If the LTCG covered by s.112A is higher than the LTCG remaining after set off of losses, then only such remaining LTCG is to be considered for computing the tax u/s. 112A, including reduction of the limit of ₹ 1 lakh.

Tax u/s. 112A

The tax payable on such LTCG exceeding ₹ 1 lakh would be at the rate of 10%. Tax would be payable on the other income, after reducing such LTCG, as if that income were the only income of the assessee.

Just as under s.112, in case of a resident individual or HUF, where such other income is less than the basic exemption limit, the LTCG would be reduced by the difference between the basic exemption limit and such other income. While the normal basic exemption limit would be ₹ 2.50 lakh, such limit should be taken at ₹ 3 lakh for resident senior citizens, and at ₹ 5 lakh for senior citizens aged 80 and above.

For non-residents, no such reduction of shortfall of other income from the basic exemption limit is permissible. Therefore, if a non-resident has such LTCG of ₹ 2 lakh and other income of ₹ 50,000, he would be liable to pay tax at 10% of ₹ 1 lakh, being the LTCG in excess of ₹ 1 lakh.

Cost of Acquisition – s.55(2)(ac)

S.55(2)(ac) provides for the cost of equity shares of a company, units of an EOMF and units of a business trust referred to in s.112A. This definition of cost of acquisition would therefore apply only in relation to such securities transferred which qualify for the rate of tax under s.112A.

S.55(2)(ac) provides the cost of acquisition in such cases as the higher of:

i. the cost of acquisition of such asset; and

ii. lower of –

   (A) the fair market value of such asset; and

   (B) the full value of consideration received or accruing as a result of the transfer of such asset.

The term "fair market value" (FMV) has been defined under the explanation to s.55(2)(ac) to mean, for listed shares, the highest price quoted on a recognized stock exchange on 31st January 2018, and for unlisted units, the net asset value as on 31st January 2018. If there is no trading in listed shares on 31st January 2018, then the highest price of the share on a stock exchange on a date immediately preceding 31st January 2018 has to be adopted.

The very fact that the FMV would be the higher of the cost of acquisition and the lower of the other two values, shows that indirectly an assessee is given an option to adopt the cost of acquisition or the FMV/actual sale price, whichever is higher, through the formula.

Given the fact that the lower of the FMV or the consideration on the transfer is to be taken for comparison with the cost of acquisition, it is very clear that no capital loss can be determined for shares falling within the ambit of s.112A

merely on account of substitution of the FMV on 31st January, 2018. The substitution of FMV can at best, result in nil capital gains, but not negative capital gains. The loss, if any, can only be on account of the fact that the actual cost of acquisition is higher than the actual sale price.

In case of two other types of assets, FMV is also defined. These assets are:

(A) equity shares which are not listed on 31st January 2018 but are listed at the time of transfer; and

(B) equity shares listed on the date of transfer, and which became the property of the assessee through an exempt transfer covered by s.47, in consideration of a share which was unlisted on 31st January, 2018.

In both these cases, the FMV would be the indexed cost of acquisition with indexation till the financial year 2017-18 (a modified FMV), and not the FMV as of 31st January, 2018 as in the case of listed shares and units. To that extent, in case of these shares, there is not a complete grandfathering of gains up to 31st January, 2018.

In all these cases, it is not necessary for the equity shares or units to have been long term capital assets as of 31st January 2018 – it is sufficient if they are long term capital assets as on the date of transfer. For example, a listed equity share acquired in November 2017 and sold in January 2019, would get the benefit of substitution of highest market price on 31st January 2018, even though the shares were held for only a little over 2 months as of 31st January 2018.

Given these basic provisions relating to cost of acquisition, let us examine how these provisions would work for different types of equity shares.

a. Bonus Shares

In case of listed bonus shares allotted before 31st January 2018, instead of a cost of Nil as per s. 55(2)(aa), the highest price of the shares as at 31st January 2018, being the FMV, can be taken as the cost of acquisition u/s. 55(2)(ac). This has been clarified in the FAQs of 4th February 2018 as under:

> *"Q 21. What will be the cost of acquisition in the case of bonus shares acquired before 1st February 2018?*
>
> *Ans 21. The cost of acquisition of bonus shares acquired before 31st January, 2018 will be determined as per sub-clause (6) of clause 31 of the Finance Bill, 2018. Therefore, the fair market value of the bonus shares as on 31st January, 2018 will be taken as cost of acquisition (except in some typical situations explained in Ans 7), and hence, the gains accrued up to 31st January, 2018 will continue to be exempt."*

In case of listed bonus shares allotted on or after 1st February, 2018, where the original shares, in respect of which such bonus are received, were acquired before 1st February, 2018, the cost of such bonus shares would be taken as nil, by virtue of the provisions of s. 55(2)(aa). The cost of the original shares, in respect of which such bonus shares are received would be substituted by the highest market price of the shares on 31st January 2018 without any dilution, and therefore the full benefit of grandfathering of gains would be available.

b. Rights Shares

The position of listed rights shares would be similar to that of listed bonus shares. In case of listed rights shares acquired before 1st February 2018, the cost of acquisition determined u/s. 55(2)(aa) would be substituted by the highest market price of the shares on 31st January 2018. This has also been clarified by the CBDT FAQs of 4th February 2018 as under:

> *"Q 22. What will be the cost of acquisition in the case of right share acquired before 1st February 2018?*
>
> *Ans 22. The cost of acquisition of rights shares acquired before 31st January, 2018*

will be determined as per sub-clause (6) of clause 31 of the Finance Bill, 2018. Therefore, the fair market value of right share as on 31st January, 2018 will be taken as cost of acquisition (except in some typical situations explained in Ans 7), and hence, the gains accrued up to 31st January, 2018 will continue to be exempt."

The cost of rights shares acquired after 31st January 2018 would continue to be the actual amount paid to acquire the rights shares (including amount paid to acquire the rights entitlements, if any), as specified in s.55(2)(aa). Here too, the original shares would get the full benefit of grandfathering of gains up to 31st January, 2018.

c. Shares acquired on Conversion of Debentures

Where listed shares are acquired on conversion of debentures, there is no problem where the conversion has taken place before 1st February 2018, as the highest market price of the shares on 31st January, 2018 can be adopted as the cost of acquisition.

However, where the conversion has taken place after 31st January 2018, and the debentures were allotted prior to that date and were listed, as per the strict language of s.55(2)(ac), the assessee cannot get the benefit of substituting the highest market price of the debentures on 31st January, 2018 for the cost of acquisition. Further, since such equity shares were not in existence on 31st January, 2018 and were therefore neither listed nor unlisted, nor were they acquired in consideration of shares which were unlisted on 31st January 2018, even the benefit of taking indexed cost up to financial year 2017-18 is not available to the assessee.

It appears that in such cases, going by the strict language of the law, the cost of acquisition should be determined only under section 49(2A); i.e., the proportionate actual cost of the debentures would be taken as the cost of the shares.

Such a view is however contrary to the statement of the Finance Minister that grandfathering of capital gains up to 31st January, 2018 was being granted. In his budget speech, the Finance Minister said:

"I propose to tax such long term capital gains exceeding ₹ 1 lakh at the rate of 10% without allowing the benefit of any indexation. However, all gains up to 31st January, 2018 will be grandfathered."

If one therefore goes by a purposive interpretation of the provisions, since listed debentures were replaced by listed equity shares, which were then sold, the natural corollary is that the fair market value (highest market price) of the listed debentures on 31st January, 2018 should be taken to be the cost of acquisition of the equity shares. It is only then that the benefit of grandfathering of gains up to 31st January, 2018 would be achieved.

Further, if the debentures were unlisted, then again on a purposive interpretation, since the transfer is an exempt transfer u/s. 47, the assessee should be entitled to claim the indexed cost of acquisition of the debentures till financial year 2017-18 as the cost of the listed equity shares, though the strict language of s.55(2)(ac) does not seem to permit this.

d. Shares acquired on Conversion of Preference Shares

There is no difficulty in case of listed equity shares acquired on conversion of preference shares, listed or unlisted, where the conversion has taken place prior to 1st February, 2018, as the highest market price of the listed equity shares on 31st January, 2018 can be taken as the cost of acquisition.

There is however a problem in the case of listed equity shares acquired on conversion of listed preference shares where the conversion has taken place after 31st January, 2018, since the provisions of s. 55(2)(ac) are again silent. Strict interpretation would mean that the cost

has to be determined in terms of s.55(2)(b)(v)(e), being the conversion of one kind of shares of the company into another kind, whereby the cost of the preference shares would be taken as the cost of the equity shares. However, this interpretation does not give the benefit of grandfathering of capital gains of 31st January, 2018. One would therefore have to adopt a purposive interpretation here as well, under which the highest market price of the listed preference shares on 31st January, 2018 would be taken as the cost of acquisition of the listed equity shares received on conversion.

The case of listed equity shares acquired on conversion of unlisted preference shares, with conversion after 31st January, 2018, would fall within clause (a)(iii)(B) of the explanation to s. 55(2)(ac). In such cases, the indexed cost of the preference shares up to the financial year 2017-18 would have to be taken as the cost of acquisition of the listed equity shares. The fact that the benefit of substitution of the cost is given to conversion of unlisted preference shares, is one more reason to take a purposive interpretation in the case of conversion of listed preference shares as discussed in the preceding paragraph. One cannot take a stand that grandfathering of gains is permitted for conversion of unlisted preference shares, but no such benefit is allowable for conversion of listed preference shares.

e. Shares Acquired on Amalgamation/ Demerger

In case of listed shares received on an amalgamation or a demerger, normally the provisions of s. 49(2) or 49(2C) respectively apply to determine the cost of acquisition of the shares of the amalgamated or the resulting company received as a result of such amalgamation or demerger. In cases where the amalgamation or demerger has taken place before 1st February 2018, these shares are held by the assessee on 31st January, 2018, and the highest market price on that date can be adopted as the cost of acquisition in place of the cost determined u/s. 49(2) or 49(2C), as the case may be.

In cases where the amalgamation or demerger has taken place after 31st January 2018, and the amalgamating or demerged company was an unlisted company, but the amalgamated or resulting company is a listed company, clause (a)(iii)(B) of the explanation to s.55(2)(ac) applies. This is on account of the fact that the amalgamation or demerger is an exempt transfer u/s. 47, and the listed shares became the property of the assessee in consideration of unlisted shares. In such cases, one would first have to determine the cost of acquisition u/s. 49(2)/49(2C), as the case may be, and compute the indexed cost from the date of acquisition of the shares of the amalgamating/demerged company till financial year 2017-18, which will then be the cost of acquisition for the purposes of computation of the capital gains.

However, clause (a)(iii)(B) does not seem to apply to a situation where the amalgamating or demerged company is a listed company. A strict reading seems to indicate that one has to take the cost of acquisition as per section 49(2)/2c), as the case may be, in such cases. In this case too, the intention does not seem to be to grant the benefit of grandfathering of capital gains only in cases of amalgamation/demerger where the amalgamating/demerged company is an unlisted company, and not to cases where such company is a listed company. In fact, listed companies should be on a better footing than unlisted companies, as their FMV is evident from the market price on the stock exchanges.

Here too, therefore a purposive interpretation seems to be called for, and, in all fairness and in accordance with the intent of the amendment, the highest market price of the amalgamating/demerged company should first be determined and taken as the cost of acquisition of those shares, and then the provisions of s.49(2)/(2C) should be applied to determine the cost of

acquisition of the shares of the amalgamated/resulting company. It is only through such interpretation that the true intention of grandfathering of capital gains can be achieved.

Some Issues

Some further issues which arise on account of the new provisions of s.112A are considered below.

a. Position of transfer of listed equity shares not eligible u/s. 112A

What is the taxability of LTCG on transfer of listed equity shares, where the transfer does not qualify u/s. 112A, either because STT has not been paid on the sale of the shares (e.g., off-market sales), or because STT has not been paid on purchase and the acquisition does not fall within the purview of the notification dated 1st October, 2018?

In such a case, the provisions of s.112 would apply. Under the first proviso to s.112, the tax payable on the LTCG cannot exceed 10% of the LTCG before giving effect to the second proviso to s.48. Therefore, in such a case, the tax payable on the LTCG would be the lower of:

i. 20% of the LTCG computed with indexation of cost, or

ii. 10% of the LTCG computed without indexation of cost.

Therefore, in any case, the rate of tax cannot exceed 10% of the LTCG without cost indexation. In fact, the provisions of s.112 appear to be more beneficial than the provisions of s.112A in so far as the rates of tax are concerned, since there is a possibility of lower tax on account of cost indexation. However, one needs to keep in mind the grandfathering provisions available u/s. 55(2)(ac), permitting adoption of fair market value as of 31st January 2018, when the provisions of s.112A are applicable. Therefore, in most cases where the shares are acquired prior to 31st January 2018, the provisions of s.112A may be more beneficial. In the case of shares acquired after that date, the provisions of s.112 appear to be more beneficial.

Does one have a choice to select the provisions of either s.112 or s.112A? There is really no choice, if one meets the requirements of s.112A. There is however a choice that the seller has as to the method of sale that can be adopted. If the method of sale is such that no STT is paid on the sale (e.g. an off-market transfer), then the provisions of s.112A would not apply, and the provisions of s.112 come into play.

b. Tax Deduction at Source

In case of payments to residents for purchase of shares, there is no provision requiring deduction of tax at source on capital gains on sale of shares. However, where a non-resident is selling the shares, s.195 does require deduction of tax at source. That is on account of the fact that s.195 also applies to payments of "any other sum chargeable under the provisions of this Act".

This has also been clarified by the CBDT in its FAQs of 4th February 2018 as under:

> *"Q 14. Whether tax will be deducted at source in case of gains by resident tax payer?*
>
> *Ans 14. No. There will be no deduction of tax at source from the payment of long-term capital gains to a resident tax payer.*
>
> *Q 15. Whether tax will be deducted at source in case of payment of long-term capital gains by non-resident tax payer (other than a Foreign Institutional Investor)?*
>
> *Ans 15. Ordinarily, under section 195 of the Act, tax is required to be deducted on payments made to non-residents, at the rates prescribed in Part-II of the First Schedule to the Finance Act. The rate of deduction in the case of capital gains is also provided therein. In terms of the said provisions, tax at the rate of 10 per cent will be deducted from payment of long-term capital gains to a non-resident*

tax payer (other than a Foreign Institutional Investor). The capital gains will be required to be computed in accordance with clause 31 of the Finance Bill, 2018."

From the above clarifications by the CBDT, it is therefore clear that TDS @ 10% is required to be deducted only on the capital gains amount, and not on the gross sales consideration. This is in line with the decision of the Supreme Court in the case of *GE India Technology Centre Pvt. Ltd. vs. CIT (2010) 327 ITR 456*, where the Supreme Court held that s. 195(1) in clear terms lays down that tax at source is deductible only from "sums chargeable" under the Act i.e., chargeable u/ss. 4, 5 and 9, and the CBDT Instruction 2 dated 26-2-2014, where the CBDT had clarified that an assessee can be treated in default for non-deduction of TDS only on the chargeable income component of a composite payment made to a non-resident.

However, the CBDT FAQs do not clarify as to who is the person responsible for deducting the TDS. S.204 has a provision clarifying "person responsible for paying" applying to LTCG of a Non-Resident Indian on transfer of foreign exchange assets, in effect, to such LTCG covered by Chapter XII-A. The residuary clause of this section provides that it would be the payer himself who would be responsible. Therefore, in effect, the sharebrokers may need to deduct the TDS on payments made to non-resident clients, other than FIIs. If the sharebroker is not able to determine the amount of capital gains, he may end up deducting TDS on the gross sale proceeds of the shares.

In the case of units of EOMFs, it would be the mutual fund which would be required to deduct TDS. In the case of units of business trusts, the business trusts would be required to deduct the TDS.

c. Computation of s.54F Exemption

LTCG covered by s.112A would qualify for the purposes of exemption u/s. 54F, if a new residential house is purchased, subject to fulfilment of the other conditions. The exemption is computed as a proportion of the cost of the new house to the net sales proceeds, which is applied to the taxable capital gains. This taxable capital gains was earlier the capital gains computed after cost indexation; the computation would now have to be done by applying the same ratio to the unindexed capital gains computed u/s. 112A read with s.48.

Conclusion

Given the substantial misuse of the exemption u/s. 10(38), through transactions such as penny stock transactions and bonus stripping, it was but a matter of time that the exemption would be phased out. Like all new provisions, the provisions of s.112A do have some controversial issues, particularly as regards amalgamations, demergers and conversion of debentures and preference shares post January, 2018. One hopes that the CBDT comes out with clarification on these issues, so that assessees do not have to face unnecessary litigation.

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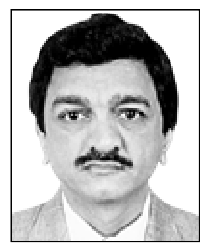
Follow me, if you will, by being intensely sincere,

perfectly unselfish, and above all,

by being perfectly pure. My blessings go with you.

— *Swami Vivekananda*



B. V. Jhaveri, *Advocate*

DIRECT TAXES

Supreme Court

1. SLP dismissed against order of High Court holding that deduction under section 80-I should be given on profit without reducing deduction under section 80HH

Supreme Court of India, Commissioner of Income-tax vs. Hindustan Level Ltd. [Special Leave Petition (Civil) Diary No(s). 4232/2019 February 15, 2019] [2019] 103 taxmann.com 89 (SC)

The Revenue filed the appeal before the Tribunal against the order of the CIT(A)'s order directing that the deduction under section 80I should be given on profits without reducing the deduction under section 80HH of the Act. The Tribunal following the judgment of Hon'ble Supreme Court in the case of *Mandideep Eng. And Pkg. Ind. P. Ltd. 292 ITR 001* justified the order of CIT(A). The Revenue aggrieved by the order of Tribunal filed the appeal before the High Court. The High Court upheld the order of the Tribunal. The relevant para of the High Court order reads as under:

"Re.:- Issue No.1

a) The impugned order of the Tribunal held that the Respondent – Assessee is entitled to the simultaneous benefit of Section 80I and Section 80HH of the Act. This by following the decision of the Supreme Court in the case of *JCIT vs. Alagendran Finance Ltd. [(2007) 293 ITR 1]*.

b) In the above view, the question as proposed being covered by the decision of the Apex Court does not give rise to any substantial question of law. Thus not entertained."

The Revenue filed the Special Leave Petition before the Supreme Court against the order of the High Court. The Supreme Court dismissed the Special Leave Petition of the Revenue.

2. Where High Court held that assessee was entitled to deduction under section 10B in respect of 'deemed export' of goods made by it through third parties, SLP filed against decision of High Court was dismissed

Deputy Commissioner of Income Tax, Circle-12(1), Bangalore vs. Metal Closures (P.) Ltd. – [Special Leave Petition (Civil) Diary No. 42733 of 2018 January 3, 2019] [2019] 102 taxmann.com 72 (SC)

In course of appellate proceedings, Tribunal took a view against assessee for 'deemed exports' to be covered by definition of 'export' for purpose of deduction under section 10B of the Income-tax Act, 1961. However on appeal, the High Court held that assessee was entitled to deduction under section 10B in respect of

'deemed export' of goods made by it through third parties. Relevant para of the High Court order reads as under:

“5. However, since the Division Bench of this Court in the case of Tata Elxsi reversed the order of the learned Tribunal and held in favour of the assessees that assessees were entitled to deduction u/s.10B of the Act in respect of the "Deemed Export" also and similarly following the said judgment, we have also taken a view in favour of the appellant-assessee International Stones India Pvt. Ltd., that the appellant-assessee is entitled to the benefit of deduction u/s.10B of the Act, we find that the present appellant-assessee Metal Closures Pvt. Ltd., who is also similarly situated, since the fact of "Deemed Export" made by it through a third party is not in dispute, also deserves to get the same relief and therefore, the present appeals filed by assessees deserve to be allowed.

“6. The relevant portion of the judgment passed in I.T.A.No.564/2016 & Connected matters *Pr. CIT vs. International Stones India (P.) Ltd. [2018] 95 taxmann.com 287 (Kar.)* decided on 12-6-2018 are quoted below for ready reference:–

> "21. As held by the Division Bench of this Court in Tata Elxsi's case, the purpose of giving these deductions in these special provisions is to encourage exports and fetch foreign currency in terms of Exim Policy propounded and announced by the Union of India. The 'Deemed Export' by the assessee Undertaking even through a third party who has exported such goods to a Foreign country and has fetched Foreign Currency for India, still remains a 'Deemed Export' in the hands of the assessee undertaking also. If the Parliament intended to put any restrictive meaning for curtailing the said deduction, such words could be employed in sub-section(1) itself, which could have excluded 'Deemed Export' from the ambit and scope of word 'export' employed in sub-section(1) of S.10B of the Act. The Explanation defining 'Export Turnover' in both these provisions does not make any such distinction between the 'Direct Export' and 'Deemed Export'.

“22. For a harmonious reading of these provisions of the Act which are undoubtedly beneficial provisions, the word 'export', read with the background of Exim Policy of Union of India would certainly include 'Deemed Export' also within the ambit and scope of the 'Export Turnover' as explained in Explanation-2 of sub-section (9A) of the said S.10B of the Act.

“23. Therefore, both the contentions raised by the learned counsel for the appellant-Revenue to restrict the deduction in the hands of the respondent-assessee by excluding the 'Deemed Exports', does not have any merit and the said contention deserves to be rejected and the same is accordingly rejected.

“24. The appellant-Revenue before us was unable to establish that both the Respondents-assessees before us and the entity through whom such export was made by the assessee for the period in question, have claimed any double or repetitive benefit u/s.10B of the Act for the same transaction of export.

“25. Therefore, we are clearly of the opinion that the issue raised in the present case by the Revenue is squarely covered by the decision of the Division Bench of this Court in Tata Elxsi's case (supra) and we respectfully agree with a view expressed by the earlier Division Bench and therefore, we answer the said substantial question of law framed above against the Revenue and in favour of the assessee and the appeals filed by the Revenue deserves to be dismissed and the same are accordingly dismissed. No costs".”

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The Revenue filed the Special Leave Petition before the Supreme Court against the order of the High Court. The Supreme Court dismissed the Special Leave Petition of the Revenue.

3. SLP dismissed where assessee filed an application before Settlement Commission claiming certain expenditure as 'speed money' for getting clearances from different authorities, since assessee failed to offer any explanation regarding nature of said expenses, Commission rightly rejected assessee's application on ground that it had not come with clean hands

Rashmi Infrastructure Developers Ltd. vs. Income Tax Settlement Commission – [Petition(s) for Special Leave to Appeal (C) No. 20185 of 2017 February 22, 2019] [2019] 103 taxmann.com 234 (SC)

The assessee filed an application before Settlement Commission. The Commission found that assessee had claimed certain expenditure as 'speed money' for getting clearances from different authorities. Since assessee failed to offer any explanation regarding nature of said expenses. The Commission rejected assessee's application on grounds that it had not come with clean hands. The assessee thus filed instant petition challenging order passed by the Commission. The Hon'ble High Court dismissed the writ petition of the assessee on the ground mentioned as under:

"11. It needs no repeating that relief under Article 226 of the Constitution of India is extraordinary and discretionary. It is a relief in equity and the writ granted is prerogative writ and not a matter of course. Therefore the obligation on the petitioner to act with utmost good faith i.e. *uberrimae fidei.* Thus the petitioner must disclose all material facts even if not favourable to him. It is not open to the petitioner to selectively disclose facts and suppress some facts and yet seek extra ordinary remedy of a prerogative writ. As pointed out above, one of the heads of expenses claimed before the Commission for arriving at estimated expenses is the amount paid as "speed money". Thus it was a material fact. The degree of materiality is of no consequence and once the court comes to the view that the non-disclosure was deliberate and possibly made with a view to present a picture different from what existed before the Commission, this Court will not exercise its writ jurisdiction. Therefore, the petitioner has not come with clean hands. In the present case, we are of the view that there was suppression of facts in the petition which was material to the issue at hand. Therefore, we see no reason to entertain this petition on the above ground also."

The assessee filed the Special Leave Petition before the Supreme Court against the order of the High Court. The Supreme Court dismissed the Special Leave Petition of the assessee.

4. Interpretation of Section 142(2C) of the Income-tax Act, 1961 – The provisions of section 142(2C), as they stood prior to the amendment whereby words *'suo motu'* were inserted in sub-section (2C) of section 142 with effect from 1-4-2008 by the Finance Act, 2008, did not preclude the exercise of jurisdiction and authority by the Assessing Officer to extend time for the submission of the audit report directed under sub-section (2A) of section 142 without an application by assessee and the said amendment was intended to remove an ambiguity and is clarificatory in nature

Commissioner of Income-tax, New Delhi vs. Ram Kishan Dass – Civil Appeal Nos. 3211 to 3230 of 2019 Oths. March 26, 2019 [2019] 103 taxmann.com 414 (SC)

The Revenue has filed an appeal against the order of the Delhi High Court which dismissed the appeals filed by the Revenue against the order of the Tribunal wherein it was held that prior to the insertion of the expression *"suo motu"* with effect from 1st April 2008 in Section 142(2C), the assessing officer had no jurisdiction to extend time for the submission of the report of an auditor appointed under sub-section (2A), of his own accord. The assessees submitted that the assessing officer may extend the period, which has been specified under the substantive part of sub-section (2C), only on an application made by the assessee and for good and sufficient reason. The Revenue contended that the authority conferred upon the assessing officer to extend time, on an application made by the assessee, does not take away the authority of the assessing officer, who has prescribed the time for the submission of the report in the first instance, to extend time without an application for extension being made by the assessee, subject to the overall ceiling of 180 days. In the submission of the Revenue, the expression "and for any good and sufficient reason" must be construed logically to mean "or for any good and sufficient reason". Further the assessee submitted that insertion of the term *"suo motu"* in the provision of section 142(2C) of the Act with effect from 1st April 2008 allows the Assessing Officer to extend the period *suo motu* and this power not vested in the Assessing Officer prior to that date. However, the Hon'ble Supreme Court observed that the amendment to section 142(2C) was brought by inserting the term *"suo motu"* to remove the ambiguity and the provision of section 142(2C) even prior to its amendment enables the Assessing Officer to extend time for the submission of the audit report directed under sub-section (2A) without an application by the Assessee. The relevant paras of the judgment read as under:

"11. The Notes on clauses to the Finance Bill, 2008 contain the following explanation:

"Clause 28 seeks to amend section 142 of the Income-tax Act, which relates to enquiry before assessment.

Sub-sections (2A) to (2D) of the said section deal with power of Assessing Officer to order special audit, where the nature and complexity of the accounts requires such audit, to seek the assistance of a chartered accountant.

Sub-section (2C) of the said section specifies the period within which the audit report is to be furnished. The proviso to the said sub-section provides that the Assessing Officer may extend the said period of furnishing of audit report, on an application made in this behalf, by the assessee and for any good and sufficient reason.

It is proposed to amend the said proviso so as to provide that the Assessing Officer may, *suo motu*, or on an application made in this behalf by the assessee, and for any good and sufficient reason, extend the said period by such further period or periods as he thinks fit.

This amendment will take effect from 1st April, 2008."

"11A. The Memorandum accompanying the Finance Act similarly provides:

"Granting of power to the Assessing Officer to extend the time for completion of special audit under sub-section (2A) of section 142.

Sub-sections (2A) to (2D) of section 142 deal with power of Assessing Officer to order a special audit. Such power is required to be exercised by the Assessing Officer having regard to the nature and complexity of the accounts of the assessee and the interest of the revenue.

Sub-section (2C) of the said section specifies the period within which the audit report is to be furnished. The proviso to said sub-section empowers the Assessing Officer to extend this period of furnishing of audit report. Further, it is also provided that the aggregate of the originally fixed period and the period(s) so extended shall not exceed 180 days from the date of issuance of direction of special audit.

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Further, such extension can be made only when an application is made in this behalf by the assessee and there are good and sufficient reasons for such extension.

It is proposed to amend the said proviso so as to also allow the Assessing Officer to extend this period of furnishing of audit report *suo motu.* Hence, while the Assessing Officer shall continue to have power to grant extension on an application made in this behalf by the assessee and when there are good and sufficient reasons for such extension, he can also grant such extension on his own.

The amendment will take effect from 1st April, 2008."

"22. The Notes on Clauses as well as the Memorandum to the Finance Act do not indicate a contrary hypothesis. The reason for the introduction of the amendment arose because of the element of ambiguity inherent in the erstwhile position as it stood before 1st April 2008. The ambiguity was precisely on the question as to whether the assessing officer was precluded from granting an extension of time of his own accord merely because the assessee was permitted to apply for an extension. Since the purpose of the amendment was to remove this ambiguity, we are clearly of the view that by the Finance Act, Parliament essentially clarified the position as it existed prior to the amendment."

"25. The issue as to whether the amendment which has been brought about by the legislature is intended to be clarificatory or to remove an ambiguity in the law must depend upon the context. The Court would have due regard to (i) the general scope and purview of the statute; (ii) the remedy sought to be applied; (iii) the former state of the law; and (iv) what power that the legislature contemplated *(See Zile Singh vS. State of Haryana [2004] 8 SCC 1).* The decision in *Sedco Forex International Drill Inc. vs. Commissioner of Income Tax [2005] 279 ITR 310 (SC); (2005) 12 SCC 717* on which learned counsel for the assesses relied involved a substitution of the Explanation to Section 9(1)(ii) of the IT Act, 1961 with effect from 1 April 2000. A two Judge Bench of this Court held that given the legislative history of Section 9(1)(ii), it can only be assumed that it was deliberately introduced with effect from 1st April 2000 and was therefore intended to be prospective. This was also so construed by the CBDT, and in the explanatory notes to the provisions of the Finance Act, 1999. As we have indicated, interpretation is a matter of determining the path on the basis of statutory context and legislative history. In taking the view that we have, we have also taken note of the fact that the same view was adopted by several High Courts. Among them are (i) the Punjab and Haryana High Court in *Jagatjit Sugar Mills Co Ltd. vs. Commissioner of Income Tax [1994] 74 taxman 8 (Pun.&Har.); [1994] 210 ITR 468;* (ii) the Kerala High Court in *Commissioner of Income Tax, Cochin vs. Popular Automobiles [2011] 333 ITR 308;* and (iii) the Allahabad High Court in *Ghaziabad Development Authority vs. Commissioner of Income Tax, Ghaziabad (UP) (2011) 12 taxman.com 334 (Allahabad); 2011 SCC* On Line All 1151. The decision of the Kerala High Court in Popular Automobiles (supra) is the subject matter of Civil Appeal No 2951 of 2012 in these proceedings.

"26. For the reasons we have adduced, we have come to the conclusion that the provisions of Section 142(2C) of the Income-tax Act 1961, as they stood prior to the amendment which was enacted with effect from 1st April 2008 by the Finance Act, 2008 did not preclude the exercise of jurisdiction and authority by the assessing officer to extend time for the submission of the audit report directed under sub-section (2A), without an application by the assessee. We hold and declare that the amendment was intended to remove an ambiguity and is clarificatory in nature. As a consequence of our decision, we specifically overrule the judgment of a Division Bench of the Delhi High Court in *Commissioner of Income Tax vs. Bishan Swaroop Ram Kishan Agro Pvt. Ltd. [2011] 203 Taxman 326 (Delhi) – ITA No. 1775/2010 - 2011 SCC Online Del 2463 dated 27th May 2011."*

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Paras S. Savla, Jitendra Singh, Nishit Gandhi, *Advocates*

DIRECT TAXES

High Court

1. Statement recorded during the course of search and seizure – Section 132(4) of Income-tax Act, 1961 – Merely because Statements recorded under section 132 (4) are admissible in evidence, it does not mean that said statements or their contents can be read out of context and beyond terms of statements itself and without corroborating material

Shri R. Bhoopathy vs. CIT [2019] 103 taxmann. com 283 (Madras) / TCA No. 584 of 2008, order dt.07-03-2019, Madras High Court

A search was conducted at the residential premises of the assessee on 02-05-2001 under section 132 of the Act. In the statement recorded under section 132 (4) the assessee admitted that he got his son admitted to Engineering Course in Sathyabhama College of Engineering, Chennai, and he paid ₹ 5 lakh as Capitation Fee and ₹ 60,000/- as Annual Fee. The assessee, after the search, filed his Return of Income for the Block Assessment Period declaring undisclosed income to the extent of ₹ 23,65,700/-. The AO while passing the assessment order for the block period made additions of the said sum of ₹ 5,60,000/- in the hands of the assessee under Section 158BC of the Act. On appeal, the learned CIT(A) as well as the Tribunal, upheld the action of the AO in making addition of ₹ 5,60,000/-. The assessee being aggrieved by the order of the Appellate Tribunal, filed an appeal before the Hon'ble Madras High Court. Hon'ble High Court allowed the appeal of the assessee by observing that merely because the Statements recorded under Section 132 (4) of the Act are admissible in evidence, it does not mean that the said statements or their contents can be read out of context and beyond the terms of the statements itself and without the corroborating material. The Court observed that there was no admission on the part of the Assessee that Capitation Fee was paid by the Assessee out of Undisclosed Income not so far declared. Just because the statements state that he paid Capitation Fee to the Engineering College viz., Satyabhama Engineering College, Chennai, it does not mean that it could result in an addition ipso facto in the already declared Undisclosed Income in the hands of the assessee in his Returns filed after the search. The Court held that the orders passed by lower authorities were perverse and unsustainable as the admission made by

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the assessee in the statements recorded was merely to the extent of payment of capitation fee and nothing about the source of such payment, much less such source being an undisclosed income.

2. Business Expenditure – Section 37(1) of the Income-tax Act, 1961 – Compensation paid by assessee developer to allottees of commercial spaces for surrender of their rights – no 'contractual obligation' to make such payment – compensation was paid to protect the 'business interests' – allowable expenditure. [AY 1995-96]

Gopal Das Estates & Housing (P.) Ltd. vs. CIT [2019] 103 taxmann.com 334 (Delhi), Order dt.20-3-2019

The assessee before the Hon'ble Delhi High Court was engaged in the business of construction and sale of commercial space. The assessee developed one building known as Dr. Gopal Das Bhawan at Connaught Place in New Delhi. The Assessee followed the Completed Contract Method ('CCM'). Thus, income was not recognised till the completion of the project. All receipts are treated as 'advance' and all direct expenses are accounted for as 'capital work and progress'. The Gopal Das Bhawan Project was completed in the Assessment Year 1995-96. Some of the allottees of the flats refused to take them for completion since the New Delhi Municipal Council changed the usage of the Lower Ground Floor. The Assessee then started negotiating with the relevant flat buyers and persuaded them to surrender their ownership and allotment letters. The Assessee decided to repay the advance money received from these flat owners which worked out to ₹ 32,08,271/-. The Assessee further paid ₹ 1,18,38,705/- being additional compensation in lieu of surrender of their rights in the flat. This expenditure was claimed by the Assessee as 'revenue in nature' and was charged to the Profit and Loss Account. The A.O. while finalizing the assessment disallowed the claim of the assessee by observing that the Assessee had not paid any compensation to the allottees but had in fact "repurchased these flats" since the allottees had "surrendered their rights in those flats." Consequently, it was held that the compensation paid to the flat owners could not be said to be business expenditure but rather was "capital investment in purchase of stock and trade." The A.O. further observed that enquiries had been made with few of flat owners to ascertain the treatment they had given to the said receipt of compensation in their books of accounts. All of them had shown the amount received from the Assessee as capital gains in their books of accounts as well as income tax returns after indexation of the cost of acquisition. The A.O. on the basis of above enquiries disallowed the claim of the assessee that the payment of compensation was business expenditure, on the ground that the expenditure was capital in nature. On appeal, the first appellate authority allowed the claim of the assessee and directed the A.O. to treat the compensation paid as Business Expenditure.

The department being aggrieved by the order of the learned CIT(A) preferred an appeal before the Hon'ble Appellate Tribunal. The ITAT raised certain queries and required the Assessee to place on record facts relating to the payment of 'compensation'. The ITAT sought clarification whether, (a) Compensation was insisted upon by the parties/persons; (b) Whether legal opinion was sought before parting with the compensation; and (c) Whether payment of compensation was provided for in the agreement entered into at the time of the booking. Documents were then placed before the ITAT by the Assessee which it analyzed. In the impugned order, the ITAT arrived at the following conclusions:

(i) Although in the space buyer's agreement, the amount given for booking of the flat is to be refunded along with the interest in certain eventualities, "nothing over and above" the said sum was payable and the term 'compensation' does not appear in either the letter of allotment or in the space buyer's agreement. (ii)The compensation amount had no relationship whatsoever either with the area comprising a flat booked or with reference to the total amount paid to the Assessee. There was no material which could justify the "quantum of payments stated to be the compensation to various persons." (iii)The opinion given by a lawyer justifying the payment of compensation, stating that since it would ultimately enhance the value of the space which could then be sold at a higher price to another buyer, was "a tailor-made opinion". The huge amounts paid by the Assessee as compensation, even when the agreement between the parties did not require it, was not justified event accounting for the cost of litigation that might ensue. (iv) The payment was for "extraneous considerations" and was not expenditure that was "expedient to the Assessee's business." The compensation was not provided for an agreement between the parties and the expenditure towards compensation far outstripped any expenditure whether legal or otherwise, which the Assessee was supposed to incur in the eventuality of some of the persons opting out of the agreement to purchase flats.

The assessee being aggrieved by the order of the Appellate Tribunal, preferred an appeal before the Hon'ble Delhi High Court. The Court observed that in the assessment years in question, the assessee has followed a consistent accounting policy by following the Completed Contract Method 'CCM'. The Revenue has never disputed that the Assessee follows the CCM and, therefore, what logically flows from the adoption of such accounting policy by the assessee cannot be overlooked by the Revenue. The Court held that one of the basic principles of accountancy is that an expenditure incurred in relation to stock and trade would be of revenue nature. There can be no doubt that the unsold flats that had been surrendered to the assessee were part of its stock-in-trade. The AO himself noted that the assessee had booked the flats to various persons after receiving periodical amounts as advance. They were termed as 'prospective buyers.' It was also noted that after completion of construction, the flats had been allotted to these persons and possession had also been handed over to them. The assessee that it had not repurchased the flats from the buyers. The stage of parting with title/ownership in relation to commercial space allotted to the buyers had not been reached. The AO himself noted that "since the assessee has not sold the space which has been surrendered by the buyers/allottees, therefore, the compensation paid in lieu of surrender of rights in flats/ space shown in work and progress in balance-sheet will enhance the value of work and progress." Based on AS 2 that compensation paid subsequent to the completion of the project is an 'extraordinary item.' It was not 'cost' of completion of the project and, therefore, such compensation could not be added to the value of the stock and trade of the assessee. AS 2 governs valuation of inventories. 'Cost' comprises all of the costs of purchase, cost of completion and other costs incurred "in bringing the inventories to their present location and condition." That which is not relevant to bringing the stock to its present condition or location cannot be a part of its value. The compensation paid to the flat buyers upon surrender of the respective allotted commercial spaces cannot be added to the value of 'stock and trade'. Further the conclusion of the ITAT that the payment was made for 'extraneous consideration' appears to be based on surmises and conjectures. The Court thus held that assessee had a plausible explanation for

making such payment of compensation to protect its 'business interests.' While it is true that there was no 'contractual obligation' to make payment, it is plain that assessee was also looking to build its own reputation in real estate market. Hon'ble High Court further observed that mere fact that recipients treated said payment as 'capital gains' in their hands in their returns would not be relevant in deciding issue whether payment by assessee should be treated as 'business expenditure'. Thus, payment made by assessee to allottees of flats for surrendering their rights was to be allowed as business expenditure of assessee.

3. Share application money – Cash Credit – Section 68 of the Income-tax Act, 1961 – Assessee furnished the relevant details and discharged the primary onus cast upon it – Addition under section 68 of the Act is unjustified. [A.Y. 2009-10]

Pr. CIT vs. M/s. Aditya Birla Telecom Ltd. [ITXA No. 1502 of 2016 order dated 26-3-2019, Bombay High Court]

The assessee before the Hon'ble Bombay High Court was a registered company, engaged in providing telecommunication services. The AO during the course of assessment proceedings observed that the assessee company had issued 19,25,000 preference shares, each of the face value of ₹ 10/- to one P5 Asia Holding Investment (Mauritius) Ltd (hereinafter referred to as "P5AHIML") at ₹ 10,890/- per share. Through allotment of these preference shares, thus, the company had received the share capital of ₹ 1,92,50,000/- and total premium of ₹ 2096.32 crore (rounded off). The dividend would be paid at the rate of 0.00001% per annum on the face value of the preference shares. Upon completion of period of ten years of issuance of preference shares, the same would be converted into equity shares at a premium of ₹ 10,890/- per share. The Assessing Officer noticed that the assessee's holding company M/s. Idea Cellular Limited and its nominee owed 1,00,00,000 equity shares of ₹ 10/- each. He was of the opinion that the assessee had received share capital towards preference shares from P5AHIML at terms which were so adverse to P5AHIML, that no prudent businessman would ever agree to subscribe to preference shares on such terms. He, therefore, invoked Section 68 of the Act and made addition of the said sum in the hands of the assessee. In the process, he relied on following factors (i) The assessee had used only a sum of ₹. 7.31 crores received from P5AHIML for its own operation, the balance amount was transferred to Idea Cellular Ltd (holding company) or to Idea Cellular Infrastructure Services Ltd. (another group company) for the purpose of other investment; (ii) In his opinion, there was no reason why P5AHIML should have transferred such huge amount without any apparent return; (iii) The assessee failed to produce the assessment order of P5AHIML; (iv) In the opinion of the Assessing Officer, P5AHIML representing Province groups and the assessee representing Idea group were front companies; (v) The assessee had opened the bank account in HSBC Bank only for receipt of funds from P5AHIML which was closed shortly after the transfer of funds; (vi) In the opinion of the Assessing Officer, culmination of these facts would be that the subscription of the preference shares by P5AHIML was colourable device and not genuine transaction. In appellate proceedings, the CIT(A) allowed the assessee to produce on record certain documents which did not form part of the assessment proceedings and called for remand report from the Assessing Officer. However, the CIT(A) dismissed the appeal. The Assessee had earlier approached the Bombay High Court in a Writ Petition seeking stay against the recoveries, wherein, the High Court, while disposing of the Writ Petition

had desired that the Commissioner should dispose of the appeal within three months. It was for this reason that the CIT(A) recorded that further investigation into the additional documents was pending and therefore, in compliance with the order of the High Court, he disposed of the appeal. The assessee being aggrieved by the order of the learned CIT (A) preferred an appeal before the Appellate Tribunal, Mumbai. The Appellate Tribunal allowed the appeal of the assessee and deleted the addition made by AO under section 68 of the Act. The department being aggrieved by the order of Appellate Tribunal, preferred an appeal before the Hon'ble Bombay High Court. The High Court observed that the Tribunal carried out the detailed inquiry into all aspects of the matter and noticed no suspicious movement of the funds. The investment made by P5AHIML was done registering itself with SEBI and after obtaining necessary approvals from Ministry of Finance. The application made to the Ministry of Finance contained full details of the investment, the background of the transaction, the terms of the agreement, identity of the investor and the investor group. P5AHIML was an investment arm of Providence Equity Partners and the Tribunal had perused the financial statements which disclosed the flow of funds in the said P5AHIML. The Court observed that Tribunal recorded that while making such investment, the investor not only looks for dividend or interest but also expects return on such investment as capital appreciation, when the investment finally gets converted into equity shares. Merely because the investment was considerably large and several corporate structures were either created or came into play in routing the investment in the assessee through P5AHIML would not be sufficient to brand the transaction as colourable device. The High Court thus dismissed the department's appeal.

4. Deduction u/s. 42 in respect of prospecting for or extraction or production of mineral oils – Government denied extension of license – Whether surrender or not ? – Deduction granted (AY 2008-09)

PCIT vs. Hindustan Oil Exploration Corporation Ltd. – 2019 (4) TMI 62 – Bombay High Court, order dt. 25-3-2019

The assessee, engaged in the business of exploration and extraction of oil, filed its return of income for the year 2008-2009 declaring Nil income. In the return, the assessee had claimed a deduction of a sum of ₹ 99.96 crore under section 42 of the Income-tax Act, 1961 (for short 'the Act'). The assessee company had entered into a Production Sharing Contract (PSC) with Government of India on 8-10-2001 for the purposes of oil exploration. As per the PSC, a consortium of three companies of which the assessee was a part, was issued a licence for carrying out exploration of oil in the Kaveri Basin by the Government of India. The initial period of contract was for three years and the total contract period was seven years divided into three phases and the entire oil exploration had to be completed in seven years in three phases. The company spent the abovementioned sum in drilling wells and exploring oil. However, no discovery could be made. At the end of the said period, the company had asked for extension, which was denied by the Government of India. The deduction of ₹ 99.96 crore was claimed by the company which was an expenditure in oil exploration on the ground that the block was surrendered on 15-3-2008 relying on section 42(1) (a) of the Act. The Assessing Officer (AO) was of the opinion that this was not a case of surrender of right to carry on oil exploration since the assessee was interested in extension of time, which was denied by the Government of India. As such,

he denied the said deduction. The CIT(A) as well as the Tribunal ruled in favour of the assessee holding that the said deduction u/s 42(1)(a) was rightly claimed by the assessee. On further appeal by the Department, the Hon'ble High Court dismissed the appeal. It observed that, as per section 42(1) for the purpose of computing the profits or gains of any business consisting of the prospecting for or extraction or production of mineral oils any expenditure by way of infructuous or abortive exploration expenses in respect of any area surrendered prior to the beginning of the commercial production by the assessee would be admissible. For applicability of clause (a) of sub-section (1), the elements vital are that the expenditure should be infructuous or abortive exploration expenses and that the area should be surrendered prior to beginning of the commercial production by the assessee. In other words, as long as these two requirements are satisfied, the expenditure in question would be recognized as a deduction. The emphasis of this provision is of infructuous or abortive exploration expenses and that there is surrender prior to the beginning of the commercial production. The term 'surrender' in this clause, therefore, has to be appreciated in light of these essential requirements of the deduction clause. The revenue had put unnecessary stress on the term 'surrender' while the main focus of the clause is on infructuous or abortive exploration expenditure in respect of area surrendered prior to the beginning of the commercial production. As long as the commercial production has not begun and the expenditure is abortive or infructuous exploration expenditure, the deduction would be allowed. The term 'surrender' itself is flexible one and does not always connote the meaning of voluntarily surrender. As in the present case, the surrender can also take place under compulsion. The assessee had no choice but to surrender the oil blocks, because the Government of India refused to extend the validity period of the contract. Nevertheless, the act of the assessee to hand over the oil blocks before the commencement of commercial production would as well be covered within the expression "any area surrendered prior to the beginning of commercial production by the assessee." The revenue does not dispute that the expenditure was infructuous or abortive exploration expenditure. Section 42 of the Act recognises the risks of the business of oil exploration which activity is capital intensive and high in risk of entire expenditure not yielding any fruitful result. Entire purpose or enactment would be destroyed if the rigid interpretation of the revenue is accepted. The departmental appeal was thus dismissed.

5. Transfer pricing adjustment – Amount paid for acquisition of shares – the difference between the actual investment and fair market value of the shares (investment) cannot be taxed under chapter X as it is a machinery provision and not a charging provisions (AY 2010-11)

PCIT vs. PMP Auto Components P. Ltd. – ITXA No. 1685 of 2016 – Bombay High Court, order dt. 20-2-2019

The Revenue raised a question before the Hon'ble High Court with regard to the Assessee investing an amount of ₹ 2.67 Crore to acquire shares of its AE (subsidiary company), which had a fair market value of ₹ 8.19 lakhs. According to the TPO there was an excess payment of ₹ 2.58 crores to acquire the shares of the AE as compared to the fair market value of the shares. The same was sought to be taxed by the TPO / AO under the transfer pricing provisions under Chapter X of the Act. However, on further appeal the Tribunal rejected the contention of revenue on the ground that this issue stands concluded by the decision

of the jurisdictional High Court in the case of *Vodafone India Services P. Ltd. vs. UOI – (2014) 368 ITR 1 (Bombay).* In the above case the Hon'ble High Court held that investment in shares is on capital account and does not give rise to any income to trigger the provisions of Chapter X of the Act. The Revenue raised threefold arguments before the Hon'ble High Court in order to support the order of the TPO / AO. It was firstly argued that the transaction is an international transaction and, therefore, the transfer pricing adjustment is required to be done in terms of Chapter X particularly when even the DRP held that additional investment of capital by respondent in its AE's shares vis-a-vis its fair market value is subject to transfer pricing adjustment. Secondly it was argued that, the decision in Vodafone (supra) is inapplicable to the present facts, as it was concerned with inbound investment and was not in respect of outbound investment, as in this case. Lastly it was argued that, the investment made in shares if sold in subsequent years, may give rise to potential loss. This when the respondent sells the shares which have been purchased at a price much higher than its fair market value. Thus, this difference has to be brought to tax as sought to be done by the Revenue. The Hon'ble High Court negated all the three contentions and dismissed the Revenue's Appeal. The Court held that though the transaction of purchase of shares by the respondent of its subsidiary company i.e. A.E. at a price much higher than its fair market value would be international transaction as defined in Section 92(B) of the Act, Chapter X of the Act would not be applicable in case of any investment made on capital account since the transaction of purchase of equity share capital would not give rise to any income. It was held that, before the provisions can be kicked in, it is necessary that income must arise under the substantive provisions found in the Act viz., under the heads of salaries or income from house property or profits and gains in business or profession or capital gains and/ or income from other sources. Section 92 of the Act requires income to arise from an international transaction while determing the ALP. Therefore the *sina qua non* is that income must first arise on account of the international transaction. It was further held that the distinction sought to be made by the revenue on the basis of this being an inbound investment and not an outbound investment as in the case of Vodafone (supra) is a distinction of no significance. Chapter X of the Act is a machinery provision and can only be invoked to bring to tax any income arising from an international transaction, then, it is necessary for the revenue to show that income as defined in the Act does arise from the international transaction. The distinction between inbound and outbound investment is a distinction which does not take the case of revenue any further, as the Legislature has made no such distinction while providing for determination of any income on adjustments to arrive at ALP arising from an international transaction. It further observed that the submission on behalf of the revenue that in future the respondent may sell these shares at a loss as they have purchased the same at much higher price than its fair market value which may result in reduction of its tax liability in future was in the realm of speculation and was merely hypothetical. The issue had to be examined on the basis of law and facts as existing before the authorities in the subject assessment year. It further observed that no provision of the Act had been referred to by the Revenue, which would allow it to tax a potential income. As such, the appeal was dismissed.

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Neelam Jadhav, Neha Paranjpe & Tanmay Phadke, *Advocates*

DIRECT TAXES

Tribunal

Unreported Decisions

1. Section 50C – When the land under sale had encumbrances at the time of sale, the adoption of stamp duty valuation as a sale consideration/full value of consideration is not justified in absence of any evidence that the sale consideration was more than the value shown in the agreement

Sir Mohd. Yusuf Trust vs. ACIT-18(1) (ITA 2243/Mum/2015)[Assessment Year: 2011-12], Order dated 8-3-2019

Facts

The assessee is a private family discretionary Trust, set up *vide* wakf deed dated 19-4-1929. The assessee filed its return of income for the impugned assessment year on 17-10-2012 declaring total income at ₹ 25,41,756/-. In the return of income, the assessee disclosed LTCG amounting to ₹ 13,96,642/- on sale of land of 17,300 sq meters situated at village Tungwa, Kurla. The return was selected for scrutiny assessment wherein the assessee was asked as to why the said land was sold at a lower consideration when the stamp value of the same is ₹ 11.76 Cr and why the provisions of sec 50C should not be invoked. In reply to the said queries, it was submitted that the land under dispute was encroached by slum dweller and thus, the assessee did not have clear title over the said land. It was further mentioned that the assessee issued a public notice for inviting a bid for sale of the said land on as is where is basis. The assessee received a bid from M/s. Essa Associates. Pursuant to the said bid, the assessee entered into a Memorandum of Intend (MOI) dated 18-12-2003 for sale of the said land. Further, the approval was obtained by the Hon'ble High Court to sell the land at the price agreed between the parties to the agreement by filing the petition dated 8-7-2004 before it. Accordingly, the permission was granted by the High Court *vide* order dated 1-10-2004. The agreement to sell was registered on 10-8-2010 and the stamp duty was paid by the buyer on current market value. However, the assessee received the sale consideration of ₹ 27,93,285/- only. The assessee's share in the said land was 50% and thus, a sum of ₹ 13,96,642/-was declared by the assessee as a LTCG in its return. Further, it was prayed before the learned AO that provisions of section 50C of the Act cannot be invoked in the present case since the assessee transferred the said land on as is where is basis with the encumbrances

attached to it. However, the learned AO without appreciating the facts and the submission filed by the assessee invoked the provisions of section 50C of the Act and made addition of ₹ 5.88 crore under the head LTCG taking the market value of the land amounting to ₹ 11,76,35,500/-. On appeal, the assessee did not find any success. Being aggrieved by the order of the learned CIT(A), the assessee preferred an appeal before Hon'ble ITAT. After considering the arguments of both the parties, Hon'ble ITAT held as under:

Held

After considering the documentary evidences and submission filed by the assessee, it was observed that the market value of the property for stamp duty purpose was determined by the concerned authority at ₹ 11.76 crore and accordingly, the stamp duty was duly paid while registering the relevant agreement. The value adopted for the purpose of payment of stamp duty is not disputed by the assessee. The learned AO has not brought on record that the property under sale was not under various encumbrances and the assessee was having the absolute marketable title of the said property. No material was brought on record by learned AO that the assessee has received much more consideration than shown in the MOI. The learned AO treated the stamp valuation rate as the value of consideration, dispite the facts that the assessee throughout the proceedings contended that it was neither possessing of the impugned piece of land nor having marketable title. The assessee offered the said piece of land on the basis 'as is where is'. Hon'ble ITAT concluded that these important facts were ignored by the lower authorities. Hon'ble ITAT, further, observed that it is an undisputed fact that when the land under sale was having encumbrances, the adoption of stamp valuation as a sale consideration by applying the provisions of section 50C was not justified in absence of any evidence to show that the sale consideration was more than the value shown in the MOI. On the above-mentioned observation, Hon'ble ITAT directed the learned AO to work out the capital gains on the basis of consideration shown by the assessee and allowed the said ground in favour of the assessee.

2. Sec 201 – Merely the assessee has agreed to compensate the interest on a loan which a contractor of the assessee borrowed from a bank due to delay in receipt of running bills from the assessee does not amount to payment of interest by the assessee to the said Contractor. There is no application of Sec 194A of the Act

ITO (TDS) - 2(4), Mumbai vs. Nagari Nivara Parishad [ITA 4442, 2090, 4443, 2092, 2091/ MUM/2014] (Assessment Year: 2000-01 to Assessment Year 2004-05), Order dated 14-12-2018

Facts

The assessee Nagari Nivara Parishad is a registered charitable trust income which is exempt u/s. 11 of the Income Tax Act, 1961. For the assessment years under consideration, the assessee procured services of its contractor M/s. B.E. Billimoria & Co. Ltd. (BEBCL). However due to financial difficulties, the assessee could not repay the running bills of the said contractor resulting in financial hardship to the contractor itself. Considering the situation, both the parties came to the understanding that the Contractor would borrow a loan from a commercial bank and interest on the said loan would be compensated by the assessee to the Contractor. Accordingly, the assessee paid the interest portion to the contractor and debited the same to the construction cost which was capitalised in books of account. Since the said interest was considered as a part of contract itself and paid due to late payment of running bills to the contractor, as a matter of abundant caution, the assessee deducted the tax u/s.

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194C of the Act. However the learned AO was of the view that since the assessee agreed to bear the interest portion on the loan borrowed by the Contractor due to late payments of the Contract amount on the part of the assessee, the compensation of interest to the contractor is covered u/s. 194A of the Act. Being aggrieved by the said stand, the assessee preferred an appeal before the learned CIT(A) and succeeded on its contention, Against the order of the learned CIT(A), the Revenue preferred an appeal before Hon'ble ITAT. After listening to both the sides, Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that it is clear from the income and expenditure account of the assessee that the assessee has not claimed any interest expenditure against the payment made to BEBCL. It was payment of compensation of expenses incurred by BEBCL against a loan availed by BEBL as the assessee was not able to pay running bills, as per the terms of the Contract entered into with the assessee. Further the TDS is deducted u/s. 194C of the Act. Hon'ble ITAT further noticed that even in the books of account, the assessee capitalised the said payment. Hon'ble ITAT observed that in the said arrangement, there is no payment of interest by the assessee to the contractor on any money borrowed. Rather in fact, it was the compensation for late payment of running charges termed as interest under consideration. On the aforesaid observations, Hon'ble ITAT decided the issue of deductibility of tax u/s. 194A of the Act in favour of the assessee and against the Revenue.

Reported Decisions

3. Section 145 r.w.s. 37 – If the project is completed substantially and the assessee has offered the entire income in year of completion based on the project completion method, the assessee is entitled to claim certain miscellaneous expenses which are yet to be incurred on provisional basis in the same year. Further the disallowance on account of non-deduction of TDS would not come into picture as the expenses are claimed on estimation basis and payees are not identified

Bengal Peerless Housing Dev Co. Ltd. vs. DCIT [ITA 2414 & 2549/KOL/2017] (Assessment Year: 2012-13), Order dated 31-12-2018, [2019] 103 taxmann.com 298 (Kolkata – Trib).

Facts

The assessee is a Limited Company and the assessment year under consideration is 2012-13. For the year under consideration, the assessee substantially completed one project and offered the entire revenue from the said project in the year under consideration. While doing so, the assessee estimated certain expenses relating to ancillary/miscellaneous work which are yet to be carried out. During the scrutiny assessment proceedings, the learned AO disallowed the same on the basis that the expenses were not incurred by the assessee for the year under consideration. He observed that invoices relating to the said expenses submitted in the assessment proceedings do not cover the present assessment year and pertain to the next financial year. He further observed that no tax is deducted by the assessee while making a provision for the expenses and in light of the same, the learned AO came to the conclusion that expenses should not be considered while determining the income from the project. Being aggrieved, the assessee has preferred an appeal before the learned CIT(A) and got the partial relief. Against the order of the learned CIT(A), the assessee as well as the Revenue preferred appeals before Hon'ble ITAT. After hearing both the sides, Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that it is not in dispute that the assessee followed the project completion method. Further it carefully analysed the said method and observed that in this method, the financial statements, that is, profit and loss account and balance sheet is prepared once in the life of the project and it is necessary to make the provision in the books of accounts for expenses like ancillary and minor/miscellaneous work, which are to be completed in subsequent years. It further noted that if the assessee does not make provision for estimated expenditures, like, expenses on minor/miscellaneous work, then in that case the assessee will not be able to show true profit and loss, in its profit and loss account. On the abovementioned observation, Hon'ble ITAT rejected the submission of the Revenue and accepted the contention of the assessee. On the second aspect regarding TDS, Hon'ble ITAT observed that since the assessee made a provision for these expenses to compute the true net profit and the payee is not known, deduction of tax is not possible. While coming to the aforesaid conclusion, Hon'ble ITAT referred to the decision of a co-ordinate bench in the case of *Apollo Tyres Ltd. vs. Dy. CIT [2017] 163 ITD 177/78 taxmann.com 195 (Delhi - Trib.)*. Finally, the assessee's appeal is allowed and the Revenue's appeal is dismissed.

4. Section 194C – Tax is deductible u/s. 194C of the Act on payments made to the artists like singers, musicians etc. who participate in reality shows as guests or judges. There is no applicability of Section 194J as payments are not made for any services rendered for production of cinematograph film.

Malayalam Communications Ltd. vs. ITO (TDS) (ITA 403/Coch/2018) [Assessment Year: 2010-11], Order dated 8-2-2019, [2019] 103 taxmann.com 63 (Cochin – Trib.)

Facts

The assessee is a Limited Company and the assessment year under consideration is 2010-11. A survey action was carried out in the business premises of the assessee to verify whether the tax has been deducted at source against the payment made to various artists who participated in the reality shows telecast by the assessee as a judge or guest. During the course of survey, it was found that the assessee deducted tax on the said payments made to the said artists at the rate of 1% u/s. 194C of the Act on the ground that the said payments were made to the artists as per the agreements entered into with them for production of programmes meant for telecast by the assessee. The learned AO came to the conclusion that the payments made cannot be said to be for the work of telecasting or producing a programme for telecasting by the assessee as contemplated under the provisions of section 194C and held that the learned AO observed that the payments were made as remuneration for the service rendered by the artists. Therefore, the same can be termed as payments for providing service which qualify for a deduction of tax at source at the rate of 10% u/s. 194J of the Act. On appeal, the learned CIT(A) uphold the action of the learned AO Being aggrieved by the order of the learned CIT(A), the assessee preferred an appeal before Hon'ble ITAT. After considering the submissions of both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT held that the only question under consideration is whether the payments made to the artists who participated in the show telecast by the assessee are subjected to the TDS u/s. 194C or 194J of the Act. Hon'ble ITAT observed that the payments made to the artists are not covered by the professional services as defined u/s. 194J of the Act. The

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persons who are engaged in reality show cannot be equated with a person engaged in production of films. On the said observation, Hon'ble ITAT held that it is not possible to accept the contention of the revenue that the payments made to the artists who participated in reality shows produced for television would come under the provisions of Section 194J and fall outside the realm of sec 194C r.w. Explanation III of the Act. While coming to the said conclusion, Hon'ble ITAT referred to the notification issued by the CBDT on 12-1-1977. Hon'ble ITAT accepted the contention of the assessee and came to the conclusion that Section 194C of the Act is applicable to the said payments. The issue was decided in favour of the assessee and against the Revenue.

5. Sec 250(6) r.w.s. 251 – As per the provisions of Section 250(6), the CIT(A) does not have any power to dismiss an appeal for non-prosecution and is under obligation to dispose of the same by passing a speaking order on merits

Ms. Swati Pawa vs. DCIT [ITA 3098/Del/2016] (Assessment Year: 2011-12), Order dated 6-2-2019, [2019] 103 taxmann.com 298 (Del. – Trib.).

Facts

The assessee is an individual and the Assessment Year is 2011-12. For the said assessment year, the learned AO made certain additions in the scrutiny assessment proceedings and passed an order u/s. 143(3) of the Act. The said order was challenged before the learned CIT(A). However, the assessee did not appear before the first appellate authority and in light of the same, the learned CIT(A) dismissed the appeal without adjudicating the additions under consideration. Against the said order, the assessee preferred an appeal before Hon'ble ITAT which held as under:

Held

While deciding the said issue, Hon'ble ITAT observed that once an appeal u/s. 246A was filed by the assessee, it means that the assessee sets in motion the machinery designed for disposal of the appeal u/ss. 250 and 251 of the Act. If the appeal filed by the assessee fulfils requirements of maintainability and admissibility prescribed u/ss. 246, 246A, 248 and 249 of I.T. Act; neither the assessee can stop the further working of that machinery as a matter of right, by withdrawing the appeal, or by not pressing the appeal, or by non-prosecution of the appeal; nor the first appellate authority, can halt this machinery by ignoring either the procedure in the appeal prescribed u/s. 250 of I.T. Act. Hon'ble ITAT observed that it is well-settled that powers of CIT(A) are co-terminus with powers of the Assessing Officer. Once the assessment proceedings are set in motion, it is not open to the learned AO to not complete the Assessment Proceedings by allowing the assessee to withdraw Return of Income; it is similarly, by analogy, not open for the learned CIT(A) to not pass order on merits on account of non-prosecution of appeal by the assessee. Hon'ble ITAT further observed that irrespective of conduct/participation of the assessee, the learned CIT(A) cannot disregard statutory role under these provisions. On the aforesaid observation, the appeal was allowed for statistical purpose and restored back to the file of the learned CIT(A).

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> This is the gist of all worship – to be pure and to do good to others.
>
> — *Swami Vivekananda*

CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION
Case Law Update

A. HIGH COURT

1. No substantial question of law arose against the Tribunal's order excluding comparable companies which (i) had substantial related party transaction (ii) were performing clinical research trials in-house while the assessee – company had outsourced its clinical research activities

Pr. CIT vs. M/s. Pfizer Limited– [TS-130-HC-2019-TP (Bom)] – Income Tax Appeal No. 1731 of 2016

Facts

(i) The assessee was engaged in manufacturing and sale of pharmaceutical products. It had adopted TNMM for benchmarking its clinical study management and monitoring supporting services and selected 6 comparables and concluded the price charged to be at ALP as margin of comparables was 12.61% i.e. within +5% range from its margin of 11.11%.

(ii) The TPO rejected 4 of the companies selected by the assessee as he was of the view that the assessee was providing specialized skill services in area of clinical trials and not merely routine support services whereas the said companies were functionally different (engaged in consultancy and management services). He proceeded to select additional comparable companies and accordingly made an upward adjustment.

(iii) The CIT(A) accepted assessee's plea for exclusion of TPO's comparable i.e., Syngene International Pvt. Ltd on ground that the company had substantial Related Party Transactions (RPT). However it rejected assessee's plea for exclusion of two other comparables viz. *SIRO Clinpharm Pvt. Ltd. and Choksi Laboratory Ltd.*

(iv) The Tribunal confirmed CIT(A)'s order with respect to exclusion of Syngene International Pvt. Ltd. noting that Revenue was not able to controvert CIT(A)'s finding of substantial RPT and further agreed with assessee's contention that it had two streams of income viz., contract research fees and sale of compounds however there was no separate segmental information available.

(v) The Tribunal also excluded the comparables contested by assessee viz., *SIRO Clinpharm Pvt. Ltd. and Choksi Laboratory Ltd.* on

ground that the business models of the aforesaid companies were different as they conducted research trials whereas the assessee company was outsourcing its entire activity of clinical research trials to hospitals.

(vi) Aggrieved, the Revenue filed an appeal before the High Court.

Held

(i) With respect to Revenue's plea to consider *Syngene International Ltd.* as a comparable, the Court held that the Revenue had not shown as to how the findings of facts by CIT(A) and Tribunal that the said company had substantial RPT was perverse.

(ii) With respect to *SIRO Clinpharm Pvt. Ltd.,* at the outset, the Court held that merely because assessee had selected the said comparable could not estop it from contesting its exclusion.

(iii) Further, with respect to exclusion of *SIRO Clinpharm Pvt. Ltd.* and *Choksi Laboratories Ltd.,* it relied on its own decision in the case of *CIT vs. Aptara Technology P. Ltd. (2018) 92 taxmann.com 240 (Bom)* wherein it was held that the company which outsources it work is not comparable for ALP determination with a company that does the activity in house and thus held that no fault could be found with the Tribunal's order.

(iv) Accordingly, it held that no substantial question of law arose and dismissed Revenue's appeal.

2. As regards transaction which are not referred to the TPO by the AO, the TPO can make *suo motu* adjustment only with respect to international transactions and not with respect to specified domestic transaction

Times Global Broadcasting Company Ltd. vs. UOI [2019] 103 taxmann.com 388 (Bom) – Writ Petition No. 3386 of 2018

Facts

(i) The assessee was engaged in the business of distribution of television channels owned by Times Group entities including BCCL and retained 8% of its fees as its service income received upon distribution and remitted the balance to the aforesaid entities according to their revenue share. With effect from 1.04.2014, the assessee demerged one of its business undertakings into BCCL.

(ii) For AY 2015-16, the assessee reported two specified domestic transactions ("SDTs") in its Form 3CEB (a) payment of subscription fees earned from distribution services (b) Payment to key management personnel. The AO made a reference to TPO to determine ALP of said SDTs reported.

(iii) The TPO held the assessee to be in default for not reporting in Form 3CEB SDT with respect to payment of creditors in demerger process (where TPO contended that by transferring creditors of the demerged company to the AE under demerger, the assessee had made a payment which would fall within ambit of any expenditure under section 92BA and thus a SDT) and made an ALP adjustment with respect to the same. He also made an adjustment with respect to the SDT of payment of subscription fees.

(iv) Aggrieved, the assessee filed a writ petition before High Court challenging the adjustments made by TPO on ground (a) TPO could not examine any SDT if not referred by AO, thus it could not make a suo moto adjustment in case of payment of creditors in demerger process and (b) so far as the payment of subscription fees was concerned, the same was made without proper notice to the assessee.

Held

(i) The Court rejected the preliminary objection of Revenue raised against the maintainability of writ petition holding that its powers under Article 226 of the Constitution of

India were wide and if found that TPO's action were without jurisdiction, it could strike down the order irrespective of alternative statutory remedies of appeal available with the assessee.

(ii) With respect to payment of creditors in demerger process:-

(i) The Court held that the TPO had no jurisdiction to make any such adjustment as the said SDT was not referred to him by the AO.

(ii) It rejected the reliance placed by the Revenue on provisions of sub-section (2A) and (2B) of section 92CA inserted w.e.f. 1-6-2011 with retrospective effect from 1-6-2002 which empower the TPO to examine any international transaction which come to his notice during proceedings before him without reference being made by AO. The Court held that the legislature while expanding the scope of TP study by TPO to transaction not referred to him or not reported by assessee has confined the applicability thereof only to international transaction and not SDT.

(iii) It held that in case of SDTs, TPO could determine ALP only on reference by AO in terms of section 92CA(1) and further, AO would have to obtain prior approval of Principal Commissioner or Commissioner before making a reference and such requirement could not be jettisoned by TPO exercising *suo motu* jurisdiction over the transaction not referred to him.

(iv) However, the Court clarified that as per the CBDT Instructions dated 20-5-2013, it was always open to TPO who notices such transactions during the course of proceedings to call for reference by the AO.

(iii) With respect to payment of subscription fee earned from distribution services:-

(i) The Court noted that assessee's contention on merits required minute examination of documents and materials on record.

(ii) Further with regard to assessee's contention of breach of natural justice, it held that it was not possible to consider the said contention in brief since the TPO had issued a number of notices and it would have to be examined whether in any of such notice he had raised precise query in relation to the adjustment for payment of subscription fee.

(iii) Accordingly, it held that since the Act provides for statutory appeals and further appeal to High Court on substantial question of law, the Court would not undertake this ground in writ petition.

(iv) Thus, it quashed TPO's order to the extent it provided for adjustment of ALP towards payment of creditors in demerger process and let the ALP adjustment on payment of subscription fees stand as it is.

3. Two companies having fundamental difference in the profiles cannot be comparable to each other, irrespective of the fact the assessee itself had included such a comparable in the TP study report

PCIT vs. Lionbridge Technologies Ltd. [TS-176-HC-2019 (Bom)-TP] – ITA No 1815 of 2016

Facts

(i) The Assessee-company was *inter alia* engaged in calling of localisation and software services. Before Tribunal, for the first time, the assessee contended for exclusion of comparable i.e., Bodhtree Consulting, which the assessee itself had included in the TP study report for determining arm's length price.

(ii) The Tribunal excluded Bodhtree Consulting as comparable on the ground of functional dissimilarity as it was a software product manufacturer as against assessee who was found to be in the calling of localisation and software services.

(iii) Aggrieved, the Revenue filed an appeal before the High Court against the Tribunal's order excluding Bodhtree Consulting as a comparable.

Held

(i) The Court held that it did not find any error in the Tribunal's finding as two companies having fundamental difference in the profiles could not be comparable to each other.

(ii) Further, it also rejected Revenue's contention that the assessee could not change its stand regarding comparability *vis-à-vis* a company having included the said company in its TP-analysis. It relied on the own decision in the case of *Tata Power Solar Systems Ltd. (2017) 77 taxman.com 326 (Bom HC)* wherein it was held that assessee was not barred from withdrawing a comparable if the same was included on account of mistake and was not comparable.

(iii) Accordingly, the Court concluded that the Tribunal's finding was not shown to be perverse in any manner and, thus, dismissed Revenue's appeal.

B. TRIBUNAL

4. India-USA DTAA Lease line reimbursements to US parent, not royalty – Not Taxable in India – In favour of the assessee

T-3 Energy Services vs. JCIT [TS-70-ITAT-2018(PUN)] Assessment Year: 2010-11

Facts

(i) T-3 Energy Services India Pvt. Ltd. ('assessee') engaged in the manufacturing of Industrial Valves & Valve Components used in the Oil Field Service Industry, had incurred expenditure on account of reimbursement of lease line charges to its parent company in AY 2010-11.

(ii) The parent company of assessee T-3, USA had entered into an agreement with service provider Qwest Communications Inc. for providing of bandwidth services and the parent company in turn, provided bandwidth services to its subsidiaries. The assessee availed lease line services from its parent company and reimbursed the lease line charges to it. The assessee contended that the reimbursement was on cost to cost basis and there was no profit element involved in it, therefore, tax was not required to be deducted.

(iii) The AO contended that the said payment was not reimbursement of expenses to the associated enterprises for any services provided by them to the assessee, but it was payment made to third party Qwest Communication Inc., through associated enterprise of assessee. The AO contended that in the absence of associated enterprise, if the assessee intended to take services of Qwest Communications, Inc, services would be provided to him at the same rates as charged by associated enterprise and it was veil to shadow profit element (income) in the hands of recipient i.e., third party.

(iv) The AO held that the said payment was covered within the definition of royalty due to retrospective amendment in Section 9 by Finance Act 2012, on which the assessee should have deducted tax u/s. 195. The AO further contended that the amended clarificatory definition of royalty under Act will be applicable to DTAA. Therefore, the ITO disallowed the payment of ₹ 20.47 lakh u/s. 40(a)(i). CIT(A) upheld the disallowance of AO.

Decision

On appeal, the Tribunal held in favour of the assessee as follows:

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(i) The Tribunal relied on Delhi HC decision in the case of *New Skies Satellite BV & Ors.* to hold that amendment made under the Act does not affect the terms of DTAA unless and until the same is amended by two Contracting States. Therefore, it held that even though the definition of royalty under the Act has been amended, however, the term 'Royalty' under the DTAA between India and USA is not amended. Accordingly, it held that the assessee is not liable to withhold tax on the payments made to its associated enterprise on account of lease line charges.

(ii) The Tribunal also relied on the Bombay HC decision in the case of Siemens Aktiongesellschaft to hold that once a term has been defined in DTAA, then the said term is to be applied unless and until the parties to the DTAA amends the same. Thus, the Tribunal held that the amended provisions of section 9(1)(vi) of the Act brought into force by the Finance Act, 2012 are applicable to domestic laws and the said amended definition cannot be extended to DTAA, where the term has been defined originally and not amended.

(iii) The Tribunal further noted that the privity of contract is between Qwest Communications Inc, the service provider and T-3, USA, who in turn had received bandwidth and passed on the services to various entities of group on cost to cost basis. Qwest Communications Inc had raised charges upon T-3, USA and the portion allocable to the assessee was charged on cost to cost basis. Therefore, it held that it cannot be said that there was any income element which has arisen in the case and consequently where the assessee had reimbursed the expenses having no income element, there is no requirement to withhold tax out of such payments. It rejected the Revenue's contention that it is not case of reimbursement but is a case of payment to third party through its associated enterprise and hence, the need for withholding tax on the ground that the said payment was not royalty under DTAA.

(iv) Further, the Tribunal noted that the assessee had declared the reimbursement of lease line charges in its TP study report and the TPO had accepted the nature of expenses i.e., reimbursement of lease line charges to be at arm's length price. Therefore, the Tribunal held that once the TPO has accepted the nature of expenses, the AO cannot sit in judgment of the TPO order since under the provisions of the Act, the order passed by the TPO is binding upon the AO. It further held that at best AO could have invoked the provisions of Income-tax Act *per se* and not question the nature of expenditure contending it to be royalty.

5. India-UAE DTAA – No PE for *Booz* UAE; Revenue's reliance on AAR in group concern's case, misplaced

Booz & Company (ME) FZ-LLC vs. DDIT [TS-27-ITAT-2018(Mum)] Assessment Year 2011-12

Facts

(i) Booz & Company (ME) FZ-LLC ('assessee'), company incorporated in UAE and engaged in the business of providing management and technical consultancy services, provided technical/professional personnel to its Indian associated enterprise named Booz & Company India Private Limited (Booz India).

(ii) The assessee received a fee of ₹ 112.83 lakh from Booz India during AY 2011-12. The assessee did not offer the said income to tax contending that since India-UAE DTAA does not have any specific clause on taxability of fees for technical services and hence the said receipt is taxable as business income. However, since it did not have Permanent Establishment (PE) in India, above said fee is not taxable in India.

(iii) The AO noted that the Booz group is a global network group of companies having subsidiaries all over the world. He noted that AAR in case of some of the group companies [TS-76-AAR-2014] had ruled that these companies had PE in India and income received

by them from Indian companies are taxable as business profit under Article 7 of Tax agreement of India and respective countries. Therefore, relying on AAR the AO held that 'Booz India' (Indian AE) to whom services were provided is the PE of the assessee. Accordingly the AO held that the income of ₹ 112.83 lakhs is taxable as business income of the assessee.

(iv) The CIT(A) confirmed the AO's order.

Decision

On Appeal, the Tribunal held in favour of the assessee as follows:

(i) The Tribunal accepted the assessee's contention that the tax authorities were incorrect in merely placing reliance on the ruling of AAR without examining the facts available in the present case and that AAR has given a common ruling with reference to all the group companies without making specific reference to the provisions of respective DTAA.

(ii) The Tribunal noted that the employees of the assessee has worked for only 156 solar days only (on all projects taken together), meaning thereby, the period of working is less than 9 months. Therefore, there is no Service PE also in terms of Article 5 of DTAA.

(iii) The Tribunal further noted that M/s. Booz India has also not earmarked any specific place under the control or disposal of the assessee. Hence, it held that there was no fixed place of business in India. Further, it held that since the assessee has provided service to M/s. Booz India and did not receive any service, the question of dependent agent PE also does not arise in India.

(iv) Therefore, the Tribunal holds that there is no PE of the assessee in India and the business income in absence of PE would not be taxable in India. Accordingly, it set aside the order of the AO.

6. India-Singapore DTAA – Salary reimbursement for Morgan Stanley's seconded employee not taxable as FTS – Held in favour of the assessee.

Morgan Stanley Asia (Singapore) Pte. vs. DDIT TS-384-ITAT-2018 (Mum.) Assessment Year 2007-08

Facts

(i) Morgan Stanley Asia (Singapore) Pte. ('assessee'), resident of Singapore deputed one of its Director/employee to India for the period from May 2004 to April 2007 to set up Morgan Stanley Advantage Services Private Limited (MSAS), an associate concern in India.

(ii) The assessee, as per the terms of contract, agreed to continue paying salary of the employee in Singapore and cross charging India for the same. The assessee received an amount of ₹ 5.78 lakh as reimbursement from the Indian company.

(iii) The AO rejected the assessee's explanation that it was in the nature of reimbursement of salary and contended that Director/employee deputed to India was highly qualified and technical experience having vast experience and expertise in this area and the role of the assessee was more than employer. The AO held that amount of ₹ 5.78 lakh received by the assessee was FTS and charged markup of 23.3% on the reimbursement received by the assessee. The CIT(A) upheld the AO's order

Decision

The Tribunal held in favour of the assessee as under:

(i) The Tribunal noted that there was contractual agreement between MSAS and assessee, which clearly provides that salary is paid by assessee on behalf of MSAS and the same is recharged by assessee to MSAS. The Tribunal held that payment by MSAS being a pure reimbursement of salary cost incurred by the assessee and would be covered under exception mentioned in *explanation 2* to Sec. 9(1)(vii) and will not be taxable as fees for technical service under the domestic law. Further, the

Tribunal noted that receipt has been taxed as salary in the hands of the employee in India.

(ii) The Tribunal relied on Delhi Tribunal ruling in *United Hotels Ltd.* wherein it was held that for each deputed person, the amount received by it is income chargeable under the head "salary" and therefore, it cannot be termed as "fees for technical services". The Tribunal also relied on the Co-ordinate Bench ruling in *Mark & Spencer Reliance India (P) Ltd. [TS-449-ITAT-2013 (Mum.)]* wherein it was held that expatriation of employee under secondment agreement without transfer of technology would not fall under the term " make available" and will not be taxable under the treaty.

(iii) Therefore, the Tribunal held that reimbursement of salary was not FTS under Act as well as India-Singapore DTAA. It further held that as per the agreement, there was no profit element involved in the impugned payment. The Tribunal held that even otherwise, the salary was taxed in the hands of the employee and accordingly, it cannot be taxed in the hands of the assessee.

Remarks

Bombay HC in *Marks & Spencer Reliance India Pvt. Ltd. [TS-178-HC-2017 (Bom.)]* held that reimbursement of salary to non-resident for seconded employee was not FTS.

7. No PE trigger for UAE Co. undertaking 'grouting' masonry work in India

ULO Systems LLC vs. Assistant D.I.T [TS-741-ITAT-2018(Del.)] Assessment Year 2007-08

Facts

(i) ULO Systems LLC (assessee) is engaged in providing grouting and precast solutions for subsea off-shore construction industry and also provides products and solutions to support and protect subsea pipelines, cables and structures.

(ii) The Revenue contended that the grouting activities fell within Article 5(1) India–UAE DTAA whereas assessee contended that the grouting activities fell within construction activity contemplated in specific provision of Article 5(2)(h).

(iii) The DRP had determined the number of days spent in India at 264 days on which the assessee contended that the same was less than the stipulated period of 9 months/duration test in India as per Article 5(2)(h) India-UAE DTAA and therefore no PE came into existence.

(iv) Assessee also argued that services having been rendered to different unrelated third party customers in India, and contracts not being inter connected, therefore, it cannot be said that the assessee had PE in India. However, Revenue relied on Co-ordinate Bench ruling in *Fugro Engineers* BV to support its stand.

Decision

On Appeal, the Tribunal held in assessee’s favour as under:

(i) The Revenue contended that by keeping the number of days less than nine months, the assessee has circumvented the provision of the Act by manipulating the stay of number of day in India, since assessee’s equipment was in India for at least 264 days on which work for execution of construction was carried on, assessee had equipment PE in India. Revenue also submitted that even movables place of business constituted a PE even if they were temporary in location but permanent in time.

(ii) Revenue contended that a place of business would constitute a PE even if it exists only for a very short period, if time and nature of business is such that it is carried on for that period of time. Revenue submitted that the assessee should be allowed benefit of limitation clause only when activities carried on are occasional but when activities are carried on from year to year regularly and periodically, then it does raise a presumption that it is being

done deliberatively to avoid establishment of PE in India.

(iii) Distinguishing Revenue's reliance on Co-ordinate Bench ruling in *Fugro Engineers* BV, the Tribunal stated that the specific provisions were not applicable on the facts of the aforementioned case whereas in the case in hand, specific Article 5(2)(h) was squarely applicable. The Tribunal held that it was a settled legal principle in latin maxim *"generalia specialibus non deroganf'*, which means a general provision would not be applicable when specific provision is there.

(iv) The Tribunal also denied Revenue's concept of 'Equipment PE' in India as such a concept was nowhere mentioned. The Tribunal opined that it is the settled principle of interpretation in view of Vienna Convention of 1969, that DTAA needed to be interpreted *"uberrimae fidei"* which meant 'with utmost good faith'. Thus, the Tribunal held that Revenue was rewriting DTAA by contending that assessee deliberately manipulated length of projects to always keep it under 270 days and hence was an ill-placed allegation only.

(v) The Tribunal rejected Revenue's observation that grouting was not a simple masonry work and involved complex aspects on the ground that there was no bifurcation of simple and complex masonry/construction work under Article 5(2)(h) and any further classification would amount to rewriting DTAA. In view of the above, the Tribunal also denied Revenue's reliance on AAR ruling in *Sea Bird Exploration FZ LLC* by stating that when there was no option, the general Article 5(1) would get attracted which meant that when there was an option, specific article would prevail.

(vi) The Tribunal stated that few DTAAs like Australia, Thailand, Canada, USA, Denmark etc., the PE clauses are so worded that there is a specific mention for application of aggregation principle on all, or even connected, sites, projects or activities for computation of threshold duration test. However, the Tribunal noted that India-UAE DTAA used singular expressions 'a building, site or construction or assembly project' and, therefore aggregation of different projects was not allowed by conscious legislative scheme.

(vii) Regarding Revenue's contention that since assessee indulged in on-going projects, it cannot be said that the stay was less than nine months, the Tribunal opined that the establishment of PE in India is with respect to each AY only and there was no bar in carrying on the activities year after year. The Tribunal remarked that "The determination of existence of PE in India is to be made by reference to provision in DTAA." The Tribunal stated that Revenue was trying to set up a new case which was not permissible by the decision of the Special Bench in the case of Mahindra & Mahindra.

❍❑❍

- Valuation of Fixed Assets (Movable and Immovables)
- Valuation of Intangible Assets
- Valuers for liquidation value of Corporate Debtors under IBC 2016 / IND AS
- Useful Life of Assets as per Companies Act 2013
- Evaluation of Project implementation as Lenders' Independent Engineers (LIE)
- Techno Economic Viability Reports (TEV)
- Assessment of Impairment of Assets as reqd by AS-28
- Structural audit / consultancy as per the norms of BMC / TMC
- Preparation of Fixed Assets Register, Barcoding and software in line with AS-10
- Credit Check, Due Diligence aka Public Domain Checks

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CA Adit Shah

INDIRECT TAXES

GST Gyan

Applicability of GST on Works Contract

I. Introduction

Goods and Services Tax is now becoming increasingly sectoral and transactional in nature due to the exceeding amount of notifications issued for every sector and industry. It is by this inference we will cover a highly debated and discussed topic under the indirect tax regime and now under GST i.e., works contract.

We would be covering a few common topics over the course of this article which are the critical pain points of the industry and relevant for works contracts of all kinds.

Works contract has to be understood in two separate terms. The term "works" was defined in the case of *Larsen and Tourbo vs. State of Karnataka 2014* which stated that *"The ordinary dictionary meaning of the word "work" means a structure or apparatus of some kind; architecture or engineering structure, a building edifice. When it is used in the plural, i.e., as works, it means architectural or engineering operations, a fortified building, a defensive structure, fortification or any of the several parts of such structures."* A further conclusion of the above stated fact would be that works means the carrying out of any construction or engineering activity which includes labour and supply of materials.

Further the term contract under the Indian Contract Act 1872 is simply laid out to be an *"Agreement enforceable by law"*. Hence when put together a works contract would essentially mean a contract of labour and supply of materials for carrying out an activity involving construction, engineering or anything related to the term works as stated above.

Further, the CGST Act, 2017 has given a definition for works contract which states on the same lines as above. Sec 2 (119) provides that *"works contract means a contract for building, construction, fabrication, completion, erection, installation, fitting out, improvement, modification, repair, maintenance, renovation, alteration or commissioning of any immovable property wherein transfer of property in goods (whether as goods or in some other form) is involved in the execution of such contract"*

Here we should look at the definition as broken down in the below points :

1. The definition of works contract is exhaustive. As stated in the above definition only the services as mentioned in the definition will come under the definition of works contract.
2. The above works should be done on an immovable property. This is a major change

from the pre GST era where the above definition states that only works pertaining to immovable property will be covered under works contract.

For e.g. : A Contract for repair and maintenance of shipping containers along with supply of parts used in the process of repair and maintenance used to be covered under works contract in the pre GST era. The above contract will not be covered under works contract in the GST regime as the shipping container is not an immovable property

Note: The definition of immovable property is not contained in the CGST Act. Historically the courts have referred the definition of immovable property from the Transfer of Property Act, 1882.

3. There should be a transfer of property in goods involved in the execution of such contract. 'Goods' here should not be mistaken for consumables. The nature of goods should remain intact even on its transfer. In case of consumables, the nature of the goods changes as they are consumed during the duration of the contract.

For e.g.: in case of a contract for construction services of roads, bridges or civil construction work the contract is usually for supply of their services and supply of RMC (Ready Mix Concrete) used for such works. In this case, supply of RMC will come under transfer of property in goods. Under the same contract electricity, water and spare parts used under the contract will come under consumables and will not be classified as transfer of property.

Further under GST, Schedule II of the CGST Act, 2017 has defined works contract as a service by stating as follows:

"The following composite supplies shall be treated as a supply of services, namely:—

(a) works contract as defined in clause (119) of section 2;

(b) supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (other than alcoholic liquor for human consumption), where such supply or service is for cash, deferred payment or other valuable consideration."

This offers clarity on a highly litigated debate on whether the works contract should be classified as a service or sale of goods under the pre GST era. Every works contract will now be regarded as a supply of service irrespective of the proportion of goods or proportion of service provided by the works contractor.

II. Registration under GST and Place of supply

The business structure and nature of any works contractor generally makes it mandatory for the industry to have a separate place of business/site and a reporting head quarter/ office. Normally the site will provide the works contracting services and the office will support such services by providing business support services.

Here the question arises that whether it is mandatory for works contractors to obtain registration for the site as well as the reporting office.

Here let us take the following scenarios to understand better:

1. A works contractor engaged in civil construction of roads is having its reporting office in Maharashtra and its site where it provides road construction services is also situated in Maharashtra. The office procures material required for construction from its vendors and arranges it to be transported to the site.

   In this case where the site is also in Maharashtra there is no requirement of a separate registration. The site can be added as an additional place of business in the registration form. All invoices need to be raised to and from the reporting office.

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2. Similarly a works contractor engaged in civil construction of roads is having its reporting office in Maharashtra but his site is located in Gujarat. The office procures material for the services and arranges for it to be transported to the site located in Gujarat. The site office subsequently uses this material for providing works contract services.

   The above scenario has multiple implications. According to Schedule I of the CGST Act states that the following supply made with or without consideration shall be taxable:

   "Supply of goods or services or both between related persons or between distinct persons as specified in section 25, when made in the course or furtherance of business:"

   As per section 22 every person making a taxable supply and having an aggregate turnover of ₹ 20 lakh or more (pan – India) shall be liable to get registered in the State from where he makes a taxable supply. Further as per section 25, each GST Registration shall be regarded as a distinct person.

   The above sections clearly indicate that the site office will also have to get registered as they are making supplies from their offices and are distinct from their reporting office.

As explained in the above scenarios it would be prudent for every works contractor to take multiple registrations for its site office and its reporting office if they are located in different states..

To be noted: A recent advance ruling of Columbia Asia Hospitals Private limited states that services provided by employees in head offices with regards to accounting, administrative or other business support services for units located in other states will be regarded as supply. The explanation given here by the advance ruling authority is that although an employer and employee relationship falls under Schedule III of the Act which treats the supply as non-taxable, there is no such relationship between the distinct entities i.e., the reporting office and the units.

The above explanation has been widely criticised but still until there is no reasonable notification or clarification in this aspect the above would remain a point of dispute. In case of works contractors any service provided by an employee to its reporting office with regards to its site office will be treated as supply as per the above disputed ruling.

III. Valuation

The valuation provisions under GST are contained u/s. 15 of the CGST Act. The section briefly states as below:

The value of supply shall include

1. Taxes, Cesses, Fees, charges levied under any other law being in force, if charged separately by the supplier.
2. Any amount that the supplier is liable to pay in relation to supply but has been incurred by the recipient and not included in the price actually paid or payable. Eg: Reimbursements taken on behalf of the supplier incurred by recipient.
3. Incidental expenses charged by the supplier for supply of goods such as transportation, insurance etc.
4. Interest or late fee for delayed payment of any consideration for any supply.
5. Subsidies directly linked to the price excluding any subsidies provided by central or state government.

The Value of Supply does not include:

1. Discount agreed before at the time of supply and the ITC attributable towards such discount has been reversed.

Here the question arises as regards the valuation for free of cost supplies. The common perception with regards to free of cost supplies is that Free of Cost supplies will not be liable for tax. However the same may not be true for certain situations.

We have to note that in case a contract which includes supply of free of cost materials by the

recipient and the contract price is reduced to the extent of such supplies, there will be a case that the supplier is contractually liable to procure such materials but the recipient has borne the cost and supplied such material to the supplier. The value of such materials will be included in the value of supply and the supplier shall have to pay GST on the same as per Section 15 (2) of the CGST Act.

Hence it is advisable that the contract price does not include or is not reduced by the quantity of free of cost supplies made and there is a separate clause in the contract for such supply where the obligation of the free of cost supplies to be made squarely falls on the recipient.

The recent amendments vide CGST rate notification 03/2019 has made certain key amendments to the original CGST rate notification 11/2017 pertaining to works contract, the gist of which is given as follows:

The notification states that:

"a. item (ii) and the entries relating thereto in columns (3), (4) and (5) shall be omitted;"

The above amendments and other relevant tax rates for works contract services have been provided as an Annexure to this article as *"Annexure for Tax Rates"*.

The below table will summarize the exemptions issued in lieu of works contract services:

Sr No.	Description of Service
1.	Pure services (excluding works contract service or other composite supplies involving supply of any goods) provided to the Central Government, State Government or Union territory or local authority or a Governmental authority by way of any activity in relation to any function entrusted to a Panchayat under article 243G of the Constitution or in relation to any function entrusted to a Municipality under article 243W of the Constitution
2.	Services by Central Government, State Government, Union Territory, local authority or governmental authority by way of any activity in relation to any function entrusted to a municipality under article 243 W of the Constitution. (This will include works contract)
3.	Services by a governmental authority by way of any activity in relation to any function entrusted to a Panchayat under Article 243G of the Constitution. (This includes works contract)
4	Services provided by way of pure labour contracts of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of a civil structure or any other original works pertaining to the beneficiary-led individual house construction or enhancement under the Housing for All (Urban) Mission or Pradhan Mantri Awas Yojana
5	Services by way of pure labour contracts of construction, erection, commissioning, or installation of original works pertaining to a single residential unit otherwise than as a part of a residential complex.

IV. Issues under works contract

The definition of works contract under the GST era has moved away from its old usage under the pre-GST era as we have discussed in the earlier topics. It has cleared many disputed topics regarding the te nature of works contract as a service or good or the applicability of work contract only on immovable properties. Yet crucial aspects of its definition, valuation and nature of supplies have come under scrutiny by the recent advance rulings.

The Advance Ruling Authority in the case of M/s. Giriraj Renewables have recently opined that the construction, erection and commissioning of a

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solar power plant will fall under the category of works contract and that the solar power plant is in the nature of an immovable property. Hence the tax rate to be charged thereof would be at the rate of 12% as a supply of works contract services and not 5% as a supply of solar power plant. The ruling again opens a puzzle for determination of immovable property. The AAR differed from the interpretation of the Appellant on whether the solar power plant is an immovable property.

The Advance Ruling Authority in the case of Maharashtra State Power Generation has classified liquidated damages in the nature of other services relying on para 5 of Schedule II of the CGST Act which states:

"Supply of service will comprise of

(e) agreeing to the obligation to refrain from an act, or to tolerate an act or situation, or to do an act".

The above rulings are just a few of the damaging AAR issued by the authorities which will again open a pandora's box for the businesses for the tax positions to be taken. There is a need for careful structuring of contracts by keeping in mind the impact of GST and the tax position taken by the companies on certain issues.

Annexure for Tax Rates

Tax Rate

The rate for works contract services have been revised by multiple notifications1. A summary version of the rates as they stand today is given in the below table.

Sr. No.	Description of Service	Rate
1.	Affordable Residential Apartments commencing after 1st April 2019 under Residential Real estate project	1.5
	1a) Other than affordable residential apartments commencing after 1st April 2019 under Residential Real Estate Project	7.5
	1b) Commercial Apartments under Residential Real Estate Project	7.5
	1c) Affordable Residential Apartments under Real estate project	1.5
	1d) Other than affordable residential apartments under Real Estate Project	7.5
	1e) Affordable housing project as per existing schemes	6
	1f) Commercial or residential apartment in existing schemes	9
	Note: The above is only a summary of the amendments made through the notification 03/2019. The notification states the detailed description of the services along with the conditions to be adhered to.	
2.	Composite supply of works contract as defined in clause (119) of section 2 of CGST Act, 2017 provided to Central, State Government, Union Territory, a local authority, a governmental authority or a Government entity by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of a. Historical Monument or archaeological site Canal, dam or other irrigation works; Pipeline, conduit or plant for i) Water supply ii) Water treatment or iii) Sewage treatment or disposal	12

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Sr. No.	Description of Service	Rate
3	Composite supply of works contract as defined in clause (119) of section 2 of CGST Act, 2017 other than that covered by items (i), (ia), (ib), (ic), (id), (ie) and (if) above provided to Central, State Government, Union Territory, a local authority, a governmental authority or a government entity by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of a) Road, Bridge, tunnel or terminal for road transportation for use by general public; b) A civil structure or any other original works under Jawaharlal Nehru National Urban Renewal Mission or Rajiv Awas Yojna c) A Civil structure or any other original works pertaining to the "In-Situ redevelopment of existing slums using land as a resource" d) A Civil structure or any other original works pertaining to the "beneficiary led individual house construction/ enhancement under the Housing for all (urban mission/Pradhan Mantri Awas Yojna" da) A Civil structure or any other original works pertaining to the "Economically weaker section (EWS) houses" constructed under the affordable housing in partnership by state or Union Territory or local authority or Urban development authority under the housing for All (Urban) Mission/ Pradhan Mantri Awas Yojna (Urban) db) A Civil structure or any other original works pertaining to the "Houses constructed or acquired under the Credit Linked Subsidy Scheme for Economically Weaker Section (EWS)/ Lower Income Group/ Middle Income Group – 1 (MIG-1)/ Middle Income Group – 2 (MIG – 2)" under the housing for all (Urban) Mission / Pradhan Mantri Awas Yojna (Urban). e) A pollution control or effluent treatment plant except located as a part of a factory. f) A structure meant for funeral, burial or cremation of deceased. g) A building owned by an entity registered u/s 12AA of the Income-tax Act, 1961, which is used for carrying out the activities of providing mid day meals under the mid-day meal scheme sponsored by the Central Government.	12
4	Composite supply of works contract as defined in clause (119) of section 2 of CGST Act, 2017 by way of construction, erection, commissioning, installation, of a) Railways, including monorail and metro b) A single residential unit otherwise than as a part of a residential complex; c) Low cost houses up to a carpet area of 60 square meters per house in a housing project approved by an competent authority empowered under the 'Scheme of Affordable Housing in Partnership' framed by the ministry of Housing and Urban Poverty Alleviation; Government of India. d) Low cost Houses up to a carpet area of 60 sq. mts. per house in a housing project approved by the competent authority under – (1) The 'Affordable Housing in Partnership component of the housing for all (Urban) Mission/ Pradhan Mantri Awas Yojana. (2) Any housing scheme of a State government. da) Low cost houses up to a carpet area of 60 sq. mts. per house in a housing project which has been given infrastructure status *vide* notification of Government of India, in Ministry of Finance, Department of Economic Affairs vide. F.No. 13/6/2009 INF, dated the 30th March, 2017;	12

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Sr. No.	Description of Service	Rate
	e) Post harvest storage infrastructure for agricultural produce including a cold storage for such purposes; or f) Mechanised food grain handling system, machinery or equipment for units processing agricultural produce as foods stuff excluding agricultural beverages.	
5	Composite supply of works contract as defined in clause (119) of section 2 of the CGST Act, 2017 other than the items covered by i), (ia),(ib),(ic),(id),(ie),(if) supplied by way of construction, erection, commissioning, installation, completion,fitting out, repair, maintenance, renovation or alteration of affordable residential apartments as covered under the new definition of affordable residential apartments for a project commencing after 1st April 2019 or in an ongoing project in respect of which the promoter has not exercised the option of paying at the rates specified under ie) and if) above in the manner prescribed therein	12
6	Composite supply of works contract as defined in clause (119) of section 2 of CGST Act, 2017 other than that covered by items (i), (ia), (ib), (ic), (id), (ie) and (if) above provided to Central, State Government, Union Territory, a local authority, a governmental authority or a government entity by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of a) A civil structure or any other original works meant predominantly for use other than for commerce, industry or business b) A structure meant pre-dominantly for use as i) an educational (ii) a clinical or (iii) an art or cultural establishment; or c) A residential complex pre-dominantly meant for self-use or the use of their employees or other persons specified in paragraph 3 of the Schedule III of the CGST Act, 2017 Explanation – For the purposes of this item the term 'business' shall not include any activity or transaction undertaken by the Central Government or any local authority in which they are engaged as public authorities.	12
7	Composite supply of works contract as defined in clause (119) of section 2 of CGST Act, 2017 involving predominantly earthwork (i.e., constituting more than 75% of the value of the works contract) provided to the Central Government, State Government, Union Territory, Local Authority, a Governmental Authority or a Government entity.	5
8	Composite supply of works contract as defined in clause (119) of section 2 of CGST Act, 2017 and associated services in respect of offshore works contract relating to Oil and Gas Exploration and production in the offshore area beyond 12 Nautical Miles from the nearest point of the appropriate base line.	12
9	Composite supply of works contract as defined in clause (119) of section 2 of CGST Act, 2017 by a subcontractor to main contractor providing services provided in 3 to 6 above to the Central Government, State Government, Union Territory, a local authority, a governmental authority or a Government Entity	12
10	Composite supply of works contract as defined in clause (119) of section 2 of CGST Act, 2017 by a sub-contractor to main contractor providing services provided in 7 above to the Central Government, State Government, Union Territory, a local authority, a governmental authority or a Government Entity	5
11	Construction services other than i, ia,ib,ic,id,ie,if, 2 to 10 listed above	18

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CA Rajkamal Shah & CA Bharat Vasani

INDIRECT TAXES
GST – Legal Update

NOTIFICATIONS

Amendment to Rule 42 & 43 for reversal of ITC *[Notification No. 16/2019-CGST dt. 29-3-2019]*

- New procedure provided for reversal of credit related to construction services, where certain apartments of the project are / would be sold after obtaining the Completion Certificate or Occupancy certificate. The turnover based formulae is replaced by project's carpet area.
- Reversal of credit is to be done on monthly basis in the proportion of estimated carpet area of apartments, which could be sold after OC and the same to be trued up at the time of completion of the project.
- Projects, which have not been completed up to 31-3-2019 have to follow such area based reversals, whereas the projects which are completed on or before 31-3-2019 have to follow earlier Rule 42 and 43 reversals (based on turnover).

Seeks to notify CGST rates on various services as recommended by GST Council for real estate sector *[Notification No. 03/2019-Central Tax (Rate), dt. 29-3-2019]*

Particulars	Conditions	Rate
A) New GST Scheme **I] For Construction of affordable residential apartments by promoter in REP or RREP Scheme (where promoter has not opted to pay GST @12% / 18%)**		
Which commences on or after 01-04-2019 or any ongoing RREP in respect of which promoter has not opted to pay applicable higher rate with ITC and which is intended for sale except where entire consideration is received after issuance of CC or first occupation whichever is earlier.	a) Tax shall be paid in cash i.e., debiting cash ledger only. b) No ITC has been availed c) Reversal of ITC – Registered person shall pay an amount by debit in electronic credit ledger or cash ledger an amount equivalent to ITC attributable to project where Time of supply is on or after	1% (0.5% CGST & 0.5% SGST) (1/3rd deduction for on account of transfer of land)

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Particulars	Conditions	Rate
	1-4-2019 which shall be calculated as per Annexure I for REP & Annexure II for RREP d) 80% of value of Inputs and Input services [other than TDR, Long term Lease of Land or FSI (including additional FSI), electricity, high speed diesel, motor spirit, natural gas] shall be received from registered persons only. However shortfall if any during financial year shall be discharged by promoters on value of inputs and input services @18% on reverse charge basis. e) Inputs and Input services on which RCM is discharged will be deemed as availed from registered person. f) Cement if purchased from URP, promoter shall discharge the tax on supply of such cement on reverse charge basis at applicable rates as if he is the person liable to pay tax. Tax shall be paid in the month in which cement is received. g) ITC not availed shall be reported every month in GSTR-3B under the head ineligible credits [Row 4(D)(2)]. h) Project wise details of inward supplies from RP and URP shall be maintained based on which shortfall if any for inward supplies from URP shall be added to outward tax liability by end of quarter following the end of financial year. i) Where landowner transfers TDR & FSI (including additional FSI) to developer for consideration wholly or partly in form of construction of apartments, than – a) Developer shall pay tax on supply of construction of apartments to landowner,	

Particulars	Conditions	Rate
	b) Such landowner shall get ITC of tax charged by developer provided he further supplies such apartments to his buyers before CC or first occupation whichever is earlier and pays tax on this further sales which cannot be less than tax charged by developer.	
II] For Construction of residential apartments other than affordable residential apartments in REP or RREP Scheme and Construction of Commercial Apartments like shops, offices, godowns, etc. (where promoter has not opted to pay GST @12% / 18%)		
Which commences on or after 1-4-2019 or any ongoing RREP in respect of which promoter has not opted to pay applicable higher rate with ITC and which is intended for sale except where entire consideration is received after issuance of CC or first occupation whichever is earlier	Same as above mentioned in point I	5% (2.5% CGST & 2.5% SGST) (1/3rd deduction for on account of transfer of land)
B) Existing GST Scheme		
I] Construction of ongoing apartments in ongoing project where promoter has opted to pay tax at the rate prescribed.	a) One time option to be opted in Form as mentioned in Annexure IV of this notification by 10-05-2019. However if option not exercised the said scheme shall be deemed to be granted. b) Invoices for supply of services can be issued between 01-04-2019 to 10-05-2019 before exercising the option.	12% (6% CGST & 6% SGST)
II] Construction of commercial apartments like shops, offices, godowns, etc., by Promoter in REP other than RREP (except where entire consideration is received after CC) and Construction of residential apartments in an ongoing project other than affordable residential apartments (except where entire consideration is received after CC)	Same as above mentioned	18% (9% CGST & 9% SGST)

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- **Works Contract Supply**

Particulars	Conditions	Rate
Composite supply of works contract supplied by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation or alteration of affordable residential apartments in a project which commences on or after 1-4-2019 who are opting new scheme.	a) Carpet area of affordable residential apartments is more than 50% of total carpet area of all the apartments in project. b) If this condition of 50% affordable housing area is not satisfied then promoter shall be liable to pay differential tax between normal rate & this concessional rate on reverse charge basis.	12% (6% CGST & 6% SGST)

- **Reverse Charge on URP Supplies**

Particulars	Rate
Supply of services other than by way of grant of development rights, long term lease of land or FSI (including additional FSI) by URP to a promoter for construction of project on which tax is payable by recipient of service u/s. 9(4) of CGST Act, 2017	18% (9% CGST & 9% SGST)

[Similar Notification No. 03/2019-Integrated Tax (Rate), dt 29-3-2019]
[Similar Notification No. 03/2019-Union Territory Tax (Rate), dt 29-3-2019]

Seeks to exempt transfer of Development Rights, FSI, Long Term lease for residential projects *[Notification No. 04/2019-Central Tax (Rate), dt. 29-3-2019]*

Additional entry is inserted to Notification No. 12/2017-Central tax (Rate), dt. 28-06-2017 to include below entry:

- Services provided by landowner to the developer by way of transfer of development rights or Floor Space Index or Long Term lease for residential projects. However the exemption is available only if residential units are transferred / sold before OC.
- Residential units unsold as on the date of issuance of completion certificate or occupation certificate, then the promoter shall be liable to pay tax under reverse charge basis on such proportionate value of DR or FSI as attributable to flats unsold,
- The liability to pay tax on above would arise on the date of CC or OC received whichever is earlier.
- Value of supply of service shall be equal to value of similar apartments charged by promoter from independent buyers nearest to the date on which TDS or FSI is transferred to promoter.
- Value of portion or residential or commercial apartments remaining un-booked shall be equal to value of similar apartments charged by promoter nearest to the date of CC or OC.

[Similar Notification No. 04/2019-Integrated Tax (Rate), dt. 29-3-2019].

[Similar Notification No. 04/2019-Union Territory Tax (Rate), dt. 29-3-2019].

New entry is inserted to section 9(3) "specified services" [Notification No. 05/2019-Central Tax (Rate), dt. 29-3-2019]

Notifies services provided by any person by way of transfer of TDR or FSI or Long Term Lease for construction of project to a promoter, then promoter shall be liable to pay tax under reverse charge u/s. 9(3) of CGST Act, 2017.

[Similar Notification No. 05/2019-Integrated Tax (Rate), dt. 29-3-2019].

[Similar Notification No. 05/2019-Union Territory Tax (Rate), dt. 29-3-2019].

Time of Supply in case of TDR or FSI or Long Term Lease received by Promoter *[Notification No. 06/2019-Central Tax (Rate), dt. 29-3-2019]*

Time of Supply in case of promoter who receives TDR / FSI / Long Term Lease and any consideration paid by promoter in the form of:

– Construction service of commercial or residential apartments in project

– Any Monetary consideration

– Any upfront amount in nature of premium, salami, cost, price, development charges, etc.

And promoter discharging tax under RCM, then TOS shall be the date of issuance of completion certificate or occupancy certificate whichever is earlier.

[Similar Notification No. 06/2019-Integrated Tax (Rate), dt. 29-3-2019].

[Similar Notification No. 06/2019-Union Territory Tax (Rate), dt. 29-3-2019].

Promoter to discharge tax under RCM for supplies received from URP *[Notification No. 07/2019-Central Tax (Rate), dt. 29-3-2019]*

The said notification specifies that promoter shall pay tax under RCM on following supplies:

Category of Supply	Rate of Tax
Supply of goods or services or both other than Cement which constitutes shortfall from minimum value of goods or services required to be purchased by promoter (i.e., 80% requirement).	18% (9% CGST & 9% SGST)
Supply of Cement following under heading 2523 in First Schedule I to Custom Tariff Act, 1975	28% (14% CGST & 14% SGST)
Supply of Capital Goods following under any chapter in First Schedule to Customs Tariff Act, 1975	At prescribed rate.

[Similar Notification No. 07/2019-Integrated Tax (Rate), dt 29-3-2019].

[Similar Notification No. 07/2019-Union Territory Tax (Rate), dt 29-3-2019].

Prescribes rate of tax for supply of Goods (other than Capital Goods and Cement) procured by Promoter from URP *[Notification No. 08/2019 – Central Tax (Rate), dt. 29-3-2019]*

The said notification prescribes rate of tax as 18% for any shortfall supplies procured by promoter from URP for construction of project u/s. 9(4) of CGST Act, 2017.

[Similar Notification No. 08/2019-Integrated Tax (Rate), dt 29-3-2019]

[Similar Notification No. 08/2019-Union Territory Tax (Rate), dt 29-3-2019].

To remove difficulty in case of supply of Construction Services covered in clause 5(b) of Schedule II of Act [Order No. 04/2019-Central Tax, dt. 29-3-2019]

The said order specifies that area of construction should be considered instead of turnover as the basis for calculating the proportion of credit attributable to taxable / exempt supplies (including zero rate supplies) covered under clause 5(b) of Schedule II to CGST Act, 2017.

[Similar Order No. 03/2019-Union Territory Tax, dt 29-3-2019].

Other than Real Estate Sector

NOTIFICATIONS

Increase in aggregate turnover limit for obtaining registration for persons engaged exclusively in supply of goods ***[Notification No.10/2019-CGST, dt. 7-3-2019]***

Any person engaged in exclusive supply of goods with aggregate turnover up to ₹ 40 lakh in the financial year is exempted. However, it does not apply to –

(i) persons who are required to obtain compulsory registration u/s. 24

(ii) persons engaged in supply of ice cream and other edible ice, pan masala and tobacco and its manufactured substitutes.

(iii) persons engaged in supply of goods in the states of Arunachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland, Puducherry, Sikkim, Telangana, Tripura, Uttarakhand

(iv) persons opting for voluntary registrations and persons who intend to continue with their registration

Due dates of GSTR 1 and GSTR 3B for April – June 2019 notified ***[Notification No. 11, 12, 13/2019-CGST, dt. 7-3-2019]***

Period	GSTR 1		GSTR-3B
	Quarterly (T/O up to ₹ 1.50 Cr.)	Monthly (T/O > ₹ 1.50 Cr.)	
April 2019	31-7-2019	11-5-2019	20-5-2019
May 2019		11-6-2019	20-6-2019
June 2019		11-7-2019	20-7-2019

Limit of aggregate turnover for availing Composition Scheme increased to ₹ 1.50 Cr. ***[Notification No. 14/2019-CGST dt. 7-3-2019]***

Persons with Aggregate Turnover up to ₹ 1.50 Cr. in the preceding financial year can opt for composition scheme. Turnover limit shall be ₹ 75 lakhs for the states of Arunachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland, Puducherry, Sikkim, Telangana, Tripura, Uttarakhand.

However, persons engaged in manufacture of ice cream and other edible ice, pan masala and tobacco and its manufactured substitutes.

Extension of due date for filing FORM GST ITC-04 ***[Notification No. 15/2019 dt. 28-3-2019]***

Due date for filing of FORM GST ITC-04 for the period July, 2017 to March, 2019 extended up to 30-6-2019.

2nd Amendment to CGST Rules ***[Notification No. 16/2019 dt. 29-3-2019]***

- Rule 41: Transfer of credit on sale, merger, amalgamation etc.

  Explanation inserted to sub-rule (1) to clarify that in case of demerger, "value of assets" means the value of entire assets of the business, whether or not ITC has been availed thereon.

- Rule 88A: Order of utilization of ITC

  New rule inserted to provide that ITC under IGST be first utilized towards liability under IGST and thereafter towards liability under CGST & SGST in any order as the case may be.

- Rule 100: Assessment in certain cases

  Rule is amended to include the forms for uploading the summary of the Order of assessments passed in FORM GST DRC-01 & 07.

- Rule 142: Notice and order for demand of amounts payable under the Act

  Rule has been amended to widen the scope of applicability of Summary of Assessment Orders, replies etc. in FORM GST DRC-01, 03, 06, 07

Composition Scheme for supplier of services ***[Notification No. 02/2019 – CGST (Rate) dt. 7-3-2019]***

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For registered persons making supplies of goods or services with turnover up to ₹ 50 lakhs in a financial year, may opt for composition scheme and pay tax @ 6%. However, such tax shall not be collected from the recipient nor he shall be entitled to any ITC. Persons eligible to pay tax under this notification are persons who are -

- not eligible to pay tax u/s 10(1)
- not engaged in making any supply which is not leviable to tax
- not engaged in making any inter-state supplies
- not a casual taxable person or non-resident taxable person
- not engaged in making supplies through e-commerce operator
- not engaged in making supplies of goods being ice cream and other edible ice, pan masala and tobacco and its manufactured substitutes

In computing the aggregate turnover, value of exempt supplies by way of extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount shall not be taken into account.

Composition Scheme for supplier of services – clarifications ***[Notification No. 09/2019-CGST (Rate) dt. 29-3-2019]***

Clause No. 8 in Notification No. 2/2019 to provide that registered person who has availed ITC opts for composition scheme as per this notification shall pay an amount by debit to electronic credit or cash ledger equivalent ITC on stock held on day of option and balance credit in electronic Credit Ledger will lapse.

Clause (iii) inserted in paragraph 3 to provide that CGST Rules 2017 as applicable to composition dealers u/s 10 shall mutatis mutandis apply to person paying tax under this notification.

To remove difficulty in implementation of above Notification [Order No. 3/2019-Central Tax, dt. 8-3-2019]

The provisions of Section 31(3)(c) i.e. registered person supplying exempted goods or services or both or paying tax under the provisions of section 10 to issue Bill of Supply & not Tax Invoice, shall apply to persons covered above in Composition scheme as per Notification No.2/2019.

Similar Order issued under UTGST Act, 2017 [Order No.2/2019 – Union Territory Tax, dt. 8-3-2019]

CUSTOMS NOTIFICATIONS

Exemption from IGST and Compensation Cess to goods imported against Advance Authorization / EPCG authorizations extended up to 31-3-2020 ***[Notification No. 08/2019-Customs dt. 25-3-2019]***

Exemption from IGST and Compensation Cess to EOU's extended up to 31-3-2020 ***[Notification No. 09/2019-Customsdt. 25-3-2019]***

CIRCULARS

Clarification related to treatment of sales promotion scheme under GST ***[Circular 92/11/2019 – CGST dt. 7-3-2019]***

- Free Samples and gifts:
  - Samples which are supplied free of cost, without any consideration, do not qualify as "supply" under GST, except where the activity falls within the ambit of Schedule I of the said Act.
  - Also, ITC shall not be available to the supplier on the inputs, input services and capital goods to the extent they are used in relation to the gifts or free samples distributed without any consideration.
- Buy one get one free:
  - Such supply is not an individual supply of free goods but a case of two or more individual supplies where a single price is being charged for the entire supply.

Accordingly, taxability shall depend whether it is a composite or mixed supply.

  – Also, ITC shall be available on inputs, input services and capital goods used for the same.

- Discounts including 'Buy more, save more' offers:
  – In case of staggered discounts offered to customers (increase in discount rate with increase in purchase volume) and pre-agreed periodic/yearly discounts given on purchase of agreed quantity during a period/year shall be excluded from the value of supply subject to satisfaction of provisions of Sec 15(3) including reversal of ITC by recipient.
  – Also, ITC shall be available on inputs, input services and capital goods used for the same.
- Secondary discounts:
  – Discounts which are not known at the time of making supply or are offered after supply is already over are not deductible from the value of supply as condition of Sec 15(3)(b) not satisfied.
  – Financial / commercial credit note may be issued, however it will have no impact under GST. Subsequently, no impact on availability of ITC in the hands of supplier.

Clarification of nature of supply of Priority Sector Lending Certificates (PSLC) *[Circular No. 93/12/2019 dt. 8-3-2019]*

It is hereby clarified that trading of PSLC by the banks on e-kuber portal of RBI may be treated as supply of goods in the course of inter-state trade or commerce and liable for IGST for both the period 1-7-2017 to 27-5-2018 and from 28-5-2018 onwards. However, where the bank liable to pay GST has already paid CGST and SGST/UTGST as the case may be, shall not be required to pay IGST towards such supply.

Clarification on refund related issues under GST *[Circular No. 94/13/2019 dt. 28-3-2019]*

- **Refund in case of Inverted Duty Structure – Fabric**

  In case of registered person who has already reversed the ITC required to be lapsed-
  - It is hereby clarified that as a one-time measure to resolve issue of refund of accumulated ITC on account of inverted duty structure for the period in which there is reversal of ITC required to be lapsed in terms of Notification No. 20/2018-CGST (Rate) dt 26-7-2018 read with Circular No. 56/30/2018-GST dated 24-8-2018 (For Woven Fabrics) shall claim refund under category "any other" instead of "refund of unutilized ITC on account of accumulation due to inverted tax structure" in Form RFD-01A.
  – Application of refund shall relate to same tax period in which reversal is done.

  In case of registered person who are yet to reverse ITC-
  – It is hereby clarified that reversal can be done through Form GST DRC-03 instead of GSTR-3B

  In case of registered person who has reversed subsequent to August 2018-
  – Such persons shall be liable to pay interest u/s. 50(1) of CGST Act on the amount reversed belatedly.
  – Such amount shall be calculated from the due date of filing Form GSTR-3B for August 2018 till the date of reversal.

- **Similar above refund procedure is applicable to Merchant Exporters whose supplier has availed benefit of notification no. 40/2017 – Central Tax (Rate) dt 23-10-2017 or 41/2017 – Integrated Tax (Rate) dt 23-10-2017.**

- **Refund after issuance of Deficiency Memo**
  - Where ITC refund claimed in re-credited to Credit Ledger subsequent to issue of deficiency memo by the Officer, it is hereby clarified that refund of such ITC can be claimed by submitting refund application manually in Form GST RFD-01A after necessary corrections of deficiency pointed out using the original ARN No of Form RFD-01A

Clarification on new registration application under GST ***[Circular No. 95/14/2019 dt. 28-3-2019]***

It is hereby clarified that in case of persons whose registration is cancelled under the provisions of Section 29(2) of CGST Act 2017 read with Rule 21 of CGST Rules 2017 on account of non-compliance of statutory provisions and are continuing business. Such persons are applying for fresh registration instead of revocation of existing GSTIN. Departmental Officers shall take due care while issuing new GSTIN.

Clarification in respect of transfer of Input Tax Credit in case of death of Sole Proprietor ***[Circular No. 96/15/2019 dt. 28-3-2019]***

It is hereby clarified that in case of death of sole proprietor if the business is continued by any transferee or successor, the input tax credit which remains unutilized in ECL is allowed to be transferred to transferee in following manner:

- **Registration liability of Transferee:**
  - The transferee or successor shall be liable to register w.e.f. date of such transfer or succession.
  - While filing Form GST REG-01 applicant is required to mention the reason to obtain registration as "death of the Proprietor"

- **Cancellation of registration on account of death of Proprietor:-**
  - The legal heir has to file cancellation of registration Form GST REG-16 mentioning reason as "death of Proprietor".
  - The transferee shall mention his GSTIN in the said form to link the GSTIN of transferor.

- It is clarified that the transferee / successor shall be liable to pay any tax, interest or any other penalty due from the transferor of business in case of death of sole proprietor.

- Manner of transfer of Credit:-
  - The transferee / successor shall file Form GST ITC-02 in respect of the registration which is cancelled on account of death of sole proprietor.
  - Form GST ITC-02 shall be filed by transferee / successor before filing for cancellation of registration.
  - On acceptance by transferee / successor the unutilized input tax credit as mentioned in Form GST ITC-02 shall be credited to transferee's ECL.

Appointment of Common jurisdiction authority ***[Order No. 2/2019-GST dt.12-3-2019]***

The order prescribes list of GSTIN's whose jurisdiction is assigned to Commissioner of Central Tax Office, Mumbai Central for the purpose of demands & recovery

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CA Naresh Sheth & CA Jinesh Shah

INDIRECT TAXES

GST – Recent Judgments and Advance Rulings

A. Writ Petition

1. Vasu Clothing Private Limited vs. The Union of India – High Court of Madhya Pradesh (2018-TIOL-2931-HC-MP-GST)

Facts, Issue involved and Contention of Petitioner

Petitioner is engaged in the business of manufacturing and exporting of garments. It has filed petition for grant of relief by way of exemption under GST on supply of goods to the Duty Free Shops (DFSs) at the international Airports in India.

The petitioner's contention is that after enactment of Central Goods and Services Tax Act, 2017 ('CGST Act') and the Rules framed thereunder, it is entitled to supply goods and services to Duty Free Shops without payment of taxes and similar supplies from all over the world **except India** are permitted without payment of taxes. The petitioner intends to supply goods to Duty Free Operator (DFO), who in turn is selling the goods from Duty Free Shops (DFSs). Duty Free Operator operating in India imports goods like liquor, tobacco products, souvenirs, eyewear, watches, fashion, chocolates, perfumes, etc. by filing import general manifest and Bill of Entry for warehousing with the customs department without payment of import duty on the first importation subject to certain conditions. The bill of entry clearly indicates the Duty Free Operator as an "importer". The imported goods are warehoused at a bonded warehouse (customs warehouse) and the bill of entry also discloses that the goods imported are for "sale only for Duty Free Shop / Export". Duty Free Operator also takes on rent a private bonded warehouse located near the airport as well as certain shops called "Duty Free Shops" at the arrival and departure terminals of international airports in India. The goods are sold to international passengers without payment of duties and taxes. Prior to GST, duty free operations were exempted from payment of Customs Duty, Countervailing Duty (CVD), Special Additional Customs Duty (SACD), Excise Duty, VAT / Sales Tax, OCTROI, etc. The petitioner's contention is that principle for exemption from payment of VAT / Sales Tax by an Indian Duty Free Shop was evolved pursuant to the judgment delivered by the Hon'ble Supreme Court in the case of *M/s. Hotel Ashoka (Indian Tourism Development Corporation Limited) vs. Assistant Commissioner of Commercial Taxes and Another* (Civil Appeal No.2560/2010, decided on 3-2-2012). In respect

of indigenous products manufactured in India which were subjected to payment of Excise Duty and VAT, Government of India, in the year 2013, issued notifications so as to allow excise duty free sale of goods manufactured in India to international passengers or members of crew arriving from abroad at the Duty Free Shops located in the arrival halls of international airports and to passengers going out of India at Duty Free Shops located in the departure hall of international airports in the country. The petitioner has made a prayer for directing the respondent to treat the goods supplied to DFS as an export without payment of CGST and IGST, only on the ground that Duty Free Shop at international airport are located beyond the customs frontier of India and any transaction that takes place in a Duty Free Shop is said to have taken place outside India.

Discussions by and Observations of HC

As per Section 2(5) of IGST Act, 2017, **export of goods** takes place only when goods are taken out to a place outside India. Petitioner is supplying goods to Duty Free Shops.

India is defined under Section 2(27) of Customs Act, 1962 as "India includes territorial waters of India". Similarly under the CGST Act, 2017 under Section 2(56) "India" means the territory of India including its territorial waters and the air-space above its territory and territorial waters and therefore, the goods can be said to be exported only when they cross territorial waters of India and **the goods cannot be called to be exported merely on crossing customs frontier of India.**

As per Section 2(4) of IGST Act, "customs frontiers of India" means the limits of a customs area as defined in section 2 of the Customs Act, 1962 (52 of 1962);

As per Section 2 (ab) of Central Sales Tax Act, 1956, "Crossing the customs frontiers of India" means crossing in the limits of the area of a customs station in which imported goods or export goods are ordinarily kept before clearance by customs authorities. Explanation — For the purposes of this clause, "customs station" and "customs authorities" shall have the same meanings as in the Customs Act, 1962 (52 of 1962).

For the purpose of CGST Act, India extends the Exclusive Economic Zone upto 200 nautical miles from baseline. The location of DFS, whether within custom frontier or outside, shall be within India. Therefore, supply to DFS by an Indian supplier cannot qualify as 'Export of Goods'. Therefore, he is liable to pay GST on supply of indigenous goods to DFS.

The petitioner is aggrieved by the fact that the benefit available to him under the erstwhile central excise regime of removing goods from his factory to DFS located in International airports without payment of duty is not available to him under the GST regime.

In case of *Kothari Industrial Corporation Limited vs. Tamil Nadu Electricity Board and another 2016 4 SCC 134,* Apex court held that there is no estoppel against law and recipient of a concession has no legally enforceable right against the Government to grant or to continue to grant a concession.

The petitioner cannot escape GST liability as he is not exporting the goods or taking goods outside India. He is selling to a person, who is having a DFS located in India [defined u/s. 2(56) of CGST Act].

A statute is an edict of the legislature, courts do not have power to enact a statute and court can only do interpretation of statute. Once the court does not have power to legislate, the question of granting exemption in absence of any statutory provision to the petitioner under the GST Act does not arise.

Decision of HC

The petitioner is liable to pay GST. In light of the aforesaid judgment, as no such exemption

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is available to the petitioner in light of the GST Act, the judgment relied upon by the petitioner is of no help. In view of above, writ petition was dismissed.

B. Rulings by Appellate Authority of Advance Ruling

2. M/s. Kundan Mishthan Bhandar – AAAR Uttarakhand (2019-TIOL-29-AAAR-GST)

Facts, Issue involved and Query of Applicant

Applicant has a sweetshop on ground floor from where they supply food items such as sweetmeats, namkeens, cold drinks and other edible items. They also run a restaurant on the first floor in the same building.

Applicant has sought advance ruling for the following questions:

i. *Whether **supply of pure food items** like sweetmeats, namkeens, and other edible items from sweetshop that also runs a restaurant is supply of goods or services.*

ii. *What is the nature and rate of tax applicable to the following items supplied from the ground floor of a sweetshop and wherein restaurant is also located on the first floor and whether applicant is entitled to claim benefit of input tax credit with respect to the same:*

   a. *Sweetmeats, namkeens, dhokla, etc. commonly known as snacks, cold drinks, ice cream and other edible items.*

   b. *Ready to eat (partially or fully pre-cooked / packed) items supplied from live counters such as jalebi, chole bhature and other edible items*

   c. *Takeaway order of sweetmeats or namkeen by a person sitting in the restaurant of a sweetshop when such products are not consumed within the premise of applicant but are takeaway.*

Discussions by and Observations of AAR

It was noticed by authority that two or more goods or a combination of goods and services were supplied together. Under GST law, supplies that are bundled, with two or more supplies of goods or services or a combination thereof can be classified either as composite supply or as mixed supply.

Composite supply is defined u/s. 2(30) of CGST Act to mean *a supply made by a taxable person to a recipient consisting of two or more taxable supplies of goods or services or both, or any combination thereof, which are naturally bundled and supplied in conjunction with each other in the ordinary course of business, one of which is a principal supply.*

Mixed supply is defined u/s. 2(74) of CGST Act to mean *two or more individual supplies of goods or services, or any combination thereof, made in conjunction with each other by a taxable person **for a single price** where such supply does not constitute a composite supply.*

For a supply to be considered as a mixed supply, firstly it should be out of coverage of Composite supply. In order to constitute a composite supply, the goods or services or both are to be supplied together, in a natural bundle and in normal course of business, **provided** one of them has to be a principal supply.

In the instant case, the nature of restaurant services is such that it may be treated as the main supply and the other supplies combined with such main supply are in the nature of incidental or ancillary services. Thus, restaurant services get the character of predominant supply over other supplies.

Therefore, in the present case, supply will be treated as supply of service and the sweet shop shall be treated as extension of the restaurant in as much as the said activity covered under clause 6(b) of Schedule II of the Act that is as under:

Following composite supplies will be treated as supply of services, namely:—

(b) supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (other than alcoholic liquor for human consumption), where such supply or service is for cash, deferred payment or other valuable consideration.

Since the supply of restaurant service is treated as principal supply therefore the rate applicable on such composite supply shall be rate attributable to the restaurant service i.e. 5% [HSN- 9963] subject to condition that input tax credit will not be availed on the provision of such service.

Ruling of AAR

In respect of question (1), supply shall be treated as supply of service and sweet shop shall be treated as extension of restaurant services.

In respect of question (2), rate of GST on aforesaid activity and takeaway items shall be 5% with the condition that no ITC can be claimed in respect of inward supply.

Appeal to the AAAR and Observations of AAAR

Aggrieved by the above-referred ruling, the applicant preferred an appeal to AAAR against the same. Applicant reiterated grounds stated in the application and submitted the following contentions relying upon various judgments:

S. N.	Contention	Judgement supporting contention
1	Impugned ruling passed by the UAAR was a non-speaking order and thus liable to set aside.	Delhi High Court in the case of *T.T. Ltd. vs. Union of India [2017 (349) E.L.T. 130 (Del)*
2	Mere Supply of food items is a transaction of supply of goods only and concept of composite supply is not applicable.	*Cochin State Power & Light Corporation Ltd. vs. State of Kerala [AIR 1965 SC 1688]*
3	The Guidance for Classification can be taken from statutes in parimateria and assistance from earlier statutes.	*Bengal Immunity Co. Ltd. vs. State of Bihar [AIR 1955 SC 661]*
4	The Sphere of Restaurant services should be understood in its 'Commercial Sense'	*Collector of Central Excise Pune vs. Dai Chi Karkaria Ltd [AIR 1999 SC 3234]*
5	The deeming provision shall be understood in a restricted manner.	*CIT Bombay City II vs. Shakuntala [AIR 1966 SC 719]*
6	The taxing Statutes must be construed strictly.	*A.V. Fernandes vs. State of Kerela [AIR 1957 SC 657]*

Further, the applicant submitted that **supply of pure food items** from a sweetshop, which also runs a restaurant is a transaction of **supply of such individual goods.** Therefore, rate of tax for supply of pure food items from a sweetshop shall be individual rate of GST as may be applicable to such items with benefit of Input Tax Credit.

Further, any item or take away **ordered or consumed within/from restaurant** shall be considered as **supply of restaurant service** on which rate of GST of Restaurant service shall apply and benefit of Input tax shall not be applicable.

The Applicant in the personal hearing also referred to the GST council press release dated 22-12-2018, wherein they have clarified that it is not the nature of establishment but the nature of supply that is the decisive factor.

Firstly, AAAR observed that the applicant is running a sweetshop and a restaurant in two distinctly marked separate parts of the same premise and is also maintaining separate accounts as well as separate billings for the two types of business. The goods sold from the sweetshop are being billed exclusively as sweetshop sales whereas the goods supplied from the restaurant are billed under Restaurant head.

AAAR cited the definition of Composite Supply and stated that when sweets, namkeens, cold drinks and other edible items are supplied to customers in the restaurant or as takeaways from the restaurant counter and which are being billed under restaurant sales head should fall under 'Composite Supply' with restaurant service being the Principal supply. The taxability of all such goods supplied to or through the restaurant will be governed by the principal service i.e. restaurant service and GST rate applicable thereon with applicable conditions. ITC will not be allowed for the above case.

Since, there is no direct nexus to the goods supplied by the sweetshop i.e. anyone can come and purchase any item of quantity from the shop counter without visiting the restaurant. The billing of such sales are done separately and such sales cannot be clubbed with restaurant service. These sales are completely independent of restaurant activity and continue even if restaurant is closed.

Therefore, such sales will be treated as supply of goods with applicable GST rates on the items sold and Input credit will be allowed on such supply.

Order of AAAR
AAAR has set aside the ruling of the Authority of the Advance Ruling and have passed the following order:

- Sale of sweets, namkeens, cold drinks and other edible items through restaurant will be treated as 'composite supply' with restaurant supply being the principal service. Existing GST rates on restaurant service will also be applicable on all such sales and no ITC will be allowed.
- Sale of sweets, namkeens, cold drinks and other edible items from sweetshop counter will be treated as supply of goods with applicable GST rates of the items being sold and ITC will be allowed on such supply.
- The applicant should maintain separate records for restaurant and sweatshop with respect to input and output and billings as well as other accounting records should also be separately maintained.

3. M/s. Geojit Financial Services Limited – AAAR Kerala (2019-TIOL-13-AAAR-GST)

Facts, Issue involved and Query of Applicant
The applicant is engaged in activity of providing various retail financial services like stock broking, share broking, etc. which were not taxable under VAT Law.

As on 30th June 2017, they had in their possession physical stock of goods such as computers, laptops etc., which were utilised by them in providing the output services. Placing reliance on the transitional provisions, they have availed input tax credit on closing stock of computers, laptops and other goods lying in the physical possession of the applicant as on 30th June 2017. The applicant has sought for Advance Ruling for following questions:

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i. Whether computers, laptops etc. used by the applicant for providing output service would qualify as inputs for the purpose of availing transitional ITC under section 140 (3) of KSGST Act?

ii. If the goods are physically available as closing stock as on 30th June 2017, can the applicant avail ITC for the VAT paid?

Applicant submitted that as per Section 140 (3) of the GST Act, 2017 a registered person, who was not liable to be registered under the existing law or who was engaged in the sale of exempted goods or tax free goods, by whatever name called, or goods which have suffered tax at the first point of their sale in the state and the subsequent sales of which are not subject to tax in the state under the existing law but which are liable to tax under this act or where the person was entitled to the credit of input tax at the time of sale of goods, if any, shall be entitled to take the credit of the value added tax in respect of inputs held in stock and inputs contained in semi – finished or finished goods held in stock on appointed day subject to the condition that:

i. Such inputs or goods are used or intended to be used for making taxable supplies under this Act;

ii. The said registered person is eligible for input tax credit on such inputs under this act;

iii. The said registered person is in possession of invoice or other prescribed documents evidencing payment of tax under the existing law in respect of such inputs; and

iv. Such invoices or other prescribed documents were issued not earlier than twelve months immediately preceding the appointed day.

Discussions by and Observations of AAR

The applicant being a service provider had no tax liability under VAT regime. Section 140 (2) of the Act covers transitional credit claim on capital goods by a dealer registered in the earlier law. The proviso to sub-section (2) of section 140 of the GST Act is specific to the point that ITC ineligible under the existing law is also ineligible for ITC under GST Act. The computers, laptops etc. used by the applicant for providing output services are capital assets. These capital goods are ineligible to claim input tax credit under VAT Laws. Section 2 (x) of Kerala Value Added Tax, define capital goods as follows:

"Capital Goods" means plant, machinery, equipment including pollution quality control, lab and cold storage equipments used in manufacture, processing, **excluding for job works or rendering of services**, packing or storage of goods in the course of business and delivery vehicles but shall not include such goods and civil structure as may be notified by government.

Section 140(2) of the Act covers transitional credit claim on capital goods by a dealer registered in earlier law. Section 140 (3) of the GST Act covers credit of eligible duties in respect of inputs held on stock and inputs contained in semi-finished goods or finished goods held in stock in appointed day.

Hence, the transitional credit claim of the taxpayer in respect of capital goods is not acceptable.

Ruling of AAR

In respect of question (i), laptops, computers etc. used by the applicant in providing its output service would not qualify as capital goods for the purpose of the transitional provisions under the Act. By virtue of the same, the said laptops, computers, etc. would qualify as inputs under Section 140 (3) of the Act.

In respect of question (ii), the goods even though physically available as closing stock as on 30th June 2017, ITC is not eligible for the VAT paid.

Appeal to the AAAR and Observations of AAAR

Applicant submitted that items in question are inputs eligible for ITC relying solely on Section 140(3) of the Act. Therefore, denial of ITC U/s. 140(2) by AAR is irrelevant.

Goods in question do not fall within the definition of capital goods defined under Section 2 (x) of the Kerala Value Added Tax Act, 2003 thereby the goods in question would automatically qualify as inputs as defined in section 2 (59) of the Act. Once the goods in question fall within the ambit of inputs, the eligibility of transitional credit benefit has to be examined under section 140 (3) of the Act and not Section 140 (2) of the Act.

Applicant further submitted that it satisfies all the four conditions prescribed under Section 140 (3) of the Act for availment of transitional credit. In the light of the above, applicant is of the view that stock held as on 30th June 2017, qualifies as inputs on which the applicant can avail ITC under Section 140(3) of Chapter XX of the Act.

The contentions raised by the applicant were examined by the AAAR in detail.

Section 2(19) of the KSGST Act, 2017 defines "Capital Goods" as goods the value of which is capitalized in the books of accounts of person claiming the input tax credit and which are used or intended to be used in the course or furtherance of business.

Further, Section 2(59) of the KSGST Act, 2017 defines "inputs" as any goods other than capital goods used by a supplier in the course or furtherance of business.

Hence, from the above definitions it is clear that, in the GST period, the input tax credit of Tax paid on computers etc. can only be claimed as "Capital Goods" but not as "Inputs".

The computers, laptops etc. fail to qualify as "inputs" under KSGST Act, 2017 and thereby fail to satisfy the condition set under clause (ii) of Section 140 (3) of the KSGST Act, 2017, hence they are not eligible to claim ITC under transitional provisions of the VAT paid during the pre-GST period on the computers and laptops etc. physically available on 30th June, 2017.

Further, the computers etc. which were lying in stock as on 30.06.2017 were declared as capital assets prior to GST and used by the applicant for providing output services. Thereby they had no tax liability under the erstwhile KVAT law. Therefore they squarely fall under the definition of "Capital Goods" under section 2(19) of the KSGST Act, 2017 and not under the Section (59) of the KSGST Act, 2017. Hence the relevant transitional provision applicable in the instant case is section 140 (2) of the KSGST Act, 2017 and Section 140 (3) of the KSGST Act cannot be invoked.

In view of the above discussions, this appellate authority for advance ruling does not find any reason to modify the decision of the Authority for Advance Ruling.

Order of AAAR

The computers, laptops etc. used by the applicant for providing output services would not qualify as inputs, though they are physically available as on 30th June 2017, for the purpose of availing transitional input tax credit of the VAT paid during the pre-GST period under section 140 of the KSGST Act 2017.

4. M/s. MRF Ltd. – AAR Tamil Nadu (2019-TIOL-87-AAR-GST)

Facts, Issue involved and Query of the Applicant

Applicant intends to enter into an agreement with M/s C2F0 India LLP, for setting up an interactive automated data exchange. The C2F0 platform provides interaction relating to sale and purchase of goods and services between a buyer and a seller. Both the Supplier and the Recipient of goods or services should register on the platform provided by C2F0.

By accepting the C2F0 terms and conditions, the supplier will be agreeable to offer certain discount in return for an early payment of an Invoice from the recipient of goods or services (i.e. the applicant).

The Applicant has stated that since the transaction is a post-invoice discount offer on optional basis, same discount is not captured in the purchase contract between the applicant and the supplier. Once the goods or services are delivered and the invoice is booked in the ERP and marked as approved to pay, the supplier via C2F0 can take voluntary decision and give discounts to the buyer to receive early payment. The supply is made in terms of the purchase contract and the recipient on receipt of the goods or services takes ITC as mentioned in the invoice.

The discount arrangement is not part of the Purchase Contracts or the invoices. It is the case of offering discount post supply falling under "Cash Discount" not agreed before or at the time of supply.

Applicant has sought Advance Ruling to clarify whether the company can avail the ITC of the full GST charged in the supply of invoice or a proportionate reversal of the same is required in case of post purchase discount given by the supplier of the goods or services.

The Applicant stated that as per Section 15(3) of the CGST Act, discount is not allowable for deduction from the price at the time of supply since the same is not known either before or at the time of supply. The taxable value for the purpose of payment of GST will be the value as per Purchase Contract without considering such discount so offered and the supplier is liable to pay tax on the value before discount.

The buyer pays **price** minus **the discount** plus GST **on the value without considering amount**. The Applicant submitted that the payment made by the recipient has to be considered as proper payment in compliance with Section 16(2). There is no requirement to reverse ITC by the recipient attributable to the amount of discount so allowed for the reason that such discount is not considered by the supply for payment of GST and the applicant is not entitled to issue any credit note for the discount amount including GST in terms of Section 34(1) and (2).

Discussions by and observations of AAR

The Authority has observed that the applicant intends to enter into an agreement with C2F0 for setting up an interactive software, which can integrate data relating to sale and purchase of goods or services between the applicant and the suppliers. The supplier on raising the invoice (undiscounted price) pays the applicable GST. The applicant avails ITC on receipt of goods or services provided by the supplier and thereafter, such invoice is staged for discount against early payment in the C2F0 platform and the price is discounted.

The Applicant states that there is no need on their part to reverse the ITC availed by them in proportion to the discount in the invoice price.

In this case, the value of supply is the **full-undiscounted value** indicated in the tax invoice and the recipient only makes payment to the extent invoice less the discount thrown up by the C2F0 software. As per section 16, the recipient is entitled to avail the ITC on the payment made by him alone and if any amount is not paid as per the Value of Supply and the recipient has availed full ITC, the same would be added to his output tax liability.

Therefore, in the instant case, the applicant can avail ITC only to the extent of the invoice value less the discounts. If he has availed ITC on the full amount, he should reverse the difference amount equal to the discount, to avoid adding to his output liability.

Ruling of AAR

In respect of question raised by the Applicant, ITC can be availed by the applicant only to the

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extent of the invoice value raised by the supplier less the discounts as per C2F0 software, which is to be paid by the buyer (applicant) to the supplier.

5. Nes Global Specialist Engineering Services Private Limited – AAR Maharashtra (2019-TIOL-64-AAR-GST)

Facts, Issue involved and Query of the Applicant

NES Global Specialist Engineering Services Pvt. Ltd. (NES India), herein after referred as the 'applicant', is engaged in providing supply of man-power services to highly technical industries such as Oil and Gas, Power, etc. NES India and NES Abu Dhabi are subsidiary companies of the parent company named NES Global Limited (NES UK). The applicant and NES Abu Dhabi proposed to enter into a service agreement by which the applicant will provide support services in respect of foreign business carried on by NES Abu Dhabi. Every service provided by the applicant shall form a part of the Master Services Agreement (MSA) & it's schedules in detail. A **draft** Intercompany Services Agreement (ISA) with NES Abu Dhabi has also been provided to the authority. The services to be provided as per MSA shall include:

a) Purchase Invoice bookings for various Costs such as Visa, Immigration, labour cancellation charged, Medical expenses of various contractors of NES Abu Dhabi;

b) Invoices Booking for all overheads;

c) Creating Invoices to various clients;

d) Booking expenses of contractors; and

e) other services (mentioned in MSA).

As per MSA, the applicant shall charge NES Abu Dhabi the cost incurred for providing the services with a margin of 10% plus taxes. The applicant is of the view that the above transaction will fall under Export of Service on fulfilment of the conditions of Section 2(6) and Section 16(1) of the IGST Act.

Applicant has sought advance ruling in respect of following questions:

i. *Whether the transaction in question is a Zero Rated Supply or a Normal Supply under the GST Act?*

ii. *If the said supply is a Zero Rated Supply, then can the same be considered as an export of service under the GST Act?*

The applicant and NES Abu Dhabi are not establishments of the same person, even though they are group companies. The shareholding pattern of both the companies proves that the Key Management Personal and Board of Directors (BOD) are different and neither of them hold shares of each other and thus do not control one another. The MSA also states that this transaction will not create any partnership or relation between the companies and will act independently.

Applicant relied on similar case of Verizon Communication India Pvt. Ltd. V/s Assistant Commissioner, Service Tax dated 12th September 2017, in which Hon'ble High Court of Delhi had taken view that such transaction will fall under Export of Service.

Discussions by and observations of AAR

Authority found that both the companies have already entered into the agreement as on 30th April, 2017 even though they have mentioned that they have proposed to enter into a service agreement. Considering the facts and various documents produced, it was contended that the applicant's transaction is in the nature of supply of services. The applicant providing services to their client located abroad, submitted that the payment for such service has been received in convertible foreign exchange. As contended by applicant, both the companies do not control

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one another and are independent of each other. Thus, it is found that clause (i), (ii), (iv) and (v) of Section 2(6) of the IGST Act, are fulfilled by the applicant. In respect of clause (iii) of said section, place of supply needs to be determined. As per Section 13(2) of CGST Act, the place of supply of service would be the location of the recipient of services i.e. NES Abu Dhabi, which is outside India.

As the applicant satisfies all the ingredients of 'export of services' defined U/S 2(6) of IGST Act, the services provided by the applicant would qualify as an export.

Ruling of AAR
In respect of question (i), the transactions (covered under the MSA) between the applicant and NES Abu Dhabi is a Zero rated supply.

In respect of question (ii), transactions will qualify as export of services.

6. M/s. Nipha Exports Private Limited – AAR Kolkata (2019-TIOL-55-AAR-GST)

Facts, Issue involved and Query of Applicant
The Applicant, a manufacturer of agriculture machinery, purchased an ambulance for the benefit of the employees.

Applicant seeks a ruling as to *whether input tax credit ('ITC') is admissible on ambulance for the purchased for the benefit of the employees under legal requirement of the factories Act, 1948.*

Applicant argues that the input tax paid on inward supply of the ambulance is eligible for credit under the Second Proviso to Section 17(5)(b) of CGST Act (amended *vide* CGST Amendment Act, 2018 w.e.f. 1-2-2019).

Discussions by and Observations of AAR
Authority found that Second proviso to Section 17(5)(b) (Effective from 1-2-2019) cannot be applicable to a transaction made in 22-11-2018, since eligibility to claim ITC u/s. 16(1) is subject to provisions of law at the time of occurrence of taxable event, irrespective of when the claim is made.

Applicant purchased the ambulance on 22-11-2018. ITC on inward supply of ambulance, being a motor vehicle, is not admissible under **Section 17(5)(a) of the GST Act.** The exception carved out under **Section 17(5)(b)(iii)(A)** of the GST Act for services which are obligatory for an employer to provide to its employees under any law for the time being in force is limited only to rent-a-cab, life insurance and health insurance.

Ruling of AAR
In view of above, ITC is not admissible on the ambulance purchased in November 2018.

7. M/s. Tewari Warehousing Company Private Limited – AAAR Kolkata (2019-TIOL-52-AAR-GST)

Facts, Issue involved and Query of Applicant
Applicant, supplying warehousing services, is constructing a warehouse on leasehold land using pre-fabricated technology. Such warehouse can be dismantled and reconstructed at a different location. Property under construction is described as "Prefabricated Warehousing System" ('System'). It is being purchased from M/s. Pennar Engineering Building Systems Ltd ('Vendor').

Applicant submitted that System is movable property and therefore, Section 17(5)(c) & (d) of CGST Act (Blocked credits) cannot be applicable.

He submitted that the System is fixed by anchor bolts **to a low RRC platform** embedded to the ground and it is only civil structure. The rest of the structure like columns, beams, wall sheets, roof shed etc. are all joined with one another by nuts and bolts and can be easily dismantled and restructured at another location.

Applicant seeks a ruling as to whether the input tax credit is admissible on the inward supplies for construction of the said warehouse.

According to the Applicant, if the nature of annexation is such that an item so annexed can be removed without any damage & future enjoyment of that item in a similar capacity is not effected, such items will not be considered as immovable property. He referred to the judgment in *Solid & Correct Engineering Works [(2010) 252 ELT 481 (SC)]* and *Sirpur Paper Mills Ltd. [97 ELT 3 (SC)] where emphasis was on intention of the party to make it permanent. It was held that machine fixed with nuts and bolts to a foundation, with no intent to permanently attach it to the earth, is not an immovable property.*

"Immovable property" is not defined under the GST Act. Property **other than goods, money and securities** should, therefore, be considered as 'immovable property' under the GST Act.

Discussions by and Observations of AAR

The Authority found that applicant is constructing the warehouse on a piece of land. He takes such land on lease from Kolkata Port Trust for a period of thirty years for the purpose of building a storage facility. The intention is beneficial enjoyment for more than two decades of the lease.

Concerned Officer pointed out that the system refers only to the pre-fabricated structure that are used the constructing the warehouse and not to the warehouse itself.

The application is not the beneficial enjoyment of the system, but of the property of the warehouse being built. **Being a Storage facility, a warehouse is associated with the space available, whereas the system refers to the materials and structures used for turning the space into a covered storage facility.** As the technology advances, the engineering for building a factory or bridge uses more and more pre-fabricated structure which has benefits in term of time & cost.

Construction of floor, its load bearing capacity and space it occupies is critical to the construction of the warehouse. The System does not apparently include any specific description of the floor as a pre-fabricated load-bearing structure. In a cross-sectional diagram of the typical pre-engineered steel building the Vendor provides a vivid pictorial illustration of the various parts of the structure-the walls, roof, doors and windows etc. that will be built upon the floor, but does not provide any description of the floor as a pre-fabricated structure.

The warehouse cannot be conceived without the beneficial enjoyment of civil structure, which is an integral part of the property. In this connection reference may be made to clause 4(v) of the circular No. 58/1/2002-CX dated 15-1-2002, where it is concluded that *"if items assembled or erected at site and attached by foundation to earth cannot be dismantled without substantial damage to its components, then items would not be considered movable and will, therefore, not be excisable goods."*

Clearly, the warehouse cannot be relocated by unfixing the pre-fabricated structures alone. The dismantling of the floor, which is the most important component of the warehouse, is not possible without substantial damage to the foundation.

Ruling of AAR

In view of above, the warehouse constructed is immovable property. The ITC is, therefore, not admissible on the inward supplies for construction of the said warehouse.

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CA Rajiv Luthia & CA Keval Shah

INDIRECT TAXES
Service Tax – Case Law Update

Citation: 2019-TIOL-594-HC-KOLKATA-WP

Case: Srijan Realty Pvt. Ltd. vs. Commissioner of Service Tax Commissionerate-II Kolkata & Ors.

Facts of the case

The petitioner is owner of commercial complex namely "Galaxy Mall". The complex has various occupants. In order to effect electric supply through an 11KV substation installed at the said complex, the petitioner entered into an agreement on October 26, 2010 with DPSC Ltd. (now known as Indian Power Corporation Ltd.) M/s. DPSC Ltd. raises single consolidated electricity bill upon the petitioner periodically. The petitioner has installed sub-meters for the respective occupants. Based on the readings of such sub-meters, the petitioner raises bills on such occupiers. WP is filed by the appellant for determining the question of law that whether redistribution of electricity by them was exigible to service tax?

Arguments put forth

The petitioner submitted as under:

a) The action of redistribution of electricity is a sale/trading activity. It cannot be termed as a service.

b) Absence of any licence under the Electricity Act, 2003 does not mean that the petitioner is not selling or trading in electric supply.

c) Electricity is a 'good'. Reference made to Chapter 27 of the Central Excise Tariff Act, 1985, wherein electrical energy under the heading 271160000 thereof as a 'good'. The West Bengal Value Added Tax Act, 2003 includes electrical agency as a 'good' capable of being bought and sold and exempt the same from any levy thereunder.

d) Reliance placed on SC Case – *State of Andhra Pradesh vs. National Thermal Power Corpn. Ltd. 2002-TIOL-107-SC-CT-LB*, wherein it was held that, electricity is a 'good' and is capable of being traded. Also in case of *Aluminium Co. vs. State of Kerala – SC* it was held that the entire transaction of supplying electricity from the point of its generation to the point of its consumption is treated as sale of goods.

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e) The State Legislature has the competence to levy taxes on sale of electricity and goods in terms of Entries 53 and 54 of List II of Schedule 7 read with Article 246 of the Constitution. In support of his contention, reliance was placed on *CCE Customs vs. Larsen & Toubro Ltd. 2015-TIOL-187-SC-ST.*

f) The dominant purpose test should be applied to find out as whether the transaction is exigible to service tax or not in view of case of *BSNL Ltd. v. UOI 2006-TIOL-15-SC-CT-LB.* Since, the transaction is eminently one for sale and the so-called service being indivisible, therefore the transaction is to be treated as a sale. Therefore service tax is not leviable.

The Respondent submitted as under

a) The petitioner is enjoying high tension electric supply from a licensee. It is converting such high tension to low tension and is supplying the low tension electricity to the various occupiers. The conversion from high tension to low tension and the distribution thereof to the occupiers is a service & exigible to service tax.

b) The petitioner does not come within exemption provided u/s. 66D(k) of Negative list i.e., it is not a transmission or distribution of electricity by an electricity transmission or distribution utility.

c) Trading of electricity can be done by a person legally permitted to do so. The petitioner is not permitted to sell electricity.

d) The petitioner is a consumer of M/s. DPSC Ltd. Therefore, the petitioner cannot claim itself to be a trader. The petitioner has no approval from any of the State/Central Authorities, to trade in electricity.

e) The nature of transactions between the petitioner and the ultimate consumers cannot be treated as a sale of electricity by the petitioner to such consumers.

Decision of the High Court

a) The petitioner obtains high-tension electric supply from India Power Corporation Ltd. It, in turn supplies electricity to the occupants of the commercial complex, on low-tension.

b) The petitioner is not an electricity trader as defined in section 2(26) of the Electricity Act, 2003. The petitioner does not have a licence to undertake trading in electricity under section 12 of the Electricity Act, 2003. The petitioner also cannot be said to be engaged in the business of transmission as, the petitioner does not have such a licence. The petitioner is not a person authorised to transmit, supply, distribute or undertake trading in electricity.

c) Sale, trading and distribution being taken out of the contention, the only other thing that remains to describe the activity undertaken by the petitioner, is service. Any other interpretation will render the steps taken by the petitioner in receiving high-tension electric supply and making over low tension electric supply to the occupants, violative of the provisions of the Electricity Act, 2003. Their activity does not come within the purview of section 66D(e) & 66D(k) of the Finance Act,1994.

d) The activity of the petitioner comes within the definition of service. The activity of the petitioner sought to be made exigible to tax does not come within exclusions contained in section 65B(44). The petitioner cannot be said to be indulging in trading of goods

or in transmission or distribution of electricity within the meaning of the Electricity Act, 2003.

e) The dominant purpose test as laid down in BSNL (supra) if at all applied would be against the petitioner, in the facts of the present case. The activity of the petitioner cannot be said to be a sale or a trade. Therefore, the only other classification of such activity is a service. The writ petition fails.

Citation: 2019-TIOL-611-HC-Mumbai

Case: Commissioner of Central Tax, Mumbai South vs. Bharat Petroleum Corporation Ltd.

Facts of the case

Respondents are engaged in manufacture and sale of various petrochemical products for retail sale of these products. Various sales outlets in the shape of petroleum pumps etc., are established and to operate those, dealers are appointed, wherein the respondent recovered licence fees from dealers. It is the case of the Revenue that license fees is subject to service tax under the head franchise service. Demand notices were dropped on the grounds that the service provided by the respondent is not in the nature of franchise service but it is service in the nature of supply of tangible goods, service which is chargeable to service tax only w.e.f. 16-5-2008. Therefore, the revenue is before this court.

Arguments put forth

The appellant submitted the following:

a) BPCL, after refining of crude oil, distributes petroleum products through a dealer network. The sellers' sales-outlet/dealer network is established on the basis that the applicant either owns the land and obtains these facilities and the licences so as to establish a petrol pump or an outlet or does not own the land and therefore obtains both, the land as also the equipments and instruments for outlet from BPCL.

b) Reliance was placed on clause (10) of the agreement entered into between the assessee and the dealer. It was argued that the products have to be sold under the name and logo of BPCL/assessee which is indicative of the fact that a representational right to sell such product has been granted. If the licence fee is charged only for such a right, then, this is clearly an arrangement falling within the meaning of rendering of franchise service.

The respondents submitted as under

a) From clause (1) of the agreement, it is apparent that the purpose of the agreement is to grant rights to use the premises which are ready for operation (as in company controlled outfit) or right to use the storage tanks, pipes, pumps etc., as per design of the respondent (in case of dealer controlled outfit). Thus the preliminary purpose of the agreement would clearly be the grant of rights to use the premises and/or equipment.

b) Licence fee is collected from the company controlled and dealer controlled outlets where the respondents are supplying pumps, storage tanks, pipes, etc. the said licence fee is not collected when no outfit is provided.

Decision

a) The definition of the term "franchise" as found in section 65(47) of the Finance Act, means an agreement by which the franchisee is granted representational right to sell or manufacture goods or

to provide service or undertake any process identified with franchisor, whether or not a trade mark, service mark, trade name or logo or any such symbol, as the case may be, is involved.

b) Clause (10) of the agreement between the assessee and the dealer was picked up and read in isolation to arrive at the above conclusion by the appellant's revenue. That is not justified at all. The agreement will have to be read as a whole and precisely.

c) The preamble to the said agreement in Clause (1) includes following

- In case of company controlled premises, the Company has at the request of the licensees agreed to permit the Licensees to enter upon the Company's premises.
- In case of dealer controlled premises, the Company has at the request of the licensees agreed to permit the licensees to use Motor Spirit and/or HSD pump/s of the design from time to time adopted by the Company including storage tank, pipes and fittings belonging thereto.

d) The said clause nowhere grants representational rights to the dealers. In fact, the said agreements in various clauses set out the terms for the petroleum products of equipment and premises and there is practically nothing in the agreement which can be termed as grant of representational rights. Revenue has relied solely on Clause (10) of the said agreement which in our opinion does not grant in representational rights. The appeal was dismissed.

Citation: 2019-TIOL-823-CESTAT-MUMBAI

Case: International Combustion India Ltd. vs. CCE, Nagpur

Background facts of the case

The appellants are engaged in the manufacture of machinery and parts thereof falling under the Heading 847410 of the Schedule of CETA, 1985. The appellants also undertake service of repair and maintenance of the machines to those buyers who opt for it. The repairs are usually carried out at the factory of the appellant. SCN's were issued for levy of service tax on such repair activity carried on by appellant.

Arguments put forth

The appellant submitted the following:

a) The repair and refurbishing is done at their premises and if needed by changing spares and after reassembly and necessary testing machines are returned to their customers on payment of excise duty on the replaced parts.

b) In case the goods are covered under the appellants standard guarantee/ warranty period (12 months), refurbishing is done free of cost i.e., the spares are replaced and no amount is charged from customers and no service charge is recovered. However, excise duty is paid on the parts used in the repairs. In case the goods are returned beyond the guarantee/warranty period when the refurbishing is done on chargeable basis.

c) The charges are only for the cost of the replaced/damaged parts. In such cases also no service charge is recovered therefore the services always free for the customers. The appellant further submitted that the case was made out

after a visit of the audit party. Service tax is leviable only on the service rendered for some consideration. If the service is rendered free of charge then there is no service tax recoverable.

Decision

a) There are two types of customers who are availing such services from the appellants. Some customers have opted for the warranty/guarantee scheme and some of them have not. The method followed by the appellants is that in respect of the customers who have opted for the warranty/guarantee the customers are not charged for the replacement of any parts, damaged, etc. In the other case the customers have charged for such parts.

b) Appellants are discharging the duty of Central excise on the spares/parts used in repair and refurbishing.

c) In the absence of consideration for the service rendered it cannot be argued that the appellants are liable to pay service tax on such services provided by them. Arguably, service tax payment is necessary when the four things are satisfied:

   (i) There is a service

   (ii) There is a service provider

   (iii) There is a service recipient

   (iv) There is a consideration for such service paid by the recipient of service to the provider of the service.

d) The department has not produced any evidence to the effect that the appellants have received remuneration for such repair or maintenance service in the absence of the same no service tax is payable by the appellants in the result no demands survive.

Citation: 2019-VIL-193-CESTAT-CHE-ST

Case: Matrimony.com Pvt. Ltd. vs. Commissioner of GST & Central Excise, Chennai

Background facts of the case

The appellants are providing information in various fields namely matrimony, properties, job opportunities and automobiles to both domestic and overseas customers through internet.

During the course of audit, it was noticed that they had incurred expenditure towards agency commission, web hosting charges, marketing expenses, advertisement charges, marketing events and other expenses in foreign currency. Though the appellant had received various taxable services from overseas service providers who do not have office in India and incurred charges/expenses in foreign currency, they did not discharge the service tax under reverse charge mechanism as per the provisions of Section 66A of the Finance Act, 1994 read with Rule 2(1)(d)(iv) of the Service Tax Rules, 1994. On being pointed out by the audit group, the appellant paid up the entire service tax along with interest.

After due process of law, the Original Authority confirmed the demand, interest and imposed penalties

Arguments put forth

The Appellants submitted as under:

a) The appellant has paid up the entire service tax and would be eligible for the CENVAT credit thereof. Being a revenue neutral situation, it was submitted that the appellant is presently contesting only the penalties imposed.

b) There are no grounds to invoke the extended period as well to establish that the appellant had not discharged the service tax, with an intention to evade payment of service tax, the penalty imposed under Section 78 of the Finance Act, 1994 may be set aside.

The Respondents submitted as under

a) It was argued that the appellants have not paid the service tax and that the short payment would not have come to light but for the intervention of the Department. Therefore, the appellant is guilty of extended period as well as the penalty imposed under Section 78 *ibid* are legal and proper.

Decision

a) It is seen that the appellants are liable to pay service tax in the present demand under reverse charge mechanism as per Section 66A of the Finance Act, 1994. It is very much true that in case the appellants pay the service tax on reverse charge basis, they would be eligible to avail credit on the said amount as a service recipient. Thus, the situation is truly a revenue neutral one. On such score, the appellant cannot be saddled with the allegation of intention to evade payment of service tax.

b) The Hon'ble jurisdictional High Court in the case of *CCE, Chennai-IV vs. M/s. Tenneco RC India Pvt. Ltd. reported in 2015 (323) ELT 299 (Mad.) - 2015-VIL-643-MAD-CE* held that the assessee could not have achieved any purpose by evading duty.

Accordingly the appeal filed by the assessee was allowed and the penalty imposed was dropped.

Citation: 2019-VIL-182-CESTAT-CHE-ST

Case: Ford India Private Limited vs. CCE Chennai

Background facts of the case

Brief facts are that the appellants are engaged in manufacture of passenger cars and are availing the facility of CENVAT credit on excise duty paid on inputs, capital goods and service tax paid on various input services. During the audit of accounts on one of the service providers of the appellant, it was noticed that the service provider namely M/s. Sunmar Constructions had constructed roads for the appellant inside the factory premises. M/s. Sunmar Constructions had paid service tax on the construction activities provided to the appellant and the service tax was also collected from the appellant. The appellant then availed credit of the service tax being input service for them. The department was of the view that construction of roads does not amount to Industrial Construction Service and that the construction of roads is specifically excluded in the said definition. That M/s. Sunmar Constructions ought not to have paid service tax on the said services. The credit therefore availed by the appellant is ineligible.

Arguments put forth

The assessee as appellants submitted as under:

a) It was submitted that the department does not dispute that the roads were constructed by M/s. Sunmar Constructions within the factory premises of the appellant. So also there is no dispute that the appellant has availed CENVAT credit only on the service tax collected by M/s. Sunmar Constructions from the appellant. The allegation is that since M/s. Sunmar Constructions ought not to have paid service tax since

the activity of construction of road does not fall within the definition of Construction of Industrial or Complex service, the credit is not eligible.

b) He relied upon the decision of the Hon'ble High Court of Gujarat in the case of *Commissioner of Central Excise vs. Nahar Granites Ltd. – 2014 (305) ELT 9 (Guj.) - 2014-VIL-145-GUJ-CE* to argue that in the said case though the process did not amount to manufacture, the Hon'ble High Court held that credit availed on inputs is eligible. Similar view has been taken by the Tribunal in the case of *Ran India Steels Pvt. Ltd. vs. Commissioner of Central Excise – 2016 (344) ELT 440 (Tri. Chennai) - 2016-VIL-194-CESTAT-CHE-CE.*

The Respondent submitted as under

a) It was argued that services provided in respect of construction of roads does not fall within the ambit of the said definition. He referred to section 66 of the said Act and submitted that the assessee can avail credit only of the service tax that is paid when the services are leviable to service tax.

Decision

a) The appellants have availed credit of the same amount under proper documents. It is now the case of the department that M/s. Sunmar Constructions ought not to have paid service tax on the construction of the roads since such activities are not leviable to service tax. On an analogous situation, wherein credit was availed on inputs, when the process does not amount to manufacture, the Courts have consistently held that the credit cannot be denied at the receiver's end.

b) In the present case, CENVAT scheme enables the service recipient to avail credit of the service tax paid by the service provider. The jurisdictional High Court in the case of Modular Auto Ltd. (*supra*) has observed that even when the activity rendered by the service provider does not amount to service, the credit availed by the service recipient for the on the service tax collected from him would be eligible for credit.

c) The basic fundamental concept for availment of CENVAT credit is to avoid cascading effect of tax and it is a compensation for arrangement for the recipient of goods or services who has suffered tax or duty at the hands of the provider or supplier. The CENVAT scheme therefore allows the manufacturer or service recipient to avail the credit of duty to the extent that has been paid by the supplier or provider and in the invoices in full unless the same is restricted or barred by some other legal provision in law. The manufacturer or service recipient cannot be denied the credit only on the score that the same has been short-paid or has been paid when not required

d) Accordingly the appeal filed by the appellants was allowed.

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Worldliness and realisation of God cannot go together.

— *Swami Vivekananda*

Janak C. Pandya, *Company Secretary*

CORPORATE LAWS

Company Law Update

[2019] 213 Comp Cas 134 (NCLAT)

[Before the National Company Law Appellate Tribunal – New Delhi]

SML Films Ltd. and Others vs. Registrar of Companies

The provisions of sections are for transparency and if the information is not provided on time to RoC, such defaults open doors for various misconducts and thus, delays in compliance with the provisions of the Companies Act regarding submission of returns and forms are source of mischiefs and these lapses need to be viewed seriously.

Brief

There were two appeals filed by the SML Films Ltd. ("Company") and its directors against the two impugned orders passed by the National Company Law Tribunal, Ahmedabad Bench ("NCLT"). The summary of facts are as follows.

1. Company was incorporated as a private limited company and appointed two directors as executive director and whole-time director respectively.
2. As required under section 303(2) of the Companies Act, 1956 ("Act"), Company was required to file Form 32 for their respective appointments with the Registrar of Companies, however company did not file such form.
3. Subsequently, Company was converted in to a public limited company.
4. As required under section 269(2) of the Act, Company was also required to file form 25C for the appointments of above two directors.
5. In 2014, Company again reappointed them as executive directors for a further period of three years.
6. Once again, Company did not file form MR-1 for their respective reappointments under the new Companies Act, 2013.
7. The Company secretary, who was appointed latter, has pointed out these lapses.
8. Company and directors then filed a compounding application before the NCLT.
9. NCLT in two separate order has compounded the offences and levy the penalties, which is totaling to ₹ 17,62,800 for both the offence.
10. In between, one of the directors died.
11. These applications are towards the quantum of above penalties and it is

submitted that NCLT has not shown the leniency and pray for lowering the penalties.

From appellants side, it was submitted that earlier Company did not have Company Secretary and thus did not get proper advice and assistance. Further, the applicants have *suo motu* come forward to submit forms and thus leniency was required to be shown. It was also submitted that since one of the directors has expired, the fees imposed on him should be reduced from total penalty to be paid.

The Registrar of Company had submitted that if concerned sections are seen, NCLT has already shown the leniency and fine imposed are at lower side.

Judgment

NCLAT has rejected the applications. The following were the main considerations.

1. NCLT has already given the concession possible.
2. The provisions of sections are for transparency and if the information is not provided on time to RoC, such defaults open doors for various misconducts.
3. The cases related to oppression and mismanagement before the NCLAT is due to these reasons.
4. Delays in compliance with the provisions of the Companies Act regarding submission of returns and forms are source of mischief and these lapses need to be viewed seriously.
5. On reduction of penalty due to death of one of the directors, no relief is granted as order was already passed before his death and that present appeal is not from his legal representative.

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Makrand Joshi, *Company Secretary*

CORPORATE LAWS
Recent Developments

KYC – Initiatives of MCA

Know your customer, alternatively known as **know your client** or simply **KYC**, is the process of verifying the identity of the person. This process initially started in the banking sector way back in 2002. However, over a period of time it has gained importance in all sectors.

Since the demonetisation in the year 2016, the Ministry of Corporate Affairs (MCA) had been very active and took various steps such striking off of the Companies, disqualification of directors etc., to tackle the black money menace and non-compliances by companies.

In an attempt to weed out unscrupulous elements, MCA brought in effect KYC of Directors, Companies, lenders-deposits etc. In this note we would be discussing various initiatives taken by the MCA for the KYC process.

1. KYC of Directors

MCA *vide* Notification dated 5th July, 2018 KYC initiative for directors to ascertain their identities by amending the Companies (Appointment and Qualification of Directors) Rules, 2014.

Every director who has been allotted Director Identification Number (DIN) on or before 31st March, 2018 was required to file e-form DIR-3 KYC with MCA on or before 5th October, 2018. If the director failed to file DIR-3 KYC, the respective DIN would be deactivated. Further, the director was also debarred from using MCA 21. The deactivated DIN can be reactivated after filing the e-form DIR-3-KYC along with the fees as prescribed by MCA, i.e., ₹ 5000/-. Even the disqualified directors were required to file e-form DIR-3 KYC.

For every individual who has been allotted DIN as on 31 March of a financial year, the due date for filing the said e-form is on or before 30th April of immediate next financial year.

The purpose is to get rid of the ghost directors - those directors, who do not even know they are directors in companies. Some of them may be peon or drivers of the owners of a company. In some cases, the director could have been long dead but his/her name continues to appear in the list of directors.

2. KYC of Companies

After the KYC of directors, MCA has introduced KYC of the Companies *vide* notification dated 21st February 2019 and has amended the Companies Incorporation Rules, 2014. Pursuant to this notification, the MCA is tracking the identity of active companies whereby the companies are mandatorily required to give Latitude and Longitude details (Geo-Tagging) of the Company to the Registrar of Companies.

Every Company incorporated on before 31st December, 2017 is required to file a one-time return

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with MCA in e-Form INC-22A - Active Company Tagging Identities and Verification (ACTIVE). However, the exceptions are the companies which have been struck off or are under process of striking off or under liquidation or amalgamated or dissolved or in Management dispute. Further, the Companies which have defaulted in filing the financial statements or the Annual return for the financial year 2017-18, the Companies whose directors DIN is deactivated due to non-filing of DIR-3 KYC and the Companies whose directors are disqualified won't be able to file this form.

The last date of filing is 25th April 2019. If the e-form ACTIVE is not filed on or before the due date, the Companies will be marked as "ACTIVE non-compliant". Once the status is changed to Active Non-Compliant, the Company will not be able to file event based forms with Registrar of Companies (ROC) viz.,

i. SH-7 (Change in Authorised Capital)

ii. PAS-3 (Change in paid-up capital)

iii. DIR-12 (Change in Director except cessation)

iv. INC-22 (Change in Regd. office)

v. INC-28 (Amalgamation/Demerger)

Further, the Directors of the Active Non-Compliant will also be marked as the "Director of the ACTIVE Non-Compliant Company".

The Company shall be liable for action u/s. 12(9) of the Companies ie., – Physical verification of Registered Office by ROC. Further, ROC on a reasonable cause to believe that the Company is not having registered office capable of receiving and acknowledging all communications and notices as may be addressed to it, the ROC may initiate action for the removal of the name of the company from the Register of Companies.

The status of the Company can be changed to "ACTIVE" after the e-form ACTIVE is filed with MCA alongwith the prescribed fees of ₹ 10,000/- and likewise the status of the director shall also be changed once all the companies in which such director is director files e-form ACTIVE.

Before filing the ACTIVE form, the Company is required to ensure that the status of DIN of all the directors are in approved category and is not deactivated either due to non-filing of DIR-3 KYC or due to the disqualification of the director u/s. 164(2).

3. KYC of Independent Director

For being eligible to be appointed as Independent Director (ID), it is proposed that an ID should have assessment, conducted by such body or institute, as may be prescribed by the Central Government.

The assessment is additional criteria to be fulfilled other than the eligibility conditions as provided in section 149(6) of the Companies Act, 2013 (hereinafter referred as "the Act").

As of now, this provision is under proposal stage. MCA had invited public comments on it in the form of proposed amendments to the Act in November, 2018. However, MCA has not yet notified it. MCA may come up with rules giving guidance of such assessment with the professional institutes. Currently, ICSI is maintaining the database of ID u/s. 150 of the Act.

This would be a welcome move by MCA as the role of ID in corporate governance and in compliance is very important and also well recognised in the industry..

4. KYC of Auditor

The onus of proof that the individual/firm is eligible to be appointed as auditor is on the individual/firm. Section 141 of the Act provides the eligibility for the appointment of the Auditor. And as per the section 139 of the Act, the Auditor is required to furnish certificate stating that he fulfils the conditions provided in section 141 of the Act. This certificate is also filed with the Registrar in e-form ADT-1 viz, form for the appointment as the auditor of the Company.

Additionally for the governed companies/body Corporate, e-form NFRA is required to be filed at the time of appointment and annually.

Besides the above, it is proposed that MCA would carry out the KYC process for professionals – chartered accountants, cost accountants and company secretaries. This is again another

architecture where the third drive will run after the companies drive. Professionals will be screened and then registered into the system.

5. KYC –Lender Deposit

While KYC has traditionally been viewed as burdensome "red tape", however, in today's world "KYC" these three letters play a key role in the lending market. Nowadays, lenders provide loan in a short span of a day. The latest news of Flipkart providing instant loan via video based KYC which itself explains its importance. Such loan approvals are possible in case of individuals however it is not feasible in case of Companies.

In case of a Company, the creditworthiness is determined by various means and one such means is the financial position of the Company. Now, even the MCA wants the companies to provide the information on its outstanding receipt of money or loan received by a company but which is not considered as deposits.

The information will include the details of loan from promoters, advance against goods and services, any amount received by a company from any other company. Though the information is already provided in the financials yet the MCA needs the details of outstanding money which is not considered as deposit by companies

MCA *vide* notification dated 22nd January, 2019 amended the Companies (Acceptance of Deposits) Rule, 2014. Pursuant to this amendment, every company is required to file one-time return in e-form DPT-3 for providing the details of outstanding receipt of money or loan received by a company in terms of Rule 2(2)(c) of the Companies (Acceptance of Deposits) Rules 2014 but which are not considered as deposits.

The companies are already required to file e-from DPT-3 annually by 30th June for giving the details of deposit taken by the companies.

The below mentioned table provides more clarity on the subject t:

Purpose	For the Period	Applicability	Due Date
One time return	From 1st April, 2014 till the date of publication of notification in official gazette	Every company to which these rules apply, except Government Company	21st April, 2019
Annually	Information as on the 31st day of March of that year duly audited by auditor	Every company to which these rules apply, except Government Company	On or before the 30th day of June, of every year

Though the due date for one time return is approaching soon, yet MCA has not yet issued the revised format of the e-form that is be used for filling.

Further, as per the Ministry of Law and Justice - the Banning of Unregulated Deposit Schemes Ordinance, 2019, The Central Government may designate an authority which shall create, maintain and operate an **online database for information on deposit takers** operating in India [Section 9(1) of the Ordinance].

Further, the RBI has mandated phase-wise implementation of the Legal Entity Identifier (LEI) system for all borrowers of banks in India. The Legal Entity Identifier (LEI) is a global reference number that uniquely identifies every legal entity or structure that is party to a financial transaction, in any jurisdiction.

This will facilitate assessment of aggregate borrowing by corporate groups, and monitoring of the financial profile of an entity/group. This requirement is be implemented in a calibrated manner.

Conclusion

Needless to say, KYC is need or the hour to make the industry more efficient, compliant and transparent so that India as a country grows as a whole and becomes strong in global economy.

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CA Mayur Nayak, CA Natwar Thakrar & CA Pankaj Bhuta

OTHER LAWS
FEMA – Update and Analysis

In this article, we have discussed recent amendments to FEMA through circulars, notifications and updation of master directions issued by RBI. In addition to it we have discussed few recent compounding orders issued by RBI:

A. Updated through Notifications

a) Hedging of exchange rate risk by Foreign Portfolio Investors (FPIs) under Voluntary Retention Route (VRR)

RBI had released a discussion paper on 'Voluntary Retention Route' (VRR) for investments by Foreign Portfolio Investors (FPIs) on October 5, 2018. The VRR scheme has been finalised after taking into consideration the comments and views received, and suitable amendments have been made to regulations under the Foreign Exchange Management Act, 1999 (Act 42 of 1999) to enable FPIs participating in the VRR scheme to hedge their interest rate and exchange rate risks related to their investments under the scheme and to undertake repo/reverse repo transactions to meet their liquidity requirements.

The changes notified in the Foreign Exchange Derivative Contracts Regulation effective from 26th day of February, 2019 are as follows:

1) Insertion of Para 7 at the end of Schedule II - Foreign exchange **derivative contracts permissible** for a person resident outside India:

   "A Foreign Portfolio Investor may enter into forward contracts, foreign currency-rupee option contract, cost reduction structures or swaps with Rupee as one of the currencies with an Authorised Dealer in India to hedge the currency risk in respect of investments made under the Voluntary Retention Route (VRR) facility subject to such terms and conditions as may be stipulated by the Reserve Bank from time-to-time."

2) After the clause (d) of Para 2 (Definitions), the following clause shall be inserted:

   "**(da)** - 'Derivative' means a financial contract, to be settled at a future date, whose value is derived from one or more financial, or non-financial variables."

3) In Schedule I (Classes of capital account transactions of persons resident in India), the existing clause (k) shall be substituted with the following, namely;

   "**(k)** - Undertake derivative contracts."

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4) In Schedule II (Classes of capital account transactions of persons resident outside India), after the existing clause (g), following clause shall be inserted, namely;

"**(h)** - Undertake derivative contracts."

5) In the Foreign Exchange Management (Borrowing and Lending) Regulations, 2018, after Para 7, the following Para 7-A shall be added:

"7-A. Borrowing and lending by persons resident outside India: A person resident outside India may undertake repo or reverse repo transactions in Rupees to borrow or lend money, subject to such terms and conditions as may be specified by the Reserve Bank.

6) In FEM (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 following changes have been made:

– The Note to clause 5 of para 5 (permission for making investment by a person resident outside India) shall be deleted.

– After clause 5 of para 5 (permission for making investment by a person resident outside India), the following clauses shall be inserted:

"**(5)(a)** – A Foreign Portfolio Investor or a Non-Resident Indian (NRI) or an Overseas Citizen of India (OCI) may trade or invest in all exchange traded derivative contracts approved by Securities and Exchange Board of India from time-to-time subject to the limits prescribed by Securities and Exchange Board of India and conditions specified in Schedule 5."

"**(5)(b)** – A Foreign Portfolio Investor may enter into contract in any interest rate derivative subject to conditions laid down by the Reserve Bank from time-to-time."

(Source: Amendment in FEMA Notification No. 1, 3(R), 20(R) & 25 vide Notification Nos. 390 & 391/2019-RB dated 26-2-2019 & GSR No. 161(E), 162(E), 163(E) & 164(E) dated February 27, 2019).

(Comment: This is a welcome move in line with the objective of the VRR channel to attract long-term and stable FPI investments into debt markets while providing FPIs with operational flexibility to manage their investments).

b) Establishment in India of a branch office or a liaison office or a project office or any other place of business

RBI has made following changes in the Notification No. 22(R)- Establishment in India of a BO/LO/PO or any other place of business regulation effective from the date of publication in the official gazette (yet to publish).

Existing provision laid down under clause (c) of Regulation 5 shall be substituted with the following:

"Provided that approval of the Reserve Bank of India is not required in case where Government approval or licence/permission by the concerned Ministry/ Regulator has already been granted. Further, in the case of proposal for opening a project office relating to defence sector, no separate reference or approval of Government of India shall be required if the said non-resident applicant has been awarded a contract by/entered into an agreement with the Ministry of Defence or Service Headquarters or Defence Public Sector Undertakings".

B. Amendments through Circulars

a) Trade Credit Policy – Revised framework date on March 13, 2019

As a measure of rationalisation of principal regulation governing the External Commercial Borrowings (ECB) and Trade Credits, RBI reissued notifications relating to Borrowing & Lendings through FEMA 3(R) – Foreign Exchange Management (Borrowing and Lending) Regulations, 2018 notified on December 17, 2018 and the new ECB framework based on the above regulation was issued on January 16, 2019 *vide* A. P. (DIR Series) Circular No. 17.

RBI has now issued framework for the Trade Credit based on the aforementioned notified regulation. Detailed instructions are set out in the Annex to this circular.

Under new framework, Trade Credits can be raised under the automatic route up to the amount specified in the Annex to this circular and in compliance with the other applicable norms. Any contravention of the applicable provisions will invite penal action or adjudication under the Foreign Exchange Management Act, 1999.

The amended Trade Credit policy will come into force with immediate effect. The Master Direction No. 5 dated January 01, 2016 on the subject is being revised to reflect the above changes.

(Source: AP Dir. Series Circular No. 23 dated March 13, 2019)

b) Export and Import of Indian Currency

The limits for carrying currency notes to Nepal and Bhutan have been revised which now states that an individual travelling to Nepal or Bhutan may carry Reserve Bank of India currency notes in Mahatma Gandhi (new) series of denomination ₹ 200 and/or ₹ 500 subject to a total limit of ₹ 25,000/-.

Instructions regarding currency notes of Government of India and Reserve Bank of India for any amount in denomination up to ₹ 100/- shall continue as hitherto.

(Source: AP Dir. Series Circular No. 24 dated March 20, 2019)

c) Investment by Foreign Portfolio Investors (FPI) in Government securities Medium Term Framework

The limits for investments by foreign portfolio investors in Government securities have been revised for the various categories which are as under.

Revised Limits for FPI Investment in Debt 2019-20 **(Rupees billion)**

Particulars	G-Sec General	G-Sec – Long Term	SDL – General	SDL – Long Term	Corporate Bonds	Total Debt
Current Limit	2233	923	381	71	2891	6499
Revised Limit for HY April-Sept 2019	2347	1037	497	71	3031	6983
Revised Limit for HY Oct 19-March 20	2461	1151	612	71	3170	7465

Revision of investment Limits for 2019-20

a. The limit for FPI investment in Central Government securities (G-secs), State Development Loans (SDLs) and corporate bonds shall be 6%, 2%, and 9% of outstanding stocks of securities, respectively, in FY 2019-20.

b. The allocation of increase in G-sec limit over the two sub-categories – 'General' and 'Long-term' – has been set at 50:50 for the year 2019-20. The entire increase in limits for SDLs has been added to the 'General' sub-category of SDLs.

c. The coupon reinvestment arrangement for G-secs shall be extended to SDLs.

(Source: A.P. (DIR Series) Circular No. 26 dated 27th March, 2019)

d) Foreign Exchange Management (Deposit) Regulations, 2016 – Opening of NRO Accounts by Long Term Visa (LTV) holders, changes related to Special Non-Resident Rupee (SNRR) Account and Escrow Account

The FEM (Deposit) (Amendment) Regulations 2018 i.e., FEMA 5(R)(1) have been notified by the Government of India *vide* GSR No 1093(E) dated November 9, 2018 necessitating changes to the extant instructions.

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The salient features of the amendments are as follows:-

1) Insertion of a new clause, allowing FPIs and FVCIs investing outside India to open a Foreign Currency Account:

   Foreign Portfolio Investor (FPI) and a Foreign Venture Capital Investor (FVCI), registered with the Securities and Exchange Board of India (SEBI), may be allowed by the AD banks, to open and maintain a non-interest bearing foreign currency account for the purpose of making investment in accordance with the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017, as amended from time-to-time.

2) Opening of NRO Accounts by Long Term Visa (LTV) holders:

   – A citizen of Bangladesh or Pakistan, belonging to minority communities in those countries, namely Hindus, Sikhs, Buddhists, Jains, Parsis and Christians, residing in India and who has been granted a Long Term Visa (LTV) by the Central Government, will now be allowed to open only one Non-Resident Ordinary (NRO) Account.

   – Once such a person becomes a citizen of India within the meaning of the Citizenship Act, 1955, then the account will be converted to a resident account.

   – A person who has just applied for LTV, that is, does not hold LTV, which is under consideration of the Central Government, can also open NRO Account. However, the account will be opened for a period of six months and then may be renewed at six monthly intervals subject to the condition that the individual holds a valid visa and valid residential permit issued by Foreigner Registration Office (FRO)/ Foreigner Regional Registration Office (FRRO) concerned.

   – Authorised Banks that have opened such NRO accounts have to report the details of the accounts opened to the Ministry of Home Affairs (MHA) on a quarterly basis.

   – The report shall contain details of:

     (i) name/s of the individual/s;

     (ii) date of arrival in India;

     (iii) Passport No. and place/ country of issue;

     (iv) Residential Permit/Long -Term Visa reference and date & place of issue;

     (v) name of the FRO/FRRO concerned;

     (vi) complete address and contact number of the branch where the bank account is being maintained.

   – The Head Office of the AD bank shall furnish the above details on a quarterly basis to the Under Secretary (Foreigners), Ministry of Home Affairs, NDCC-II Building, Jai Singh Road, New Delhi – 110 001.

3) Changes in the regulations for SNRR Account:

In the extant provisions, SNRR accounts cannot be held for more than seven years. The same has now been revised and now, SNRR accounts opened by person's resident outside India can remain operative beyond the stipulated period of seven years with RBI approval. Further, the restriction of seven years will not be applicable to SNRR accounts opened by person's resident outside India who are registered with SEBI and wish to

make investment in India in accordance with Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017, as amended from time-to-time.

4) <u>Changes in the regulations for Escrow Account:</u>

The extant Schedule 5 of the Foreign Exchange Management (Deposit Regulations) 2016 pertaining to Escrow Accounts has been, now, replaced to align the same with the provisions of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017. Therefore, Escrow Accounts can be opened by residents and non-residents for acquisition/transfer of capital instruments/convertible notes and can also be funded by guarantee(s).

(Source: AP Dir. Series Circular No. 28 dated March 28, 2019)

C. Master Direction – External Commercial Borrowings, Trade Credits and Structured Obligations

New ECB regulations have come into existence in form of Notification No. FEMA 3(R)/2018-RB in the month of December, 2018, in suppression of Notification 3/2000-RB and Notification 4/RB-2004, the detailed ECB framework for the same was issued in the month of January, 2019 and new Trade Credit Policy framework in the month of March, 2019.

RBI has now issued Master Direction on External Commercial Borrowings, Trade Credits (TC) and Structured Obligations on March 26, 2019, by compiling new Frameworks together in supersession of earlier directions contained in Master Direction - External Commercial Borrowings, Trade Credit (TC), Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers dated January 1, 2016.

D. We have discussed below few recent compounding order issued by RBI

1) Transfer or issue of any Foreign Security (FEMA 20/2000-RB)
Taking on record the transfer of shares from Resident to Non-Resident without obtaining certified Form FC-TRS.

Applicant	M/s. Raha Poly Products Limited
Compounding Application Number	C.A. HYD 340
Compounding Authority Name	Foreign Exchange Department, Hyderabad
Amount imposed under Compounding Order	₹ 13,07,260/-
Date of order	07th February, 2019
Facts of the case	Apart from the other facts of the case, applicant company had taken on record transfer of shares held by resident Indian to the foreign investor in their books without obtaining certified form FC-TRS from AD Bank.
Selected Contravention	Taking on record transfer of shares from resident to non-resident without obtaining certified form FC-TRS from the AD bank: Regulation 4 of Notification No. FEMA 20/2000-RB states that "an Indian entity shall not

	issue any security to a person resident outside India or shall not record in its books any transfer of security from or to such person, provided that the Reserve Bank may, on an application made to it and for sufficient reasons, permit an entity to issue any security to a person resident outside India or to record in its books transfer of security from or to such person, subject to such conditions as may be considered necessary.
Comments	Though Foreign Exchange Management (Transfer or Issue of Security By a Person Resident Outside India) Regulations, 2000 has been replaced by revised regulations; Regulation 4 of extant FEMA 20(R)/2017-RB dated 07/11/2017 corresponds to Regulation 4 of erstwhile FEMA 20/2000- RB dated May 3, 2000.
2) Transfer or Issue of any Foreign Security (FEMA 20/2000-RB) **Acquisition of equity stake in a step-down subsidiary (SDS) in India, through wholly owned subsidiary (WOS) resulting in foreign direct investment (FDI) through overseas direct investment (ODI).**	
Applicant	M/s. Maini Precision Products Limited
Compounding Application Number	CA No 4794/2018
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 29,66,706/-
Date of order	February, 2019
Facts of the case	An applicant had incorporated overseas WOS namely Maini Precision Products Holding. The WOS purchased shares of Sudarshan Maini Precision Products Private Limited, Bangalore, from Mrs. Karin Berger, Germany, a non-resident without prior RBI approval. This resulted in 'FDI through ODI'. Applicant had also not made reporting of setting up of SDS.
Selected Contravention	Acquisition of equity stake in a step down subsidiary (SDS) in India, through wholly owned subsidiary (WOS) resulting in foreign direct investment (FDI) through overseas direct investment (ODI): Regulation 5 of FEMA Notification No. 120 states that "Save as otherwise provided in the Act, rules or regulations made or directions issued thereunder, or with prior approval of the Reserve Bank, no person resident in India shall make any direct investment outside India. Further, Regulation 13 of Notification *ibid* states that "A JV/WOS set up by the Indian party as per the Regulations may incorporate step down subsidiary provided the Indian party reports to the Reserve Bank, the details of such decisions taken by the JV/WOS within 30 days of the approval of those decisions and include the same in APR.
Comments	Here, it is pertinent to note that RBI views "FDI through ODI" arrangement as a round tripping case and asked to transfer such shares to Indian company as part of regularisation.

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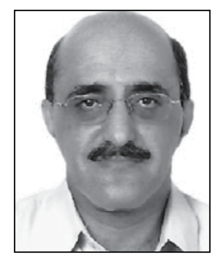

CA Zubin F. Billimoria

In Focus – Accounting and Auditing

Overview of Disclosure Requirements under Ind AS

Introduction

General

Accounting Standards which are prescribed and notified by regulators and professional bodies have three broad requirements as under:

(i) Recognition principles for financial statement items

(ii) Measurement principles for financial statements items

(iii) Disclosure requirements

Whilst the first two involve application of the principles laid down in the respective Standards, the *disclosure requirements laid down in the Standards are like a* ***report card of the financial position of the entity and a communication tool to the various users / stakeholders / regulators*** *and reflect the actual application and compliance with the requirements of the Standards.*

The disclosure requirements in respect of the Indian Accounting Standards (Ind ASs) as notified, manifests itself through the following **sources**:

(i) **The respective Ind ASs**

(ii) **Schedule III notified by the MCA**

(iii) **The Guidance Note on applicability of Schedule III issued by the ICAI**

Whilst the broad disclosure requirements under various Ind ASs, where there are similar standards under Indian GAAP are the same, there are several topic specific disclosures which are different under Ind AS. Accordingly, the disclosure requirements under Ind AS can be further categorised under the following broad sections for ease of understanding:

(i) **General Financial Statements Related Disclosures for all types of entities**

(ii) **Topic Specific Disclosures**

(iii) **Additional Disclosures under certain Ind ASs**

The discussion which follow is only to cover the broad underlying principles in respect of the disclosures and is not intended to be a complete or comprehensive list of all disclosures for which the readers are advised to refer to the various sources referred to above.

General Financial Statement related disclosures for all types of entities

The requirements in respect thereof are prescribed in Schedule III under Divisions II and

III for entities other than NBFCs and NBFCs, respectively, as well under certain other Ind ASs like Ind AS-1, Ind AS-8 and Ind AS-10. These are broadly outlined hereinbelow.

General Instructions for Preparation of Financial Statements

These are laid down in Schedule III which provide for the format for the various types of financial statements together with the specific disclosures under various line items. *It also contains provisions to the effect that in case of conflicts with the requirements under any regulations, guidelines, circulars etc. or under Ind ASs, the requirements under the Schedule would stand modified to that extent.*

It is pertinent to note that Division III of Schedule III which is applicable to NBFCs, has made an *exception to the option of presenting assets and liabilities in accordance with the current and non-current classification* as laid down in Ind AS-1, which permits as an alternative a classification in order of liquidity. In this context, **para 63 of Ind AS-1** specifically provides that for ***some entities, such as financial institutions, a presentation of assets and liabilities in increasing or decreasing order of liquidity provides information that is reliable and more relevant than a current/non-current presentation because the entity does not supply goods or services within a clearly identifiable operating cycle.***

The following are certain broad principles governing the preparation and presentation of financial statements which are laid down under **Ind AS-1:**

- Comparative information in respect of the preceding period needs to be restated to give effect to changes in accounting policies, errors and retrospective reclassification adjustments.
- Balance sheet as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in the financial statements.
- Equal prominence needs to be given to all the components.
- Financial statements need to be distinguished from the other information which is outside the scope of the Standard.
- **The financial statements should adopt a fair presentation and compliance framework which encompasses the following:**
  - *True and fair presentation*
  - *Explicit and unreserved statement of compliance*
  - *Compliance with all requirements of Ind-ASs*
  - *Selection of appropriate accounting policies*
  - ***Deviations only in very rare circumstances supported by explicit disclosures.***
- An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial except when required by law.
- An entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an Ind AS. Off-setting is generally permissible to achieve substance over form. Items like valuation allowance, provision for obsolescence etc. which were earlier offset are no longer permissible for offsetting.
- An entity shall present a complete set of financial statements (including comparative information) at least

annually. When an entity changes the end of its reporting period and presents financial statements for a period longer or shorter than one year, an entity shall disclose, in addition to the period covered by the financial statements:

a) the reason for using a longer or shorter period, and

b) the fact that amounts presented in the financial statements are not entirely comparable.

- Except when Ind ASs permit or require otherwise, an entity shall present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements. An entity shall also include comparative information for narrative and descriptive information if it is relevant to understanding the current period's financial statements.

- An entity shall present, as a minimum, two balance sheets, two statements of profit and loss (including other comprehensive income), two statements of cash flows and two statements of changes in equity, and related notes.

Disclosures related to Accounting Policies

Apart from disclosure of significant accounting policies for various types of transactions as laid down in the individual Ind ASs, the following are certain broad principles governing the disclosures related to accounting policies which are laid down under **Ind AS-1**:

a) the measurement basis (or bases) used in preparing the financial statements, and

b) the other accounting policies used that are relevant to an understanding of the financial statements.

Apart from the above general principles, the following specific aspects on disclosures merit special attention in the context of accounting policies, which are very specific to Ind AS compared to the existing Indian GAAP.

Management Judgments

An entity shall disclose, in the summary of significant accounting policies or other notes, the judgments, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. *This is a significant departure from the current disclosures which are made under Indian GAAP, which are very generic since now the areas involving judgments and the process applied for the same needs to be disclosed. Some of the prominent areas where significant judgment could be involved are determining whether control / joint control / significant influence is exercised over an entity in terms of the relevant Ind ASs, assessing transfer of significant risks and rewards in different circumstances as required under the relevant Ind ASs etc.*

Sources of Estimation Uncertainty

An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of such assets and liabilities, the notes shall include details of:

a) their nature, and

b) their carrying amount as at the end of the reporting period.

This is another important set of disclosures considering the preponderance of estimation required in several areas across various Ind ASs. Some of the common examples of areas involving estimation uncertainty are useful lives of property, plant and equipment and intangible assets, actuarial assumptions for employee benefit plans, future cash flows for discounting etc.

Disclosures related to the Balance Sheet

Currently, there is no specific format for the balance sheet which is prescribed in Ind AS-1. However, Schedule III of the Companies Act, 2013, lays down the detailed format for the balance sheet, separately for NBFCs and other entities which need to be followed to the extent it is not inconsistent with the requirements under any Ind AS. However, Ind AS-1 does provide for the following **minimum line items** which need to be disclosed:

Description of the Items
Property, plant and equipment
Investment Property
Intangible Assets
Financial Assets showing the following separately: • Investments accounted under Equity Method • Trade and Other Receivables • Cash and Cash Equivalents
Biological assets
Inventories
Total assets classified as held for sale and assets included in disposal groups considered as held for sale
Financial Liabilities showing the following separately: • Trade and other Payables • Provisions
Liabilities and Assets for Current Tax
Deferred Tax Assets and Liabilities
Liabilities included in disposal groups considered as held for sale
Non-controlling interests, presented within equity

The above disclosures remain practically academic since Schedule III provides for disclosures which are much more detailed.

The following are certain other broad principles governing Balance Sheet disclosures which are laid down under **Ind AS-1**:

- Additional line and sub-line items can be presented based on assessment of the nature and ***liquidity*** of assets, ***function*** of assets and amounts, nature and timing of liabilities.
- ***Assets within the same class subject to different measurement basis (e.g., amortised cost, FVTOCI, cost, fair value etc.) should be presented in separate line items.***
- *There are specific disclosure requirements which are laid down in the individual and specific Ind-ASs for different line items which also need to be adhered to. The position thereof vis-à-vis Schedule III, would need to be carefully evaluated.* ***It may be noted that Schedule III does not provide the option of presenting assets and liabilities in the order of liquidity. However, an entity is permitted to use a mixed basis of presentation, including current / non-current classification (discussed below) and in the order of liquidity when this provides information that is reliable and more relevant e.g., when an entity has diverse operations.***
- *The concepts of* ***current and non-current classification and operating cycle*** *which were there in the erstwhile revised Schedule VI of the Companies Act, 1956 are also similarly provided for under Ind AS-1 and remain relevant in the context of presentation in accordance with liquidity as discussed above.*

Disclosures related to Statement of Profit and Loss (including Other Comprehensive Income

As is the case with the balance sheet, currently, there is no specific format for the Statement of Profit and Loss (including Other Comprehensive Income) which is prescribed in Ind-AS-1.

However, Schedule III of the Companies Act, 2013, lays down the detailed format for the Statement of Profit and Loss (including Other Comprehensive Income), separately for NBFCs and other entities which need to be followed to the extent it is not inconsistent with the requirements under any Ind AS. However, Ind AS-1 does provide for the following minimum line items which need to be disclosed:

Description of the Items
Revenue with Interest Revenue calculated using EIR to be shown separately
Gains and Losses arising from derecognition of financial assets measured at amortised cost
Finance Cost
Impairment Losses on financial assets and reversal thereon
Share of profit and loss of associates and joint ventures using equity method of accounting
Gain or loss arising out of reclassification of financial assets out of amortised cost category to fair value category
Tax expense
Total of discontinued operations

The above disclosures remain practically academic since Schedule III provides for disclosures which are much more detailed.

The following are certain other broad principles governing the Statement of Profit and Loss (including Other Comprehensive Income) disclosures which are laid down under **Ind AS-1**:

- Additional line, sub-line items, headings and sub-headings which are relevant for an understanding of the users should be provided.
- ***No items should be classified as extraordinary items.***
- Expenses should be presented by nature of items as against IAS-1, which is the corresponding International Standard, which also permits functional classification.
- *There are specific disclosure requirements which are laid down in the individual and specific Ind-ASs for different line items which also need to be adhered to. The position thereof vis-à-vis Schedule III, when notified would need to be carefully evaluated.*

Ind AS-1 introduces a new concept of **Other Comprehensive Income** which is broadly similar to the concept of Profit and Loss Appropriation earlier or what is commonly referred to as ***below the line adjustments for unrealised gains and losses. This needs to be shown separately below the Statement of Profit and Loss account and is part of the same unlike in the case of IAS-1 which provides an option to show it as a separate statement.***

The other comprehensive income section shall present line items for amounts of other comprehensive income in the period, classified by nature (including share of the other comprehensive income of associates and joint ventures accounted for using the equity method) and grouped into those that, in accordance with other Ind ASs:

(a) will not be reclassified subsequently to profit or loss; and

(b) will be reclassified subsequently to profit or loss when specific conditions are met.

The main components of OCI are as under:

- Changes in revaluation surplus
- Remeasurement of defined benefit plans
- Gains and losses arising from translation of financial statements of foreign operations
- Gains and losses arising from ***investments in equity instruments*** designated as

fair value through other comprehensive income and from ***financial assets*** measured at ***fair value through other comprehensive income***

- Changes in the fair value attributable due to change in credit risk for liabilities designated at fair value through profit and loss.

Disclosures Related to Statement of Changes in Equity

Ind AS has introduced the concept of Statement of Changes in Equity which captures the movement against various components of equity and retained earnings (including OCI). As is the case with the Balance Sheet and Statement of Profit and Loss (including OCI), currently, there is no specific format for the Statement of Changes in Equity which is prescribed in Ind AS-1. However, Schedule III of the Companies Act, 2013, lays down the detailed format for the Statement of Changes in Equity, separately for NBFCs and other entities which needs to be followed to the extent it is not inconsistent with the requirements under any Ind AS. However, Ind AS-1 does provide for the following **minimum disclosure requirements:**

- Total comprehensive income for the period, showing separately the amounts attributable to the owners and to non-controlling interests.
- For each component of equity, the effects of retrospective application or retrospective restatement recognised as per Ind AS 8.
- For each component of equity (comprising of each class of contributed equity, accumulated balance of each class of other comprehensive income and retained earnings), a reconciliation of the carrying amount at the beginning and end of the period, separately disclosing the changes resulting from the following:
  a. Profit or loss;
  b. Other comprehensive income; and
  c. Transactions with owners in their capacity as owners in the form of contributions and distributions and changes in ownership interests that do not result in loss of control.

Disclosures related to Statement of Changes in Cash Flows

These are laid down under Ind AS-7 and are broadly similar to the requirements under the existing Indian GAAP requirements prescribed under AS-3. However, the following are certain specific and additional disclosures laid down under Ind AS-7 and certain other matters which merit attention:

- Bank overdrafts which are repayable on demand and are an integral part of the entity’s cash management activities should be included as a part of cash and cash equivalent by reducing the same therefrom.
- Classification of taxes on income arising from operating, financing and investing activities.
- Reconciliation of movements of financial liabilities / borrowings on the financing cash flows.
- The amount of any undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating separately any restrictions on the use of these facilities. ***(Recommended disclosures).***
- Cash flows increasing due to changes in operating capacity. ***(Recommended disclosures).***
- Cash flows arising from operating, financing and investing activities arising from each operating segment. ***(Recommended disclosures).***

- ***It may be noted that listed entities are required to present cash flows from operating activities under the Indirect Method only, as per the SEBI (LODR) Regulations, 2015.***

Other Disclosures

Apart from the above specific disclosures related to the financial statements and accounting matters, there are several other general disclosures which are required to be given in the financial statements as per Ind AS-1, which are summarised hereunder:

- The following information should be **prominently displayed and repeated as deemed necessary**, for a proper understanding of the users:
  - a) **Name** of the reporting entity and any **change** thereof from the preceding period.
  - b) Whether financial statements are **separate** or of the **group**.
- **Disclosure of presentation currency as per principles in Ind AS-21, if the same is different from the functional currency.**
- **The level of rounding off adopted. For this purpose the requirements under Schedule III should be adhered to.**
- An entity shall disclose its **capital management policies**, covering the following matters:
  - a. Qualitative information about the objective policies and processes for the entity's capital management and any changes thereon during the year.
  - b. Summary of quantitative data about the components of capital e.g., subordinated debt, debt equity / leverage ratio etc.
  - c. Compliance with externally imposed capital requirements like capital adequacy ratio, minimum capital / net worth requirements etc.
- An entity shall disclose the following, if not disclosed elsewhere in information published with the financial statements:
  - a) the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office);
  - b) a description of the nature of the entity's operations and its principal activities; and
  - c) the name of the parent and the ultimate parent of the group.

Topic Specific Disclosures

Apart from the general disclosures discussed above, there are certain disclosures pertaining to specific topics which are peculiar to and specific to Ind AS and which were not there under Indian GAAP, which merit special attention. These are broadly grouped under the following headings. *For the purpose of our discussion and considering the limitations of space and the focus area of this article, it is assumed that the readers are familiar with the broad requirements of the respective Ind ASs.*

Associates, Subsidiaries, Joint Ventures and Interests in Other Entities [Ind AS-110, 112, 28 & 27]

The disclosures in respect of the above class of entities which are also referred to as group entities need to be analysed in the context of the ***separate financial statements*** and in the ***consolidated financial statements***. Whilst the broad principles for identification of subsidiaries, joint ventures, joint operations

and associates and their consolidation are laid down in Ind AS-110, 111 and 28 respectively, the disclosures in the separate and consolidated financial statements are laid down in Ind AS-27 and 112 respectively.

The following are the **broad disclosure requirements** which are laid down in **Ind AS-112** in the **consolidated financial statements**:

- ***Significant judgments and assumptions in determining whether there is control, joint control or significant influence over an entity. This is because control, joint control and significant influence may not always be based on the shareholding alone but based on other factors laid down in the respective Ind AS.***
- ***Significant judgment and assumptions in determining an investment entity as defined under Ind AS-110 since such entities are generally excluded from consolidation.***
- Following disclosures need to be given in respect of **subsidiaries with material non-controlling interests:**
  - (i) Name and principal business
  - (ii) Interest of the parent
  - (iii) Share of profit in non-controlling interest during the period and in the accumulated balance
  - (iv) Summarised financial information
  - (v) Nature of risks including future commitments for funding that could result in losses
  - (vi) Significant restrictions in using assets or settlement of liabilities
  - (vii) Protective rights of non-controlling interest holders
  - (viii) Effect of change in controlling interest without loss of control
  - (ix) Accounting effect arising due to loss of control including gain / loss and the presentation thereof.
  - (x) Reasons for differences in reporting period
- Following disclosures need to be given in respect of **investment entities which are not consolidated**
  - (i) Name and principal business
  - (ii) Interest of the parent
  - (iii) Significant restrictions, if any
- Following disclosures need to be given in respect **of joint arrangements and material associates and jointly controlled entities**
  - (i) Name, nature of relationship and place of business
  - (ii) Proportion of ownership interest or participating shares
  - (iii) Method of accounting adopted
  - (iv) Financial summary
  - (v) Market value, if quoted
  - (vi) Nature and extent of significant restrictions, if any
  - (vii) Reasons for difference in accounting period
  - (viii) Unrecognised share of losses
  - (ix) Commitments, if any

The following are the **broad disclosure requirements** which are laid down in **Ind AS-27** in the **separate financial statements,** in respect of group entities:

- A list of **significant** investments in subsidiaries, joint ventures and associates, including the following:

(i) The names of the investees.

(ii) The principal place of business and country of incorporation, if different.

(iii) The proportion of ownership interest and voting interest, if different.

(iv) The method of accounting employed.

- The disclosures related to investment entities as discussed above which are laid down in Ind AS-112.

Business Combinations [Ind AS-103]

Business combinations are an important facet of corporate life and Ind AS-103 has brought about significant changes in the manner of accounting for business combinations. Before proceeding to the disclosure requirements, it would be worthwhile at this stage to broadly understand the **different modes of structuring of business combinations** as envisaged in Ind AS-103 as under:

a) one or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer;

b) one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners;

c) all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity (sometimes referred to as a roll-up or put-together transaction); or

d) a group of former owners of one of the combining entities obtains control of the combined entity.

The following are some of the main disclosure requirements for each business combination that occurs during the reporting period:

- The name and a description of the acquiree.
- The acquisition date.
- The percentage of voting equity interests acquired.
- The primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
- A qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors.
- The acquisition-date fair value of the total consideration transferred and the acquisition – date fair value of each major class of consideration, such as:

a. cash;

b. other tangible or intangible assets, including a business or subsidiary of the acquirer; liabilities incurred, for example, a liability for contingent consideration; and

c. equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of determining the fair value of those instruments or interests.

- For **contingent consideration arrangements** and **indemnification assets**:

a) the amount recognised as of the acquisition date;

b) a description of the arrangement and the basis for determining the amount of the payment; and

c) an estimate of the range of outcomes (undiscounted) or,

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if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.

- For **acquired receivables**:
  - a) the fair value of the receivables;
  - b) the gross contractual amounts receivable; and
  - c) the best estimate at the acquisition date of the contractual cash flows not expected to be collected. The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables.
- The amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed.
- For each contingent liability recognised, the information required in terms of Ind AS-37.
- The total amount of **goodwill** that is expected to be **deductible for tax purposes.**
- In a **bargain purchase:**
  - a) the amount of any gain recognised in other comprehensive income;
  - b) the amount of any gain directly recognised in equity ;and
  - c) a description of the reasons why the transaction resulted in a gain in case of (i) above.
- For each business combination in which the **acquirer holds less than 100 per cent** of the equity interests in the acquiree at the acquisition date:
  - a) the amount of the non-controlling interest in the acquiree recognised at the acquisition date and the measurement basis for that amount; and
  - b) for each non-controlling interest in an acquiree measured at fair value, the valuation techniques and key model inputs used for determining that value.
- The following additional information:
  - a) The amounts of revenue and profit or loss of the acquiree since the acquisition date included in the consolidated statement of profit and loss for the reporting period; and
  - b) The revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period.

  If disclosure of any of the information required by this subparagraph is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable.

Non-Current Assets held for Sale and Discontinued Operations [Ind AS-105]

This is another Ind AS which was partly covered under the earlier AS-24 which dealt with discontinued operations. However, its scope is much wider and apart from covering discontinued operations it also covers non-current assets and disposal groups which meet the *held for sale criteria* as prescribed in the Standard.

The following are the **main disclosures** in respect of **discontinued operations**:

- a single amount in the statement of profit and loss comprising the total of:
  a. the post-tax profit or loss of discontinued operations and
  b. the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.
- an analysis of the single amount indicated above, either in the Statement of Profit and Loss or in the notes, into:
  a. the revenue, expenses and pre-tax profit or loss of discontinued operations;
  b. the related income tax expense related thereto; and
  c. the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.
  d. the related income tax expense in respect of the aforesaid gain.
- the net cash flows attributable to the operating, investing and financing activities of discontinued operations which may be presented either in the notes or in the financial statements. These disclosures are not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition
- the amount of income from continuing operations and from discontinued operations attributable to owners of the parent which may be presented either in the notes or in the Statement of Profit and Loss.

The following are the **main disclosures** in respect of **non-current assets and disposal groups classified as held for sale**:

- An entity shall present a non-current asset classified as held for sale and the assets of a disposal group classified as held for sale separately from other assets in the balance sheet. Further, the liabilities of a disposal group classified as held for sale shall be presented separately from other liabilities in the balance sheet. *These assets and liabilities shall not be offset and presented as a single amount.*
- The following additional information shall also be disclosed in the notes in the period in which the non-current asset or disposal group has either been classified as held for sale or sold:
  a) a description of the non-current asset (or disposal group);
  b) a description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal;
  c) the gain or loss recognised, and, if not separately presented in the statement of profit and loss, the caption in the statement of profit and loss that includes that gain or loss;
  d) if applicable, the reportable segment in which the non-current asset (or disposal group) is presented in accordance with Ind AS 108.

Operating Segments [Ind AS-108]

The concept of operating segments represents a departure from the current concept of business and geographical segments laid down under AS-17 and moves from a risk and rewards approach to an approach used by the ***Chief***

Operating Decision Maker (CODM) to review allocation of resources between different businesses. Whilst the broad financial reporting disclosures are similar to the existing AS-17, there are certain specific and peculiar disclosures which are laid down, *including for entities which do not disclose any operating segments*.

The main disclosures are summarised hereunder:

The following **general information** needs to be disclosed by all entities:

- Factors used to identify the reportable segments including the basis of organisation. (e.g., products / services, geographical, customers, regulatory environment etc).
- Judgments made by the management in applying the aggregation criteria.
- Types of products and services.

The following information needs to be disclosed about the **reported segment profit or loss:**

- Measure of profit or loss for each reportable segment.
- Measure of total assets and liabilities for each reportable segment, if regularly reviewed by the CODM.
- The following information about each reportable segment if *the specific amounts are included in measuring the segment profit or loss reviewed by the CODM or are otherwise regularly provided to him, even if not included in the measurement of segment profit or loss:*
  - a) Revenues from external customers;
  - b) Revenues from transactions with other operating segments;
  - c) Interest revenue and expenses;
  - d) Depreciation and amortisation;
  - e) Material items of income and expense disclosed in accordance with Ind AS-1;
  - f) Entity's interest in the profit or loss of associates and joint ventures accounted under the equity method;
  - g) Income tax expense or income; and
  - h) Material non-cash items, other than depreciation and amortisation.

The following **reconciliations** are required to be disclosed:

- The total of reportable segment revenue to the total revenue.
- Reportable segments measure of profit or loss to the entity's profit or loss before tax and discontinued operations. *If income tax is allocated the reconciliation should be with the total profit.*
- The total reportable segments assets and liabilities to the total assets and liabilities, respectively.

The following are certain **entity wide disclosures** which need to be *given even if there are no reportable segments:*

- Information about products and services which is based on disclosures made in the financial statements, unless it is impractical to develop this information.
- Revenues from external customers based on geography including from customers in an individual foreign country which are material.
- Similar information, as above, for non-current assets other than financial instruments, deferred tax assets, post-employment benefit assets and rights under insurance contracts.
- If the revenue from transactions with a single customer are more than 10% of the

revenue and the reportable segment to which it pertains.

Financial Instruments [Ind AS-107]

This represents an entirely new set of disclosures since there was no Accounting Standard under Indian GAAP which covered financial instruments. The only remote connection with these new set of disclosures is seen in the case of Banks and recently in case of NBFCs (including Housing Finance companies) whereby the RBI and the NHB (for housing finance companies) has prescribed similar types of disclosures to a limited extent.

Further, another unique feature in respect of Financial Instruments is that though the classification, recognition and measurement principles are dealt with in Ind AS-109 and Ind AS-32, the entire gamut of only the disclosures in respect of Financial Instruments are dealt with specifically in Ind AS-107. Whilst a detailed discussion thereof would merit a separate article or even a book, an attempt is made hereunder to only provide the broad disclosure requirements.

Balance Sheet Disclosures

These can be further categorised as under:

- **Categories of Financial Assets and Liabilities**
- **Financial Assets or Liabilities at FVTPL**
- **Equity Investments designated at FVTOCI**
- **Reclassification of Financial Assets**
- **Off-setting of Financial Assets and Liabilities**
- **Collateral**
- **Allowance for Credit Losses**
- **Compound Financial Instruments with Multiple Embedded Derivatives**
- **Defaults and Breaches**

The main disclosures under each of the above categories are highlighted hereunder:

Categories of Financial Assets and Liabilities

- **Financial assets measured at fair value through profit or loss,** showing separately: (i) those designated as such upon initial recognition or subsequently in accordance with Ind AS-109 and (ii) those mandatorily measured at fair value through profit or loss in accordance with Ind AS-109.
- **Financial liabilities at fair value through profit or loss, showing separately:** (i) those designated as such upon initial recognition or subsequently in accordance with Ind AS-109 and (ii) those that meet the definition of held for trading in Ind AS-109.
- **Financial Assets and Liabilities at amortised cost.**
- **Financial assets measured at fair value through OCI, showing separately** (i) financial assets that are so measured in accordance with Ind AS-109; and (ii) investments in equity instruments designated as such upon initial recognition in accordance with Ind AS-109.

Financial Assets or Liabilities at FVTPL

In respect of **Financial Assets or groups thereon not mandatorily required to be classified at FVTPL,** the following specific disclosures are required to be given:

- the maximum exposure to credit risk at the end of the reporting period.
- the amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk
- the amount of change, during the period and cumulatively, in the fair value of the

financial asset (or group thereon) that is attributable to changes in the credit risk of the financial asset determined either:

a) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk; or

b) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset.

- Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate or index of prices or rates.
- the amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the financial asset was designated.

In respect of **Financial Liabilities at FVTPL,** the following specific disclosures are required to be given:

- the amount of change, cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability.
- the difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.
- any transfers of the cumulative gain or loss within equity during the period including the reason for such transfers.
- if a liability is derecognised during the period, the amount (if any) presented in OCI.

Equity Investments designated at FVTOCI

- The specific investments in equity instruments have been designated to be measured at FVTOCI and the reasons for using this presentation alternative.
- The fair value of each such investment at the end of the reporting period.
- Dividends recognised during the period, showing separately those related to investments derecognised during the reporting period and those related to investments held at the end of the reporting period.
- Any transfers of the cumulative gain or loss within equity during the period including the reason for such transfers
- In case of derecognition / disposal:

  a) Reasons for disposal

  b) Fair value on date of disposal

  c) Cumulative gain or loss on disposal

  d) Reclassification of Financial Assets

Reclassification of Financial Assets and Liabilities:

- the date of reclassification.
- a detailed explanation of the change in business model and a qualitative description of its effect on the entity's financial statements.
- the amount reclassified into and out of each category.
- For **each reporting period** following reclassification **until derecognition**, an entity shall disclose for assets **reclassified out of the FVTPL so that they are measured at amortised cost or FVTOCI**

  a) The effective interest rate determined on the date of reclassification; and

  b) The interest revenue recognised.

- If, **since its last annual reporting date,** an entity has reclassified financial assets **out of FVTOCI so that they are measured at amortised cost or out of FVTPL**, it shall disclose
  - a) the fair value of the financial assets at the end of the reporting period; and
  - b) the **fair value gain or loss** that would have been recognised in profit or loss or other comprehensive income during the reporting period if the financial assets **had not been reclassified.**

Off Setting of Financial Assets and Liabilities
An entity shall disclose, at the end of the reporting period, the following quantitative information separately for recognised financial assets and recognised financial liabilities which are subject to off setting:

a) the gross amounts of those recognised financial assets and recognised financial liabilities;

b) the amounts that are set-off in accordance with the criteria in Ind AS 32 when determining the net amounts presented in the statement of financial position;

c) the net amounts presented in the balance sheet;

d) the amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph (b) above, including: (i) amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in Ind AS 32; and (ii) amounts related to financial collateral (including cash collateral); and

e) the net amount after deducting the amounts in (d) from the amounts in (c) above.

Collateral

- the carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified; and
- the terms and conditions relating to its pledge.
- When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose:
  - a) the fair value of the collateral held;
  - b) the fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and
  - c) the terms and conditions associated with its use of the collateral.

Allowance for Credit Losses

- The carrying amount of financial assets measured at FVTOCI is not reduced by a loss allowance and an entity shall not present the loss allowance separately in the balance sheet as a reduction of the carrying amount of the financial asset.
- However, an entity shall disclose the loss allowance in the notes to the financial statements

Compound Financial Instruments with Multiple Embedded Derivatives
If an entity has issued an instrument that contains both a liability and an equity component and has multiple embedded derivatives whose values are interdependent (such as a callable convertible debt instrument), it shall disclose the existence of those features.

Defaults and Breaches

- For loans payable recognised at the end of the reporting period, an entity shall disclose:

a) details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;

b) the carrying amount of the loans payable in default at the end of the reporting period; and

c) whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were approved for issue.

- If, during the period, there were breaches of loan agreement terms other than those described above (i.e. various covenants), an entity shall disclose the same information as required above, if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the end of the reporting period).

Profit and Loss Statement Disclosures

- Net gains or losses on financial assets or financial liabilities measured at FVTPL showing separately those on financial assets or financial liabilities designated as such upon initial recognition or subsequently, and those on financial assets or financial liabilities that are mandatorily measured at FVTPL
- For financial liabilities designated as at fair value through profit or loss, an entity shall show separately the amount of gain or loss recognised in other comprehensive income and the amount recognised in profit or loss.
- Net gains or losses on financial liabilities and financial assets measured at amortised cost.
- Net gains or losses on investments in equity instruments designated at FVTOCI.
- Net gains or losses on financial assets measured at FVTOCI showing separately the amount of gain or loss recognised in OCI during the period and the amount reclassified upon derecognition from accumulated OCI to profit or loss for the period.
- Total interest revenue and total interest expense (calculated using the effective interest method) for financial assets that are measured at amortised cost or that are measured at FVTOCI (showing these amounts separately); or financial liabilities that are not measured at fair value through profit or loss.
- Fee income and expense (other than amounts included in determining the effective interest rate) arising from:

  a) financial assets and financial liabilities that are not FVTPL; and

  b) trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions.

Other Disclosures

These can be further categorised as under:

- **Hedge Accounting**
- **Fair Value Disclosures (in addition to those covered in Ind AS-113)**
- **Risk Disclosures**
- **Transfers of Financial Assets**

The main disclosures under each of the above categories are highlighted hereunder:

Hedge Accounting

These disclosures can broadly be categorised as under:

- The entity's **risk management strategy** and how it is applied to manage the risk for each category of risk exposure together

with the **hedging instruments that are used**, including the manner of use thereof, the **economic relationship between the hedged item and the hedging instrument** for assessing **hedge effectiveness** and the manner of establishment of the **hedge ratio** and the sources of hedge ineffectiveness.

- An entity shall disclose **by risk category quantitative information** to allow users of its financial statements to evaluate the **terms and conditions of hedging instruments** and how they **affect the amount, timing and uncertainty of future cash flows** of the entity. For this purpose, the entity shall provide a breakdown that discloses:
  - a) a profile of the timing of the nominal amount of the hedging instrument; and
  - b) if applicable, the average price or rate (for example strike or forward prices etc.) of the hedging instrument.
- An entity shall disclose, in a **tabular format**, the following amounts related to **items designated as hedging instruments separately by risk category for each type of hedge** (fair value hedge, cash flow hedge or hedge of a net investment in a foreign operation):
  - a) the **carrying amount of the hedging instruments** (financial assets separately from financial liabilities);
  - b) the **line item in the balance sheet** that includes the hedging instrument;
  - c) the **change in fair value of the hedging instrument** used as the basis for recognising hedge ineffectiveness for the period; and
  - d) the **nominal amounts** (including quantities such as tonnes or cubic metres) of the hedging instruments.
- An entity shall disclose, in a **tabular format,** the following amounts related to **hedged items separately by risk category for the types of hedges** as follows:
  - a) for **fair value hedges:** (i) the **carrying amount of the hedged item** recognised in the balance sheet (presenting assets separately from liabilities); (ii) the accumulated amount of **fair value hedge adjustments** on the hedged item included in the carrying amount of the hedged item recognised in the balance sheet (presenting assets separately from liabilities); (iii) the line item in the balance sheet that includes the hedged item; (iv) the change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period; and (v) the accumulated amount of fair value hedge adjustments remaining in the balance sheet for any hedged items that have ceased to be adjusted for hedging gains and losses .
  - b) for **cash flow hedges and hedges of a net investment in a foreign operation: (i) the change in value of the hedged item used as the basis for recognising hedge ineffectiveness** for the period (i.e. for cash flow hedges the change in value used to determine the recognised hedge ineffectiveness; (ii) the balances in the **cash flow hedge reserve and the foreign currency translation reserve** for continuing hedges; and (iii) the balances remaining in the cash flow hedge reserve and the foreign currency translation reserve from any hedging relationships for which hedge accounting is no longer applied.

- An entity shall disclose, in a **tabular format,** the following amounts **separately by risk category for the types of hedges** as follows:
  a) for **fair value hedges**: (i) **hedge ineffectiveness** — i.e., the difference between the hedging gains or losses of the hedging instrument and the hedged item — recognised in profit or loss (or other comprehensive income for hedges of an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income; and (ii) the line item in the statement of profit and loss that includes the recognised hedge ineffectiveness.
  b) **for cash flow hedges and hedges of a net investment in a foreign operation:** (i) **hedging gains or losses** of the reporting period that were **recognised in other comprehensive income;** (ii) **hedge ineffectiveness recognised in profit or loss;** (iii) the line item in the statement of profit and loss that includes the recognised hedge ineffectiveness; (iv) the amount **reclassified from the cash flow hedge reserve or the foreign currency translation reserve into profit or loss** as a reclassification adjustment; (v) the line item in the statement of profit and loss that includes the reclassification adjustment ; and (vi) for **hedges of net positions,** the **hedging gains or losses recognised** in a separate line item in the statement of profit and loss

Fair Value Disclosures (in addition to those covered in Ind AS-113 discussed later)

These disclosures can broadly be categorised as under:

- For each class of financial assets and financial liabilities an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount.
- In disclosing fair values, an entity shall group financial assets and financial liabilities into classes, but shall offset them only to the extent that their carrying amounts are offset in the balance sheet.
- Description of how the fair value was determined.
- Details / reasons if the fair value cannot be determined.

Risk Disclosures

The risk disclosures are an important constituent of the entire gamut of financial statement disclosures which represent a sea change in the overall financial statement disclosures. Ind AS-107 provides that these disclosures, if given in any other part of the Annual Report (e.g., MD&A) need not be repeated but only cross referenced thereof. The disclosures in respect thereof can be broadly categorised as under:

Qualitative Disclosures (for each type of risk)

- the exposures to risk and how they arise;
- objectives, policies and processes for managing the risk and the methods used to measure the risk; and
- any changes in the above from the previous period.

Common Quantitative Disclosures (for each type of risk)

- Summary quantitative data about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to key management personnel of the entity (as defined in Ind AS-24, Related Party Disclosures).
- The disclosures on **Credit Risk, Liquidity Risk and Market Risk (discussed later).**

- Concentrations of risk if not apparent from the disclosures made above.

Credit Risk

- Maximum amount of exposure before deducting value of collateral.
- Description of the collateral.
- Information about the credit quality of financial assets that are neither past due or impaired.
- Information about the credit quality of financial assets whose terms have been renegotiated.
- Analytical disclosures about financial assets which are past due or impaired.

Liquidity Risk

- Maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.
- Maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows.
- Description of how the entity manages the liquidity risk as determined above.

Market Risk

- Unless an entity has information as discussed below, it shall disclose:
  - a) A sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;
  - b) The methods and assumptions used in preparing the sensitivity analysis; and
  - c) Changes from the previous period in the methods and assumptions used, and the reasons for such changes.
- If an entity prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (e.g., interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis in place of the analysis discussed above.
- In such cases, the entity shall also disclose:
  - a) an explanation of the method used in preparing such a sensitivity analysis, and of the main parameters and assumptions underlying the data provided; and
  - b) an explanation of the objective of the method used and of limitations that may result in the information not fully reflecting the fair value of the assets and liabilities involved.

Transfers of Financial Assets

The disclosures which need to be given depend upon whether the assets are derecognised or not in entirety.

In case of assets which are **not derecognised in entirety,** the following disclosures are required to be given:

- Nature of the transferred assets.
- Nature of the risks and rewards of ownership to which the entity is exposed.
- Description of the nature of the relationship between the transferred assets and the associated liabilities, including restrictions arising from the transfer on the reporting entity's use of the transferred assets.
- When the counterparty (counterparties) to the associated liabilities has (have) recourse only to the transferred assets,

a schedule that sets out the fair value of the transferred assets, the fair value of the associated liabilities and the net position (the difference between the fair value of the transferred assets and the associated liabilities).

- When the entity continues to recognise all of the transferred assets, the carrying amounts of the transferred assets and the associated liabilities.
- When the entity continues to recognise the assets to the extent of its continuing involvement, the total carrying amount of the original assets before the transfer, the carrying amount of the assets that the entity continues to recognise, and the carrying amount of the associated liabilities.

In case of assets which **are derecognised in entirety,** the following disclosures are required to be given:

- Carrying amount of the assets and liabilities that are recognised in the entity's balance sheet and represent the entity's continuing involvement in the derecognised financial assets, and the line items in which the carrying amount of those assets and liabilities are recognised.
- Fair value of the assets and liabilities that represent the entity's continuing involvement in the derecognised financial assets.
- Amount that best represents the entity's maximum exposure to loss from its continuing involvement in the derecognised financial assets, and information showing how the maximum exposure to loss is determined.
- Undiscounted cash outflows that would or may be required to repurchase derecognised financial assets or other amounts payable to the transferee in respect of the transferred assets. If the cash outflow is variable then the amount disclosed should be based on the conditions that exist at each reporting date.
- Maturity analysis of the undiscounted cash outflows that would or may be required to repurchase the derecognised financial assets or other amounts payable to the transferee in respect of the transferred assets, showing the remaining contractual maturities of the entity's continuing involvement.
- Qualitative information that explains and supports the above quantitative disclosures.
- Gain or loss recognised at the date of transfer of the assets.
- Income and Expenses recognised, both in the reporting period and cumulatively, from the entity's continuing involvement in the derecognised financial assets (e.g., fair value changes in derivative instruments).

Fair Value Measurements [Ind AS-113]

The concept of fair value measurements is one of the important ingredients of Ind AS accounting and consequently all entities are required to give certain disclosures when assets and liabilities, especially financial instruments are recognised, even if they are not measured at fair value for the purposes of financial statements. Further, the disclosures are mainly aimed at measurements which use level 3 unobservable inputs which are subjective and judgemental. Accordingly, the disclosures can be broadly categorised as under:

- The extent of usage of fair value in the valuation of assets and liabilities.
- The valuation techniques, inputs and assumptions used in measuring fair value.
- The impact of level 3 fair value measurements on the profit and loss account or other comprehensive income.
- Reasons for non-recurring fair value measurements.

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- The fair value hierarchy adopted.
- The reasons for transfer between the hierarchical levels for recurring fair value measurements.
- The valuation techniques adopted, including any changes therein, for both recurring and non-recurring fair value measurements.
- Quantitative information about significant unobservable inputs for recurring level 3 fair value measurements.
- The amount of total gains and losses recognised in profit and loss and OCI, together with line items in which these are recognised, for recurring fair value measurements categorised within level 3 of the fair value hierarchy.
- Sensitivity analysis, both narrative and with quantitative disclosures about the significant unobservable inputs.

Investment Property [Ind AS-40]

Though the concept of Investment Property was also used and recognised under Indian GAAP, there was no separate Standard dealing with the same. Whilst some of the disclosures regarding the depreciation and the reconciliation of the carrying value are similar to the current disclosures in respect of fixed and intangible assets, there are certain specific disclosures as under which need attention.

- The extent to which the fair value of investment property (which is only required to be disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued. If there has been no such valuation, that fact shall be disclosed.
- The amounts recognised in profit or loss for: (i) rental income from investment property; (ii) direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income during the period; and (iii) direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income during the period.
- The existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal.
- Contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.

Revenue from Contracts with Customers (Ind AS-115)

This is a new Standard which replaces the existing Ind ASs dealing with Revenue Recognition and Revenue arising from Construction Contracts with effect from the financial year 2018-19. It lays down a five step model for ascertaining revenue and consequently provides for enhanced disclosures vis-a-vis the existing Ind ASs. The disclosures provide for both qualitative and quantitative information about the following matters:

- An entity's contracts with its customers.
- The significant judgments and any changes thereon made in applying the Ind AS to contracts with customers.
- Any assets recognised from the costs to obtain or fulfil a contract with a customer.

The salient features of the disclosures under each of the above are highlighted hereunder.

Contracts with Customers

- Revenue recognised from contracts with customers, separately from its other sources of revenue.
- Any impairment losses recognised (in accordance with Ind AS 109) on any

receivables or contract assets arising from an entity's contracts with customers, separately from impairment losses from other contracts.

- **Disaggregation of revenue** recognised from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors and its relationship with the disclosures under Ind AS-108.
- An entity shall disclose the following in respect of its **contract balances**:
  - a) the opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed;
  - b) revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period; and
  - c) revenue recognised in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods (for example, changes in transaction price).
- An entity shall disclose information about its **performance obligations** in contracts with customers, including a description of all of the following:
  - a) when the entity typically satisfies its performance obligations (for example, upon shipment, upon delivery, as services are rendered or upon completion of service), including when performance obligations are satisfied in a bill-and-hold arrangement;
  - b) the significant payment terms (for example, when payment is typically due, whether the contract has a significant financing component, whether the consideration amount is variable and whether the estimate of variable consideration is typically constrained);
  - c) the nature of the goods or services that the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (i.e. if the entity is acting as an agent);
  - d) obligations for returns, refunds and other similar obligations; and
  - e) types of warranties and related obligations.
- An entity shall disclose the following information about its **remaining performance obligations**

a) the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period; and

b) an explanation of when the entity expects to recognise as revenue the amount disclosed above in either of the following ways: (i) on a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations; or (ii) by using qualitative information.

Significant Judgments and changes thereon

- An entity shall explain the judgments, and changes in the judgements, used in determining both of the following:
  - **a) the timing of satisfaction of performance obligations; and**
  - **b) the transaction price and the amounts allocated to performance obligations.**
- For **performance obligations that an entity satisfies over time,** an entity shall disclose both of the following:

a) the methods used to recognise revenue (for example, a description of the output methods or input methods used and how those methods are applied); and

b) an explanation of why the methods used provide a faithful depiction of the transfer of goods or services.

- For **performance obligations satisfied at a point in time,** an entity shall disclose the significant judgments made in evaluating when a customer obtains control of promised goods or services.
- An entity shall disclose information about **the methods, inputs and assumptions used for all of the following:**

  a) determining the transaction price, which includes, but is not limited to, estimating variable consideration, adjusting the consideration for the effects of the time value of money and measuring non-cash consideration;

  b) assessing whether an estimate of variable consideration is constrained;

  c) allocating the transaction price, including estimating stand-alone selling prices of promised goods or services and allocating discounts and variable consideration to a specific part of the contract (if applicable); and

  d) measuring obligations for returns, refunds and other similar obligations.

- An entity shall disclose a reconciliation of the amount of revenue recognised in the statement of profit and loss with the contracted price showing separately each of the adjustments made to the contract price, for example, on account of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, etc., specifying the nature and amount of each such adjustment separately.

Assets Recognised from the Costs to obtain or fulfil a contract with customers

- The judgments made in determining the amount of the costs incurred to obtain or fulfil a contract with a customer.
- The method used to determine the amortisation for each reporting period.
- The closing balances of assets recognised from the costs incurred to obtain or fulfil a contract with a customer, by main category of asset (for example, costs to obtain contracts with customers, pre contract costs and setup costs); and
- the amount of amortisation and any impairment losses recognised in the reporting period.

Additional disclosures under certain Ind ASs

Apart from the above topics which represent a significant departure from the existing GAAP, there are ***several other additional and specific disclosures under other Ind ASs***, which are in addition to the existing disclosures which were already there under Indian GAAP, the important ones of which are indicated hereunder:

Inventories [Ind AS-2]:

- Carrying amount of inventories at fair value less costs to sell.
- Amount of write down or reversal of write down and circumstances leading to reversal of write down.
- Carrying amount of inventories pledged as security for liabilities.

Events After the Reporting Period [Ind AS-10]

- Disclosure that the *entity's owners or others have the power to amend the financial statements.* A suggested disclosure could be that the financial statements

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are authorised for issue by the Board of Directors on a specific date (which needs to be indicated) and *are subject to the approval of the shareholders at the AGM.*

Income Taxes [Ind AS-12]

- The amount and expiry date, if any, of any deductible temporary differences, unused tax credits and unused tax losses for which no DTA is recognised.
- The aggregate amount of temporary differences associated with investments in subsidiaries, associates and joint ventures, branches etc. for which DTL has not been recognised.
- The amount of income tax consequences of dividends to shareholders of the entity that were proposed or declared before the financial statements were approved for issue but which are not recognised as a liability.

Property, Plant and Equipment [Ind AS-16]

- The amounts of PPE pledged as security for liabilities.
- When cost model is used, the fair value of PPE if materially different from the carrying amount. **(Recommended disclosure).**

Employee Benefits [Ind AS-19]

- Contributions to defined contribution plans by KMPs.
- Information about the nature, characteristics and risks associated with defined benefit plans.
- Information about funding arrangements and funding policy which affect future contributions.
- Information about maturity profile and weighted average duration about defined benefit obligations.
- Post-employment benefits to KMPs.

Borrowing Costs [Ind AS-23]

- The capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

Related Parties [Ind AS-24]

- Disclosure about whether the RPTs are on an arm's length basis.
- Compensation to KMPs for each of the following categories, in addition to the total amount:
  a) Short term employee benefits
  b) Post-employment benefits
  c) Other long term benefits
  d) Termination benefits
  e) Share based payments

Intangible Assets [Ind AS-38]

- A description of the carrying amount and ***remaining amortisation*** period of any individual intangible asset that is material the financial statements.
- The amounts of intangible assets pledged as security for liabilities.
- Amount of contractual commitments for acquisition of intangible asset

Conclusion

The above discussion is just the tip of the iceberg of an area which would involve a sea change not only in the nature, depth and volume of financial and non-financial information that would have to be disclosed but also require entities to change and gear up their existing systems and procedures to capture the requisite information. Further, a lot of reliance would have to be placed on external sources and specialists to compile the data as well as on management judgments which could result in possible bias. Finally, the auditor's life which in the recent past is under a lot of strain is not likely to get easier with these disclosures!

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Kishor Vanjara, *Tax Consultant*

Tax Articles for Your Reference

Articles published in The Bombay Chartered Accountant Journal (BCAJ), The Chamber's Journal (CJ), The Chartered Accountant Journal (CAJ), All India Federation of Tax Practitioners Journal (AIFTPJ), Sales Tax Review (STR), Income Tax Report (ITR), Times of India and Economic Times for the period Dec., 2018, Jan., Feb. and March 2019 has been arranged and indexed topic-wise.

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'A'				
Accountancy and Audit				
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In Focus – Accounting and Auditing SA 230:Audit Documentation: If it is not documented, it is not done	Milan Mody & Ramesh Ramakrishnan	C J	Vol.VII/No.5	157
In Focus – Accounting and Auditing RBI Reserves – Can RBI pay ₹ 3.6 lakh crore to Government?	Rashmin Sanghvi	C J	Vol.VII/No.6	119
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Start-ups caught in Angel Tax imbroglio can breathe easy	Deepshikha Sikarwar	Economic Times	08/03/2019	8
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Whether Adjustment Required for Share of Loss from Partnership Firm?	Pradip Kapasi, Gautam Nayak & Bhadresh Doshi	BCAJ	50-B/Part 4	65
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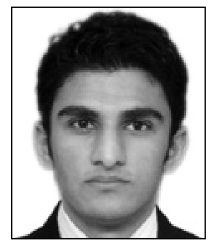

Rahul Sarda, *Advocate*

Best of the Rest

Commercial Suits – Whether Written Statement can be taken on record after expiry of 120 days?

The Special Leave Petition was filed challenging the orders passed by the High Court *inter alia* allowing the Respondent to file its Written Statement post the period of 120 days from the date of serving the summons upon payment of additional costs and taking on record the Written Statement in a Commercial Suit.

Relying on the letter and spirit of the provisions laid down in CPC pursuant to filing of written statement within 120 days and various judgments of the Delhi High Court, where the said Court has not extended the time to file Written Statement to the parties, the Apex Court held that the time cannot be so extended. The requirement to file the Written Statement within the stipulated time is mandatory in nature and therefore extension could not be granted.

M/s. SCG Contracts India Pvt. Ltd. v. K.S. Chamankar Infrastructure Pvt. Ltd. & Ors., Civil Appeal No.1638 of 2019 dated 12/02/2019 – Supreme Court

Application under Section 9 is not maintainable against one partner of partnership firm by treating him as a corporate debtor

The appeal was filed by the Appellant challenging the order of the NCLT dismissing the application under Section 9 of the Insolvency and Bankruptcy Code, 2016 ("IBC") filed against a company, in capacity of partner of a partnership firm.

The Appellant had entered into an agreement with two other group entities and formed a partnership firm for completing construction work of seven residential buildings. In terms of partnership agreement, the Appellant gave certain advance to one partner of the firm to carry out construction work. Since one partner (being the Respondent in the appeal) of the firm failed to complete construction as per agreed terms, the Appellant issued a demand notice for recovery of amount paid as advance and filed a winding up petition before the High Court, which was transferred to the NCLT after promulgation of IBC. The NCLT held that the Respondent was a partner of the partnership firm by associated companies of the Appellant. Therefore, it was held that the application under section 9 against the respondent, one of the partners of the partnership firm was not maintainable.

Held on appeal that even if one of the partners or more than one partner is the 'Corporate Debtor' as the amount is due from the partnership firm, the application under Section 9 of the I&B Code against one of the partners of such partnership firm will not be maintainable.

Gammon India Ltd., vs. Neelkanth Mansions & Infrastructure (P.) Ltd., Company Appeal (AT) (Insolvency) No. 698 of 2018, dated 19-12-2018 – NCLAT, Delhi.

Insolvency and Bankruptcy Code & Prevention of Money Laundering Act – Overriding effect

Corporate Insolvency Resolution Process was initiated against the Appellant under section 7 of IBC. A moratorium was declared by the NCLT prohibiting institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgments decree or order in any court of law, tribunal, arbitration panel or authority amongst others. It was also mentioned in order of the NCLT that moratorium declared by it was not applicable to criminal proceedings, if any, initiated under provisions of PMLA by Enforcement Directorate and CBI.

The Enforcement Directorate had passed an order provisionally attaching properties of the Appellant under Section 5 of PMLA which was confirmed by the Adjudicating Authority under PMLA. On appeal by the Appellant before the PMLA Appellate Tribunal, it was held that proceedings under section 8 of PMLA before Adjudicating Authority were civil proceedings since PMLA did not empower the Adjudicating Authority to levy any penalty or impose punishment to any persons involve in the proceedings and it does not adjudicate on the criminality of the offence. It was also held that the Adjudicating Authority ought to have stayed proceedings on passing of moratorium order by NCLT. Further held that continuation of proceedings from date of commencement of moratorium order is contrary to the intention of the Legislature. Hence, consequential orders of confirmation of provisional attachment order being contrary to law were set aside. The stand of the Enforcement Directorate that the PMLA had an overriding effect over the IBC was negated.

Siddhi Vinayak Logistic Ltd. v. Deputy Director, Enforcement [2019] 101 taxmann.com 491 (PMLA-AT, New Delhi)

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CA Anish Thacker & CA Parag Ved, *Hon. Jt. Secretaries*

The Chamber News

Important events and happenings that took place between 7th March, 2019 and 7th April, 2019 are being reported as under:

I. Admission of New Members

1) The following new members were admitted in the Managing Council Meeting held on 22nd March, 2019.

Type of Membership	No. of Members
Life Membership	18
Ordinary Membership	24
Student Membership	97

II. WRIT Petition Challenging CBDT's Action Plan

The Chamber has filed a word petition before the Bombay High Court challenging Chapter 3 of the Central Action Plan formulated by the Central Board of Direct Taxes ('CBDT') where Commissioners of Income-tax (Appeals) ['CIT(A)'] are to incentivised based on passing of 'quality' orders. The Bombay High Court, in its interim order dated 22nd March, 2019 has directed the CBDT to reconsider the norms and to apprise it of the utility of the norms that the Commissioners would need to achieve. The matter has been fixed for the next hearing on 11th April, 2019.

III. PAST PROGRAMMES

1. CORPORATE CONNECT COMMITTEE

- A Lecture Meeting on "Current Economic Scenario and Ease of Doing Business in India" jointly with ECC of Indo Japanese Association was held on 12th March, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churchgate. The meeting was addressed by Mr. H. P. Ranina, Senior Advocate & noted Economist and Mr. Rishabh Shroff, Advocate.

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- A Lecture Meeting on "Banning of Unregulated Deposit Scheme Ordinance" was held on 15th March, 2019 at Jai Hind College, AV Room, 4th Floor, Churchgate. The meeting was addressed by Mr. Sharad Abhyankar, Advocate.

2. INDIRECT TAXES COMMITTEE

A Workshop on GST Law jointly with AIFTP (WZ), BCAS, GSTPAM, MCTC & WIRC OF ICAI was held on 12th & 14th March, 2019 at GSTPAM, Mazgaon Library, 1st floor, Vikrikar Bhavan, Mazgaon. The workshop was addressed by Mr. C. B. Thakar and Ms. Nikita Badheka, Advocates. The Workshop was moderated by CA Deepak Thakkar. Brains' Trustees for the workshop were CA S. S. Gupta, CA Naresh Sheth, CA Sujata Rangnekar and CA Vikram Mehta.

3. INTERNATIONAL TAXATION COMMITTEE AND PUNE STUDY GROUP

A Full Day Seminar on Contemporary issues in International Taxation was held on 16th March, 2019 at ELTIS, Plot No. 419, Pune (jointly with Pune Study Group). The seminar was addressed by CA Kishor Phadke, CA Maulik Doshi, CA Naresh Ajwani and CA Rajesh P. Shah. The seminar included a panel discussion on Transfer Pricing which was moderated by CA Ameya Kunte and for which Mr. M. V. Kini, CA Darpan Mehta & Mr. Anis Chakraborty were the panellists.

4. IT CONNECT COMMITTEE

A Seminar on Business Intelligence (BI) and Microsoft Power was held on 5th April, 2019 at IMC, Churchgate. The seminar was addressed by Mr. Ramaswamy Krishnan.

5. MEMBERSHIP & PR COMMITTEE

A Lecture Meeting on "Dynamic Memory" was held on 11th March, 2019 at CTC Conference Room, 3, Rewa Chambers, 31, New Marine Lines, Churchgate. The meeting was addressed by Mr. Shriniwas Vakati.

6. STUDENT COMMITTEE

- A Student Orientation Course was held on 13th, 14th & 15th March, 2019 at Maharashtra Seva Sangh Hall, Mulund West. The course was addressed by CA Rakesh Vora, CA Keval Shah, CA Ankit Chande, CA Jatin Lodaya, CA Heneel Patel and CA Kalpesh Katira.

- The 3rd Dr. Y. P. Trivedi National Tax Moot Court Competition was held on 29th & 30th March, 2019. We have received registrations from 18 colleges, of which 5 colleges were from Mumbai. The Semi-final round was judged by ITAT Members, Hon'ble Shri Shamim Yahya, Hon'ble Shri Pawan Singh, Hon'ble Shri Ram Lal Negi and Hon'ble Shri Ravish Sood,. The final round was judged by sitting Bombay High Court Judges, Hon'ble Justice Shri M. S. Sonak and Hon'ble Justice Shri D. S. Naidu.

IV. Future Programmes

1. **ACCOUNTING & AUDITING COMMITTEE & CORPORATE CONNECT COMMITTEE**
   A "Study Course on Valuation" is scheduled to be held on 8th June, 2019 at Babubhai Chinai Hall, IMC, Churchgate.

2. **DELHI CHAPTER**
   A "Income Tax Litigation – Workshop on Skill Development" is scheduled to be held on 19th & 20th April, 2019 at India International Centre, Lecture Room, Delhi.

3. **INTERNATIONAL TAXATION COMMITTEE**
   - The "13th Residential Refresher Course on International Taxation, 2019" is scheduled to be held from 20th June, 2019 to 23rd June, 2019 at The Grand Bhagwati, Surat.
   - The "5th International Study Tour" is scheduled to be held from 25th May, 2019 to 5th June, 2019 at Central Europe.
   - A "Half Day Seminar on Recent Developments in Compounding of Offences" under FEMA is scheduled to be held on 24th April, 2019 at Babubhai Chinai Hall, IMC, Churchgate.
   - A "Two Day Conference on FEMA" is scheduled to be held on 3rd & 4th May, 2019 at India International Centre, Lecture Room, Delhi

4. **MEMBERSHIP & PR COMMITTEE**
   - A "Panel Discussion on Right to Information Act and Public Interest Litigation is scheduled to be held on 23rd April 2019 at Walchand Hirachand Hall, IMC, Churchgate
   - A "Full Day Seminar on Direct Taxes" at Amravati is scheduled to be held on 4th May, 2019 at Diamond Hall, Hotel Grand Mehfil, Amravati.

5. **MEMBERSHIP & PR COMMITTEE & COMMERCIAL & ALLIED LAWS COMMITTEE**
   Lecture Meeting on Right to Information Act – A must learn for professionals is scheduled to be held on 30th April, 2019 at Babubhai Chinai Hall, IMC, Churchgate.

   (For details of the future programmes, kindly visit www.ctconline.org or refer the CTC News of April, 2019)

❍❑❍

“Representation – Tax Litigation Management”

In response to the CBDTs request seeking suggestions on tax litigation management and in continuance of the Chambers commitment to represent matters at appropriate forums for inter alia improvement in tax administration, a detailed representation was made on 23rd March, 2019. The suggestions made by the Chamber have been appreciated by the CBDT and we have received the letter from them which is reproduced below. We appreciate the inputs of Past President Shri Vipul Joshi for making this representation.

23rd March, 2019

To,

Mr. Sanjeev Sharma
Commissioner of Income Tax, APA-2,
Delhi 110 001.

Respected Sir,

Re: Tax Litigation Management

1. The Chamber of Tax Consultants (CTC), Mumbai was established in 1926. CTC is one of the oldest (about 92 years) voluntary non-profit making organizations in Mumbai formed with the object of educating and updating its members on Tax and other Laws. It has a robust membership strength of about 4000 professionals, comprising Advocates, Chartered Accountants and Tax Practitioners. The Chamber also has created a niche with the Government and other regulatory agencies, where representations by the Chamber are received with all seriousness.

2. We sincerely appreciate the effort of the CBDT in setting up a committee to examine suggestions to reduce litigation and ensure a time bound finalization of disputes. We are confident that an appropriate mix of amendment in legislation and proper monitoring will help to reduce and ease the direct tax litigation process in the country.

3. Based on the feedback received from our members, we would like to present our suggestions as under:

Issues at Assessment level

1. We strongly believe that a litigation process starts from the assessment stage. Therefore, for any measure on reduction of income tax litigation,this stage is of the primary importance. Ultimately, and in the long term, success or failure of any drive to reduce income tax litigation would primarily depend upon the quality of assessment proceeding as well as the assessment orders. Therefore, the first aim should be to have strong quality oriented [and not necessarily only revenue oriented] assessment mechanism, which will go in a long way in reduction of income tax litigation.

ML-654

2. While one may appreciate the view point of the Department that the revenue aspect cannot be lost sight of, we strongly believe that what should be the base philosophy should be not to collect maximum revenue in all possibility manners but to collect just revenue in a fair and judicious manner, the philosophy based on Constitution of India. It is now very well – settled legal position that an Assessing Officer acts as a quasi – judicial authority while framing the assessment and, consequently, all legal principles, including the principles of natural justice, that are applicable to an adjudicating authority get also attracted while framing the assessment under the Act. We believe that if the assessments are made in just, transparent and impartial manner, that alone would generate far greater revenue, apart from tremendously increasing the faith, the respect and the compliance culture in the minds of the tax payers. We come across many cases where the additions are made in a very casual, cryptic and callous manner; sometimes even the Assessing Officers admitting weakness of the same and expressing their helplessness but, at the same time, giving confidence to the assessee that this addition would be deleted at the appellate stage. This is how in many cases tax litigations start. We are prepared to present a few of such sample cases to just drive home this point.

3. Therefore, we suggest that the targets / incentives for the Assessing Officers should not only be on the basis of the amount of the tax assessed but on the quality of the assessment orders framed. This should be supplemented with a robust supervisory / monitoring mechanism.

4. The Officers must be sensitized to ensure that orders passed by them are in accordance with the law and are in line with judicial principles and precedents, and are not merely driven by revenue considerations. An improvement in the quality of orders passed by Officers would greatly enable the easing of the litigation process.

5. The current mechanism of ***Grievance Committee*** comprising local CITs needs to work more effectively. Better guidelines are needed to ensure that high-pitched assessments that are made casually and cryptically without regard to the factual and legal aspects and / or without following due process of law are avoided and, if made, remedial measures are taken in a time bound manner.

6. The position of ***Ombudsmen*** needs to be reinstated and, in fact, needs to be strengthened, in its scope as well as in its effective implementation. We understand that the Ombudsmen appointed under other statutory mechanism have proved to be the effective in resolving minor issues very quickly and efficiently.

Before the CIT (Appeals)

1. What has been discussed above applies, with a greater force, to the functioning of CIT (Appeals) as well. There is a need to ***sensitizes CIT (Appeals)*** that they are appellate authorities and not merely extension of the Assessing Officer. Therefore, they need to function in a more judicious manner rather than as revenue enhancers. While we do agree with the need to monitor the work performed by them on the basis of the parameters such as speed of disposing of the appeals, quality of orders passed, etc., we strongly feel that incentivizing them to enhance assessments or strengthen orders of Assessing Officers should not be the case. This is not only against the very basic principle governing position of an appellate authority but, can also be a cause for totally avoidable litigations.

2. Filing of appeals has been made electronic. The system of CIT (A) insisting on ***physical filing*** of the same papers must be discouraged by a specific order.

3. A system of ***taking up matters sequentially and expeditiously*** needs to be put in place. There is an inordinate delay in hearing matters. The system of taking up a case needs to be monitored or specific instructions to be issued – with any departure made from the rules being explained by an Appellate Authority. The system of digitally numbering appeals filed needs to be relooked at and made publicly known.

4. An Appellant can be given an option to indicate, at the time of filing appeal, whether the appeal is covered or not, accompanied by a submission and the relevant rulings. If a CIT (A) deems proper to adjudicate the appeal in favour of the Appellant on the basis of the submissions so made by the appellant, the Appellant can be informed accordingly and a hearing can be dispensed with. Only if the matter is likely to be dismissed or partly allowed must a hearing be held.

   In fact, similar option / facility can be given to the Appellant to exercise at any stage of appellate hearing.

   A proper guideline can be evolved to dispose of such appeals, including earmarking a particular date of a week to dispose of such appeals.

5. **Remand Reports**
   Many times the requests for Remand Report are not responded by the A.O. within the time specified in the remand order. Sometime, ultimately, the appellate orders are passed without remand reports. This is also is a hurdle in tax litigation mechanism.. Sometimes, due to paucity of time or otherwise, remand reports do not contain any fresh verification in terms of the direction in the remand orders but merely reiterate the contentions of the A.O. in the assessment order. This frustrates the very purpose of remand report and which also may weakened the Department's case. A system must be in place to strictly monitor remand cases, to ensure that quality remand reports are prepared in the time bound manner.

6. A system of ***monitoring the time taken to pass an order*** is a must. It is observed that after the appeals are heard, the orders are not passed for months.

7. ***Orders giving effect*** to the orders of higher authorities are inordinately delayed. Some system of monitoring this by a higher Authority is needed. The Appellant can be asked to file a calculation in a prescribed format which would show the income after giving effect and the tax payable or refund position arising therefrom. This will help in speeding up the process.

8. ***Vacancies and Additional Charges*** with CIT (A) is a practice that may be avoided. It results in hearings being fixed and matters heard but no orders being passed for long periods.

Issues at the ITAT level
There are various administrative issues with the functioning of the ITAT which can be taken up before the Hon'ble President / Hon'ble Members of the ITAT. However, issues that may be looked into by the CBDT are as under:

1. ***Covered cases*** – a separate mechanism can be provided for covered cases. These must be disposed on a priority basis, with the time frame being 3 to 6months. The form can

provide for mentioning a matter as covered and additional details in prescribed form can be filed. Marked matters can be taken up on specific Fridays – and if an Appellant can demonstrate that the matter is covered without any detailed arguments, then the matter can be disposed.

2. ***Issues involving similar appeals by various litigants*** – e.g. bogus purchase, penny stocks, 14A – these issues need a uniform approach being taken. The CBDT can identify such issues and seek to appoint a Special Bench by bunching all such appeals, with the option to the other litigants to join as interveners. This will definitely lead to avoidance of multiple litigations across India and will also ensure quality adjudication.

3. ***Setting aside of a matter*** for rehearing at a lower level should be resorted to only in extreme circumstances. This will ensure that litigants do not waste years and come back to the same forum after few years with respect to the same litigation. In cases requiring limited re-evaluation of facts, the Members may be encouraged to call for Remand report from the concerned Assessing Officer within a time bound manner and basis. Alternatively, the setting aside should be with clear instruction and / or on specific issues only.

Issues related to Prosecution

1. While we understand the need to initiate prosecution as a mechanism to encourage compliance, we suggest that the same should be initiated only in deserving cases, in contrast with the present practice of initiating prosecution even in small / marginal cases. Technical faults be clearly excluded from the same. More clear instructions may be issued for the same. Now that the message by the Department regarding fear of prosecution is well conveyed, having created the desired effect, a one – time amnesty scheme for marginal defaults can be thought of.

Broad Measures

1. We believe that if the Department adopts the practice, as prevalent in some other countries, to come out with its own manual / interpretation on the provisions of the Income – tax Act, this will bring clarity and certainty on many aspects and, most importantly, will bring standardization and uniformity in the approach of Assessing Officers and CIT (Appeals) on such specific issues. This alone will go in a long way to reduce the income tax litigations. Further, on some of the issues, the Department can periodically come out with appropriate circular / instruction / notification / clarification reflecting its stand on various High Courts and Supreme Court judgments, whether they are accepted in principle by the Department. This also will reduce unnecessary litigation as many time it is observed that the counsel for the Department, be at Tribunal or at High Court, are not even aware whether the Department has accepted the specific position or not. The above measure will not only reduce the income tax litigation but, in fact, will make available greater time and focus of the revenue officers to go for quality assessments / appeals.

2. Please appreciate that our above recommendations will, in fact, help the Department in generating larger revenue. For example, it is a common knowledge that many times, when assessments / appeals are set aside due to the same having not passed in proper or judicious manner, by the time the matters are taken up in the second round, the initiate momentum as

well as evidences are lost / dilute become less effective, resulting deletion of such addition in second round of litigation. If only the original orders are passed in judicious manner, including observing principles of natural justice, no assessee would be able to approach higher appellate authority with a plea to set aside such order and thereby saving one more round of litigation. This is only one example but the long term positive effect for the revenue can be envisaged on the basis of many other examples.

Digitization

The need to further digitize the litigation process is a must. All documents related to litigation ought to be filed online as scans so that at subsequent levels issues like files not being traceable do not arise and the same scan that was filed at stage 1 can be used years later when the matter reaches completion. Towards this, the forms need to be suitably modified so as to be more standardised and Appellate authorities and their administrative staff need to be trained into evaluating such filings and sorting appeals into categories.

We would be pleased to explain the above suggestions in more detail, if required, as well as in assisting task force that is set up towards the same.

We pledge our full support to CBDT in its drive for a better system of litigation management in the country.

Sincerely yours,

For **THE CHAMBER OF TAX CONSULTANTS**

Sd/-
Hinesh R. Doshi
President

Sd/-
Mahendra Sanghvi
Chairman

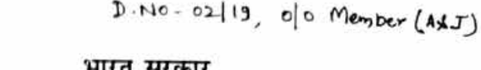
Sd/-
Apurva Shah
Co-Chairman

Law & Representation Committee

Cc to: Shri Arun Jaitley
Finance Minister
Ministry of Finance,
North Block, Parliament Street,
New Delhi – 110 001

Mr. Sushil Chandra
The Chairman,
Central Board of Direct Taxes
Ministry of Finance,
North Block, Parliament Street,
New Delhi – 110 001

ML-658



P. K. DASH
Special Secretary & Member

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NORTH BLOCK, NEW DELHI-110001
Tele : 011-23093621 Fax : 011-23093340
E-mail : dash.prasana@gov.in

Dated : 02.04.2019

Dear Shri Doshiji,

I thank you for sending suggestions on Tax Litigation Management from the Chamber of Tax Consultants, Mumbai/Delhi. The suggestions are very constructive and useful. I have forwarded the same to the Committee for necessary action.

2. I would like to thank all the members of your Chamber through you, for sending such constructive proposal to the Board and I look forward to your suggestions, in future, as a responsible major stakeholder of the Department.

With best regards,

Yours Sincerely,

(P.K. Dash)

Shri Hinesh R. Doshi
President
The Chamber of Tax Consultants
3, Rewa Chamber, Gr. Floor, 31, New Marines Lines
Mumbai – 400 020

Notice of Election

To
The Members,
The Chamber of Tax Consultants,
Mumbai

The election of the President and fourteen Members of the Managing Council for the ensuing year 2019-20 shall take place on **Monday, May 6th, 2019** at the **Office of The Chamber of Tax Consultants, 3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai–400 020.**

Nominations in the prescribed form should be filed so as to reach the office of the CTC not later than **6.00 p.m. on Tuesday, April, 23rd 2019.** The nomination forms shall be available at the CTC office from **Wednesday, April, 17th 2019**.

FOR AND ON BEHALF OF THE MANAGING COUNCIL OF
The Chamber of Tax Consultants

Sd/-
Anish M. Thacker/Parag S. Ved
Hon. Jt. Secretaries

Place: Mumbai
Dated: 13th February, 2019

Office: 3, Rewa Chambers, 31, New Marine Lines, Mumbai-400 020.

Notes:

1. Ordinary and Life Members are only eligible to vote at the election.
2. A Member who has completed at least two full years as a member shall be entitled to contest for the post of Managing Council member or to propose or second a candidate for the election. Each such member can propose not more than three candidates. The candidate for the post of President should have completed ten years of post qualification experience relating to tax laws or any branch of accountancy or company secretarial practice.
3. Members whose membership subscription is in arrears shall not be entitled to contest any election or to propose or second any candidate for the election or to vote at the election.
4. Withdrawal of nomination for the elections can be made by the candidate on or before 6.00 p.m. on Monday, April 29th, 2019.
5. If elections are required to be held, the names of the valid candidates shall be intimated through the website of the Chamber as well as through a circular. The Members are requested to check through these mediums.
6. If elections are not required to be held, due to any reason whatsoever, the same shall be intimated through the website of the Chamber as well as through the Notice Board at the Chamber's office. The Members are requested to check through these mediums.
7. The voting, if required, will commence at 11.00 a.m. and shall end at 5.00 p.m.
8. The above is only a gist of the Elections Rules. Please read Election Rules of the Chamber carefully on the website www.ctconline.org.
9. Please note that the Election Committee comprising of the following persons, is constituted for this purpose.

   (1) Mr. Keshav Bhujle; (2) Mr. Ajit Rohira; (3) Mr. Bhavesh Vora

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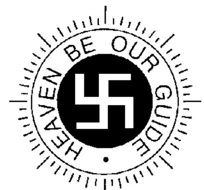

The Chamber of Tax Consultants

Vision Statement

The Chamber of Tax Consultants (The Chamber) shall be a powerhouse of knowledge in the field of fiscal laws in the global economy.

The Chamber shall contribute to the development of law and the profession through research, analysis and dissemination of knowledge.

The Chamber shall be a voice which is heard and recognised by all Government and Regulatory agencies through effective representations.

The Chamber shall be pre–eminent in laying down and upholding, among the professionals, the tradition of excellence in service, principled conduct and social responsibility.

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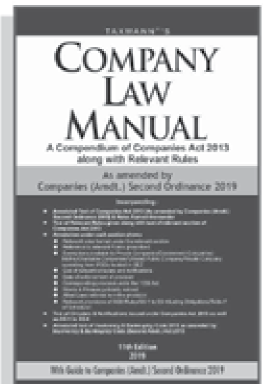
Companies Act 2013

As Amended by

Companies (Amendment) Second Ordinance 2019



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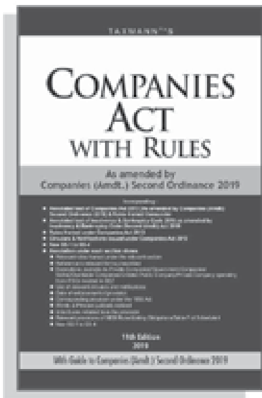

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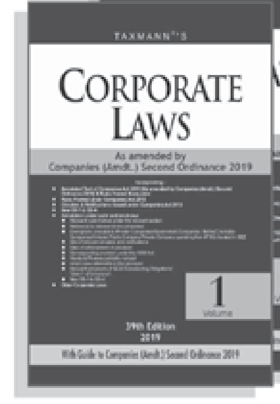

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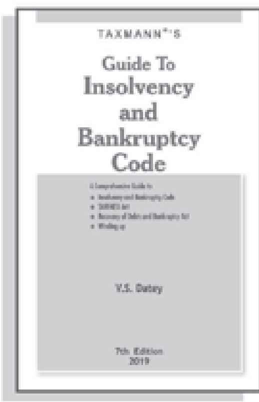

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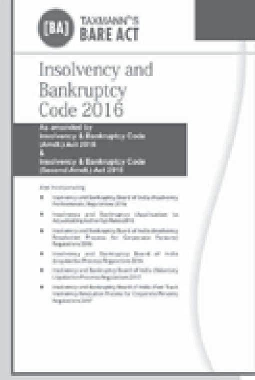

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ML-662

Student Committee

3rd Dr. Y. P. Trivedi National Tax Moot Court Competition was held on 29th & 30th March, 2019 at Government Law College and ITAT Court Rooms

CA Hinesh Doshi (President) along with Hon'ble Justice (Retd.) Shri P. P. Bhatt (President ITAT, Mumbai), Hon'ble Shri G. S. Pannu & Hon'ble Shri G. D. Agrawal (Vice-Presidents, ITAT, Mumbai), Hon'ble ITAT Members, Past Presidents, Quarter-final Judges, Chairperson and other Committee Members

CA Hinesh Doshi (President) presenting memento of appreciation to Hon'ble Justice (Retd.) Shri P. P. Bhatt (President ITAT, Mumbai)

CA Hinesh Doshi (President) along with Hon'ble ITAT Members (Semi-Final Judges), Chairperson and other Committee Members

High Tea - CA Hinesh Doshi (President) along with Hon'ble Justice (Retd.) Shri P. P. Bhatt – President ITAT, Mumbai

High Tea with ITAT Members at ITAT Bar Association Library

Semi Final Judges

Hon'ble Shri Shamim Yahya,
Hon'ble Shri R. L. Negi, ITAT Members

Hon'ble Shri Pawan Kumar Singh,
Hon'ble Shri Ravish Sood, ITAT Members

Student Committee

3rd Dr. Y. P. Trivedi National Tax Moot Court Competition was held on 29th & 30th March, 2019 at Government Law College and ITAT Court Rooms

Quarter Final Judges

CA Pradip Kapasi & Mr. Ajay Singh, Advocate

Mr. Vipul Joshi & Mr. Kishu Daswani, Advocates

Mr. K. Gopal & Ms. Aarti Sathe, Advocates

Ms. Aarti Vissanji, Advocate & CA Anish Thakkar

Preliminary Round Judges

Mr. Sanjay Sanghvi, Advocate & Mr. Jeet Kamdar, Advocate

CA Apurva Shah & Mr. Tenzil Padvekar, Advocate

CA Harshal Bhuta & Mr. Amar Gahlot, Advocate

CA Ashok Mehta & Mr. Rakesh Joshi, Advocate

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Student Committee

3rd Dr. Y. P. Trivedi National Tax Moot Court Competition was held on 29th & 30th March, 2019 at Government Law College and ITAT Court Rooms

CA Hinesh Doshi (President) giving his opening remarks at Final Round and Valedictory Function. Dignitaries on the dais from L to R: Ms. Mallika Devendra (Prof. in-Charge Moot Court Committee), Smt. Suvarna Keole (Principal – Government Law College) Hon'ble Justice Shri D. S. Naidu, Bombay High Court, Hon'ble Justice Shri M. S. Sonak, Bombay High Court, Shri Y. P. Trivedi, Senior Advocate and CA Nishtha Pandya (Chairperson)

Shri Y. P. Trivedi, Senior Advocate addressing the students

Hon'ble Justice Shri D. S. Naidu, Bombay High Court addressing the students

Hon'ble Justice Shri M. S. Sonak, Bombay High Court, addressing the students

Student Committee

3rd Dr. Y. P. Trivedi National Tax Moot Court Competition was held on 29th & 30th March, 2019 at Government Law College and ITAT Court Rooms

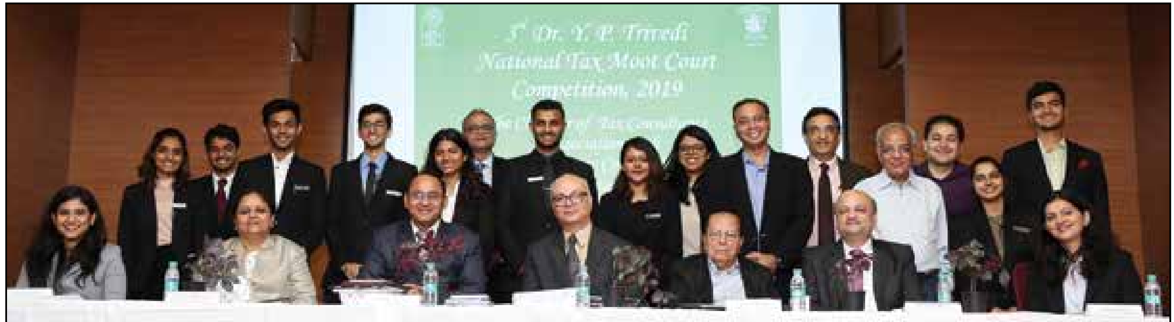
Dignitaries at Moot Court Competition

Best Speaker: Mr. Rhythm Kataria from Dr. Ram Manohar Lohiya National Law College, Lucknow

2nd Best Speaker: Mr. Ramachandran Bhalchandran from Dr. Ram Manohar Lohiya National Law College, Lucknow

Winning Team: Government Law College, Mumbai

Runner up Team: Dr. Ram Manohar Lohiya National Law College, Lucknow



Group Photo of Dignitaries with Members of Moot Court Association and CTC Student Committee Members

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Membership & Public Relations Committee

Triangular Box Cricket Tournament held jointly with GSTPAM & MCTC on 17th March, 2019 at KEC Ground, Kandivali

CTC Cricket Team

Appreciation by CA Hinesh Doshi (President) of Shri Ashwani Taneja and Ms. Aakanksha Kumar for Drafting Moot Court Problem on Benami and Income Tax Law

Felicitation of CA Hinesh Doshi, (President) and CA Dr. Kirit Somaiya at Ghatkopar CPE Study Circle of WIRC on 26th March, 2019

International Taxation Committee & Pune Study Group

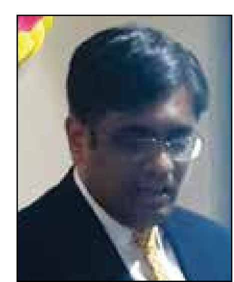
Full Day Seminar on Contemporary Issues in International Taxation was held on 16th March, 2019 at ELTIS, Plot No. 419, next to Atur Centre, Pune

CA Rajesh P. Shah (Chairman) welcoming the speakers. Seen from L to R: CA Hinesh Doshi (President) and CA Kishor Phadke

Panel Discussion - Seen from L to R: Mr. M. V. Kini, Mr. Anis Chakraborty, Mr. Darpan Mehta and CA Ameya Kunte

Faculties

CA Kishor Phadke



CA Maulik Doshi

CA Naresh Ajwani

FEMA SC on Regulations dealing with Remittances under LRS was held on 6th March, 2019 at CTC Conference Room

CA Rajesh L. Shah addressing the delegates

Student Committee

Industrial visit to Volkswagen Car Plant and Parag Milk Foods Pvt. Ltd. was held on 6th & 7th March, 2019 at Pune

Visit to Volkswagen Car Plant

Visit to Parag Milk Foods Pvt. Ltd.

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Student Committee

Student Orientation Course was held on 13th, 14th and 15th March, 2019 at Maharashtra Seva Sangh Hall, Jawaharlal Nehru Road, Mulund

CA Hinesh Doshi (President) giving his opening remarks. Seen from L to R: CA Sachin Maher (Convenor) and CA Rakesh Vora (Speaker)

CA Nishtha Pandya (Chairperson) welcoming the speakers

Shri Kirit Somaiya delivering Key note address

Faculties

CA Rakesh Vora

CA Keval Shah

CA Ankit Chande

CA Jatin Lodaya

CA Heneel Patel

CA Kalpesh Katira

Membership & PR Committee

Lecture Meeting on "Life is Beautiful" was held on 8th March, 2019 at Babubhai Committee Hall, IMC, Churchgate

CA Hinesh Doshi (President) Welcoming Pujya Sant Gyanvatsaldasji by offering shawl. Seen from L to R: CA Sachin Gandhi (Co-Chairman), and CA Sanjeev Lalan (Chairman)

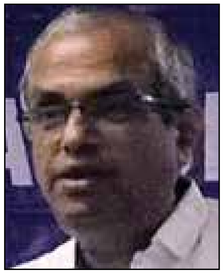
CA Sanjeev Lalan (Chairman) welcoming the delegates

Pujya Sant Gyanvatsaldasji addressing the delegates

ML-669

Bengaluru Study Group

Bengaluru Study Group meeting on Tax Implications of JDA was held on 14th March, 2019 at KFCCI, 3rd Floor, K. G. Road, Bengaluru



CA Vishnu Moorthy addressing the delegates

CA Ashok Raghvan addressing the delegates

Indirect Taxes Committee

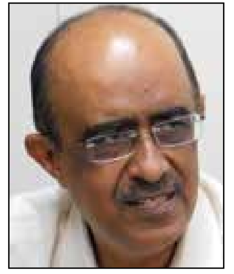
Indirect Taxes Study Circle meeting on Cross Charge, ISD & Intermediary was held on 14th March, 2019 at Jai Hind College, A.V. Room, Churchgate

Mr. Suyog Nawal, Advocate (Group Leader) addressing the delegates

Mr. Ranjit Mathani, Advocate (Chairman) addressing the delegates

IT Connect Committee

IT Connect Study Circle on Peer –to-peer Lending Platforms and Digital Investing was held on 7th March, 2019 at CTC Conference Room



CA Dinesh Tejwani addressing the delegates

CA Jigar Shah addressing the delegates

Direct Taxes Committee

Intensive Study Group meeting on Recent Important Decisions under Direct Taxes was held on 25th March, 2019 at CTC Conference Room, Churchgate

CA Abhitan Mehta addressing the delegates

Membership & PR Committee

Lecture Meeting on "Dynamic Memory" was held on 11th March, 2019 at CTC Conference Room

Mr. Srinivas Vakati addressing the delegates

Study Circle & Study Group Committee

Study Group meeting on Recent Judgments under Direct Taxes – Part II was held on 19th March, 2019 at Babubhai Committee Hall, IMC, Churchgate

CA Kishor Karia addressing the delegates

Commercial & Allied Laws

Commercial & Allied Laws Study Circle on Evolution of IBC through judicial precedents was held on 13th March, 2019 at CTC Conference Room, Churchgate

Mr. Amir Arsiwala, Advocate addressing the delegates

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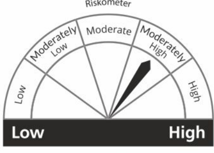

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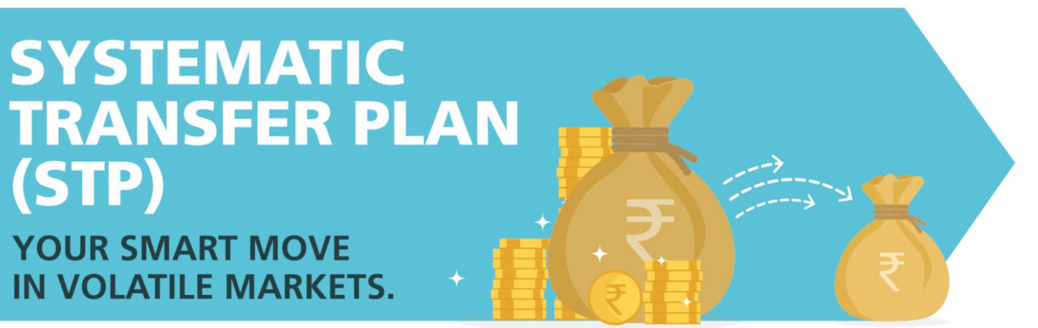

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