Price ₹ 300/- per copy

No. MCS/149/2019-21 / R.N.I. No. MAHENG/2012/47041 - Total Pages: 176

THE CHAMBER'S JOURNAL

Vol. VIII | No. 2
November 2019

Your Monthly Companion on Tax & Allied Subjects

Charitable Organisations

Part I

(N.G.O / N.P.O)

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3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai – 400 020
Phone : 2200 1787 / 2209 0423 / 2200 2455
E-Mail: office@ctconline.org • Website : http://www.ctconline.org.

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Editorial

BELIEF …….. FAITH …… RELIGION …….. NATION

India is at a cross road at the moment, on many fronts. This includes with respect to the interaction of the above four factors in life of the citizens of this nation, individually as well as collectively.

The issue has become very sensitive, complex and dicey mainly because of very strong emotions, reactions and opinions involved; mostly ignited, and kept so, by self-proclaimed religious and political heads since decades and centuries. As such, in a way, this turmoil is fastened upon the citizens as a legacy passing from one generation to another. The last bastion of the citizens' hope is our Judiciary, at whose door such delicate issues are left to be attended, very conveniently, by political and religious leaders instead of effectively and earnestly dealing with the same. The Judiciary, to its credit, while grappling with such sensitive issues left so unattended at its door, is trying to do the delicate balancing act while walking on the rope. One hoped that the Judiciary would, and should, have the last word and its say would be accepted and respected. Alas, this does not appear to be so. In other words, the churning continues and, without doubt, at the cost of the common man.

The interplay between belief, faith, religion and the nation, though appears to be, and has been made to appear, very sensitive and delicate, it need not necessarily be so. Though at a very basic level, such interplay depends upon individual perception, over the centuries, it has been made dependent upon the religious and political heads who control the psyche of the mass followers and who mould/ignite their passion to suit their own purpose. However, actually, at a very fundamental level, belief or faith is, and should remain, very personal and truly serves purpose at that personal/individual level only. In fact, ultimately, it is meant to work best at personal level only. Therefore, practice of any belief or faith, religious or otherwise, is very individual and personal and should better be left at that level only, without any concern with what belief or faith another person is following, or not following. The problems start when such belief or faith achieves/acquires mass contortion and comparisons are made with the persons following a different faith or belief, thereby sowing the seeds for hatred and intolerance, with the idea of supremacy that is sought to be achieved by violent means. The history is witness to this. Then again, the line of distinction between *dharma* and *rashtradharma* is often obliterated.

Though the issue may require to be dealt with in greater depth, isn't it a high time that the intellectuals – of course, *sans* pseudo intellectuals – across the board, from all faiths and beliefs,

come forward and voice their concern about this sorry state of affairs which our nation is presently facing? Is being merely a mute spectator really an option?

The cover story for the present issue is "Charitable Organisations". It is paradoxical that an activity of charity, which is supposed to be voluntary, selfless and without any extraneous consideration, has attracted so much resistance, along with suspicion, on the part of the legislature; be it in the context of the Income-tax Act, 1961, Bombay Public Trusts Act, 1950, Foreign Contribution (Regulation) Act, 2010, etc. But one cannot blame the legislature entirely, when we Indians have great ingenuity to misuse even this noble cause. Hence are lots of rules, regulations and restrictions as well as controversies. The Special Story attempts to address some of the issues involved.

Vipul B. Joshi
Editor

From the President

Dear Members,

The beginning of November coincided with the conclusion of Diwali as well as the Tax Audit Season for most of us. At the conclusion of every deadline, we take a short break and ready ourselves for the next deadlines, in our case, the transfer pricing audit deadlines and the GST Audit deadlines. Incidentally for practicing GST, the Audit deadlines have been extended to 31st December, 2019 for the Audit for 2017-2018 and 31st March, 2020 for the audits for 2018-19.

The extension has left us in perfect harmony as far as the RRC on GST is concerned. Freshening ourselves up for 31st March, 2020, we will be in the pink city of Jaipur between 9th and 12th January,2020 at a superb venue, the Fairmont, after which we will be ready to tackle the upcoming deadline, with enhanced knowledge and renewed vigour. With an enrollment of 308 delegates, the discussion and fellowship promises to be of the highest quality. The same is the case with the Direct Tax RRC at Coimbatore from 27th February 2020 to 1st March 2020 where the enrollment to date is within touching distance of 200. Both, the

Indirect Tax Committee and the RRC Committee deserve compliments for conceptualizing and designing wonderful training sessions at exciting locations, to which all of you, as usual, have overwhelmingly responded. It will be my pleasure and privilege to be with you at these RRCs as well as at the International Tax RRC in June, 2020.

On the macro front, the news seems to be mixed. The Supreme Court finally delivered its verdict on the Ram Temple at Ayodhya and I must say that the people of India have gracefully and peacefully accepted its verdict. The issue to my mind really is that God resides within each of us and we, by accepting the Courts verdict, and choosing to continue to live in harmony, have once again shown that to the common man, religion takes a back seat as compared to day to day existential issue. On the other hand, Corporate Governance standards continue their downward spiral with more gloomy news coming to light. The issues at Infosys, regarded by many as one of India's best managed companies, and the arrest of the Singh brothers of Ranbaxy fame, continue to remind us that walking the path of the straight and the narrow is indeed tough. On the economic front too, the news fait to cheer as we recorded the poorest GDP Growth since the last several years, in the quarter just gone by. One would hope that despite the global trends not showing any signs of a turnaround, the Government at the Centre, not shy of taking bold decisions, takes some concrete steps to herald economic revival in the medium to long term.

The recently concluded elections in Maharashtra have also resulted in an unexpected outcome. It remains to be seen which parties are able to come together to provide to Maharashtra, whose Capital is also the Nations Financial Capital, the political stability it craves and indeed deserves.

The past month saw an interesting kaleidoscope of programs being conducted by the Chamber, a four day MLI Course at the West End Hotel attended by many young practitioners, most of whom were not regular participants, kicked off the month strongly. A work shop on Prosecution proceedings and a Lecture Meeting on Tackling Assessment proceedings pertaining to Demonetisation were quite timely. Regularly conducted Study Circle meetings on GST, FEMA and meetings at Pune and Bengaluru added to the different pieces in the mosaic. A Lecture Meeting under the SAS on Speed reading which was very well received added to brightness and color.

The budget preparation exercise of the Government has begun and requests have started coming in for suggestions. The Chamber's Law & Representation Committee has geared itself for another strong and relevant representation document to be presented shortly to the Government. I seek your participation therein by contributing with your thoughts and suggestions which you may please send to the Chamber's office.

I would like to sign off by quoting Pandit Nehru whose birthday we recently celebrated as Children's Day:-

"We live in a wonderful world that is full of beauty, charm and adventure. There is no end to the adventure we can have, if only we seek them with our eyes open."

VIPUL K. CHOKSI

President

Introduction, Concept and Role of NGO's in India

S. N. Inamdar,
Sr. Advocate

Government & Non-Government Organizations (NGO) exist for a common objective viz., upliftment of general public – economically and culturally and raise their living standards. Thus NGO's are an important ally of the Government & share the burden of tasks & duties which are essentially of the Government. They, therefore are expected to go hand in hand & be complementary to each other. Government has enough funds, while NGOs have to struggle for raising funds – for which they are largely dependent on generosity of general public itself. But unfortunately, the experience of last several years and the way the laws are framed governing NGO leads one to suspect or believe that Government looks at them with suspicion & by assuming without any foundation, that they are most likely to misappropriate or grab the public money. But instead of taking steps to remove their misunderstandings, it continues to make, amend or substitute strict laws (those too in the wrong ways). Where Government should treat them as valuable partners, they are looked upon as looters, grabbers & worst – as tax evaders.

NGO's play invaluable role & contribute substantially in activities of public interest – may be education, help to victims of natural calamities, protection of environment & many more. But look at the way protestors of tree cutting in Aarey in Mumbai – even students – who protect environment were treated as if they are hardened criminals. Its high time – Government changes its attitude. What respected Baba Amte did & his Ashram is continuing to do for leprosy affected people, their settlement in life & leprosy eradication is monumental which no Government Agency has been able to achieve. That too largely depending on pubic support & their contribution.

This concept owes its origin to tradition in India, where sacrifice & donations (Daan) to public cause was always treated as the highest good deed a human being can perform.

There is a Sanskrit saying:-

शतेषु जायते शूर, सहस्त्रेषु च पण्डित: ।
वक्ता दशसहस्त्रेषु, दाता भवति वा न वा ।।

It means a brave man is found one in hundred, a learned man can be found one in thousand, a good speaker, one in ten thousands but a generous donor – you may or may not find at all.

But generosity of Indian People has belied the above statement.

All it needs is – Government may or may not encourage people to donate for good social causes (S. 80G) but it should not at least discourage them. Such discouragement unfortunately comes from stringent and complicated, misdirected & harsh tax laws. I therefore propose to examine such tax provisions in the above background.

Charitable Organizations exist for social good for the benefit of public and not for private gain. It is therefore only fair, logical & proper not to impose income tax on their income which at least initially – largely consists of voluntary contributions. It is said that law is an ass. It is ok

if it is an ass because an ass can be controlled & kept in check by reins or bridle. Sad thing is that law is complicated, even those applicable to charitable organisations who are doing great service to humanity. In Maharashtra, charitable organizations are governed by three different laws. Firstly there is Indian Trust Act, 1882, then there is a State enactment Maharashtra Public Trusts Act, 1950 & then there is Income-tax Act. To confound the confusion, there is no uniformity in these laws. Take for intance, modes of investments permitted to be made by such charitable organisations. S. 20 of Indian Trusts Act 1882 says that Trust Fund can be invested by the Trustees in specified securities or investments. S. 35 of the Maharashtra Public Trust Act says that it should be deposited in a Scheduled bank or in any other investment which the Charity Commissions may, by general or special order, in investments permitted by him. S. 11(5) prescribes its own list of permissible investments. Trustees of a Charitable Organisation are at a loss to understand what to do & how to reconcile these provisions.

Another draconian provision is contained in S. 115BBC which seeks to tax anonymous donations (in cash or kind) at the **maximum rate of tax**. This provision defies logic. On the one hand, the Government comes out at regular intervals with voluntary disclosure schemes where under it gives tax evaders a concession! It does not impose penalty or initiates prosecution. But if a recognised charitable organisation receives anonymous donation it taxes such trust at the maximum rates. Otherwise, it mandates that the Trustees must maintain a register indicating name & address of the person making such contribution and such other particulars as may be prescribed. Queer definition of, "anonymous" donations! It surprisingly exempts trusts created or established wholly for religious purpose. Strange & weird logic. It is felt that this provision is patently violative of Article 14 of the Constitution of India which guarantees equality before law. The distinction between religious trusts & non-religious but charitable trust cannot stand legal scrutiny as the classification is not reasonable. Chapter XII-EB introduced w.e.f. 1-6-2016 brings in a concept of, "accredited income" & seeks to tax value of net assets in certain circumstances. The idea seems to be to take back the exemption already enjoyed by the trust existing admittedly for charitable purposes. This is a blatant example of how not to draft a legal provision. Besides it is clearly violative of Article 265 which permits taxation of income & not value of net assets as income. Surprisingly S. 2(24) has not been amended to include, 'such value' in the definition of income.

Trustees of a charitable organisation often wonder whether they should spend time on the good work they are doing or in understanding & following such silly and complicated provisions.

The complication starts right from the definition of the expression, 'charitable purpose' in S. 2(15). So let us start at the beginning – a very good place to start!

The expression, 'charitable purpose' is defined in S. 2(15) to include relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests & wildlife and preservation of monuments or places or objects of artistic or historic interest) and the advancement of any other object of general public utility. So far so good. But then w.e.f. 1-4-2009 a provision stepped in which says that the advancement of any other object of general public utility shall not be a charitable activity, if it involves the carrying on of any activity **in the nature** of trade. Commerce or business or any activity of rendering services in relation to any trade, commerce or business for a cess or fee or any other consideration irrespective of the nature of use or application or application or retention of the income from such activity if it exceeds 20% of the total receipts of the trust or institution undertaking such activity or activities of that previous year.

This proviso is a model of how not to draft an (unnecessarily complex) provision for achieving a simple object. It is a dynamite potentially

leading to avoidable litigation as almost each phrase or word used will present interpretational difficulties. It is stated that the proviso, was inserted to prevent trade associations & chambers of commerce from claiming to be charitable institutions & thus to get over S. C decision in FICCI's case. Actually S. 28(iii) already treats income derived by trade, professional or similar association from specific services performed for its members as income under the head, 'income from business or profession'. In this connection Circular No. 11/2008 dated 19-12-2008 may be referred to. Can the Government not make simple laws – easy to comprehend & convenient to comply with? Instead of the complicated proviso, Government could have inserted an exclusionary clause listing the specific services (from which income is derived) which will not be considered as income derived from property held under trust for charitable purpose. Similarly as stated earlier, in case of anonymous donations why should the Government bother about the source of income which comes into the kitty of charity. Let us assume it is unaccounted money or assets – so what? It was not detected by the Government. It has come into the mainstream, Instead of bothering about source of such donations, laying down unpracticable & silly conditions, the Government should keep a strict watch & vigil on the spending on charitable purposes by the trust. The Foreign Contribution (Regulation) Act & a Lokayukta Act already make effective provisions in respect of contribution received from undesirable elements. Companies Act takes care of donations to political parties.

Some interesting case law may now be seen which lay down the basic principles governing the taxation of charitable organisation:-

1. In ***Director of Income Tax vs. Bharat Diamond Bourse (2013) 126 Taxman 365***, the Supreme Court has held that where primary or dominant purpose of institution is charitable and other objects which by themselves may not be charitable but are merely ancillary or incidental to primary or dominant object, the same would not prevent institution from validity being recognised as a charity. [Here it may be noted that the Bombay HC in Deccan Gymkhana's case has made a distinction between objects & powers which in many cases are mentioned under object clause].

2. In ***Sole Trustee Lokshikshan Trust vs. CIT 101 ITR 234,*** the Supreme Court has held that the word, 'education' in S. 2(15) has been used in the sense of systematic instruction, schooling or training & not in the wide & extended sense, according to which every acquisition of further knowledge constitutes education. [Education begins in the cradle and ends in the grave - famous proverb]. Also see ***New Noble Education Society vs. CIT 201 Taxman 33 (AP).***

3. In ***CIT vs. Thyaga Brahma Gana Sabha 52 Taxman 396,*** the Madras HC held that education in the context of the law of charity is not limited to teaching in the narrow sense. Raising the artistic taste of the country by public performances of dramas, musical programmes etc., would be an educational purpose.

4. Kerala HC has held in ***Dawn Educational Charitable Trust vs. CIT 233 Taxman 204,*** that where assessee – trust was running posh (?) school for children of non-resident Indians on commercial lines under the guise of charitable purpose, it would not be entitled to claim exemption u/s. 12A. Surprisingly SLP has also been dismissed. The decision requires reconsideration, unless facts are starkly different. Privy Council had held way back in 1939 in ***Trustees of the Tribune Trust: In re. 7 ITR 415*** that eleemosynary element is not essential. The element of providing something for nothing or for less than the ordinary price need not necessarily be present in any purpose of general public utility. Only object of private gain is excluded.

5. In ***CIT vs. Gujarat Maritime Board 166 Taxman 58***, the SC has made clear that advancement of any object or benefit to the public or section of the public (as a class) as distinguished from benefit to an individual or group of individuals would be a charitable purpose. Entire mankind need not be benefited, see 82 ITR 704 (SC).

6. In deciding whether any activity is in the nature of trade, commerce or business (as used in the first proviso to S. 2(15) it has to be examined whether there is an element of profit making. Expression, 'charitable purpose' cannot be construed literally and in absolute terms. Correct interpretation of the said proviso would be that it carves out an exception & that exception is limited to activities in nature of trade, commerce or business. Thus if dominant & prime objective of the institution is profit making and activities are directly in nature of trade, commerce or business or indirectly in rendering of any service in relation to any trade, commerce or business, then it would not be entitled to claim its objects to be a charitable purpose. [***India Trade Promotion Organization vs. Director General of Income Tax 250 Taxman 97 SC***].

7. Kerala HC has held in ***CIT vs. Programme for Community Organization 228 ITR 620*** that in S. 11, 'Income' must be understood in commercial sense & not as, 'total income' as assessed. Taxes & levies on income/wealth must be excluded. Sec. 127 ITR 378, 162 ITR 612 & 153 ITR 159.

8. Expenditure applied for charitable purposes will include expenses for capital purposes also. ***CIT vs. Kannmika Parmeshwari Devastanam & charities 133 ITR 779 (Mad),*** see also 315 ITR 237. Repayment of borrowings is also covered 242 ITR 457.

Lastly let us take a look at some relevant circulars issued by Ministry of Finance:–

1. Circular Letter F. No. 12/113/68 IT dated 28-10-1968 it is clarified that charitable trusts whose income is exempt u/s. 11, a statement in writing may be made by it u/s. 194A or the institution hereby giving for a certificate for deduction at a lower rate or for authorization for non-deduction of tax at source u/s. 197. This circular is still in force and it is felt that though confusing wording are used, a fair reading of it suggests that it cannot be restricted to educational trusts particularly when S. 10(21) has been omitted w.e.f. 1-4-1988 & educational trusts/institutions are brought u/s. 11.

2. Instruction No. 1132 dated 3-1-1978 contains an extract from ***CIT vs. Sarladevi Sarabhai Trust (No.2) 172 ITR 698 @ 709*** which clarifies that payment made by one charitable trust to another charitable trust is proper application of income for charitable purpose u/s. 11(1)(a).

3. In Circular No. 21/2016 dated 27-5-2016, it is clarified that temporary excess of receipts beyond the specified cut off in the year may not necessarily result in cancellation of its registration in the very nature already granted. It is for this reason that sub-sec. (8) has been inserted in S. 13 by Finance Act, 2012 w.e.f. 1-4-2009.

4. Same circular also states that in the above circumstances, it shall not be mandatory to cancel registration unless such cancellation becomes necessary on the grounds prescribed under the Act. The above circular therefore will have to be read with & in harmony with S. 115 TD and- Chapter XII-EB to avoid undue & additional hardship caused by cancellation of registration.

In conclusion, it may be stated that NGO's which are charitable organizations should receive a kind & charitable approach from the Government and should not be equated with tax evaders.

"Charity may begin at home, but it should not end in the office of the tax department!"

❍□❍

Obligatory spend on CSR – Whether diverted by overriding title?

S. N. Inamdar,
Sr. Advocate

Section 135(5) of the Companies Act, 2013 mandates that the Board of every company shall ensure that the Company spends in every financial year at least 2% of the average net profit of the company made during the three immediately **preceding** financial years (emphasis supplied). Average net profits are to be computed in accordance with the provisions of S. 198 & S. 198(5) states that income tax should not be deducted in arriving at the net profit. Thus it can be stated that expenditure on CSR should be made from or out of profits before tax.

There is a proposal to provide for punishment in case of default (Existing S. 450 does not cover this default). There is also a proposal to transfer the unspent amount on CSR in any year to a designated bank account. Today Board only has to report the unspent amount & reasons for it.

This means that every company is under a statutory obligation to spend at least 2% of the average net profits of the preceding three years. Thus the obligations arise on & from the very first day of the 4th previous year.

Explanation 2 to S. 37(1) the I.T. Act, 1961 makes it clear that any expenditure incurred by an assessee on the activities relating to Corporate Social Responsibility referred to in S. 135 of the Companies Act, 2013 shall not be deemed to be an expenditure incurred by the assessee for the purpose of the business.

The provision leads to two premises:–

1. It assumes that but for this provision expenditure on CSR is a business expenditure covered by S. 37(1) as the *explanation* contains an exception to S. 37(1) only.

2. Secondly it does not apply to depreciation or other allowable amortization of expenses

It is reported that a High Level Committee has recommended that expenditure on CSR should be allowed as business expenditure. When the *Explanation* 2 was introduced by Finance (No. 2) Act, 2015 the avowed intention declared was that the companies are expected to spend

amount of their after tax profits. If it is allowed as expenditure in computing taxable profits, it will mean that 30% or 25% of the expenditure is borne by the Government.

Be that as it may, pending final decision from the Government it may be interesting for a student at tax level to examine the possibility of applying the principle of diversion by overriding title so that at least minimum of 2% is excluded from the computations of taxable income at the inception itself u/s 29.

The principle was explained by the Supreme Court in ***CIT vs. Sitaldas Tirathdas 41 ITR 367 (SC) i***n the following words:-

"The true test of determining whether there has been a diversion of income by an overriding title is whether the amount sought to be deducted in truth has ever reached the assessee as (his) income. There is difference between an amount which a person is obliged to apply **out of his** income and an amount which **by the nature of the obligation** cannot be said to be a part of the income of the assessee. Where, by any obligation, income is diverted before it reaches the assessee it is deductible. However, where the income is required to be applied to discharge an obligation after such income reaches the assessee the same consequences in law does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another. A portion its own income which has been received and then applied. The first is a case in which income never reaches the assessee even if he were to collect. He does so not as part of his own income but for and on behalf of the person to whom it is payable

Thus it can be seen that the issue is dicey & not of an easy solution.

In ***CIT vs. Travancore Sugar & Chemicals under 88 IT R I*** the Supreme Court observed that income can be said to be diverted only when it is diverted at source so that when it accrues it is really not the income of the assessee but as somebody else's income. It is thus clear that whereby the obligation income is diverted before it reaches the assessee is deductible.

But in ***Ashokbhai Chimanbhai vs. CIT VOT 55 1TR,*** the Supreme Court held that profits do not accrue from day-to-day, but only on making up of the accounts as at the last day of the accounting year. Can this decision be pressed into service to argue that since the legal obligation u/s. 135 arises from the very first day of the fourth previous year, income to that extent does not reach the assessee as his income but is diverted at source before it accrues to the assessee? Here the word 'source' does not refer to the source of income but to enjoyment of income. When we say that a particular amount reaches an assessee as his income means subject to payment of tax, he is free to use or enjoy as the way he desires.

In a ***CIT vs. Sunil J Kharewala 126 Taxman 161*** the Supreme Court observed that under the Income-tax Act, it is the total income of an assessee computed under the provision of Act that is assessable to Income Tax. So much of the income which an assessee is not entitled to receive by virtue of an overriding title created in favour of a third party [which need not be a person u/s. 2(31)] would get diverted at SOIIICC & the

same cannot be added in computing the total income of the assessee. The determinative factor is the nature & effect of the assessee's obligation in regard to the income in question. When a third person becomes entitled to receive the amount under an obligation and an assessee even before he could lay a claim to receive it, as his income is diverted by an overriding title, it cannot be treated as his income but when after receipt of income by the assessee the same is passed on to a third person in discharge of an obligation of the assessee it will be a case of application of income and not diversion of income by overriding title.

One would feel that if the obligation is absolute & is imposed by law, assessee's case would be much stronger.

However, deciding the nature of the obligation is a question most difficult to answer and a spin of coin would decide it as satisfactorily as an attempt to find reasons.

In ***CIT vs. New Horizon Sugar Mills P. Ltd 141 Taxman 254,*** the Supreme Court has held that an amount towards Molasses Storage Reserve Fund (under the provision of law) by sugar manufacturer is not taxable as income.

But the Madras HC held in ***Seshashayee Paper & Boards in vs. CIT 145 ITR 498*** a provision u/s. 15 of the Payment of Bonus Act could not be said to have been statutorily diverted towards bonus so as to be excluded from assesses income.

But the same H.C in ***Madras Race Club vs. CIT 219 ITR 29*** has held that where the assessee Race Club conducted races under an agreement with Government for Chief Minister's Rehabilitation Fund & Beggar's Relief Fund and the entire net collection were handed over to the Government it was in case of diversion of such income at source.

Another decision worth noting in this context is that of ***Rajkot District Gopalak Co-op. Milk Produces Union vs. VCIT 204 ITR 590 (Guj).*** In this case the Gujarat HC observed that what is taxable is the real income, income which never reaches the assessee cannot to be said to be his real income. Payment to be made as a result of statutory or contractual obligation even though it may be related to profit may be in the nature of an obligation as a result of which profits to that extent are diverted by an overriding title. Thus in such a case what is required to be considered is the true nature of the obligation & the payment to be made to discharge that obligation (emphasis supplied).

Profit can be said to have reached an assessee as his income when he has the choice of freedom to use that income as he desires.

The reader may keep these & other principles & provisions in mind.

(1) It is a statutory obligation based on previous three years average net profits with obligation to spend minimum 2% of such profits in the fourth previous year. Therefore the obligation commences from the very first day of the fourth premium year.

(2) Recent amendment to Companies Act, 2013 treats CSR non-compliance as a criminal

offence though the High Level Committee has recommended a second look at this provision. This amendment is now proposed to be omitted (since withdrawn).

(3) Unspent amount in a year on CSR is required to be transferred to a separate designated account & has to be spent on CSR activities. Thus in either case, assessee cannot use it or spend it as his income.

(4) Company cannot declare dividends out of those profits or use it in any other manner so as to benefit the shareholders.

(5) The obligation is statutory & absolute depriving the assessee of profit to the extent of 2% at the very threshold.

(6) Accounting entries to not decide the nature of profit whether taxable or out of purview of taxation,

Reader may consider the above & deliberate (in his own mind) as to whether the above matter is arguable. If it is so, what is the effective remedy – appeal, writ representation to Government or any other?

❍□❍

If patience is worth anything, it must endure to the end of time. And a living faith will last in the midst of the blackest storm.

– Mahatma Gandhi

Our duty is to encourage every one in his struggle to live up to his own highest idea, and strive at the same time to make the ideal as near as possible to the Truth.

– Swami Vivekananda

If patience is worth anything, it must endure to the end of time. And a living faith will last in the midst of the blackest storm.

– A. P. J. Abdul Kalam

Charity and Charitable Purpose and Controversies of proviso to Section 2(15)

CA Hitesh R. Shah

Background

The taxation of charitable trusts is governed by Chapter III of the Income-tax Act ('the Act') which contains sections 11, 12, 12A, 12AA and 13. These provisions along with section 2(15) of the Act are very clear and self-contained code in respect of institutions which are considered as charitable in nature and the exemptions that these institutions are eligible for under the Income-tax Act.

1. Charity

Charity as commonly understood means the bequeathing of property in favour of others basically for a religious purpose. In its restricted and common sense it means, relief of the poor. In English law "charity" is understood to mean a gift for general public use and comprehends, "relief of aged, impotent and the poor people". It has been held by the English courts that a trust is not charitable unless it is attracted to the public benefit. It should benefit the community or a section of the community. A trust would not be charitable if it only conferred private benefits.

The very concept of 'charity' denotes altruistic thought and action for wellbeing of others. It is philanthropic in nature. Its objects must necessarily be to benefit others rather than one's self. The action, which flows from charitable thinking, is always directed at benefiting others. Thus, it is this direction of thought and effort, which determines that it is a charitable purpose.

As per Black's Law Dictionary, sixth edition *"the word 'charitable', in a legal sense includes every gift for a general public use, to be applied consistent with existing laws, for benefit of an indefinite number of persons, and designed to benefit them from an educational, religious, moral, physical or social standpoint. This term is synonymous with 'beneficent', 'benevolent', and 'eleemosynary'".*

The episode narrating the journey undertaken by `Charity' through the Income-tax Act is unimaginably very long and appears to be never ending.

Topic covered is very vast, subject to several amendments and also there are plethora of judicial decisions on the subject. An effort has been made to explain the provisions and also the catena of judicial decisions propounding the legal aspects.

2. Exemption of Income to Charitable Institution (Section 11)

Sections 11 and 12 contain the provisions concerning the condition to be fulfilled by the charitable trusts in order to claim exemption from Income-tax.

Section 11(1) of the Act lays down that **any income, profits and gains derived from property held under trust wholly for religious and charitable purposes,** (or held in part only for such purposes-in case of trust created before 1-4-1962) shall not be included in the total income

of the trust or institution (including a society or any other legal obligation) to the extent such income is applied or accumulated for application to such purposes. The exemption is allowable under specified circumstances on fulfilment of certain conditions.

Thus, it is seen that one of the conditions is that the property must be held for Charitable Purposes so as to get benefit of exemption under section 11 of the Act.

Hence, it is necessary to understand meaning of phrase "Charitable Purpose" as defined under section 2(15) of the Act.

3. Charitable Purpose [Section 2(15)]

"**Charitable purpose**" includes relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest, and the advancement of any other object of general public utility:

Provided that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless–

(i) such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and

(ii) the aggregate receipts from such activity or activities during the previous year, **do not exceed twenty per cent of the total receipts,** of the trust or institution undertaking such activity or activities, of that previous year.

The above definition was amended from Assessment Year 2016-17 onwards.

Definition of Charitable Purpose given in section 2(15) is inclusive definition and covers seven purpose or objects to be considered as Charitable purpose *viz*:

(i) Relief of Poor (ii) Education (iii) Yoga (iv) Medical relief (v) Preservation of Environment (vi) Preservation of monuments (vii) Advancement of any other object of general public utility. Objects which do not fit into any of the first six categories, it falls in to last category of advancement of any other object of general public utility.

Now let us understand the terms Relief of Poor, Education and Medical Relief:

4. Relief of Poor

Relief of the poor encompasses a wide range of objects for the welfare of the economically and socially disadvantaged or needy. It will, therefore, include within its ambit purposes such as relief to destitute, orphans or the handicapped, disadvantaged women or children, small and marginal farmers, indigent artisans or senior citizens in need of aid (**CBDT circular No 11/2008).**

The term 'relief of poor' has to be understood in a wider perspective. Scope of relief of poor is very wide and it includes financial support for marriages and can even include businesses carried on for the benefit of the poor [***Thiagarajar Charities vs. ACIT (SC) 92 Taxman 152 (1997)***]. Charity should be considered as relief of the poor and not as the 'advancement of any other object of general utility'. [***Dharmadeepti vs. Commissioner of Income Tax (1974) 114 ITR 454 (SC)***]

5. Education

The word education has always remained a subject matter of controversy for the purpose of claiming exemption under section 11 of the Act.

There is no definition of the expression 'education' in the Act. However, section 2(15) of the Act which defines the expression 'charitable purposes' includes education as one of the charitable purposes.

a) Meaning of the word education u/s. 2(15) of the Act

The meaning of the word 'Education' and context in which it is used under the Income-tax Act has been explained by Hon'ble Supreme Court in case of ***Sole Trustee, Lok Shikshana Trust vs. CIT (1975) 101 ITR 234***: *"The sense in which the word 'education' has been used in section 2(15) is the systematic instruction, schooling or training given to the young in preparation for the work of life. It also connotes the whole course of scholastic instruction which a person has received. The word 'education' has not been used in that wide and extended sense, according to which every acquisition of further knowledge constitutes education. According to this wide and extended sense, travelling is education, because as a result of travelling you acquire fresh knowledge. … But that is not the sense in which the word 'education' is used in clause (15) of section 2. What 'education' connotes in that clause is the process of training and developing the knowledge, skill, mind and character of students by normal schooling."*

b) Education is not restricted to Schools or colleges

In case of ***Gujarat State Co-operative Union vs. CIT [1992] 195 ITR 279***, the Hon'ble High Court has further explained that the judgment of Hon'ble Supreme Court in case of Sole Trustee, Lok Shikshana Trust only indicate the proper confines of the word "education" in the context of the provisions of section 2(15) of the Act. *It will not be proper to construe these observations in a manner in that the word "education" is limited to schools, colleges and similar institutions and does not extend to any other media for such acquisition of knowledge. The observations of the Supreme Court do not confine the word "education" only to scholastic instructions but other forms of education also are included in the word "education".* **The word "schooling" also means instructing or educating**. It, therefore, cannot be said that the word "education" has been given an unduly restricted meaning by the Supreme Court in the said decision.

c) Affiliation with University or Boards not necessary for the purpose of educational activities

The Calcutta High Court in ***CIT vs. Doon Foundation [1985] 154 ITR 208*** has observed that section 10(22) does not impose a condition that an educational institution to be eligible for exemption thereunder should be affiliated to any university or any board. As per the High Court, so long as the income is derived from an education institution existing solely for educational purposes and not for purposes of profit, such income is entitled to exemption under section 10(22).

d) Teaching and Dancing

The object of teaching music and dancing in all its forms, by merely imparting coaching/training as per norms of foreign colleges by an institution in India which is not recognised by any board or government bodies and which does not have any formal syllabus has been considered as educational activities and fits within the definition of section 2(15) of the Act [*Delhi Music Society vs. Director General of Income Tax 357 ITR 265 (Delhi)*].

e) Coaching Centre

The coaching centres are where candidates are specially prepared to appear in competitive examinations such as civil services, entrance examination for IIMs,

IITs and other professional colleges. Profit motive pervades and is the essence of the business activity undertaken by the coaching institutes. The primary object of the coaching institutes is personal or self gain and activity undertaken is with the said objective. Knowledge of education imparted by 'charity' or philanthropy is missing.

6. Medical Relief

The term 'medical' as defined in Major Law Lexicon by P. Ramanatha Aiyar (2010 Edition) means "**of pertaining to or having to do with the art of healing disease, or the science of medicine; containing medicine; used in medicine".**

The term 'medical' has been defined very broadly. The definition clearly provides that the '**art of healing any disease**' constitutes medical relief and **the same need not be restricted to conventional methods of treatment.**

Activities carried on to provide medical relief by treating patients either with or without charge is considered as charitable purpose. It may be noted that the activity need not be philanthropic, in the sense that one has to provide free medical services or subsidised medical services.

a) Free Treatment or Concessional Treatment by Hospitals

Philanthropy is not restricted to giving the free treatment only to the extremely poor but it would also be philanthropy to give treatment at a concessional rate to those who, though not extremely poor, yet cannot afford to pay the full and normal charges - ***Breach Candy Hospital Trust vs. Chief CIT [2010] 192 Taxman 98/322 ITR 246 (Bom.)***

b) Medical Treatment is not restricted to poor only

Free or concessional treatment given by the assessee to its employees, has been considered as philanthropic purpose. - ***Breach Candy Hospital Trust vs. Chief CIT [2010] 192 Taxman 98/322 ITR 246 (Bom.)***

c) Surplus in One Area of activity and deficit in another area by hospital

If the hospital unit is run as whole and there are possibilities that there would be some surplus in some areas and deficit in other areas. **Cross subsidization is not unknown**. What is important is entire receipts should be used for treatment of Hospital and medical care. ***Breach Candy Hospital Trust vs. Chief CIT [2010] 192 Taxman 98/322 ITR 246 (Bom.) (Shushrusha Citizens Co-operative Hospital Ltd (2018) 91 Taxmann.com 136)***

d) Income from running a chemist or Pharmacy is an incidental activity and not a business

Chemist or Pharmacy in a hospital which mainly supplies medicine for the treatment of inpatients admitted to hospital. The dominant object of hospital is to treat the patient. Hence supply of medicine is inseparable and part of providing treatment to the patients. It is a composite activity and cannot be separated. In many judicial pronouncements, supply of medicine has been considered as an incidental activity.

If the primary object was treatment of patients then, the incidental object of sale of medicine would not debar the institution from being considered as providing medical relief [***CIT vs. P Krishna Warrior (1972) 84 ITR 119 (Ker)***] [***Baun Foundation Trust vs. Chief Commissioner of Income Tax (2013) 33 taxmann.com 67 (Bombay)***]

7. The preservation of environment (including water sheds, forests and wildlife) or preservation of monuments or places of objects of artistic or historic interest

The Finance No. 2 Act, 2009 with retrospective effect from 01-04-2009 had inserted 'the preservation of environment or preservation of monuments or places of objects of artistic or historic interest' as part of the definition of 'charitable purpose' within the meaning of section 2(15) of the Act. The above said objects are in addition to the object of the advancement of any other object of general public utility, which as per section 2(15) of the Act is for charitable purpose.

a) Construction of monuments in the memory of war heroes and once such monument is constructed, the preservation of the said monument would be charitable purpose entitling the assessee to fall within the amended definition enshrined in section 2(15) of the Act.

b) Establishing and maintaining Gaushalas and Panjrapole with the object to protect, preserve, maintain and develop breed of cows and its progeny, falls within the definition of charitable purpose within the meaning of section 2(15) of the Act.

8. Conducting of activities of Yoga

There has been a controversy whether activity of pursuing Yoga falls within the meaning of charitable purpose as defined in section 2(15) of the Act or not.

Practice of Yoga gives positive relief in cases of asthma, migraine, hypertension, stress, etc. Thus, even for assessment years prior to assessment year 2016-17, Yoga would qualify as 'medical relief' falling within purview of charitable purpose.

Propagation of yoga by way of conducting yoga classes on a regular basis and in a systemised manner falls under category of 'Imparting of education' as provided under section 2(15) of the Act and is a charitable purpose - ***DIT (E) vs. Patanjali Yogpeeth (NYAS) 87 Taxmann.com 54 (DEL)***

Now, the very insertion of 'Yoga' in the definition of 'charitable purpose' under section 2(15) of the Act by the Finance Act, 2015 with effect from 1-4-2016 has removed all the doubts that propagation of yoga itself is a charitable purpose to make the assessee eligible for claiming exemption under section 11/12 of the Act.

9. Advancement of any other object of general Public Utility

a) Section 2(15) - Back Ground up to AY 2009-10

Section 2(15) of the Act which defines 'charitable purposes' though in an inclusive rather than an exhaustive manner, had a rather quiet existence, unaffected by the frequent amendments to the Income-tax Act, 1961, till 1st April 1984. *Vide* Finance Act, 2013, and with effect from 1st April 1984, the words 'not involving the carrying on any activity for profit' were deleted from Section 2(15) of the Act, and, with this amendment, this definition was as follows:

"Charitable purpose" includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility"

b) Provisos to Section 2(15) was inserted by Finance Act 2008 and 2009

Vide Finance Act, 2008, a new proviso (i.e. first proviso) was also added to this provision, carving out an exception in the cases of 'advancement of any other object of general utility, and, by the immediately following Finance Act, 2009, there was yet another proviso (i.e. second proviso) introduced to carve out an exception from the exception itself.

In essence, the effect of these provisos was that even when an assessee was pursuing 'a charitable purpose' in the event of advancement of any other object of general public utility' it would cease to

be for charitable purposes if it involves (a) carrying on an activity in the nature of trade, commerce or business; or (b) rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of nature of use or application or retention of the income from such activity. However, these provisions are not to apply when the activities are such a modest scale that the aggregate value of receipts in respect of the same do not exceed ₹ 25 lakh.

c) Object of introduction of said provisos

It is worthwhile to note the reference of Speech of the Minister of Finance on 29-2-2008, extract of which is given under:–

" 'Charitable purpose' includes relief of the poor, education, medical relief and any other object of general public utility. These activities are tax exempt, as they should be. However, some entities carrying on regular trade, commerce or business or providing services in relation to any trade commerce or business and earning income have sought to claim that their purpose would also fall under 'charitable purpose'. Obviously, this way not the intention of Parliament and, hence, I propose to amend the law to exclude the aforesaid cases. Genuine charitable organizations will not in any way be affected."

The object of the introduction of the provisos to clause (15) of Section 2 of the said Act was to deny the benefit of Income-tax Act exemption to "purely" commercial and business entities which wear the mask of a charity. Genuine charitable organizations were not to be affected in any way.

d) Legal position of the said Provisos

Therefore, as the legal position even after the insertion of the above two provisos, as long as the object of general public utility is not merely a mask to hide true purpose or rendering of any service in relation thereto, and where such services are being rendered as purely incidental to or as subservient to the main objective of 'general public utility', the carrying on of *bona fide* activities in furtherance of such objectives of 'general public utility' cannot be hit by the provisos to s. 2(15).

e) Amendment to the provisos to section 2(15) by Finance Act, 2015

By the Finance Act, 2015, these two provisos also stand substituted with a new proviso to Section 2(15) with effect from 1st April 2016. This new proviso is as follows:

"**Provided** that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless–

(i) such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and

(ii) the aggregate receipts from such activity or activities during the previous year, **do not exceed twenty per cent.** of the total receipts, of the trust or institution undertaking such activity or activities, of that previous year.

f) Differentiation between provisos introduced in Finance Act, 2009 and proviso undergone a change in Finance Act, 2015

It may be noted that while the earlier proviso simply stated that exclusion from

'charitable purposes' will come into play "if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business" and extends even to situations "in which such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

In the new provisos w.e.f. 01.04.2016, if an institution engaged in the activities in the nature of trade, commerce or business etc. and "such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility" it is excluded from the scope of charitable purposes only when "the aggregate receipts from such activity or activities during the previous year, do not exceed twenty per cent of the total receipts, of the trust or institution undertaking such activity or activities, of that previous year".

g) Provisos to section 2(15) will apply only to advancement of any other object of general public utility and not to other objects clearly specified in section 2(15) as Charitable Purpose

CBDT *vide* its **Circular No. 11/2008, dated 19-12-2008** has clarified that the newly inserted proviso to section 2(15) will not apply in respect of the first three limbs of section 2(15), i.e., relief of the poor, education or medical relief. Consequently, where the purpose of a trust or institution is relief of the poor, education or medical relief, it will constitute charitable purpose even if it incidentally involves the carrying on of commercial activities. Entities who have these objects will continue to be eligible for exemption even if they incidentally carry on a commercial activity, subject, however, to the conditions stipulated under section 11(4A) or the seventh proviso to section 10(23C) which are that (i) the business should be incidental to the attainment of the objectives of the entity, and (ii) separate books of account should be maintained in respect of such business. Above circular has been relied upon in case of ***Director of Income Tax Exemption vs. Ahmedabad Management Association (Guj) 366 ITR 85*** and also in various other judicial decisions as well.

10. Controversies of Proviso to section 2(15)

Some of the controversies have been dealt as under:

a) Application of Income for Charitable Purpose no longer a valid criteria

If an activity in the nature of trade, commerce or business is carried on and it generates income (surplus), the fact that such income is applied for charitable purposes, would not make any difference and the activity would nonetheless not be regarded as being carried on for a charitable purpose. If a literal interpretation is to be given to the proviso, then it may be concluded that this fact would have no bearing on determining the nature of the activity carried on by Charitable institution.

b) Income received by Institution established for charitable purpose

Merely because an institution, which otherwise is established for a charitable purpose, generates income (surplus) would not make it any less a charitable institution. It is to be noted that if an institution having an objective of advancement of general public utility, generates an income (surplus), it would be falling within the exception carved out in the first proviso to Section 2(15) of the said

Act, then there would be no institution whatsoever which would qualify for the exemption under Section 11 or section 10(23C) of the Act and the said provision would be rendered redundant. This is so, because, if the institution had no income, recourse to Section 11 or section 10(23C) would not be necessary. The intention behind introducing the proviso to Section 2(15) of the said Act could certainly not have been to render the provisions of Section 11 or Section 10(23C) redundant.

It is also not necessary that a person should give something for free or at a concessional rate to qualify as being established for a charitable purpose. If the object and purpose of the institution is charitable, the fact that the institution collects certain charges, does not alter the character of the institution.

c) Activity is in nature of trade, commerce or business

It is necessary to understand what is meant by the expressions "trade", "commerce" or "business". The term 'business' defined in Section 2(13) of the Act, is an inclusive definition which includes within its ambit any trade, commerce or manufacture or any adventure in the nature of trade, commerce or manufacture. However, the word 'trade or commerce' has not been separately defined in the Act. Therefore, the common parlance test would decide its meaning in the context of the activity being examined. In fact, the Delhi High Court in ***GS1 India vs. Director General Of Income Tax (Exemption) 360 ITR 138,*** has very beautifully expressed it by stating that "the words trade, commerce and business" are etymological chameleon and suit their meaning to the context in which they are found. Apex Court in the context of the definition of the word 'business' as found in Section 2(4) of the 1922 Act which is identical to the definition of business in Section 2(13) of the Act, has observed in ***Narain Swadeshi Weaving Mills vs. Commissioner of Excess Profit Tax [1954] 26 ITR 765 (SC)*** that "the word business connotes some real, substantial and systematic or organized course of activity or conduct with a set purpose."

In case of ***State of Andhra Pradesh vs. H. Abdul Bakhi & Bros. [1964] 5 STC 644*** (SC), the Supreme Court held that "the word 'business' was of indefinite import and in a taxing statute, it is used in the sense of an occupation, or profession which occupies time, attention or labour of a person, and is clearly associated with the object of making profit".

d) Broad and extended term of Business for the purpose of Proviso to section 2(15) is not intended

In case of ***Institute of Chartered Accountants of India vs. DIT (E) 374 ITR 99 (DEL)*** it was held that, while construing the term "business" as appearing in the proviso to Section 2(15), the object and purpose of the Section has to be kept in mind. It was observed therein that a very broad and extended definition of the term "business" was not intended for the purpose of interpreting and applying the first proviso to Section 2(15) of the Act so as to include any transaction for a cess, fee or consideration.

e) Profit Motive Test

"An activity would be considered 'business' if it is undertaken with a profit motive, but in some cases, this may not be determinative. Normally, the profit motive test should be satisfied, but in a given case activity may be regarded as a business even when profit motive cannot

be established/proved. In such cases, there should be evidence and material to show that the activity has continued on sound and recognized business principles and pursued with reasonable continuity. There should be facts and other circumstances which justify and show that the activity undertaken is in fact in the nature of business.

f) Dominant Object test

'The expressions "trade", "commerce" and "business" as occurring in the first proviso to section 2(15) of the Act must be read in the context of the intent and purport of section 2(15) of the Act and cannot be interpreted to mean any activity which is carried on in an organised manner.

The expressions "business", "trade" or "commerce" as used in the first proviso must, thus, be interpreted restrictively and where the dominant object of an organisation is charitable any incidental activity for furtherance of the object would not fall within the expressions "business", "trade" or "commerce".'

In Institute of Chartered Accountants of India's case stated above while considering whether the activities of ICAI fell within the proviso to Section 2(15) as introduced with effect from 01.04.2009, this court, after considering the Supreme Court decision in the case of ***CST vs. Sai Publication Fund [2002] 258 ITR 70/122 Taxman 437*** held:–

"Thus, if the dominant activity of the assessee was not business, then any incidental or ancillary activity would also not fall within the definition of business."

In the case of ***Addl. Commissioner of Income Tax vs. Surat Art Silk Cloth Manufacturers Association [1980] 121 ITR 1 (SC),*** the Supreme Court held as under:–

'The test which has, therefore, now to be applied is whether the predominant object of the activity involved in carrying out the object of general public utility is to subserve the charitable purpose or to earn profit. Where profit-making is the predominant object of the activity, the purpose, though an object of general public utility would cease to be a charitable purpose. But where the predominant object of the activity is to any out the charitable purpose and not to earn profit, it would not lose its character of a charitable purpose merely because some profit arises from the activity.'

Similar view was also taken by The Supreme Court in various judicial decisions viz. ***Thiagarajar Charities vs. Asstt. CIT (1997) 140 CTR (SC) 295 : (1997) 225 ITR 1010 (SC) : TC S23.2399 Queen's Educational Society vs. CIT [2015] 372 ITR 699/215 Taxman 286/55 taxmann.com 255; Indian Chamber of Commerce vs. CIT [1975] 101 ITR 796 (SC); Aditanar Educational Society vs. Addl. CIT [1997] 224 ITR 310/90 Taxman 528 (SC)*** and ***Oxford University Press vs. CIT [2001] 247 ITR 658/115 Taxman 69 (SC).***

Although in that cases the statutory provisions being considered by the Supreme Court were different and the utilisation of income earned is, now, not a relevant consideration in view of the express words of the first proviso to section 2(15) of the Act, nonetheless the test of dominant object of an entity would be relevant to determine whether the entity is carrying on business or not.

g) Incidental Activities

The question whether the charitable or religious trust or institution would qualify for exemption from income tax in full even if incidentally some of the activities

carried on result in profit or gain being derived and such profit or gain is utilised for fulfilment of the objective of the trust, had been an area of controversy in various cases. The disputes of the past were resolved by the Courts in the light of the statutory definition prevailing at the material time applicable to the case. The Supreme Court has, therefore, found it necessary to lay down the law that no distinction be made between the primary objectives and the incidental activities and so long as the incidental activities, involving any transactions giving rise to income, profit or gain, had not been carried on solely with the profit motive but primarily for the purpose of fulfilment of the predominant object of the trust which is charitable or religious in nature, the exemption cannot be denied: This is sought to be highlighted in judgment of the Supreme Court in ***CST vs. Sai Publication Fund (2002) 177 CTR (SC) 1*** in which the governing principles have been reiterated. These principles should be read as supplementary to the law declared by the Supreme Court in various cases under the Income-tax Act in which the exemption has been held to be admissible notwithstanding the incidental activities giving rise to income.

The Supreme Court held in ***Addl. CIT vs. Surat Art. Silk Cloth Manufacturers Association (1979) 13 CTR (SC) 378 : (1980) 121 ITR 1 (SC) : TC 23R.195*** that where the main or primary objects are distributive, each and every one of the objects must be charitable in order that the trust or institution may be upheld as a valid charity; but if the primary or dominant purpose of a trust or institution is charitable, another object, which by itself may not be charitable but which is merely ancillary or incidental to the primary or dominant purpose would not prevent the trust or institution from being a valid charity.

It further held that the test which has not to be applied is whether the predominant object of the activity involved in carrying out the object of general public utility is to sub serve the charitable purpose or to earn profit; where profitmaking is the predominant object of the activity, the purpose, though an object of general public utility, would cease to be a charitable purpose; but where the predominant object of the activity is to carry out the charitable purpose and not to earn profit, it would not lose its character of a charitable purpose merely because some profit arises from the activity.

The Hon'ble Delhi High Court in ***Institute of Chartered Accountants of India vs. Dy. IT [2011] 13 taxmann.com 175/202 Taxman 1 (SLP*** has been admitted in Supreme Court against the said judgments) while considering running of a coaching class by ICAI was a business activity, has observed as under:-

"The purpose and object to do business is normally to earn and is carried out with a profit motive; in some cases the absence of profit motive may not be determinative. The appellant has given no such finding as far as the activities of the institute are concerned. The appellant without examining the concept of business has held that the institute was carrying on business as coaching and programmes were held by them and a fee is being charged for the same."

In ***ICAI Accounting Research Foundation vs. DIT (Exemption) [2009] 183 Taxman 462 (Delhi),*** the Hon'ble Delhi High Court has considered the controversy, wherein the department has taken a view that research foundation was carrying on research activity by taking fees and charges, and therefore it is not eligible for exemption as charitable institution. The Hon'ble High Court has considered the concept of business and charitable purpose and also the proviso to section 2(15) and held that the research foundation was not carrying on any business activity and it was eligible as charitable institution.

Judgment in case ***Queen's Educational Society vs. CIT [2015] 372 ITR 699/231 Taxman 286/55 taxmann.com 255 (SC),*** was rendered in respect of section 10(23C) but still has bearing on the subject. The Supreme Court went on to summarize the law that arises under Section 10(23C) as follows:

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

(ii) The predominant object test must be applied-the purpose of education should not be submerged by a profit-making motive.

(iii) A distinction must be drawn between the making of a surplus and an institution being carried on "for profit". No inference arises that merely because imparting education results in making a profit, it becomes an activity for profit.

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

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

11. Denial of benefit of exemption u/s. 11 to the income of institution covered by Proviso to section 2(15) of the Act [Section 13(8)]

Section 13(8)

"Nothing contained in section 11 or section 12 shall operate so as to exclude any income from the total income of the previous year of the person in receipt thereof if the provisions of the first proviso to clause (15) of section 2 become applicable in the case of such person in the said previous year. A new section i.e. Section 13(8) was inserted to the Act by Finance Act, 2012 but with effect from 1-4-2009".

By this amendment it was provided that benefit of Sec. 11 or Sec. 12 of the Act would not be available if the receipts from the activity in the nature of trade, commerce or business or from any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, exceeded the threshold provided for in the proviso to Sec. 2(15) of the Act.

Introduction of section 13(8) has created certain controversies in respect of denial of benefit of exemption under section 11 to the institution whose income is covered by proviso to section 2(15) and exceeds the threshold limit such as;

a) Such denial will be applicable to entire income of the institution viz. charitable as well as non-charitable income i.e. income covered by proviso to section 2(15) of the Act and exceeded the threshold limit or only to the non charitable income?

It appears from the plain reading of the section 13(8) that it applies only to the extent income of the institution arises from the activities hit by the first proviso to section 2(15) in any assessment year, the institution will be disentitled for exemption under section 11 to that extent.

However, there are conflicting judicial decisions. In case of ***Ahmedabad Urban Development Authority vs. Assistant Commissioner of Income-tax (Exemption), Ahmedabad [2016] 69 taxmann.com 381 (Ahmedabad-Trib.)*** The taxation of income is not confined to the income derived from the units which operate like a business entity. Section 13(8) prohibits applicability of section 11 & 12 in respect of any income of the Trust and is not restricted to the business activity of the Trust. Therefore,

the surplus derived by the Trust is entirely brought to taxation.

In case of ***Chandigarh Lawn Tennis Association vs. Income Tax Officer, (Exemptions), Ward, Chandigarh [2018] 95 taxmann.com 308 (Chandigarh - Trib.)*** it was held that only the business income which will be over and above the prescribed limit will be subjected to taxation.

b) Denial of benefit is applicable only for the assessment year in which such income exceeded threshold limit or it will apply even in subsequent year?

The application of Sec. 13(8) is dependent upon the receipts in a given year from the activity in the nature of trade, commerce or business or from any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration. The application of sec. 13(8) is for each year, independently.

(***Gujarat Cricket Association vs. Joint Commissioner of Income-Tax (Exemptions), Ahmedabad) [2019] 101 taxmann.com 453***)

c) Such denial will it result in automatic cancellation of registration u/s 12A or 12 AA of the Act?

It provides that where the receipts are hit by the proviso to section 2(15), the benefit of exemption to its income for the previous year relevant to the subject assessment year will not be available. Thus, income is brought to tax to secure the revenue's interest but it does not necessarily result in automatic cancellation of registration. ***DIT (exemptions) vs. North India Association 79 taxmann.com 410 (Bom).***

12. Following judgments throw more light in understanding the object of advancement of any other object of general public utility, business income and activity incidental to charitable purpose.

Advancement of object of general public utility:

a) CIT (Exemption) vs. Bombay Presidency Golf Club [2019] 264 Taxman 55 (Bombay)

In the instant case, the main object of the assessee club is to provide golf facilities to the members for promotion of the sport. The Tribunal correctly held that there was no element of the assessee's activity being in the nature of trade, commerce or business. Once the applicability of the proviso to section 2(15) is ruled out, the question of the exemption under section 11 would arise.

b) CIT(E) vs. Kanakia Foundation 108 taxmann.com 43 (Bombay)/[2019] 265 Taxman 281 (Bombay)

The Commissioner has referred to clause (f) of the objects but reproduced only part of it to contend that the object is "to convert plays into episodes on T.V……" and this cannot be termed as charitable. In our opinion, the Commissioner has wholly misread the objects. Clause (e) of the objects is to create a culture among the elite class of the society for considering work of art an asset then can be passed on to the next generation with pride and prestige. Immediately, following clause (f) which has not been fully reproduced by the Commissioner in his order is to write through or with the help of literary persons, of different aptitudes or classes, plays in art and culture and other languages on different topics, to translate plays written different languages into other languages, or to convert plays into drams into short plays or episodes on T.V. or radio plays. The Commissioner, thus, picked a portion of this clause in isolation to argue that the same was not charitable.

c) CIT (Exemption) vs. Fertilizers Association of India 399 ITR 209 (Delhi)

Held that mere charging of fee from members or non-members for rendering services like training, conducting seminars would not **ipso facto** lead to denial of exemption when the dominant object of the assessee remained charitable and the aforesaid activities were only incidental to the main activity of the assessee.

d) Director of Income-tax (Exemption) vs. Ahmedabad Management Association 366 ITR 85 (Gujarat)

The assessee, a public charitable trust, was dedicated to pursue the objects of continuing education, training and research on various facets of management and related areas. Activities of assessee were held to be educational activities and it does not fall in Advancement of object of general Public utility and hence proviso to section 2(15) shall not apply.

e) Indian Machine Tools & Manufacturers Association vs. Director of Income Tax(E) Mum [2018] 91 taxmann.com 465 (Bombay)

Assessee claimed exemption under section 11 in respect of surplus earned by it by organising exhibition, which was a well-organized and regular activity incidental to assessee's business but assessee had not maintained separate books of account in respect of said activity, as mandated under section 11(4A), exemption under section 11 could not be granted.

Incidental Income

f) Director of income Tax (Exemptions) vs. Shree Nashik Panchvati Panjrapole 397 ITR 501 (Bom.)

Where dominant activity carried out by assessee-trust for over 130 years was to take care of old, sick and disabled cows, incidental activity of selling milk which might result in receipt of money, by itself, would not make it trade, commerce or business under section 2(15).

Decision in case of Gujarat High Court in the case of ***DIT(E) vs. Sabarmati Ashram Gaushala Trust [2014] 44 taxmann.com 141/223 Taxman 43/362 ITR 539*** was relied upon.

It was held in the said decision that it would make no difference as there is no bar in law to a trust selling its produce at market price as observed above by the Gujarat High Court

g) Director of income Tax (Exemptions) vs. Lalalajpatrai Memorial Trust 383 ITR 345 (Bom.)

The principal purpose for which the premises were let out was for conducting an educational activity, namely, the Management Institution and there was no material to show that building is used for purposes other than the Management Institution or for any other purpose which is not an educational purpose. First Proviso to section 2(15) would also not be attracted in this situation.

It can be seen from the above discussion that though the word 'Charity' appears to be simple, but under the Income-tax Act, Charitable purpose has resulted in unending controversies and subject to review by various High Courts and Supreme Court. At the end it is suggested that law should be simpler, keeping in mind the philanthropic activities of the Charitable trust so as to avoid unnecessary litigations, definitely there needs to be some checks so that the law is not abused under the guise of charity.

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Income, Application, Accumulation and Deficit

CA Vipin Batavia

1. Definition of Income of the Trust - Section 2(24)(iia)

Section 2(24)(iia) defines the Income -

"Income" includes voluntary contribution received by a trust created wholly or partly for charitable or religious purposes or by an institution established wholly or partly for such purposes or by an association or institution referred to in clause (21) or (23) or by a fund or trust or institution referred to in sub-clause (iv) or (v). (or by any university or other educational institutions referred to in sub clause (iiiad) or (vi) or Hospital or other institution referred to in sub-clause (iiiae) of clause (23C) of Section 10 or by an electoral trust.)

Explanation.– For the purpose of this sub clause trust includes any other legal obligation.

Different types of income in case of a Charitable Trust.

i) Income derived from the property held under the trust (includes activity income)

ii) Voluntary contribution in general

iii) Voluntary contribution with specific direction – Corpus Donation

iv) Interest incomes from Banks & Investments

v) Income from property

vi) Capital Gains

vii) Income from business which are incidental to the attainment of the objectives of the trust.

viii) Deemed income u/s. 12

1.1 Real Income Theory

The language used in sec. 11(1)(a) and the scheme of providing exemption demonstrates that the income to be considered is the real income.

In the following cases Supreme Court has, despite the method of accounting followed, considered "real income":

i) ***State Bank of India Travancore vs. CIT Kerala (1986) 158 ITR 102 (SC)***

ii) ***CIT vs. Shoorji Vallabhdas & Co. (1962) 46 ITR 144 (SC)***

1.2 Income in Commercial sense

For the purpose of determining the income of the Trust eligible for exemption under section 11, the income arising from property held under Trust constitutes the income of the Trust. It will mean income from property, business, dividends, interest on securities or other interest etc. It will also include donations (other than Corpus donations) received by the trust by virtue

of the provisions of section 2(24)(iia). In other words, the income for the purpose of section 11 is the income as per the accounts of the trust.

This is confirmed by many court pronouncements and by the CBDT in Circular No. 5-P (LXX-6) dated 19-6-1968.

1.3 Hypothetical Income?

Hypothetical income is an income that the Trust may or may not have a vested right to receive and does not have a character of certainty. Supreme Court in the case of ***CIT vs. Shoorji Vallabhdas & Co,*** held that the substance of the matter is the income. If there is no income at all, there cannot be a tax, even though in book-keeping an entry is made about a hypothetical income.

1.4 Can book entries be considered as income?

The mere passing of a book entry cannot be regarded as income. This is held by Supreme court in the case of ***CIT vs. Chamanlal Mangaldas Girdhardas Parekh Ltd. (1960) 39 ITR 8.***

Similar views were again held by Supreme Court in the case of ***CIT vs. India Discount Co. Ltd. (1970) 75 ITR 191*** and by Punjab and Haryana High court ***CIT vs. N. D. Radhakishan Co. (1983) 140 ITR 860.***

Again in 1980 Supreme Court held in the case of ***CIT vs. Toshoku Ltd. (1980) 125 ITR 525*** that mere making of entries did not amount to receipt of income.

1.5 Whether following the mercantile system of accounting will determine the income?

Unless there is real income accruing to the Charitable Trust, merely following a mercantile system of accounting will not determine the income of the trust.

The same has been decided by the Apex Court in the case of ***Godhara Electric Co. Ltd. vs. CIT (1997) 91 ITR 351 (SC)***. Similar views were held in the case of ***CIT vs. Kerala Finance Corporation Ltd. (1985) 155 ITR 246 (Ker)***. & ***Allahabad High Court in National Handloom Development Corpn. Ltd. vs. Dy. CIT (2004) 266 ITR 647 (All)***

1.6 Whether classification of income u/s. 14 applies to trust?

As the income from property held under trust has to be arrived at in normal commercial sense, there is no scope for computing the income from property by applying the provisions of Sec. 14 of the Act. This position was affirmed by the Madras High Court in the cases of ***CIT vs. Rao Bahadur Calavala Cunnan Chetty Charities (1982) 135 ITR 485 (mad)*** and CIT vs. ***Estate of V. L. Ethiraj (1982) 136 ITR 12 (Mad).***

1.7 Whether taxes paid can be considered application of income?

Yes.

It was held by Allahabad High Court in the case of ***CIT vs. Trustee of Nizams' Supplemental Religious Endowment Trust (1981) 127 ITR 378 (AP),*** that the payments made in a particular year, irrespective of the fact that they relate to the earlier assessment years, are yet outgoings and constitute expenditure.

1.8 Whether tax refund is income derived from the property held under trust?

The Bombay High Court held in case of ***Godrej Trust vs. Fifth ITO (1991) 38 ITD 185*** that the refund of tax is an income but a contrary view taken by Delhi High Court in the case ***of CIT vs. Humdard Dawakhana (249 ITR 601).***

1.9 Whether subscription received is income derived from property held under trust?

The Division Bench of the Bombay High Court in the case of ***CIT, City I vs. Cotton Textiles Export***

Promotion Council (1968) 67 ITR 539 held that the subscription has to be considered as income derived from property held under trust. Similar view is upheld in the case of ***CIT vs. Divine Light Mission (2005) 278 ITR 659 (Del).*** The Bombay High Court in the case of ***CIT vs. W.I.A.A. Club Limited (1982) 136 ITR 569*** held that the portion of life membership fees attributable to entrance fees was capital receipts. Admission fees received by the trust are not taxable since they are capital receipts and such receipts are added to trust fund or corpus fund.

1.10 Whether the Grants in Aid is considered Voluntary Contribution?

The Bombay High Court has held in the case of ***CIT vs. Gems & Jewetlery Export Promotion Council (1983) 143 ITR 579*** that the grant in aid received by the organisation even with certain conditions were considered to be voluntary contribution.

2. APPLICATION OF INCOME

2.1 Meaning of Application

According to Sec. 11(1) of the Act, in order to claim exemption of income derived from property or on receipts from voluntary contributions, the organisation must apply its income for charitable or religious purposes.

Section 11(1)a) provides that income of the trust shall not be included to the extent to which such income is applied to such purposes in India. Therefore in order to exempt income, it is a pre-requisite that income has to be applied. The Kerala High Court held in the case of ***Sanjeevamma Hanumanthe Gowda Charitable Trust vs. DIT (2006) 285 ITR 327*** that the emphasis is on application of income.

Section 11(1)(a) further states that in order to claim exemption 85% of the income derived from the property held under the trust including donations (other than corpus donations) has to be applied in the previous year.

2.2 Meaning of the Term 'Applied'

The Term Applied has been used in s. 11(1)(a), but the same has not been defined in the Income Tax Act, 1961.

In common parlance the word applied is normally understood as spent. But this term in the context of sec. 11(1)(a) has a wider meaning held by Kerala High Court in the case of ***CIT vs St. George Forane Church (1988) 170 ITR 62,*** the court observed that "The word 'applied' is wider than the word 'expenditure'".

2.3 Term 'Applied' has been used in Broadest Sense

The word applied has been used in broadest sense and in its widest amplitude. This term confirms all expenditure incurred for the purposes of charitable or religious purposes. It covers not only amount spent but also the amount irretrievably earmarked and allocated for future spending as held by Allahabad High Court in the case of ***CIT vs. Radhaswami Satsang Sabha (1954) 25 ITR 472.***

2.4 Applied versus Spent

The most commonly used word for incurring expenditure is denoted by the word spent. The LEGISLATURE USED THE EXPRESSION APPLIED. Are the terms applied and spent synonymous?

The word spent signifies actually paid. There must be an outgoing to qualify this. The term applied in the broadest sense comprises not only the amount spent but also extends to the amount accumulated for future spending.

The Supreme Court held in the case of ***CIT vs. India Molasses Co. (1959) 37 ITR 66,*** that the word expenditure means "pay out and spending something which is gone out irretrievably". Considering these two words the word applied is of a wider import.

2.5 Important Points on the term 'Applied'
The term 'applied' consists of the following:

1. This word has been used in a broad sense and in its widest amplitude.
2. It recognises not only the amount spent but also earmarked for future spending. This is evident from reading of Sec. 11(2) of the Income-tax Act, 1961.
3. It consists of all expenditure incurred in the nature of revenue as well as Capital expenditure.
4. Deemed application is an application treated under the provisions of the Income Tax Act. This is apparent from reading of Sec. 11(2) of the Income-tax Act, 1961 and option to be exercised by the trust as per clause 2 to explanation to section 11(1).
5. Mere passing of book entry without earmarking of funds could not be said to be 'applied'.
6. Repayment of the loan is also treated as application of the income.

2.6 Application required to be done in India
Section 11(1)(c) of IT Act states that any income applied on activities outside India is not eligible for exemption.

The application of income from property held under the trust or accumulated for such charitable or religious purposes must be within the taxable territory of India except the trust created before 1-4-1952 or engaged in promotion of International Welfare in which India is interested. In other words, NGOs registered after 1-4-1952 are not allowed to have any international activity unless such activity is specifically exempted by CBDT by a general or special order.

Supreme Court held in the case of ***H.E.H. Nizam's Religious Endowment Trust vs. CIT - Andhra Pradesh (1966) 59 ITR 582*** that only income from the property wholly or in part held in trust actually applied or set apart for application for future spending or religious or charitable purposes within the taxable territories of India is exempted from inclusion in the total income.

The same analogy is upheld in the following cases:

a. ***Director of Income Tax (Exemptions) vs. National Association of Software & Services Companies (2012) 345 ITR 362 (DEL)***

b. ***The Nizam's Pilgrimage Money Trust vs. CIT (1988) 171 ITR 323***

c. ***In the case to Handloom Export Promotion Council vs. Assistant Director of Income tax (Exemptions)–IV, Chennai (2015) 62 taxmann.com 288 (Chennai-Trib.)***

2.7 Foreign Travelling whether Allowable as Application of Income
Held yes in the case of ***DDIT (E) vs. The Associated Chambers of Commerce and Industry of India (2015) Tax Pub (DT) 3621 (Del.-Tri.)***

But as stated in earlier paragraph that the application of income is to be done within India therefore the amount to be spent in India for foreign travel will not be covered.

2.8 Application of Income on total or net income
The Supreme Court held by affirming the decision of the Kerala High Court in the case of ***CIT vs. Programme for Community Organization (2001) 248 ITR 1,*** that the application under Sec. 11(1)(a) has to be computed on the total income and not on net income. The income has to be referred in a commercial sense. In other words, the spending of 85%, under sec. 11(1)(a), has to be computed with reference to total income and not

the net income. Similar view was held in the case ***CIT vs. Rao Bahadur Calavala Cunnan Chetty Charities (1982) 135 ITR 485.***

2.9 Following expenditure are considered as application of income

1) Administrative Expenses - The expenditure incurred for the management and administration of the trust are also treated as application of income.

2) Capital expenditure – All capital expenditure spent in furtherance of the objects and purposes of the trust will be treated as application of income. ***M. Ct. M. Tiruppani Trust vs. CIT 230 ITR 636 – (SC)*** and various High Courts have also conformed this situation.

3) Loans for education purpose – Loans granted for educational purpose will also be application of income but when the loan is returned in subsequent year it will be considered as part of income in that year (CBDT Circular – 100 dated 24-1-1973)

4) Payment of taxes - The payment of taxes by the trust are considered as application of income and it should be treated as having been applied for charitable purposes (***CIT vs. Jhanki Ammal Ayya Nadar Trust (1985) 23 Taxmann 416 (Mad.)***

5) Donation to other trust – When the amount is donated to other charitable trust for charitable purposes it is treated as application of income.

6) Contrary to trust deed – Under Section 11(1)(a) what is relevant is application of income for charitable purpose. Even though it is contrary to the terms of trust deed which does not empower the trustees to apply for that charitable purpose. (***Trustees of H.E.H. the Nizam's Pilgrimage Money Trust vs. CIT (1987) 65 CTR 290 (AP)***

7) Expenditure in earlier year: Expenditure of defending criminal charges and repayment of loan for construction of building are considered as application of income.

8) The word 'applied' necessarily does not mean 'spent'. Even if the amount has been earmarked and allocated for the purposes of the institution, it will be application for its purposes – ***CIT vs. Radhaswami Satsang Sabha (1954) 25 ITR 472 (All.).***

2.10 In following cases the application will not allowed

a) Corpus donation by one trust to another.

An *Explanation* 2 is inserted w.e.f. 01-04-2018, to Sec. 11, states that any amount credited or paid, out of the income of the trust to any other trust or institution registered u/s. 12AA, being contribution with a specific direction that they shall form part of the corpus of the trust or institution, shall not be treated as application of income.

b. Donation out of accumulated income is not an application

As per the explanation provided in section 11(2), any donation made out of income accumulated will not be considered as application.

c. *Explanation* 3 is added w.e.f. 1-4-2019 that for the purpose of determining the amount of application the provisions of section 40(a)(ia) and section 40A(3) & (3A) shall *mutatis mutandis* apply in computing the income chargeable under the head "profits and gains of business or profession". That is in case of default in TDS provisions and expenses incurred in cash exceed ten thousand rupees then in such cases the application of income will not be allowed to that extent.

d. Income transferred to reserve fund is not an application of income

e. Payments made as advance are not treated as application.

3. ACCUMULATION

(Deemed application of income)

3.1 Accumulation for specific purpose Sec. 11(2)

A charitable trust having registration u/s. 12A or 12AA can accumulate its income for a specific purpose to be utilized in future, which will be allowed as deduction as deemed application of income during the previous year in which it is accumulated. `

This deeming provision as per amended provisions w.e.f. A.Y. 2016-17 are as under:

a. Furnishing a statement in prescribed form (Form-10) and prescribed manner to assessing officer stating the specific purpose and period for which the income is being accumulated. The period of accumulation in no case should exceed 5 years.

b. Money so accumulated is to be invested in any of the modes as specified in section 11(5). As per the wordings of the new form-10 it is to be invested before the filling of the form-10.

c. This statement, Form-10, is to be furnished on or before the due date of filing of return and compulsorily by way of electronic mode. As per the ITR 7 the details of accumulation, purpose and details of investments are to be furnished therefore practically. Form 10 should preferably be filed before the filing of ITR.

d. The benefit of accumulation would also not be available if return of income is not furnished before the due date of filing return of income.

Provided that in computing the period of five years referred to in clause (a), the period during which the income could not be applied for the purpose for which it is so accumulated or set apart, due to an order or injunction of any court, shall be excluded.

3.2 *Purpose of accumulation whether Specific or General/Singular vs. Plural Objects*

A) Specific or General

The purpose of accumulation should be specific. The power vests with the management to choose such objects for which the income is accumulated.

Delhi High Court in the case ***Bharat Kalyan Pratisthan vs. DIT (Exp) (2008) 299 ITR 406*** held that the purpose for which accumulation is sought has to be specific object and further held that having mentioned the broader purpose like medical relief, education, relief to poor was held sufficient by the High Court in this case.

The Calcutta Tribunal in the case ***Paradip Port Trust vs. ACIT (2011) 141 TTJ 218*** held that Form 10 mentioning "future development" was held within the charitable objects therefore benefit of exemption cannot be denied.

The Delhi High Court took contrary view in the case of ***DIT vs. Mitsui and Co. Environmental Trust (2008) 303 ITR 111.*** It held that wherein Form 10 mentioning "amount would be utilised for the objects of the trust" the AO has denied the benefit on the ground that the purpose of accumulation had not been specified but court has held that the purpose of accumulation need not be specific.

B) Singular or Plural Objects

The Calcutta High Court held in the case of ***DIT vs. Trustees of Singhania Charitable Trust (1993) 199 ITR 819*** that plurality of objects is not allowed in Form 10. Holding that Section 11(2) contemplates only specific or concrete application.

However in following cases the plurality of objects upheld.

a) ***CIT vs. Hotel and Restaurant Assn. (2003) 261 ITR 190 (Del)*** and ***Sir Shobha Singh Public Charitable Trust vs. Astt. Director of IT(E) 251 ITR (AT) 48.***

b) ***Director of Income Tax (Exp) vs. Eternal Science of Man's Society (2007) 290 ITR 535 (Del).***

c) ***Director of Income Tax (Exp) vs. Mamta Health Institute for Mother and Children (2007) 293 ITR 380 (Del).***

3.3 Important points to be noted for accumulation u/s 11(2)

Accumulation u/s 11(2) shall be deemed to be income of the previous year in which following situation occurs:-

a) Income is applied to purposes other than Charitable or Religious.

b) Ceases to remain invested in any of the modes specified in section 11(5).

c) Not utilised for the purpose for which it was accumulated within the period of 5 years.

d) Credited or paid to any other trust registered u/s. 12AA or having exemption u/s. 10(23C).

If the purpose specified for accumulation cannot be achieved then the AO has power to change the purpose [Section 11(3A)].

3.4 Option to be exercise to spend the income in the next year or the year of receipt

As per clause 2 of *explanation* to Section 11(1) provides deemed application of income if the income is received in previous year but applied for religious or charitable purposes in subsequent year by any amount –

(i) For the reason that the whole or any part of the income has not been received during that year, or

(ii) For any other reason, then –

(a) In the case referred to in sub-clause (i) so much of the income applied to such purposes in India during the previous year in which the income is received or during the previous year immediately following as does not exceed the said amount, and

(b) In the case referred to in sub-clause (ii) so much of the income applied to such purposes in India during the previous year immediately following the previous year in which the income was derived as does not exceed the said amount.

May at the option of the trust to be exercised in writing to the assessing officer before the expiry of time allowed for filing of return u/s 139(1) then in that case such income will be deemed to be income applied during the previous year.

Such option is to be exercised in a prescribed form 9A.

This form is to be filed before the due date of filing of return u/s. 139 and it is to be furnished electronically either under Digital Signature or Electronic Verification Code. This application in Form No 9A is effective from AY 2016-17.

3.5 The CBDT by their Circular No. 7/2018 dated 20-12-2018 authorized all the CIT (Exptn) to admit the belated applications for the condonation of delay in filing of form 9A and Form 10 in respect of A.Y. 2016-17 where such forms are filed after the expiry of the time allowed under the relevant provisions of the Act.

The Commissioners will while entertaining such belated applications satisfy themselves that the assessee was prevented by reasonable cause from filing of the Form 9A and Form 10 within stipulated time and further for Form 10 the CIT should see that the accumulated amount is deposited in the permitted mode u/s. 11(5).

4 Excess application of last year's (Deficit)

There is no provision in Income-tax Act for the charitable trust that it can carry forward the excess application of the income to be set off against the future income

The various High Courts have decided in favour of this and held that if a charitable trust has incurred deficit in a particular year then it treated as application against the future income it means the trust can carry forward the excess spending and set off against the future income.

This is confirmed by various High Courts in cases mentioned herein below:

i) ***CIT vs. Maharana of Mewar Charitable Foundation (1987) 164 ITR 439 (RJ)***

ii) ***CIT vs. Shri SwetambarMurtiPujak Jain (1995) 211 ITR 293 (GJ)***

iii) ***CIT vs. Matriseva Trust (2000) 242 ITR 20 (Madras)***

iv) ***Gems and Jewellery Export Promotion council vs. ITO 68 ITD 95 (Bom Tribunal)***

v) Volkart Foundation ITA No. 4209/Bom/73-74

vi) Balkan-ji-Bari ITA No. 3078 (Bom)/77-78(1979) 2 Taxman 377.

The income tax department did not accept this proposition and filed SLP in Supreme Court in the case of ***DCIT (Exp.) New Delhi vs. Subros Education Society.*** The Supreme Court by its order dated 9-11-2017 *vide* ITA No. 6240/Del/2016 (AY 2012-13) has dismissed the said SLP.

The matter of excess spending by the trust to be set off against the future income is now settled by the dismissal of the SLP filed by the Department. Therefore with this judgment set off of excess spending has become law of the land which the IT Dept. has also accepted.

With this judgment of the Apex Court some issues have cropped up that whether the amount of earlier years' excess spending shall be taken up with the standard accumulation of 15% or it is to be taken up without standard accumulation of 15%. In my view and as per the system of taxation of charitable trust the excess spending other than 15% should be set off against the future income since the 15% standard accumulation is not in fact spent by the trust. It is pertinent to note that some software for filing of returns do not calculate accumulation of 15% in case of excess spending.

There are some practical difficulties in claiming the set off or carry forward of excess spending in ITR-7. There is no column or system in ITR-7 to claim or set off the excess spending of earlier years and to carry forward the current year's deficit. The ITR-7 is not updated to resolve this situation. The practical solution opted by many such assessee trusts is to increase the application of income of the current year by adding earlier years excess spending in the column of other expenses under the head of application of income. Now it is to be seen how the department will accept it. We hope that the ITR-7 for the next year is amended to cover this matter.

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Charitable Trusts – Business, depreciation and prohibition as to application of income in a certain manner

CA Anil Sathe

Background/Introduction

The taxation of charitable trusts has undergone significant changes over the past decade. The attitude of the tax authorities has changed from a benign one to that where claims by charitable trusts are looked at with suspicion. At times the treatment is hostile. It must be admitted that certain unscrupulous persons who have sought to use the exemption to Charitable/ religious entities under the Income-tax Act (Act) as a vehicle for tax avoidance/evasion. Having said that the law has been made increasingly complex making it difficult for charitable entities to comply with the same. The amendment made with effect from our A.Y. 2009-10 to Section 2(15) has raised a large number of controversies. The tax authorities have often taken an extreme view that any activity which has the colour of business will result in the object of the entity not being a "charitable purpose" and as a consequence the exemption under Section 11 is being denied. That amendment is dealt with exhaustively in another article in this special issue.

In this article, I will be dealing with the following aspects

(a) Position of Section 11(4) and 11(4A) Post insertion of the proviso to Section 2 (15)

(b) Allowability or otherwise of depreciation- Section 11(6)

(c) Allowability of other exemptions when an exemption under Section 11 is claimed 11(7)

(d) Impact of section 13

Section 11(4)/11(4A)

Before proceeding to analyse the import of Section 11(4)/11(4A) after the insertion of the proviso to Section 2(15), it is necessary to reproduce the relevant parts of said proviso as it stands today–

(15) "Charitable purpose" includes relief of the poor, education, ……., and the advancement of any other object of general public utility:

Provided that the advancement of any other object of general public utility shall not be a charitable purpose, ***if it involves the carrying on of any activity*** in the nature of trade, commerce or business, ***or any activity of rendering any service*** in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless–

(i) Such activity is undertaken in the course of actual carrying out of such

advancement of any other object of general public utility; and

(ii) The aggregate receipts from such activity or activities during the previous year, do not exceed twenty per cent of the total receipts, of the trust or institution undertaking such activity or activities, of that previous year

Emphasis supplied by me

On a plain reading it is apparent that for the proviso to be attracted two conditions should be satisfied namely

(i) The objects of the assessee are *in the nature of advancement of any other object of general public utility* (if the objects pursued are in the nature of education medical relief etc., the proviso does not apply)

(ii) The trust itself is engaged in "carrying on" the activity in the nature of trade commerce or business, or rendering services to any trade or business

The latter part of the proviso carves out the exceptions to the application of the proviso.

Section 11(4)

A question that one needs to answer is that if business is such a big taboo that its existence in the life of a trust vitiates the exemption then how does one reconcile the continued existence of Section 11(4) and (4A) on the statute for more than a decade when both provisions deal with "business". In the light of the above analysis let us proceed to analyse Section 11(4). Firstly, it is necessary to appreciate that Section 11(4) and 11(4A) operate in completely distinct and different areas though they are often used in conjunction and as alternatives to each other. Section 11(4) reads as under

Section 11.....

(4) For the purposes of this section "**property held under trust**" includes **a business undertaking so held**, and where a claim is made that the income of any such undertaking shall not be included in the total income of the persons in receipt thereof, the Assessing Officer shall have power to determine the income of such undertaking in accordance with the provisions of this Act relating to assessment; and where any income so determined is in excess of the income as shown in the accounts of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes.

Section 11 grants exemption in respect of income from property held under trust for charitable purposes. There is an impression in the minds of most that if a trust has any income in the nature of business income it will be denied the exemption under Section 11. If one carefully analyses the proviso to Section 2(15), the same would be attracted only in the eventuality that the trust itself ***carries on an activity in the nature of trade commerce or business or renders service in relation to trade and commerce or business.*** Both these limbs require an overt act by the trustees or persons acting through them or on their behalf of ***carrying on an activity*** in the nature of business.

If a business undertaking including the personnel who run or manage it is settled on a trust, such an undertaking being "property held under trust" then the proviso ought not to apply. Though such a situation is a rare in today's world, in the immediate post-independence era industrialists or businessmen settled entire undertakings on charitable and religious trusts. For example if a factory along with its management which operates the business of the factory is settled on the trust with a direction that the income be

utilised for the objects of the trust then in such a situation the trustees or those who run the charitable activities of the trusts are not "carrying" on a trade commerce or business nor are they rendering service in relation to any trade or commerce or business. What they are merely enjoying is the "income" of the undertaking which income the law mandates that they apply for the objects of the trusts and claim exemption under Section 11.

One must remember that even after the insertion of the proviso to Section 2(15), there were no amendments to section 11(4) and 11(4A). If the intent of the legislature was to deny exemption to any income in the nature of business income, an amendment to these two provisions would have been made. One must interpret the law harmoniously and not as to make some part of it otiose.

In the situation envisaged the entire business undertaking is settled on the trust and the trustees are entitled to its income for the purposes of achieving the objects of the trust. It is only that part of the assessed business income of the undertaking which is in excess of the income as per the books of account that will not be entitled to exemption. The rationale for such a provision seems to be that the income of the undertaking which is the property of the trust will be computed under Sections 28 to 44. Consequently, if the assessment results in any income in excess of the income recorded in the books it would be as a result of an infringement of the law. Such income would not therefore enjoy exemption.

Section 11(4A)

The harmonisation of Section 11(4A), with the amendment to Section 2(15) poses some difficulty. The said section reads as under

(4A) Sub-section (1) or sub-section (2) or sub-section (3) or sub-section (3A) shall not apply in relation to any income of a trust or an institution, being profits and gains of business, unless the business is **incidental to the attainment of the objectives of the trust** or, as the case may be, institution, and separate books of account are maintained by such trust or institution in respect of such business.

The proviso to Section 2(15) carves out an exception. If the activity in the nature of trade commerce and business is carried on *in the course of the actual carrying out of any other object of the nature of advancement of general public utility and receipts of such business do not exceed 20% of the gross receipts of the trust then the proviso will not apply.*

Section 11(4A), unlike Section 11(4) clearly covers an activity carried out by the trust through its trustees or other persons acting for them. The only requirements of section are that the activities are incidental to the objects of the trust and separate books of account are maintained. It therefore appears that Section 11(4A) is an adjunct to the carve out prescribed by the latter part of the proviso to Section 2(15). Consequently in a situation that the activity in the nature of business is carried out in the course of achieving the objects of the trust, the receipts are 20% or less of the gross receipts of the trust and separate books of account are maintained, the exemption would be available.

Here it must be pointed out that the activities contemplated in 11(4A) are those activities which are **incidental to** the attainment of the objectives of the trust. If the activities are intrinsic to the objects of the trust, then the proviso ought not to apply. For example, in a religious trust if propagation of religion is a part of its objects then publishing books on the nature of the religion its beliefs et cetera is intrinsic to the objects. This is distinct and different from an activity being carried on "in the course" of achieving objectives or incidental to objectives. Admittedly

the dividing line between what is "intrinsic" and what is "incidental" may be difficult to draw and will have to be decided in the context of the fact matrix. Several judicial pronouncements support this proposition. A couple of them are

DIT (Exemptions) Mumbai vs. Lala Lajpatrai Memorial Trust 69 taxmann.com 158 (Bom.)

ADIT vs. Jeevan Vidya Mission 64 taxmann.com 62 (Mum-Trib.)

To summarise the proviso to Section 2(15), Section 11(4), Section 11(4A) harmoniously read together give rise to the following propositions:

(a) If the activity of a trust having as its object the advancement of general public utility is intrinsic to its objects the proviso to section 2(15) does not apply and income if any generated from such activity will enjoy exemption under section 11

(b) If a business is settled on the trust then the entire income of such business {subject to the limitations prescribed in section 11(4), will enjoy exemption

(c) If a business *carried on* by the trust is incidental to its objects, receipts whereof are less than 20% of the receipts of the trust and separate books of account are maintained of such an activity the exemption will be available. In the event any of these conditions is infringed the exemption will be lost in entirety.

Depreciation

The issue of allowability of depreciation or treatment of such depreciation as application of income of the trust has always been a bone of contention. This is on account of the fact that any capital expenditure resulting in acquisition of an asset was treated as application of income for the objects of the trust. Consequently, it was urged by Income tax authorities that allowance of depreciation on such assets would amount to double deduction.

However various judicial pronouncements have categorically held that income of a charitable trust must be computed according to commercial accounting principles. Therefore, trusts have been claiming depreciation on assets cost whereof has been allowed as an application. Courts have also allowed such claims on the principle that if the charitable activity is to continue unhindered the asset acquired would have to be replenished or substituted at the end of its life and this would be possible only if a reserve for the same was created by claim of depreciation. The issue was finally settled by a decision of the Supreme Court in ***CIT Pune vs. Rajasthan & Gujrathi Charitable Foundation Pune 98 taxmann.com 127 (SC)***. Unfortunately, it was not realised that the freshly acquired asset would be treated as an application under Section 11.

This anomaly was set right by the insertion of Section 11(6) which reads as under

Section 11.....

(6) In this section where any income is required to be applied or accumulated or set apart for application, then, for such purposes the income shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as an application of income under this section in the same or any other previous year.

This amendment came into force from assessment year 2015-16 . The amendment raised a few issues, the first being as to whether the said amendment was prospective or retrospective. This appears to have been settled in favour of the assessee with a number of judicial pronouncements holding that the amendment is

prospective. ***DIT (Exemptions) vs. Medical Trust of Seventh Day Adventists 84 taxmann.com 202 (Mad), PCIT vs. Sri Sri Adichunchunagari 72 Taxmann.com 133 (Kar.)***

Further the amendment itself clearly states that depreciation will not be allowed in respect of any asset cost of which has been claimed as an application. Therefore, where the cost has not been claimed as an application, (for example the asset has been financed out of a corpus donation) depreciation would be allowed.

Claim for exemption under any other provision

Section 11(7) provides as under

Section 11……

Where a trust or an institution has been granted registration under clause (b) of sub-section (1) of Section 12AA or has obtained registration at any time under Section 12A [as it stood before its amendment by the Finance (No. 2) Act, 1996 (33 of 1996)] and the said registration is in force for any previous year, then, nothing contained in Section 10 [other than clause (1) and clause (23C) thereof] shall operate to exclude any income derived from the property held under trust from the total income of the person in receipt thereof for that previous year.

Prior to the insertion of this section there was a controversy as to whether an entity claiming an exemption under Section 11 could also claim exemption under any other provision of law. For example, certain trusts whose investment in shares was permitted by law or those who had made investments in mutual funds earned dividend. Such dividend was exempt under Section 10. The issue was while computing the application test of 85% whether it was permissible to exclude such income. If this was permitted a charitable trust could enjoy complete exemption while spending only a limited quantum of its receipts. To illustrate if a trust had an income of ₹ 100 consisting of ₹ 50 from dividend and ₹ 50 from voluntary contributions it could enjoy a complete exemption by spending only ₹ 42.50. There were decisions on both sides of the spectrum. This was clearly not the intent of the law, and therefore the above provision was inserted.

Post the amendment a charitable trust registered under 12A, can claim exemption only under Section 10(1), which is agricultural income and the income under Section 10(23C), which is the special exemption available to charitable trusts.

Section 13

Section 13 provides for situations which would exclude the operation of Section 11, that is if the events or situations envisaged in the various clauses of Section 13 arise then the trust would stand to lose its exemption either in entirety or in part.

The situations are as under

(1) Any part of the income of the trust for private religious purposes which does not enure for the benefit of the public - 13(1)(a)

(2) Any income of the trust for charitable purposes created or established after the commencement of the Act if any income thereof is utilised for the benefit of any particular religious community or caste - 13(1)(b)

(3) Any income of a trust for charitable religious purposes which is used or applied directly or indirectly for the benefit of any person referred to in subsection (3) - 13(1)(c)

(4) Any income of the trust if it is invested or remains invested in any form other than those prescribed under Section 11(5)- 13(1)(d)

It is interesting to note that while in regard to sub-clause (a) the word "any part" has been used,

in regard to all other clauses the word "any" has been used.

The question of whether in the event that any of the situations envisaged in clauses (b) to (d) arise, whether the trust would stand to lose its exemption in toto or only that part of the income that triggers the infraction would lose exemption has been a matter of debate. In regard to clauses (c) and (d) the position seems to be reasonably well settled and various courts by referring to the proviso to Section 164 have held that it is only that part of the income that triggers the infraction that would lose exemption and would be taxed at the maximum marginal rate. The rationale for that seems to be sound, in as much as involuntary infraction ought not to result in a trust which is otherwise genuine and well-managed, losing exemption. As far as sub-clause (b) is concerned in that case however the trust would lose exemption in entirety for "existing" for, the benefit of any particular religious community or caste would certainly militate against the principles of our secular country. I must however hasten to add that this restriction applies only to a trust for **charitable purposes or charitable institution**. If the trust exists for **charitable and/ or religious purposes** then in that case, the said clause will not apply. Reliance can be placed on

CIT vs. Ahmed Rana Caste Association 140 ITR (SC)

CIT vs. Dawoodi Bohra Jamat 43 taxmann.com 243 (SC)

As far as sub-clause (a) is concerned the denial of exemption is restricted only to that part of the income which does not enure for the benefit of the public.

If, however the proviso to Section 2(15) is attracted then the trust would stand to lose the exemption in regard to the entire income - Section 13(8).

Savings and restriction to the operation of Section 13

Section 13(6) provides that if an educational or medical trust provides educational or medical facilities to persons referred to in Section 13(3), it is only that part of the income which is applied for the benefit of these persons that will lose exemption. This is a welcome provision for the list of persons in Section 13(3) is so wide that an involuntary infraction of Section 13(1)(c) is possible.

Section 13(9) imposes a condition that an accumulation under Section 11(2) shall be permitted only if the trust files the statement as prescribed under that section within the due date specified under sub-section 139(1) and also furnishes the return of income by that date.

Conclusion

The tax provisions applicable to charitable trusts have become increasingly complex. While one certainly appreciates that an exemption from payment of taxes does not come without the duties that one has to discharge, the law in this regard must be administered with the human touch. One must certainly go by the principles enunciated by the Supreme Court in the decision of ***Commissioner of Customs (Import) vs. Dilip Kumar & Company Civil Appeal No. 3327 of 2007***, where the Supreme Court held that while crossing the threshold of exemption the law must be interpreted strictly but having crossed it, the interpretation should be liberal. The provisions should then be interpreted in a manner that advances the object and suppresses the mischief.

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Formation and Management of a Trust

CA Shailesh Bandi

Formation and Management of a Trust (including Meetings & Resolutions), drafting of Trust Deed/MOA & Rules & Regulations and Indian Trust Act, 1882

Introduction

The Indian Trust Act, 1882 by section 3 defines Trust as an obligation annexed to the ownership of the property and arising out of a confidence reposed in and accepted by the owner or declared and accepted by him for the benefit of another or of another and the owner. According to that section the person who reposes or declares the confidence is called the author of the trust, the person who accept the confidence is called the trustee, the person whose benefit the confidence is accepted it is called the beneficiary. The beneficial interest or interest of the beneficiary is his right against the trustee as owner of the trust property. Trusts generally are mechanisms whereby property can be passed to legal owners' or to persons who cannot be given the property. Thus in trust relationship donor constitutes a legal owner by appointing trustees in whose favour the donor as owner divests himself of the property and vests in the trustees. Such trustees become legal owners for the benefit of beneficiaries are known and recognised in law.

The trust can be public trust or a private trust.

A private trust is governed by the provisions of Indian Trust Act, 1882 and the public trusts in Maharashtra and Gujarat are governed by Bombay Public Trust Act, 1950. In other states where such legislation like Bombay Public Trust Act does not exist the provisions of section 92 of Code of Civil Procedure, 1908 will go on such public trust.

Hereinafter we shall restrict our discussion only in relation to the public trust.

In public trust the beneficiaries are general public and such beneficiaries are incapable of being ascertained.

According to Bombay Public Trust Act, 1950, public trust means an expressed or constructive trust for either charitable or religious purpose for public or may have both purposes.

Bombay Public Trust Act does not define the trust. Therefore the words and expression used but not defined in the Mumbai Public Trust Act and defined in the Indian trust act shall have the meaning assigned to them in that Act.

FORMATION OF TRUST

A public charitable or religious institution can be formed either as

a. a Trust; or

b. a Society; or

c. a Company registered u/s. 8 of the Companies Act, 2013.

It generally takes the form of a trust when it is formed primarily by one or more persons. To form a Society at least seven persons are required. Institutions engaged in promotion of art, culture, commerce etc., are often registered as non-profit companies. These forms are enumerated as under:

1. Charitable Trust settled by a settlor by a Trust Deed or under a Will.

2. Charitable or religious institution/ association can be formed as a society.

3. Charitable institution can be formed by registering as a company u/s. 8 of the Companies Act, 2013, as non-profit company (without addition to their name, the word "Limited" or "Private Limited").

CREATION/ FORMATION OF TRUST

Creation of a Public Trust

The following are the requisites for creation of a Trust:

(i) The existence of the *author/settlor* of the Trust or someone at whose instance the Trust comes into existence and the settlor to make an unequivocal declaration which is binding on him.

(ii) There must be a *divesting of the ownership* by the author of the trust in favour of the trustee for the beneficial enjoyment by the beneficiary.

(iii) A *Trust property.*

(iv) The objects of the trust must be precise and clearly specified so as to for which the property is thereafter to be held, i.e. the beneficiaries.

It is essential that the transferor of the property *viz.* the settlor or the author of the trust must be competent to contract. Similarly, the trustees should also be persons who are competent to contract. It is also very essential that the trustees should signify their assent for acting as trustees to make the trust a valid one.

When once a valid trust is created and the property is transferred to the trust, it cannot be revoked. If the trust deed contains any provision for revocation of the Trust, provisions of sections 60 to 63 of the Income-tax Act will come into play and the income of the Trust will be taxed in the hands of the settlor as his personal income.

Public Trusts for Charitable or Religious Purposes

The income derived from a property held under charitable or religious trusts is exempt from tax u/s 11 subject to the fulfilment of certain conditions. However, any profit or gain of a business carried on by such trust shall not be exempt unless the business is incidental to the attainment of the objectives of the trust/institution and separate books of account are maintained by such trust/institutions in respect of such business.

Who can form a Charitable or Religious Trust

As per section 7 of the Indian Trusts Act, a Trust can be formed –

a. by every person competent to contract, and

b. by or on behalf of a minor, with the permission of a principal civil court of original jurisdiction.

A person competent to contract is defined in section 11 of the Indian Contract Act as a person

who is of the age of majority according to the law to which he is subject and who is of sound mind and is not disqualified from contracting by any law to which he is subject. Thus, generally speaking, any person competent to contract and competent to deal with property can form a Trust. Besides individuals, a body of individuals or an artificial person such as an association of persons, an institution, a limited company, a Hindu undivided family through it's *karta*, can also form a Trust.

It may, however, be noted that the Indian Trust Act does not apply to public trusts which can be formed by any person under general law. Under the Hindu Law, any Hindu can create a Hindu endowment and under the Muslim law, any Muslim can create a public wakf. Public Trusts are essentially of charitable or religious nature, and can be constituted by any person.

Capacity to create a Trust

As a general rule, any person, who has power of disposition over a property, has capacity to create a trust of such property. According to section 7 of the Transfer of Property Act, 1882, a person who is competent to contract and entitled to transfer the property or authorized to dispose of transferable property not his own, either wholly or in part and either absolutely or conditionally, has 'power of disposition of property'.

Thus, two basic things are required for being capable of forming a trust – power of disposition over property and competence to contract.

Who can be a Trustee

Every person capable of holding property can become a trustee. However, where the trust involves the exercise of discretion, he can accept or act as a trustee only if he is competent to contract. No one is bound to accept trusteeship. Any number of persons may be appointed as trustees. However, no trust is defeated for want of a trustee. Where there is no trustee in existence, an official trustee may be appointed by the court and the trust can be administered. An executor of a Will may become a trustee by his dealing with the assets under the provisions of the Will. When an executor is *functus officio* to any of the assets and yet retains them, he becomes a trustee in respect of those assets.

Requisites of a Trust

While creating a Trust, one must identify the following while Drafting the Deed of Trust

1. Author or settlor of the trust
2. Trust name by which Trust shall be known
3. Place were its office shall be situated (proof of such address & then consent letter to be prepared)
4. Names of the Trustees with address, occupation, PAN No. and Aadhaar No. (Copy of the Pan Card Aadhaar card should be attached)
5. Beneficiaries
6. Preamble
7. The property settled, for Trust – In case of immovable property, it should contain full description of the property sufficient to identify it
8. An express intention to direct the Trust property from the trustees
9. The objects of the Trust
10. Minimum and maximum number of Trustees
11. The procedure for appointment, removal, replacement of trustees
12. Trustees rights, duties and powers
13. Administration of trust

14. Provision for maintenance of accounts, auditing etc.

15. Clause enabling, spending and utilization of the Trust funds or corpus.

16. Bank Account operations

17. Borrowing money on security for the purpose of the Trust

18. Investment of the Trust funds and dealing with Trust properties

19. Alienation of immovable property of the Trust

20. Amalgamation clause

21. Dissolution of Trust Irrevocable nature of the trust.

The Procedure for creating the different types of Entites to be classified as NGO/NPO i.e., Trust

Registration of Charitable Trust
Registration of Public Trust (Sec. 18 of Bombay Public Trust Act)

1. It shall be the duty of the trustee of a public trust to which this Act has been applied to make an application for the registration of the public trust.

2. Such application shall be made to the Deputy or Assistant Charity Commissioner of the region or sub-region within the limits of which the trust has an office for the administration of the trust or the trust property or substantial portion of the trust property is situated, as the case may be.

3. Such application shall be in writing & shall be in such form and accompanied by such fee as may be prescribed.

4. The application shall be made within 3 months of creation of the Public Trust.

5. The application shall *inter alia* contain the full detail as prescribed in the form of Schedule II – (under Rule-6).

6. Every application made under sub-section (1) shall be signed and verified in the prescribed manner by the trustee or his agent specially authorized by him in this behalf. It shall be accompanied by a copy of an instrument of trust, if such instrument has been executed and is in existence.

7. Where on receipt of such application, it is noticed that the application is incomplete in respect of any particulars, or does not disclose full particulars of the public trust, the Deputy or Assistant Charity Commissioner may return the application to the trustee, and direct the trustee to complete the application in all respects or disclose therein the full particulars of the trust, and resubmit it within the period specified in such direction; and it shall be the duty of the trustee to comply with the direction.

8. It shall also be the duty of the trustee of the public trust to send memorandum in the prescribed form containing the particulars, including the name and description of the public trust, relating to the immovable property of such public trust, to the Sub-Registrar of the sub-district appointed under the Indian Registration Act, 1908, in which such immovable property is situated for the purpose of filing in Book No. I under section 89 of that Act.

Such memorandum shall be sent within three months from the date of creation of the public trust and shall be signed and verified in the prescribed manner by the trustee or his agent specially authorized by him in this behalf.

When the Registering Officer is satisfied that the provisions of the Act as applicable to the

document presented for registration have been complied with, he shall endorse thereon a certificate containing the word "registered", together with the number and page of the book in which the document has been copied. Such certificate shall be signed, sealed and dated by the Registering Officer, and shall then be the conclusive evidence that the Trust has been duly registered. A registered trust deed shall become operative (retrospectively) from the date of its execution.

While making the Registration, the following documents are required to be filed for registration of a Charitable Trust.

- Covering Letter
- Application Form in Form – Schedule II under rule 6 duly notarised
- Court fee stamp of ₹ 2/- to be affixed on application form
- Certified copy of the Trust Deed
- Consent letter of Trustees.

The office of the Charity Commissioner maintains a register containing all details of the Trust; *viz*,

1. Reg. No.
2. Name and address of the trust
3. Names of all the trustees (past & present)
4. Mode of succession of trusteeship
5. Objects of the trust
6. Particulars of documents creating a trust
7. Description of movable and immovable properties
8. Particulars of encumbrances on trust property etc.

The above is maintained in the register is known as P. T. Register. A certified copy of the P.T. Registrer in Schedule-I (*vide* Rule 5) can be obtained by applying in simple application with ₹ 10/- Court fee stamp by paying prescribed fees for the same. It is advisable for all the trusts to have a certified copy of P. T. Register entry.

Registration under the Societies Registration Act

Society as a form of charitable institution will be suitable, where a large number of contributors making regular contributions would require some kind of indirect control by the office bearers. The best examples are professional organizations.

The Charity Commissioner is also an authority to register such organizations as a society. When a trust is constituted as a society, it is required to be registered under the Societies Registration Act, 1860.

In the case of Society the Memorandum of Association of the Society and the Rules and Regulations governing the Society are to be separately made.

After the Memorandum and Rules and Regulations of the Society have been made, they are to be signed and witnessed in the prescribed manner, the members should obtain the registration of the society.

For the purpose of registration as society, following documents are required to be filed :

a. Letter requesting for registration stating in the body of the letter various documents annexed to it. The letter is to be signed by all the subscribers to the Memorandum or by a person duly authorised by all of them to sign on their behalf.

b. Memorandum of Association, in duplicate, neatly typed and pages serially numbered.

c. Rules and Regulations in duplicate.

d. Where there is a reference to any particular existing places of worship like

temple, mosque, church, etc., sufficient documentary proof establishing legal competence and control of applicant society over such places should be filed.

e. An affidavit of the President or Secretary of the society, on a non-judicial stamp paper of prescribed value, stating the relationship between the subscribers, duly attested by an Oath Commissioner, Notary Public or First Class Magistrate.

f. Documentary proof of address such as House Tax receipt, rent receipt in respect of premises shown as Registered Office of the society or no objection certificate from the landlord of the premises.

If the Registrar is satisfied with the documents filed, he then requires the applicant society to deposit the registration fee. Normally, registration fee is ₹ 50, payable in cash or by demand draft. After the registration formalities have been completed and the Registrar is satisfied that the provisions of the Act have been complied with, he issues a certificate of Registration. Certified copies of the Rules and Regulations and Memorandum can be obtained by making simple application.

An entity registered under the Societies Act also gets registration under the local Public Trusts Act; i.e., Bombay Public Trust Act by making an application simultaneously as mentioned above in case of trust deed. This is so because the definition of a Public Trust in Bombay Public Trust Act includes a "Society" which is registered under the Societies Registration Act.

Registration under Companies Act

A charitable institution/association can be registered as a non-profit company and obtain a licence u/s 8 of the Companies Act.

Section 8 company is a company licensed under Section 8 of the Companies Act, 2013 (the Act), erstwhile known as Section 25 company under the Companies Act, 1956.

The Objects of the Section 8 company can be akin to that of the Trust or Society and therefore, Section 8 company is a company registered for charitable or not-for-profit purposes.

Section 8 Company is similar to a Trust or Society; exception is that a Section 8 company is registered under the Central Government's "Ministry of Corporate Affairs (MCA)" whereas the Trusts and Societies are registered under State Government regulations.

The key feature of a Section 8 company is that name of the company can be incorporated without using the word "Limited" or "Private Limited" as the case may be & no dividend is paid to its members.

The requirement of minimum capital under the Act also does not apply to Section 8 Company *vide* Notification of June 5, 2015.

REQUIREMENT & PROCEDURE

1. Minimum two people required for registration of Section 8 company

2. To obtain Digital Signature Certificate (DSC) for proposed Directors not having Directors Identification Number (DIN)

3. To obtain DIN from Ministry of Corporate Affairs (MCA) for proposed Directors by filing Form DIR-3, if not having DIN

4. Filing of Form INC-1 for Reservation of Name by Proposing 3 names

5. Post approval of name from the concerned Registrar of Companies, file Form INC-12 {pursuant to Section 8(1) of the Act and Rule 19 of Company (Incorporation) Rules, 2014} (the Rules) along with the following

i. Draft Memorandum of Association of the proposed company in Form INC-13

ii. Draft Articles of Association of the proposed company

iii. Declaration by Practising Chartered Accountant/ Practising Company Secretary/ Practicing Cost Accountant in Form INC-14.

iv. Declaration from each person making application in Form INC-15.

v. Estimated Income and Expenditure for next 3 years

(***Note***: Form INC-12 is in physical mode and the e-form is not yet available on MCA21 Portal. Thus, the same needs to be filed in Form RD-1 with prescribed fees).

The following will have to be attached to Form RD-1

i. Form INC-12

ii. Draft Memorandum of Association of the proposed company in Form INC-13

iii. Draft Articles of Association of the proposed company

iv. Declaration by Practising Chartered Accountant/Practising Company Secretary/ Practicing Cost Accountant in Form INC-14

v. Declaration from each person making application in Form INC-15

vi. Estimated Income and Expenditure for next 3 years

6. The Central Government after examining grants the license in Form INC-16

7. After obtaining the license, following forms need to be submitted

   I. Form INC-7

   II. Form INC-22

   III. Form DIR-12

8. Post scrutiny of the submitted forms and documents the Corporate Identification Number (CIN) will be issued by the concerned Registrar of Companies.

The List of documents required:

I. Identity Proof: Copy of Permanent Account Number (PAN) of all Directors/Promoters (Mandatory)

II. Address Proof: Copy of valid Passport/ Driving Licence/Aadhaar/Telephone Bill/ Electricity Bill (not older than 2 months)

III. Latest passport size photographs of all Directors/Promoters

IV. Rent Agreement or Leave & Licence Agreement, if registered office premise is taken on rent

V. Utility Bills of proposed registered office

VI. Consent to act as Director in Form DIR-2

VII. Directors Directorship details in other Companies/LLPs, if any.

(***Note***: A Company incorporated u/s 8 will be active as long as the annual compliances under the Act and the Rules made thereunder are complied with. In case annual compliances are not complied with, the company will be a Dormant Company and maybe struck off from the register.)

Registration under Income-tax Act

Charitable or religious trusts, societies and Section 8 companies are required to obtain

registration under the Act for claiming exemption under sections 11 and 12 of the Income-tax Act.

The detailed procedure for registration of the aforesaid entities u/s. 12AA of the Income-tax Act is as under.

i. Application for registration in Form No.10A in duplicate.

ii. List of Names and Addresses of the Trustees.

iii. Copy of Registration Certificate with Charity Commissioner or copy of application to him.

iv. Certified True Copy of the Trust Deed.

v. PAN No. or Copy of application of the Trust.

vi. PAN of the trustees.

Procedure for registration (Sec 12AA)

The Commissioner, on receipt of an application for registration of a trust or institution made under clause (a) of section 12A, shall –

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

ii. after satisfying himself about the objects of the trust or institution and the genuineness of its activities he –

   a. shall pass an order in writing registering the trust or institution;

   b. shall, if he is not so satisfied, pass an order in writing refusing to register the trust or institution,

   and a copy of such order shall be sent to the applicant.

iii Provided that no order under sub-clause (ii) shall be passed unless the applicant has been given a reasonable opportunity of being heard.

In all these entities, it is important to for the Trustees/Governing council members/ Board of Directors as the case may be to run their entities in an efficient manner and it would be prudent to include within its ambit under the clauses of the Trust Deed/Memorandum of Association of the Society and the Rules and Regulations governing the Society/Memorandum and Articles of Association of the Company as to their Powers and Functions. The Document should clearly bring out as to the minimum no. of meetings to be held, who shall convey the meetings. It should further be expressed that the minutes of the meeting shall be maintained and what types of resolutions should be passed i.e., what type of Business would require an ordinary or a special resolution should be expressly stated.

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If money help a man to do good to others, it is of some value; but if not, it is simply a mass of evil, and the sooner it is got rid of, the better.

– Swami Vivekananda

Property held under the Trust, Voluntary Contribution, Annonymous donations and Grants

CA Tushar Doctor & CA Zankhana Mehta

1) **Property held under the Trust**

For the purpose of determining the income of the Trust eligible for exemption under section 11, the income arising from property held under Trust constitutes the income of the Trust. It will mean income from property, business, dividends, interest on securities or other interest. It will also include donations received by the trust, by virtue of the provisions of section 12. In other words, the income for the purpose of section 11 is the income as per the accounts of the Trust. It means the income in the commercial sense, without reference to the heads of income. The concept of total income as defined in section 2(45) is not applicable to trusts entitled to exemption under section 11. The rationale is that in case of a trust one has to determine the surplus available for application on objects of the trust. Hence, all expenses resulting in monetary outflow for the trust have to be taken into account even if such expenses are otherwise not allowable as a deduction in computing the taxable income in case of other assessees.

a) Income of the Trust must be understood in its commercial sense.

Therefore loss on sale of shares incurred to make the investment in specified investment u/s. 11(5), amounted to application of income.

[Chidambaram chettiar foundation vs. ITO (1991) 39 TTJ 82(AT) (MAD)]

b) Head wise computation of income is not necessary ***[DJT (Exempt) vs. Girdhanlal Shewnarain Tantia Trust 199 ITR 215 (Cal.)]***

c) Depreciation is allowable even where the assessee has not incurred the cost of acquiring the assets, as the asset was transferred from another trust ***[CIT vs. Institute of Banking Personnel Selection (IBPS) 2003 131 Taxman 386 (Bom).]***

d) Application of income may not result into Revenue Expenditure

Even if Capital Expenditure is incurred on the objects of Trust, income would exempt ***[CIT vs. Kannika Parameshwori Devastharam & Charities [1982] 133 ITR 779 (Mad)].***

CIT vs. S.T. George Forana Church (1988) 170 ITR 62 (Ker).

e) Repayment of loan taken for construction of a building shall qualify as income application for charitable purpose.

[CIT vs. Janmabhoomi Press Trust (2000) 242 ITR 703 (Kar)]

Payment of Income Tax

Yes, amounts to application of income on the objects of the Trust [As per ***CIT vs. Ganga Charity Trust Fund 162 ITR 612 (Guj)***]

Payment of Taxes

Amounts to application for Charitable purpose as necessary to preserve the corpus which in turn is essential for existence of Trust.

[CIT vs. Janaki Ammal Ayya Nadar Trust (1985) 153 ITR 159 (Mad)].

Tax liability shall be excluded in the year of payment whether it relates to current or preceding year.

CIT vs. Trustees of H.E.H The Nizam Supplemental Religious Endowment Trust [1981] 127 ITR 378 (AP).

f) A Business Undertaking held by Trust is treated as property held under trust.

To claim exemption u/s. 11, the business should

1) Be incidental to attainment of objects of Trust [if profit is applied for attainment of objects, the business income will claim sec 11 benefit] ***CIT vs. Thanthi Trust***

2) Maintain separate Books.

This position is also confirmed by the CBDT in its Circular No. 5-P (LXX-6) dated 19th June, 1968 & also by ***CIT vs. Trustees of H.E.H. Nizam's Supplemental Religious Endowment Trust (1981) 127 ITR 378. (A.P.); CIT vs. Rao Bahadur Calwala Cunnan Chetty Charities (1982) 135 ITR 485 (Mad.),*** and ***CIT vs. Estate of V. L. Ethiraj (1982) 136 ITR 12, (Mad.).***

The total income as per section 2(45), being artificially computed income, will normally differ from the actual income of the Trust, but so long as the Trust has utilised its actual income, it will not be liable to tax, irrespective of the position of the total income. If it has not utilised part of the actual income, the balance, after accumulation of 15 per cent under section 11(1)(a) and any additional amount under section 11(2), will be liable to tax.

2) **Voluntry Contributions**

Any voluntary contributions received by a trust created wholly for charitable or

religious purposes or by an institution established wholly for such purposes (not being contributions made with a specific direction that they shall form part of the corpus of the trust or institution) shall for the purposes of section 11 be deemed to be income.

In the case of a trust, voluntary contributions received can be divided into corpus donations, anonymous donations and other donations.

Section 2(24)(iia) provides that the term 'income' includes voluntary contributions received by the following entities:

(a) Wholly or partly religious or charitable trust.

(b) Scientific association exempt u/s. 10(21).

(c) Certain funds/trusts/institutions notified by the Central Government exempt u/s. 10(23C)(iv) & (v).

(d) University, other educational institution, hospital or medical institution exempt u/s. 10(23C)(vi) & (via).

(e) University, other educational institution, hospital or medical institution having annual aggregate receipts not exceeding ₹ 1 crore, exempt u/s. 10(23C)(iiiad) & (iiiae).

Till the assessment year 1972-73, there was no provision deeming voluntary contributions to be income of a charitable trust generally, except for section 12(2), which deemed donations received from other trusts to be income derived from trust property for the purpose of section 11. The Supreme Court had then held in the case of ***Guru Estate vs. CIT (1963) 48 ITR 53,*** that donations received by a temple from pilgrims were not income chargeable to tax. The Bombay High Court had held in the case of ***H. H. Maharani Shri Vijaykunverba Saheb of Morvi vs. CIT (1963) 49 ITR 594***, that a voluntary payment made entirely without consideration and not traceable to any source which a practical man may regard as a real source of his income, depending entirely on the whim of the owner, cannot fall in the category of income. This decision has been approved of by the Supreme Court in the case of ***Padmaraje R. Kadambande vs. CIT(1992) 195 ITR 877,*** where a similar view was taken. Hence, voluntary contributions are not 'income' in the general sense of the term. Section 2(24)(iia) was therefore necessary to bring donations received by a trust within the ambit of income.

In the case of Trustees of ***Shree Kot Hindu Stree Mandal vs. CIT (1994) 209 ITR 396,*** the Bombay High Court has held that membership fees and subscription are not voluntary contributions, not being gratuitous payments, and are therefore not "income". In the case of ***CIT vs. W.I.A.A. Club Ltd. (1982) 136 ITR 569,*** the Bombay High Court held that the portion of life membership fees attributable

to entrance fees was capital receipt, while the remaining life membership fees was commuted value of annual subscription taxable as income.

The Trustees of a Charitable Trust are entitled to accept donations unless expressly prohibited under the Trust Deed, as held by the Supreme Court in the case of ***Sardar Bahadur S. Indrasingh Trust vs. CIT (1971) 82 ITR 561.***

3) **Corpus Donations**

i. Corpus donations are donations, which are received with a specific direction from the donor that the donation shall form part of corpus of the trust. Corpus donations shall not be recognised as income. Such corpus donations need not be applied for the objects as required for other voluntary contributions. Any income derived from such corpus donations should be applied for the objects – ***CIT vs. Sthanakvasi Vardhman Vanik Jain Sangh (2003) 260 ITR 366 (Guj).***

ii. Subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by the Central Government or a State Government as the case may be shall not form part of income of such trust or institution.

iii. Sec. 11(1)(d) excludes from the total income of the person, any income in the form of contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

iv. Although corpus donation is fully exempt but these are to be considered for the limit of maximum amount, which is not chargeable to income tax i.e., ₹ 250,000/- prescribed for audit of accounts.

v. In the case of ***Lala Kanshi Ram Goela Beriwala Charitable Trust vs. ITO (1991) 41 TTJ (el) 408,*** it was held by the Tribunal that the mere fact that the donors' letters were obtained on identical typed forms was of no consequence, and the donations were to be regarded as corpus donations,

The Mumbai Tribunal in the case of ***Smt. Santaben Natwarlal Hargovandas Foundations vs. ADIT, 91 TTJ 331*** held that the donations supported by the will of the donor as also the letter of the executor of the will making it clear that donation was towards corpus of the trust was sufficient evidence that the donation was eligible for exemption u/s. 11(1)(d).

In the case of ***Prabodhan Prakashan vs. ADIT(E) (1994) 50 ITD 135,*** the assessee had claimed that amounts received in offertory boxes, which had the inscription that donations deposited in such offertory boxes were towards the corpus, were corpus donations. The Tribunal held that amounts collected through such boxes were

not corpus donations, as the inscription was not a direction from the donor but a statement by the donee. It was held that exemption as corpus donations could be claimed only on the basis of a positive indication from the donor to the effect that the donation was towards the corpus. A similar view has also been taken by the Calcutta Bench of the Tribunal in the case of ***Shri Digambar Jain Naya Mandir vs. ADIT (1999) 70 ITD 121,*** where it has been held that merely placing two offertory boxes marked "Corpus Donations" and "Donations" was not sufficient to treat the donations as corpus donations.

In the case of ***Hakmuddin Mulla Hassubhai Singaporewala Charitable Trust vs. ITO (1985) 23 TTJ (Bom) 43,*** the Bombay bench of the Tribunal held that in the case of a trust whose deed contains a stipulation that the donations received shall form a part of the corpus of the trust, it shall not be necessary for the trust to obtain separate direction letter from the donor.

Section 11(1)(d) grants an unqualified exemption for donations to the corpus, irrespective of the provision in the Trust Deed authorising the trust to apply a part or whole of the corpus, if and when they deem fit. Therefore, whether the corpus are utilised for the objects in subsequent years or not, the donations to the corpus are exempt under section 11(1)(d). The Delhi bench of the Tribunal has also confirmed that corpus donations can be applied for the objects of the trust, if the trust deed so permits, and that such application would qualify for exemption under section 11, in the case of ***ITO vs. Abhilash Kumari Charitable Trust (1987) 28 TTJ 523.***

vi. In the case of St. Ann's Home for the Aged, (1982) 17 TTJ (Bang.) 185, it has been held that voluntary contributions expressly received for construction of a building were corpus donations, since they were received and utilized for a capital purpose. In the case of ***Angel Charities vs. ITO (1988) 27 ITD 545 (Del),*** the receipts from staging of a drama for collection of funds for a new building was held to be corpus donations. In the case of ***ITO vs. Satya Kabir Shabani Gadi (1994) 50 TTJ (Ahd.) 501,*** the Tribunal held that "Building Fund" and "Kayami Fund" were corpus of the trust and donations received towards such funds were corpus donations.

4) Donation to other trust

If a Charitable Trust donates its income to another trust, the provisions of section 11(1)(a) can be said to have been met by such donor trust & donor trust can be said to have applied its income for religious & charitable purpose.

Utilisation by donee trust is irrelevant for the purpose of deciding whether donor trust can get exemption u/s. 11 or not.

[CIT vs. Saraladevi Sarabhai Trust No. 2 (1988) 172 ITR 698 (Guj.)]

[CIT vs. Thanthi Trust (1999) 239 ITR 502 (S.C.)]

5) **Contrary to Trust Deed**

Even if trustee spent money beyond their powers given by trust deed, but on the objects of trust for charitable purpose, exemption u/s 11 will be available.

[Trustees of HEH the Nirzam's Pilgrimage Money Trust vs. CIT (1987) 65 CIT (AP) 290

Under the existing provisions of section 11, the corpus donations given by one trust to another trust were considered as application of income in the hands of donor trust. Further, the recipient trust was able to claim the exemption in respect of such corpus donations without applying them for charitable or religious purposes. In order to curb such a practice, amendment of the section provides that any corpus donation out of the income to any other trust or institution registered u/s. 12AA shall not be treated as application of income of donor trust for charitable or religious purposes.

Similar amendment has been made in section 10(23C) in respect of corpus donations given by any fund, trust, institution, any university, educational institution, any hospital or other medical institution referred to in Section 10(23C)(iv) to (via) or to any other trust or institution registered u/s. 12AA.

6) **Anonymous Donations**

i. According to Sec. 115BBC, "Anonymous donation" means any voluntary contribution where a person receiving such contribution does not maintain a record of the identity indicating the name and address of the person making such contribution and such other particulars as may be prescribed.

ii. Anonymous donation received by the following entities shall be subject to tax under Sec. 115BBC:

Sl. No.	***Nature of entities***	***Sec.***
1.	Any University, Educational Institution or Hospitals, existing solely for non-profit or philanthropic purpose, where the aggregate annual receipts do not exceed ₹ 1 crore.	10(23C) (iiiad) and (iiiae)
2.	Any University, Educational Institution or Hospitals other than those institutions referred above and approved by prescribed authority.	10(23C)(vi) and (via)

Sl. No.	*Nature of entities*	*Sec.*
3.	Any Fund or institution established for charitable purposes as may be notified	10(23C)(iv)
4.	Any Trust or institution wholly for public religious purposes or wholly for public religious & charitable purposes	10(23C)(v)
5.	Any Trust created wholly or partly for charitable or religious purposes	11

iii. Anonymous donations are not taxable u/s. 115 BBC in the following cases

(a) Anonymous donation received by wholly religious institution or trust;

(b) Anonymous donation received by a trust or institution created for wholly religious and charitable purposes. However, where such donation is received with a specific direction from the donor that the same shall be used for any educational or medical institutions run by such trust/ institution, amount of anonymous donation shall be subject to tax u/s. 115BBC. On reading the above provision one cannot help but wonder as to how a person can give directions that the donation should be for a specific university or hospital or other educational/medical institution and yet remain anonymous. Surely the onus would be on the department to bring on record substantive circumstantial evidence to establish the same. As discussed earlier, w.r.t. box collections, the courts have held that amounts received in offertory boxes marked as "corpus donations" could not be treated as corpus donations as the inscription on the box could not be treated as direction from the donor.

(c) Anonymous donation received by educational institutions or medical institutions covered u/s. 10(23C)(iiiab) (iiiac), wholly or substantially financed by the Government are not taxable. Also interesting to note that political parties enjoying exemption u/s. 13A are also outside the admit of section 115BBC.

iv. The anonymous donations shall be taxed at 30% plus surcharge plus cess.

(a) In the case of wholly charitable institutions, anonymous donation shall be subject to tax @ 30% on the aggregate of anonymous donations received in excess of the higher of the following:

i. ₹ 1,00,000; or

ii. 5% of the total donations received by such institution.

b) In the case of partly charitable and partly religious institutions, any anonymous donations specifically directed towards a medical or educational institution run by such trust/institution shall be subject to tax @30% on the aggregate of anonymous donations received in excess of the higher of the following:

i. ₹ 1,00,000; or

ii. 5% of the total donations received by such institution.

v. The residual income of the trust will be computed by reducing from the total income of the trust, the anonymous donations that have been taxed at the rate of 30% and not the total anonymous donations received by the trust.

vi. It may be noted that while computing the taxable income of the trust or institution, the total voluntary contributions shall be reduced by the taxable portion of anonymous donations and the balance shall be utilized towards the objects of the trust/institution for claiming exemption Sec. 11 or 10(23C) as the case may be – Sec 115BBC (1)(ii).

vii. Thirteenth proviso has been inserted to section 10(23C) to provide that anonymous donations shall be included in computing the total income of entities covered by that section. Sub-section (7) has been added to section 13 to provide that nothing contained in section 11 or 12 shall operate as to exclude anonymous donations from the total income of the trust.

viii. An interesting issue arises as to whether the amount of anonymous donation is to be considered for calculating the permissible accumulation of 15% specified in section 11(1)(a). Since the anonymous donation is liable to tax @30%, arguably the same will not be considered in calculating the 85% of the income to be applied on the objects of the trust. Hence if the total income is say, ₹ 3 lakh including anonymous donation of ₹ 1 lakh then tax will be payable on ₹ 1 lakh @30% and if out of the balance income of ₹ 2 lakh, 85% (₹ 1.70 lakh) is applied on the objects of the trust then the trust will not be liable to any tax.

However, it may be possible to take a different view that the trust is entitled to accumulate up to 15% of its total income of ₹ 3 lakh. Since tax @30% is anyway payable on the anonymous donation of ₹ 1 lakh, ₹ 1.55 lakh only (85% of 3 lakh – ₹ 1 lakh) would have to be applied on the objects. As is apparent the second view is beneficial to the trust as the minimum amount to be applied on its objects is reduced.

A further argument can be advanced that the 30% tax on the anonymous donations

should be considered as an application of income of the trust.

The better view seems that since the anonymous donations are liable to tax @30% the same should not be considered for the 85% application. The balance income will be entitled to the exemption u/s. 10(23C) or u/s. 11 if it complies with the conditions of that section.

ix) Other voluntary contributions (which are neither anonymous nor corpus donations) are treated as income. They are eligible for exemption under the other provisions of section 11, subject to fulfilment of conditions specified therein.

x) In a case where the trust does not qualify for exemption, both corpus donations and other donations will become chargeable to tax.

7) **Grants**

Grants are the contributions received by the trusts may be from State Government or Central Governments, local authorities, or from other trusts or institutions or from other funds or it may be a private grant even may be a local grant or foreign grant. The grants can be for capital expenditure or revenue expenditure. The grants are may be tied-up with various conditions or it may be for a specific project or it can be a general grant. The treatment of such grants depends on the nature of the grants specifically the conditions attached with it.

i) In ***Nirmal Agricultural Society vs. ITO 71 ITD 152 (Hyd.),*** the Tribunal considered a situation where specified tied-up grants were received from a foreign donor, the assessee had to utilise the grant in the manner suggested by the donor within a period of three years, and if the grant was not spent in the said period, that unspent money had to be returned to the donor. The Tribunal held that the grants were not donations within the purview of section 12, as voluntary contributions covered by section 12 are those contributions freely available to the recipient without any stipulation, which the receipient could utilise towards its objectives according to its own discretion and judgment. Tied-up grants for a specified purpose meant that the recipient had agreed to act as a trustee of a special fund granted by the foreign donor. Only the unspent balance could be treated as income of the recipient, if the donor did not insist on refund of the amount. A similar view has been taken by the Rajasthan High Court in the cases of ***Sukhdeo Charity Estate vs. CIT 149 ITR 470*** and ***Sukhdeo Charity Estate vs. CIT 149 ITR 470*** and ***Sukhdeo Charity Estate vs. ITO 192 ITR 615.***

However, a different view was taken by the Bombay High Court in ***CIT vs. Gem & Jewellery Export Promotion***

Council 143 ITR 579 (Bom.). In this case, the Court considered grants received from the Government. The Court held that the conditions imposed by the Government to the grants were merely intended to see that the amounts were properly utilised and did not detract from the voluntary nature of the grant. There was no element of any consideration anywhere for the grant. Therefore, the grants-in-aid were voluntary contributions. It may however be noted that in this case, it was not argued before the Court that such grants were not income at all in the year of receipt.

ii) Most project grants are specific or restricted contribution to be utilised as per the terms of the project/grant agreement, therefore, they should be treated as legal obligations and not voluntary contribution. It may be noted that under *Explanation* (1) to section 13(7) it is stated that for the purposes of sections 11 and 12 Trust includes any other legal obligation. A legal obligation is generally considered on par with Trust and is not included in the income. The project agreement or the 'letter of intent/instruction' from the donor is of paramount importance. The assessee has to prove that the donation was not voluntary in nature. However it must be noted that grants received for a specific purpose are not within the gamut of taxation. In ***Nirmal Agricultural Society vs. ITO [1999] 71 ITD 152 (Hyd.)*** it was observed that it is important to note that when the assessee organizations receive tied-up grants or specific contribution, it is not entitled to freely dispose it and therefore acts as a 'trustee' of a special fund granted by the donor, which cannot be amalgamated with the income or the normal corpus. Reiterating the same, in ***Sukhdeo Charity vs CIT [1984] 149 ITR 470;*** it was discussed that if the donor has a motive behind his grant, then that cannot be considered as voluntary in nature. Since the term voluntary comes to mean an obligation on the part of a donor to contribute towards the assesse organization's own usages. The distinguishing factor between voluntary contribution and project grant is the letter of intent/instruction issued by the donor to the assessee organization, which lays the basis that the amount so received is not a voluntary contribution. It has been held in various courts that project grants should not be treated as voluntary contribution and therefore,

cannot be treated as income. In a recent case, the Delhi High Court reaffirmed that any grant with specific direction from the donor cannot be treated as income ***DIT vs. Society for Development Alternatives [2012] 18 Taxmann.com 364 (Delhi)***. In this case, the assessee organisation had received grants for specific purposes/ projects from the government, non-government foreign institutions etc. These grants were to be spent as per the terms and conditions of the project grant. The amount, which remained unspent at the end of the year got spilled over to the next year and was treated as unspent grant. It was held that the unspent grant being a legal obligation/liability cannot be treated as voluntary contribution subject to the provision of utilisation and application as per the Income-tax Act. There are Court decisions where grants given without consideration and with general directions of utilisation were held as voluntary contribution, therefore, in order to be treated as the restricted grant the donor must impose specific contractual obligations on the organisation otherwise it will be treated as voluntary contribution and therefore income. It was held that interest income from property of trust clearly falls under section 11(1)(a).

iii) The problem for organisations arises when they have to utilize 85% of their grant in a year. In compliance with Section 11 of the Income-tax Act, project grants have to be shown as income. If the donee credits an amount which has to be spent over three years with a stipulated condition, an organization faces contradiction with the donor's intention of utilization and section 11 of Income-tax Act.

The organization has to accumulate the income under section 11(2) to be spent in next 5 years. There is no legal necessity for invoking section 11(2) when the grant by virtue of the project agreement was not available to the organisation for utilisation.

The organisation has to be cognizant that the grant made to it has to be utilised according to the intent stated by the donor. No discretion can be entertained by the organisation in utilising it for its own purposes. Further it is important for the organisation to maintain a separate donor account from which application to projects has to be complied with.

It is extremely important for an organisation to stick to the letter of intent delivered by the donor as it is a valid proof for the organisation in

differentiating a project grant from a voluntary contribution.

iv) Grant-in-aid, are in nature voluntary contributions and hence cannot be considered to be project grants. Yet again no specification of the grant-in-aid by the donor results in bringing it under the purview of Section 12(1). Grants-in-aid are also computed in income tax when funded by the government to voluntary organizations. In ***CIT vs. Gem & Jewellery Export Promotion Council (1983) 143 ITR 579,*** the Bombay High Court was concerned with the case of a company established to protect and promote the export of Gems and Jewellery. The Company received grants-in-aid from the Government, which were subject to certain conditions as regards the utilisation of the funds. The said grants were not received for any benefit or privilege or for any other consideration. On these facts, it was held that the grants-in-aid were voluntary contribution.

8) Sponsorship

Sponsorship is when a business makes a donation to a charity and in return receives advertising or promotion of its brand, products or services. The sponsorship money may be taxable depending on its purpose and how the money will be used by the non-profit organisation.

In ***DCIT vs. India Olympic Association (IOA) (ITAT Delhi)*** (order dated 19-7-2018) it was held that tax exemption cannot be denied to IOA merely for receiving sponsorship.

"Coming back to the objects of the impugned association, the fundamental or dominant function of the association is to represent the country in international forums. Associations of different disciplines in sports in India are members/affiliated to IOA. In furtherance of its activities, the association not only requires grants from the Government, but on many occasions sponsorships. This cannot be an activity by itself amounting to carrying on of any business, trade or commerce. The impugned association is engaged in multi level activities of diverse nature but the primary and dominant activity is promoting sports activities not only in India but also in international forum. The impugned association would not lose its character of charitable purpose merely because some sponsorship was accepted.

After considering the entire facts in totality in the light of discussion hereinabove and also drawing support from the speech of the Finance Minister and subsequent clarification issued by the CBDT within the framework of amended provisions of section 2(15) of the Act, in our considered opinion, there was no material which may suggest that the assessee association was conducting its affairs solely on commercial

lines with the motive to earn profit. There is also no material which could suggest that the assessee association has deviated from its objects which it has been pursuing since past many decades. In our humble opinion and understanding of law, proviso to section 2(15) of the Act is not applicable to the facts of the case and the assessee-association deserves benefit u/s. 11/ Of the Act."

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If we are to teach real peace in this world, and if we are to carry on a real war against war, we shall have to begin with the children.

– Mahatma Gandhi

The Vedanta recognizes no sin it only recognizes error. And the greatest error, says the Vedanta is to say that you are weak, that you are a sinner, a miserable creature, and that you have no power and you cannot do this and that.

– Swami Vivekananda

If four things are followed - having a great aim, acquiring knowledge, hard work, and perseverance - then anything can be achieved.

– A. P. J. Abdul Kalam

Peace is not a relationship of nations. It is a condition of mind brought about by a serenity of soul. Peace is not merely the absence of war. It is also a state of mind. Lasting peace can come only to peaceful people.

– Jawaharlal Nehru

Computation of Income of Trust – Capital Gains u/s. 11(1A), Investment u/s. 11(5) and Disallowance of Application of Income u/s. 11(1) R.W. 40(a)(ia)/40A(3)/40A(3a)

Rahul Hakani,
Advocate

CAPITAL GAINS ARISING FROM TRANSFER OF CAPITAL ASSET BEING PROPERTY HELD UNDER TRUST FOR CHARITABLE OR RELIGIOUS PURPOSES – SECTION 11(1A)

Introduction

Sub-section (1A) has been inserted in section 11 by the Finance (No. 2) Act, 1971, with retrospective effect from 1-4-1962. Prior to insertion of Section 11(1A), under section 11, income derived from property held under trust for charitable or religious purposes was exempt from income-tax to the extent such income is actually applied to such purposes during the previous year itself or within the three months next following. As 'income' includes 'capital gains', a charitable or religious trust would forfeit exemption from income-tax in respect of its income by way of capital gains unless such income is also applied to the purposes of the trust during the stipulated period. Thus, **Circular No. 72 dated 6/1/1972** explaining the reason for insertion of Section 11(1A) states that insertion is made with a view to prevent "unintended effect of progressively reducing corpus of the trust and the income yielded by it".

Sub-section (1A) to Section 11 provides that, in a case where a capital asset being property held under trust for charitable or religious purposes is transferred and the whole or any part of the net consideration for the transfer (i.e., full value of consideration as reduced by the expenditure incurred wholly and exclusively in connection with the transfer) is utilised for acquiring another capital asset, the capital gain arising from the transfer will be regarded as having been applied to charitable or religious purposes.

As regards the quantum of exemption, it is provided that where the whole of such net consideration is utilised in acquiring the new capital asset, the entire amount of the capital gain will be regarded as having been applied to charitable or religious purposes while, in a case where only a part of the net consideration is utilised for acquiring the new capital asset, so much of such capital gains as is equal to the amount, if any, by which the amount so utilised exceeds the aggregate of the cost of acquisition of the capital asset transferred and the cost of any improvements made to such asset, will be regarded as having been applied to such purposes. The "cost of the transferred asset" means the aggregate of the cost of acquisition (as ascertained for the purposes of sections 48 and 49) of the capital asset which is the subject of the transfer and the cost of any improvement thereto within the meaning assigned to that expression in sub-clause (b) of clause (1) of section 55;

Section 11(1A) further provides that where a capital asset, being property held under trust in part only for charitable or religious purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then, the appropriate fraction of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes. The term "appropriate fraction" means the fraction which represents the extent to which the income derived from the capital asset transferred was immediately before such transfer applicable to charitable or religious purposes.

Where the property transferred is held under trust in part only, it is provided that the quantum of exemption where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain and in any other case, so much of the appropriate fraction of the capital gain as is equal to the amount, if any, by which the appropriate fraction of the amount utilised for acquiring the new asset exceeds the appropriate fraction of the cost of the transferred asset.

From a combined reading of sections 11(1)(a), 11(1)(b) and section 11(1A), it is clear that the income of a trust including capital gains is treated on a separate footing and the assessee-trust has to fulfil the conditions laid therein for the purpose of availing exemptions from taxation. Hence, capital gains arising from property held for charitable or religious purposes cannot, therefore, be equated with the income which is computed under the general provisions of the Act (under Section 45 of the Income-tax Act, 1961) in respect of other assessees who are not entitled to the benefit of the aforesaid provisions. The capital gains under section 11(1A) are not distinguished as 'short-term' or 'long-term' capital gains; any capital gains are permissible under section 11(1A).

Capital Asset – Meaning and Scope

Section 11(1A) applies to a capital asset. However, the term capital asset is not defined in Section 11(1A). The Calcutta High Court in ***CIT vs. East India Charitable Trust (1996) 206 ITR 152(Cal)(HC)*** has considered and applied the definition of Capital Asset u/s. 2(14) for determining capital asset for the purposes of Section 11(1A). Thus the expression 'capital asset' will be very wide as is the case with it under section 2(14). By applying the definition of capital asset u/s. 2(14), the High Court further held that the expression 'investment or deposit' can be very well construed to be a capital asset. It was held as under :

> "Thus, capital asset includes property of any kind held by an assessee. 'Deposits or investments' are a kind of property and next, do not fall in the exclusionary limb of the said definition. The definition when pitted against the definition of assets in section 2(e) of the Wealth-tax Act, 1957, makes it absolutely clear that the very term 'investments and deposits' are to be accepted as capital assets."

Thus, where reinvestment is made as an investment or deposit in modes specified under Section 11(5) of the Act, then it will be sufficient compliance of section 11(1A). Prior to insertion of Section 11(5), there were controversies as to which deposits would constitute a capital Asset [i.e. deposits with banks, deposits with third parties etc as well as period of deposit etc.]. However, after insertion of 11(5), if the capital asset is classified as deposits/investments, then it has to be in conformity with the modes specified u/s. 11(5), otherwise the provisions of Section 13(1)(d) will apply for denial of exemption.

Time Limit for Reinvestment

Section 11(1A) does not provide for any specific time-limit within which the net consideration arising from transfer of a capital asset are

required to be reinvested for claiming capital gains as exempt. In ***Trustees of Dr. Sheth's Charitable Trust vs. Seventh ITO [1982] 2 ITD 649 (Bom.)(Trib.),*** the assessee-trust sold certain shares and received the consideration just three days before the end of the accounting year. It reinvested the capital gains in another capital asset within 6 months in the succeeding year. Its claim for exemption under section 11(1A) was denied which was confirmed by the Tribunal. However, the Tribunal held that assessee could have exercised the option under Section 11 for deemed application of such capital gains. Thus, where capital gains are not reinvested during the same previous year, Assessee can avail benefit of deemed application in-terms of Explanation 2 to Section 11(1)(a) or Section 11(2). This position of law is further fortified from the language of Section 11(1A) itself which begins with "For the purposes of sub-section 1-…." .

Thus, where there is a transfer of a capital asset during a previous year but the assessee has not received sale consideration then the time limit or condition for reinvestment must be from the date of actual receipt of sale consideration in view of co-joint reading of Explanation 2 to Section 11(1) read with section 11(1A).

Time-Limit for Holding the New Capital Asset

No time-limit has been prescribed for holding of the new asset for a specified period for availing of the exemptions under section 11(1A). The main intent of section 11(1A) is to provide an opportunity of keeping the corpus intact to the organisation. Therefore, whenever a capital asset is disposed off the benefits of section 11(1A) can be availed of by re-investing these into other capital assets. In ***Dalmia Charitable Trust vs. ITO [1986] 27 Taxman 46 (Mag.),*** the Delhi Tribunal held that when the amount of capital gains was invested in a new capital asset and the new asset was also disposed of in the same year, then the exemption under section 11(1A), was not permissible. It was held as under :

> "As regards the view taken by the ITO about the holding of the capital asset by the charitable trust, no time-limit, as such, is given for that purpose in section 11(1A). When one capital asset is sold and another capital asset is acquired then that capital asset should be held as property held under trust. A reasonable meaning of section 11(1A) insofar as the particular assessment year was concerned, was that in that year the trust could hold some capital assets in place of original capital assets. In other words, if at the end of the year the ITO finds that a trust is holding a capital asset in place of a capital asset which had earlier been transferred the intervening capital gains should not be assessed to tax subject to section 11(1A). There was nothing in the statute itself which prohibited the charitable trust from converting the capital assets more than once, but the basic condition was that the entire sale consideration should be utilised for acquiring capital assets which continue to be held as capital asset in one form or the other throughout the year. In the instant case, if after transferring a capital asset the sale proceeds were utilised to acquire some other capital assets which were again transferred and the proceeds were held in cash by the charitable trust it could not be held that the conditions of section 11(1A) were satisfied."

However, in ***South Point Education Society vs. ITO [2015] 43 ITR(T) 287 (Kol)*** it was held that where assessee disposed off investments being its capital assets held under Trust wholly for charitable purpose and net consideration from such disposal was utilized for acquiring other capital assets for charitable purpose,

assessee's claim was to be allowed on capital gain arising from such disposal of original investments even though new capital assets were not held till end of financial year. The relevant extract is as under :

> "By considering the provisions of section 11(1A) of the Income-tax Act, 1961, we find that there is no requirement as has been considered by the lower authorities. The only condition is that where a capital asset, being property held under trust wholly for charitable or religious purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then, the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes. There is no condition that capital asset should be held till the end of the financial year. We are not inclined to accept the interpretation placed by the ld. CIT(Appeals) that the term 'so held' implies that the capital asset which was acquired out of the net sale consideration should be held in that form till the end of the financial year."

As discussed above, section 11(1A) does not specify any time-limit for retention of the capital asset. Further, it appears that the trust can keep on selling the capital assets acquired and acquire new capital assets with the sale proceeds (i.e., converting capital assets more than once). However, as at the year end, the trust should be holding some capital asset in place of the original capital asset. If at the year-end, the sale proceeds are held in cash, exemption under section 11(1A) may not be available. However, if the proceeds are held in fixed deposits, exemption is available as fixed deposit is a capital asset.

Forms and modes of investing or depositing the money accumulated or set-apart u/s. 11(2) – Section 11(5)

Section 11(5) refers to pattern of investment by the assesse trust. Section 11(5) was introduced by the Finance Act, 1983, with effect from 1-4-1983, i.e., for and from the assessment year 1983-84. Under section 11(2) of the Act, charitable/religious trusts are permitted to accumulate their unutilised income for a period not exceeding 5 years, provided *inter alia* that the income is invested or deposited in the modes specified in section 11(5) of the Act. Under section 11(5), clauses (i) to (xi) make mention about certain specified modes, followed by a residual clause (xii) under which investment is permissible in 'any other form or mode of investment or deposit as may be prescribed'. Rule 17C specifies the other modes of investments contemplated in this clause. Section 13(1)(d), as amended by the Finance Act, 1983, provides that the income of any charitable or religious trust or institution will not be entitled to exemption under sections 11 and 12, if certain conditions stipulated therein are not complied with.

Consequences of not investing or depositing in the forms and modes prescribed u/s. 11(5)

If there is a failure to invest or deposit moneys in the Forms & modes prescribed u/s 11(5) then as per Section 13(1)(d), any income thereof during the previous year will become taxable or in other words there will be forfeiture of exemption on such income.

The issue which often arises is whether breach of Section 11(5) read with Section 13(1)(d) would lead to forfeiture of entire exemption.

In ***DCIT vs. Sheth Mafatlal Gagalbhai Foundation Trust [2001] 249 ITR 533 (Bom.)*** the question before the Bombay High Court was "Whether violation of Section 11(5) r/w

Section 13(1)(d) by the assessee-trust attracts maximum marginal rate of tax on the entire income of the Trust? The Bombay High Court held that in case of contravention of Section 13(1)(d), maximum marginal rate of tax under Section 164(2) proviso is applicable only to that part of income of the trust which has forfeited exemption and not the entire income. In ***CIT vs. Fr. Mullers Charitable Institutions [2014] 363 ITR 230 (Kar)(HC)*** it was held that in case of a charitable trust, it is only income from investment or deposit which has been made in violation of section 11(5) that is liable to be taxed and that violation under section 13(1)(d) does not tantamount to denial of exemption under section 11 on total income of assessee-trust. [Department **SLP Dismissed/Rejected reported in [2014] 227 Taxman 369 (SC).** Following the above two decisions, recently the Bombay High Court in ***CIT vs. Audyogik Shikshan Mandal [2019] 261 Taxman 12 (Bom)(HC)*** held that where funds of assessee-trust were utilized for purchase of car in name of its trustee, there was violation of section 13(2)(b), read with section 13(3); however, denial of exemption under section 11 should be limited only to amount which was diverted in violation of section 13(2)(b). In ***CIT vs. Santokba Durlabhji Trust Fund [2018] 406 ITR 457 (Raj)(HC)*** the legal position was reiterated and it was held that where assessee, a charitable trust, received gift of shares, in view of fact that assessee failed to dispose off or convert said shares into permissible investments, denial of exemption under section 13(1)(d)(iii) was to be restricted to only income earned from shares to be taxed at marginal rate under section 164(2) and not entire income of assessee. However, in Department SLP Leave is granted – **[2018] 255 Taxman 368 (SC). Thus, though majority High Courts are in favour of the Assessee, the Supreme Court has also dismissed SLP's in several cases yet the Supreme Court is yet to decide the issue on merits.**

Thus the legal position as emerges is that breach of Section 11(5) read with Section 13(1)(d) would not lead to forfeiture of entire exemption. In-fact, the above interpretation is also supported by Circular No. 387, dated 6th July, 1984 reported in (1985) 152 ITR (St) 1. *Vide* the said Circular, it has been laid down that where a trust contravenes S. 13(1)(d), the maximum marginal rate of Income-tax will apply only to that part of the income which has forfeited exemption and not to the entire income.

Investments or Deposits – Meaning & Scope

Thus, where funds of the trust are utilized towards investment or deposit, trust has to comply with the provisions of Section 11(5) failing which there will be forfeiture of exemption in terms of Section 13(1)(d). Many a times assessee trust may have utilized the funds for the objects of the trust and claimed as an application of income. However, the A.O. may tax income arising from such utilization of funds on the ground that assessee has made investment/deposit and such investment/deposit do not comply with the form and modes prescribed u/s. 11(5). Hence, it is necessary to understand the scope and meaning of the expressions investment and deposit.

The Delhi High Court in ***DIT vs. Alarippu [2000] 244 ITR 358 (Delhi)*** held that investment means to lay out money in business with a view to obtain income or profit. Deposit, on the other hand, means that which is placed anywhere, as in any one's hands for safe keeping, something entrusted to the care of another. These two expressions have been used in cognate sense and have to be understood as such. In order to constitute an investment, the amount laid out should be capable of and result in any income, return or profit to the investor and in every case of investment the intention and positive act on the part of the investor should be to earn such income, returns, profit. In order to constitute an investment, the monies shall be laid out in such

a manner as to acquire some species of property which would bring in an income to the investor.

It was further held that Loan, on the other hand, is granting temporary use of money, or temporary accommodation. The words 'investment', 'deposit' and 'loan' are certainly different. The word 'deposit' does not cover transaction of loan which can be more appropriately described as direct bailment. The essence of deposit is that there must be a liability to return it to the party by whom or on whose behalf it has been made on fulfilment of certain conditions. In the commercial sense, the term is used to indicate the aforesaid transaction as deposit of money for employment, in business, deposits for value to initiate security for, deposit of title deeds, similar documents as security for loan, deposit of money bills in a bank in the ordinary course of business of current account and deposits a sum of interest on a fixed deposit in a bank.

In view of the above findings, it was held that amount given to Mahila Haat was neither for the purpose of investment nor for deposit.

In ***Baidya Nath Plastic Industries (P) Ltd. vs. K.L Anand, ITO [1998] 230 ITR 522 (Delhi)*** it was held that the distinction between "loan" and "deposit" is that in the case of the former it is ordinarily the duty of the debtor to seek out the creditor and to repay the money according to the agreement, while in the case of the latter it is generally the duty of the depositor to go to the banker or to the depositee, as the case may be, and make a demand for it.

In following cases, it was held that there is no violation of Section 11(5):

In ***ITO vs. Jesuit Conference of India [2011] 47 SOT 29/12 taxmann.com 297 (Delhi)*** the Assessing Officer treated the assessee's sale and purchase of mutual funds as a business activity not incidental to the attainment of the objects of the assessee-trust. The case of the assessee was that the investments made by it were within the mode prescribed by section 11(5)(xii). The Tribunal did not agree with the conclusion reached by A.O. and held as under:

> "Moreover, section 11(5) of the Act envisages investment in the prescribed modes. It does not make any qualifications as to capital investment or trade investment. In accordance therewith also, it is immaterial whether the transaction was one or there were numerous transactions. The pertinent point is that the investment was made in accordance with the modes of investment qualifying for exemption, as prescribed thereunder. That being so, there was no reason to treat the same as business income of the assessee There has not been shown any violation of the provisions of section 11(5) of the Act as having been committed by the assessee."

In ***DDIT vs. M.C. Natha Bhatia High School Trust [2017] 163 ITD 460 (Mum.)(Trib.***) it was held that there is no stipulation under section 11(5) placing restriction on reshuffle of specified investment. In the said case, the assessee-trust was running an educational institution. It was registered under section 12AA. The assessee-trust was collecting moderate fees from students and expenses of trust for school were always more than educational receipts, which were met out of dividend/ interest income of its investment made as per section 11(5). In course of assessment, the Assessing Officer taking a view that one set of mutual funds was divested within period of sixty days in violation of provisions of section 11(5), denied the assessee's claim for exemption of income. ITAT did not agree with the conclusion reached by the A.O. It was held as under :

> "The assessee under the provisions of cl. 17 of sec. 11(5) of the Act is entitled to Invest sum accumulated under a scheme of mutual funds prescribed u/s. 10(23) of the Act. The pattern of investment has

been notified in Rule 17C of the Income Tax Rules 1962. We find that entire sum earmarked for the purpose of specific accumulation has been invested in the specified securities as per the provisions of section 11(5) of the Act and therefore as far as Investments are concerned there is no violation of provisions of sec. 11(5) of the Act. We are of the view that under the provisions of sub-section of section11 of the Act, there is no lower limit for the lock-in period nor there is stipulation that investments so made cannot be reshuffled during the outer limit of five years' period. In this context, the AO's observation that one set of mutual funds were divested of within the period of sixty days is untenable."

In ***St. Joseph's Technical School vs. Asstt. DIT(E) [2015] 42 ITR(T) 67 (Mumbai-Trib.)*** it was held that interest-free short-term loan given by assessee-society to other society having similar objects was not covered by section 11(5) so as to deny exemption under section 11 to assessee.

In ***Sankshema vs. Dy. DIT [2015] 70 SOT 37 (Hyd.-Trib.)*** it was held that where contribution to chit funds was done only as an arrangement for better management of society's funds, exemption under section 11 could not be denied.

In ***Dy. CIT(E) vs. Sri Vekkaliamman Educational & Charitable Trust [2014] 52 taxmann.com 139 (Chennai-Trib.)*** it was held that purchasing of gold by a trust on plea of distribution of gold medals to be given to meritorious students was an investment in gold bullion in violation of section 11(5).

In ***Dr. Vikhe Patil Foundation vs. ITO [2013] 155 TTJ 176 (Pune-Trib.)*** it was held that where impugned shares in co-operative banks had been acquired by assessee-trust as a pre-condition for raising loans from co-operative banks to be used for furtherance of its objects, acquisition of shares cannot be considered as an 'investment' within meaning of section 13(1)(d) read with section 11(5) to disallow exemption under section 11.

In ***ADIT vs. Natrip Implementation Society [2013] 26 ITR(T) 333 (Delhi-Trib.)*** it was held that where assessee-society was formed at instance of Government with object to create world class automotive testing, validation etc., advances given by assessee towards implementation of project had to be treated as application of income and not as an investment out of grant received by assessee.

In ***All India Rubber Industries Association vs. ADIT [2018] 173 ITD 615 (Mum.)(Trib.)*** assessee charitable trust, formed with an object to promote and safeguard rubber industry, made contribution towards share capital i.e., towards corpus of Rubber Skill Development Centre, a section 25 company formed under Prime Minister Sector Skill Development programme. Assessing Officer denied claim of exemption under section 11 on ground that sum invested by assessee in Rubber Skill Development Centre was in violation of section 11(5) read with section 13(1)(d). It was noted that assessee had made contribution towards corpus of investee institution which was also a section 25 company and notably, such companies are prohibited from declaring any dividend on its share capital and, therefore, in that sense, assessee was not entitled to any return. It was also evident from material on record that Rubber Skill Development Centre also held registration under section 12A. Hence, money contributed by assessee was towards promotion of objects of assessee-association itself and, therefore, same could not be treated as a violation falling within purview of section 13(1)(d) read with section 11(5) and, consequently, assessee could not be held ineligible for benefits of section 11.

The Delhi High Court in ***CIT (Exemptions) vs. Dr. Bhai Mohan Singh Foundation [2018] 95 taxmann.com 332 (Delhi)*** has held that where assessee a charitable trust was restrained from

converting shares held by it in private limited company to other forms of permissible investment by virtue of restraint order of Delhi High Court in case of settlors from whom it had received shares, it could not be held liable for violation of provisions of section 11(5) read with section 13(1)(d) for holding shares for more than prescribed period. [**Department SLP dismissed -[2018] 257 Taxman 90 (SC)**].

Maximum Marginal Rate

The breach of Section 11(5) leads to forfeiture of exemption u/s. 13(1)(d). The forfeited exemption u/s. 13(1)(d) has to be taxed at maximum marginal rate as per proviso to Section 164(1). The Mumbai Tribunal in the case of ***Jain Jamsetji Tata Trust vs. Jt. DIT (Exemption) [2014] 148 ITD 388 (Mum.)(Trib.)*** observed that when the short term capital gain arising from the sale of shares subjected to STT is chargeable to tax at 15% then the maximum marginal rate on such income cannot exceed the maximum rate provided under the Act. Accordingly, the Tribunal observed that short term capital gain on sale of shares already subjected to STT, is chargeable to tax at maximum marginal rate which cannot exceed the rate provided u/s. 111A of the Income-tax Act. This decision was followed by the Mumbai Bench in the case of ***Mahindra & Mahindra Employees Stock Option Trust vs. Addl. DCIT [2015] 155 ITD 1046 (Mum.)(Trib.)*** and observed that capital gain is to be assessed by applying the provisions of section 112 even if the income is assessed as per section 164 of the Act.

However, Chennai tribunal in ***DIT vs. India Cements Education Society [2016] 157 ITD 1008 (Chennai-Trib.)*** has taken a contrary view. It was held as under:

> "Further, we find that in both these decisions, the Mumbai Bench has not considered the meaning of maximum marginal rate as defined in section. 2(29C) of the Act which reads as follows:
>
> '2(29C) "maximum marginal rate" means the rate of income-tax (including surcharge on income-tax, if any) applicable in relation to the highest slab of income in the case of an individual[association of persons or, as the case may be, body of individuals] as specified in the Finance Act of the relevant year]'
>
> 9. Being so, the above two decisions of the Mumbai Bench cannot be said that they laid down correct proposition of law. Hence, these are not considered. Therefore, the benefit of section 112 of the Act so as to assess the gain from the transfer of the capital asset cannot be given to the deemed AOP. Accordingly, this appeal of the Revenue is allowed."

The Department appeal against the decision of the Mumbai Tribunal in ***Jain Jamsetji Tata Trust vs. Jt. DIT (Exemption) (Supra)*** is admitted by the Bombay High Court *vide* its order dated 21-6-2017 [Income Tax Appeal No. 1847 of 2014]. The Substantial question of Law admitted is as under :

> "Whether on the facts and in the circumstances of the case and in law, the Tribunal was justified in holding that the maximum marginal rate on sale of shares u/s. 115A of the Act is 15% despite the express provisions of Section 164(2) r/w. Section 2(29C) of the Act that the maximum marginal rate is the highest slab of income in the case of an AOP which is 30%?"

Provisions of S. 11(5) do not apply to 15% Income (Basic Exemption) Accumulated u/s. 11(1)(a)

In the case of ***Addl. CIT vs. A.L.N. Rao Charitable Trust (1995) 216 ITR 697 (SC)*** Supreme Court

considered the provisions of section 11(1)(a) in the light of section 11(2) and held that section 11(2) does not in any manner restrict the operation of section 11(1). The accumulated income which is exempt under section 11(1)(a) need not be invested in the Government securities. It is only in respect of any additional accumulated income beyond 25% that (now 15%), if the assessee wants exemption of this additional accumulated income also, the assessee is required to invest the additional accumulated income in the manner laid down in section 11(2) after following the procedure laid down therein. The legal position was reiterated in ***S.RM.M.CT.M. Tiruppani Trust vs. CIT [1998] 230 ITR 636 (SC)*** wherein it was held that Section 11(1)(a) does not require investment of this limited accumulation (15%) in the Government securities.

Disallowance of Application of Income u/s. 11(1)(a)/(b) in View of Section 40(a)(ia)/40A(3)/40A(3A)

Introduction

The Finance Act, 2018 has inserted *Explanation* 3 to Section 11(1). The said *Explanation* 3 provides as under –

> "For the purposes of determining the amount of application under clause (a) or clause (b), the provisions of sub-clause (ia) of clause (a) of section 40 and sub-sections (3) and (3A) of Expenses or payments not deductible in certain circumstances section 40A, shall, *mutatis mutandis*, apply as they apply in computing the income chargeable under the head "Profits and gains of business or profession".

Thus, a new *Explanation* 3 has been inserted after section 11(1) with effect from assessment year 2019-20 to provide that for the purposes of determining the amount of application of income under section 11(1)(a)/(b), the provisions of section 40(a)(ia), and of section 40A(3)/(3A), shall, *mutatis mutandis*, apply as they apply in computing the income chargeable under the head "Profits and gains of business or profession". Section 40(a)(ia) provides that in computation of profits and gains of business, 30% of any sum payable to a resident on which tax is not deducted/paid in accordance with the said section is not allowable as a deduction. Section 40A(3) provides that no deduction is allowable in computation of profits and gains in respect of cash payments exceeding ₹ 10,000. Section 40A(3A) provides that if a deduction is allowed in year 1 on mercantile basis and subsequently in year 2 the assessee makes cash payment, the payment so made shall be deemed to be profits and gains of business of year 2, if the payment exceeds ₹ 10,000.

As per the Memorandum to the Finance Bill 2018, the *Explanation* is inserted to encourage cashless economy and curb generation of black money. The relevant extract is as under :

> "At present, there are no restrictions on payments made in cash by charitable or religious trusts or institutions. There are also no checks on whether such trusts or institutions follow the provisions of deduction of tax at source under Chapter XVII-B of the Act. This has led to lack of an audit trail for verification of application of income."

Prior to insertion of *Explanation* 3, the department were making the provisions of section 40(a)(ia) and 40A(3) applicable to the trust. However, in following decisions it was held that said provisions were not applicable for computing income of the trust u/s. 11:

Bombay Stock Exchange Ltd. vs. Dy. DIT [2015] 228 Taxman 195 (Mag.) (Bom);

Vidya Pratishthan vs. Dy. CIT [2011] 44 SOT 90 (Pune) (URO);

ITO vs. Mother Theresa Educational Society [2016] 68 taxmann.com 320 (Visakh)(Trib.);

ITO vs. Haryana State Counseling Society [2016] 71 taxmann.com 274 (Chd)(Trib);

Kendriya Academy Vidhyalaya Shiksha Samiti vs. Asstt. CIT [2016] 73 taxmann.com 391 (Jp)(Trib.);

ITO vs. Kalinga Cultural Trust [2018] 61 ITR (Trib.) 24 (Hyd)

***Explanation* 3 is Applicable Prospectively**

The *Explanation* is applicable from A.Y. 2019-2020 and subsequent years. Though the provisions of Section 40(a)(ia) and 40A(3) are made applicable to computation of Income u/s 11 by way of an explanation, it cannot be said that the explanation will be applicable retrospectively. This is because there is a presumption under the law that the amendment is prospective unless made applicable retrospectively. The Finance Act, 2018 itself states that the *Explanation* is applicable prospectively. Further, Section 40(a)(ia) and 40A(3) are specific disallowances only applicable for computing income under the Head Profit and Gains of Business and Profession and thus it could not have been presumed to be applicable to computation of income u/s. 11 prior to insertion of *Explanation* 3.

Mutatis Mutandis

As per websters dictionary the expression *"mutatis mutandis"* means "with the necessary changes having been made" and/or "with the respective differences having been considered". It means "with due alteration of details".

Thus, when a law directs that a provision made for a certain type of case shall apply mutatis mutandis in another type of case, it means that it shall apply with such changes as may be necessary, but not that even if no change be necessary, some change shall nevertheless be made. The phrase is an adverbial phrase, qualifying the verb "shall apply" and meaning "those changes being made which must be made". The phrase has its own and usual meaning, *viz.*, that only such verbal changes are to be made in the statute as would make the principles embodied therein applicable in respect of an application for reference. [See ***Paresh Chandra Chatterjee vs. The State of Assam AIR 1962 SC 167*** & ***Aparna Trading Corporation (I) Private Limited vs. CCT (1982) 51 STC 199 (Cal)***]

Thus, the expression permits due alteration of changes as may be necessary.

Inter-play between *Explanation* 3 and Basic Exemption of 15% for Accumulation u/s. 11(1)(A) and Applicability of *Explanation* 3 to Application of Accumulated Income (15%)

The disallowance of application of income in view of *Explanation* 3 will not result in such disallowance constituting Income for computing the exemption of 15% u/s. 11(1)(a) and thereby increase the quantum of basic exemption. This is because the exemption of 15% is for amounts accumulated/set-apart whereas disallowance of amounts under *Explanation* 3 are incapable of being accumulated/set-apart as they are already applied.

Further, it appears that amounts applied for the objects of the trust out of amounts accumulated on account of basic exemption of 15% will not be hit by *Explanation* 3.

Applicability of *Explanation* 3 to Application of Income Accumulated under Section 11(2)

From a bare perusal of *Explanation* 3, it becomes clear that *Explanation* 3 applies for the purpose of determining the amount of application under clause (a) or (b) of section 11(1) only. The said explanation is not expressly made applicable to investments or deposits made in terms of Section 11(2). Hence, it appears that the provisions of *Explanation* 3 to section 11(1) does not apply to income accumulated to charitable

purposes under section 11(2) if any TDS default is made in respect of application of income out of such accumulated income.

Applicability of *Explanation* 3 to Payments made out of Corpus Donation

Explanation 3 does not apply to payments out of corpus donations. Hence, if any default is made in respect of payment from corpus donation, then no disallowance or addition to income can be made.

Applicability of *Explanation* 3 to Capital Expenditure

The provisions of section 40(a)(ia) and 40A(3) are not applicable to capital expenditure as same is not claimed as a deduction while computing total income. This legal position has been laid down by several judicial precedents. As far as computation of income u/s. 11 is concerned, it has been held that Capital Expenditure incurred towards the objects of the trust are allowed as application of Income. Thus, if the legal position existing u/s. 40(a)(ia)/40A(3) is applied, then while computing income u/s. 11, application of capital expenditure without deducting TDS or incurred in cash cannot be disallowed. However another view is also possible that as provisions of section 40(a)(ia)/40A(3) are applicable *mutatis mutandis* (i.e. with the necessary changes having been made and/or with the respective differences having been considered) capital expenditure incurred without complying with the provisions of Section 40(a)(ia)/40A(3) shall not be allowed as application of income.

Applicability of *Explanation* 3 to Computation of 'Income' for purposes of Section 11(1)(A)

Explanation 3 does not apply to TDS defaults in making payments which are reduced from gross receipts in computing "income" for the purposes of section 11(1)(a). Section 11(1)(a) deals with income and application of income. It has been held in various judicial precedents that expenditure incurred for the purpose of earning income has to be reduced from gross receipts and only the balance is to be regarded as income for the purpose of section 11(1)(a). Thus, if the said expenses can be claimed at the threshold in computing income itself then the question of applying section 40(a)(ia)/40A(3)/(3A) to such expenses does not arise since *Explanation* 3 applies to "disallowance" of application of income.

Whether Trust can avail Option u/s. 11(2) in respect of amounts disallowed as application of income by invoking *Explanation* 3

Section 11(2) enables assessee trust to accumulate/ set-aside amounts not applied during the previous year, for a period of 5 years for applying to the objects of the trust subject to conditions specified u/s. 11(2). One view is that option u/s. 11(2) will be available as there is no bar provided from accumulating amounts disallowed as an accumulation. However, another view can be that option under Section 11(2) cannot be availed as it is available for accumulation of income and since the disallowed amount is already applied, it is incapable of accumulation and also incapable of satisfying various conditions under section 11(2).

❍□❍

You see, God helps only people who work hard. That principle is very clear.

– A. P. J. Abdul Kalam

HOT SPOT

Concept of Mutuality in light of Calcutta Club's Judgment and its implication under GST

CA Abhishek Deodhar & CA Rushil Shah

The judgment of the Supreme Court in the case of Calcutta Club Ltd.[1] has thrown the issue of levy of indirect tax on clubs and associations into sharp focus. Through this article, we attempt to explain the doctrine of mutuality and its application under various indirect tax laws. We have also endeavoured to summarize the judgment of the Supreme Court with special emphasis on arguments taken by both sides and the findings of the Court on these arguments.

Nature of associations and genesis of the doctrine of mutuality

The concept of mutuality can be illustrated with a simple and relatable scenario. The alumni of a college decide to arrange an annual reunion party every December. In order to meet the expenses of the reunion (such as rent, food and drink expenses, etc.), each alumnus contributes ₹ 1,000/-. All expenses are defrayed from the common fund so accumulated. In case of a deficit, additional funds are solicited from each alumnus. In case of a surplus, the group may decide to retain the same to be used for the next year's reunion. The alumni of the college can be said to have formed an association of persons for the purpose of having reunion events on an annual basis.

Over a period of time, the group may decide to form a company or a co-operative society and thereby the association would become 'incorporated'. Further, several rules such as restrictions on alcohol consumption, right to vote, limits on contribution, application of surplus, etc., may be introduced in the form of bye-laws, articles of association and memorandum of association.

The doctrine of mutuality states that such associations and its members are not distinct persons insofar as the association is merely a conglomeration of its members. This doctrine posits a relationship of agency between the association and its members. The association is deemed to act as an agent of its members in procuring various facilities such as refreshment, premises for use, etc.

1. 2019 SCC OnLine SC 1291

The doctrine of mutuality has evolved through English jurisprudence in the late 19th Century. The famous English case of *Graff vs. Evans*[2] which has also been cited in the Calcutta Club Ltd. judgment was one of the earliest cases to deal with this doctrine. In this case, the Grosvenor Club in London was incorporated in the form of a trust. Mr. Graff, acting in his capacity as the manager of the Grosvenor Club, arranged for refreshments including drinks to be served to members on payment of a fixed sum of money. The question arising before the Court was that whether a licence to sell liquor was required in terms of the Licensing Act, 1872. The Court reasoned that members of the club were joint owners of the club property and the trustees were the agents with respect to special property in goods. Accordingly, it was held that supply of liquor to members could not amount to a retail sale of liquor requiring a licence. This judgment firmly laid down the foundations of the doctrine of mutuality under the common law. The decision was subsequently followed in several English cases, including *Trebanog Working Men's Club & Institute Ltd. vs. Macdonald*[3]. These decisions also emphasized on the relationship of agency intrinsic to the concept of mutuality.

Indian jurisprudence prior to the 46th Amendment (including the Young Men's Association case)

The history of the doctrine of mutuality can be viewed in relation to the 46th Constitutional Amendment to the Constitution which was enacted in 1982. The cases prior to 1982 are discussed in this section. The levy of sales tax on supply of refreshment by a club to its members was examined in the several High Court cases[4], including the Madhya Pradesh and Mysore High Courts. These Courts largely tended to favour the English view as expressed in *Graff vs. Evans* and set aside the levy of sales tax.

However, in 1968, a 3-Judge Constitution Bench of the Supreme Court, in the case of Enfield India Ltd.,[5] overruled these decisions on the grounds that the English cases had no applicability in the context of taxing statutes as these cases dealt with criminal liability. The Court observed that in matters of a quasi-criminal nature, the substance and not the form of the transaction took precedence. However, in case of taxing statutes, it was held that the tax liability cannot be ignored or set aside after only considering the substance of the transaction. In this judgment, the Court treated the incorporated club and its members as distinct persons and consequently, concluded that the club had sold refreshment to its members. The Court noted that there was no material on record to show that the club was merely acting as an agent of its members. The levy of sales tax was upheld, rejecting the doctrine of mutuality.

It is in this above background that a 6-Judge Constitution Bench of the Supreme Court heard the case of Young Men's Indian Association in 1970[6]. This judgment dealt with levy of sales tax in case of three clubs, viz., the Cosmopolitan Club, Madras which was registered under the Companies Act, 1913 as a non-profit organization, the Young Men's Indian Association which

2. (1882) 8 QB 373
3. (1940) 1 KB 576
4. Madhya Pradesh High Court in the case of Bengal Nagpur Cotton Mills Club [(1957) 8 STC 781 (MP)]; Mysore High Court in the case of Century Club & Ors. [(1965) 16 STC 38 (Kar)]
5. *Deputy Commercial Tax Officer, Saidapet & Anr. vs. Enfield India Ltd., Co-operative Canteen Ltd.* [(1968) 2 SCR 421]
6. *The Joint Commercial Tax Officer, Harbour Division, II-Madras vs. the Young Men's Indian Association (Regd.), Madras & Ors.* [1970 (1) SCC 462]

was registered under the Societies Registration Act, 1860 and the Lawley Institute which was in the form of a trust. In this judgment, the Court referred to the English jurisprudence on the doctrine of mutuality discussed above. Further, the decisions of the Madhya Pradesh and Mysore High Courts referred to above were also noted with approval. The Supreme Court took cognizance of the Enfield India Ltd. judgment which had distinguished English cases on the grounds that it dealt with quasi-criminal or criminal matters. However, the Court held that the doctrine of mutuality had been applied in several English cases in the context of tax as well[7]. Consequently, the Supreme Court refused to follow the ratio laid down in the earlier Enfield India Ltd. judgment.

Despite this position, it may be pertinent to note the dissenting view expressed by Justice Shah. Justice Shah noted that the doctrine of mutuality was not applied in case of taxing statutes even in England[8] and that in taxing statutes the form of the transaction should prevail over the substance. However, Justice Shah agreed with the majority view that the levy of sales tax failed on the ground that the club was acting as an agent of its members in procuring goods for them and was not transferring property in goods for a price.

46th Amendment introducing Article 366(29A)(e)

The above jurisprudence, along with other issues such as levy of sales tax on works contracts, hire purchase, etc., was analyzed by the 61st Law Commission in 1974[9]. The Law Commission noted the positions taken in the cases of both Enfield India Ltd. and Young Men's Indian Association. Analyzing the position, the Commission did not recommend any amendment to the Constitution from the perspective of levy of tax on clubs on three grounds, viz., the number of clubs and associations are not large; such tax would discourage the co-operative movement and that there is no serious question of tax evasion in such cases.

Despite the above recommendation, the 46th Constitutional Amendment[10] introduced Clause 29A in Article 366 of the Constitution in 1982 which read as under:

(29A) "tax on the sale or purchase of goods" includes –

…

(e) a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;

(f) a tax on the 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 (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration,

The Statement of Objects & Reasons explains the rationale behind the above amendment in the following terms:

> *Similarly, while sale by a registered club or other association of persons (the club or association of*

7. *Inland Revenue Commissioners vs. Westleigh Estate Co. Ltd.* [1924 (1) KB 390]
8. *Duke of Westminster vs. Inland Revenue Commissioners* [19 TC 490, 519]
9. The entire report may be accessed at http://lawcommissionofindia.nic.in/51-100/Report61.pdf
10. Section4 of the Constitution (Forty-sixth Amendment) Act, 1982

persons having corporate status) to its members is taxable, sales by an unincorporated club or association of persons to its members is not taxable as such club or association, in law, has no separate existence from that of the members.

…

It is, therefore, proposed to suitably amend the Constitution to include in Article 366 a definition of "tax on the sale or purchase of goods" by inserting a new clause (29A)…

Thus, the amendment purportedly was brought in to cover unincorporated associations, on the assumption that incorporated associations were already in the tax net. This assumption has been taken into consideration by the Supreme Court in the Calcutta Club Ltd. judgment.

Reference to the Constitution Bench in the case of Calcutta Club Ltd.

Although the 46th Constitutional Amendment seemingly did away with the doctrine of mutuality, a few subsequent Supreme Court judgments such as Fateh Maidan Club[11] and Cosmopolitan Club followed the doctrine and remitted the matters back to the Tribunal to ascertain the facts as to whether the club was acting as the agent of the members. The applicability of the 46th Constitutional Amendment was not discussed in these cases.

Similarly, the doctrine of mutuality had been applied by the Calcutta Tribunal in setting aside levy of West Bengal Sales Tax on the Calcutta Club Ltd. The West Bengal tax authorities filed a writ petition against this decision and the matter eventually came before a Division Bench of the Supreme Court. The Division Bench of the Court referred the matter to the Constitution Bench on the following three counts[12]:

1) Whether the doctrine of mutuality is still applicable to unincorporated clubs or any club after the 46th Constitutional Amendment?

2) Whether the Young Men's Association case still holds the field even after the 46th Constitutional Amendment? Whether the Fateh Maidan Club and Cosmopolitan Club express the correct principle of law?

3) Whether the 46th Constitutional Amendment, by deeming fiction, provides that provision of food and beverages by incorporated clubs to permanent members constitutes a sale exigible to sales tax?

Judgment from sales tax perspective

The arguments as recorded in the decision and findings of the Court from the sales tax perspective are summarized below:

Revenue arguments	*Assessee arguments*	*Findings of the Court*
Argument 1: Intention behind 46th Amendment		
The 61st Law Commission report and the Statement of Objects & Reasons appended to the 46th Constitutional Amendment make it clear	Statement of Objects & Reasons makes it clear that only unincorporated clubs or associations of persons were referred to in Article 366(29-A).	The 61st Law Commission had recommended not making any amendment to the Constitution on account of supply by clubs to its members. Three reasons were

11. *Fateh Maidan Club vs. Commercial Tax Officer, Hyderabad & Anr. [(2017) 5 SCC 638]*; *Cosmopolitan Club* v. *State of Tamil Nadu & Ors. [(2017) 5 SCC 635]*

12. *State of West Bengal & Ors. vs. Calcutta Club Ltd. [(2017) 5 SCC 356]*

Revenue arguments	*Assessee arguments*	*Findings of the Court*
that the amendment has been introduced to do away with the doctrine of mutuality and therefore sought to do away with the basis of the judgment in the Young Men's Indian Association case. [*Para 5 of the judgment*]	In no circumstances can a company be included in 'body of persons'.	given for this recommendation, viz., such clubs and associations are few in number; it might discourage the co-operative movement; no serious question of tax evasion arises as the member takes his own goods) [*Para 10 of the judgment*]. The Statement of Objects & Reasons has not read the Young Men's Indian Association case in its correct perspective. It has wrongly assumed that sale of goods by a club having corporate status was taxable. Proceeding on this incorrect basis, what the 46th Constitutional Amendment sought to do was to bring to tax sales by clubs which have no separate existence (i.e. unincorporated clubs). Hence, it clear that only unincorporated clubs were sought to be covered by the 46th Constitutional Amendment [*Para 33 of the judgment*].
Argument 2: Wording of sub-clause (e) *vis-à-vis* wording of other sub-clauses		
The wording of sub-clause (e) refers to 'supply', whereas the wording of sub-clauses (a) and (b) refers to 'transfer'[13]. This indicates that the ambit of sub-clause (e) would include transactions where there is no transfer of property as well.	No counter-argument recorded in the judgment.	No findings specifically recorded in the judgment.

13. Sub-clause (a) reads as: a *tax on the transfer, otherwise than in pursuance of a contact, of property in any goods for cash, deferred payment or other valuable consideration. Sub-clause (b) reads as: a tax on the transfer of property in goods (whether as goods or in some other form) invoked in the execution of a works contract.*

Revenue arguments	*Assessee arguments*	*Findings of the Court*
Hence, doctrine of mutuality seems to be done away with. [*Para 5 of the judgment*]		
Argument 3: Phrase 'unincorporated association or body of persons' to be read disjunctively		
The phrase 'unincorporated association or body of persons' used in sub-clause (e) should be read disjunctively, i.e. 'unincorporated' refers only to associations, whereas body of persons would include both incorporated as well as unincorporated bodies. [*Para 5 of the judgment*]	Applying the principles of *ejusdem generis*, 'unincorporated associations' should be read with 'body of persons' and hence, would not include members' clubs in a corporate form. [*Para 6 of the judgment*]	Reference was made to the definition of 'person' under the General Clauses Act, which includes company or association or body of individuals, ***whether incorporated or not.*** Article 366 (29A) does not employ a similar phrase. The phrase 'body of persons' is used to make it clear beyond doubt that corporate persons are not referred to [*Para 35-36 of the judgment*].
Argument 4: Sub-clause (f) would cover the transaction, assuming sub-clause (e) does not		
The present case deals with supply of refreshment by clubs or associations to its members. Assuming without admitting that sub-clause (e) does not apply in this case, sub-clause (f) which refers to supply of food or drinks as a part of a service would apply. [*Para 5 of the judgment*]	Sub-clause (f) has been enacted for a very different purpose, viz., to overcome judgment in the case of Northern India Caterers (India) Ltd.[14] which dealt with supply of food and drinks in a restaurant as a part of a service. This has nothing to do with supply by clubs or associations. [*Para 6 of the judgment*]	Sub-clause (f) only includes 'food' or other article of consumption and not 'goods' as is referred to in sub-clause (e). Further, the statement of objects and reasons makes it clear that sub-clause (f) is to overcome various decisions relating to restaurants. The subject matter of this sub-clause is hence, entirely different and cannot be used in this case [*Para 39-44 of the judgment*]
Argument 5: Deeming fiction under the West Bengal Sales Tax Act relied upon		
Explanation 1 to Section 2(10) of the West Bengal Sales Tax Act specifically includes clubs within the scope of 'dealer'.	No counter-argument recorded in the judgment.	In light of the other findings, the Court does not advert to this argument of the revenue [*Para 49 of the judgment*].

14. *Northern India Caterers (India) Ltd. vs. Lt. Governor of Delhi [(1978) 4 SCC 36]*

Revenue arguments	*Assessee arguments*	*Findings of the Court*
The explanation reads: A co-operative society or a club or any association which sells goods to its members is a dealer. [*Para 5 of the judgment*]		
Argument 6: Enfield case has done away with the doctrine of mutuality for tax matters		
The decision of the Supreme Court in the case of Enfield India Ltd. has specifically done away with application of the doctrine of mutuality in case of tax matters. [*Para 5 of the judgment*]	No counter-argument recorded in the judgment.	Young Men's Indian Association judgment has expressly distinguished Enfield India Ltd. Hence, Enfield India Ltd. case does not take the matter any further [*Paras 24-26 of the judgment*].
Argument 7: As held in the Bacha F. Guzdar case, doctrine of mutuality has no application when association is in corporate form		
The decision of the Supreme Court in the case of Bacha F. Guzdar[15] has held that shareholders are not owners of the assets of the company. Hence, the doctrine cannot apply when the clubs are incorporated. [*Para 5 of the judgment*]	Section 2(5) of the West Bengal Sales Tax Act[16] requires that there should be a profit motive. The judgment in the case of Bacha F. Guzdar will not apply to Section 25 Companies (i.e. not-for-profit companies). [*Para 6 of the judgment*]	The present case deals with a Section 25 Company where payment of dividend to shareholders is prohibited, and the profits, if any, have to be applied to promote the objects of the Company. Bacha F. Guzdar case did not deal with such a Section 25 Company. On the other hand, the Supreme Court, in the case of Cricket Club of India Ltd.[17], held that a club is not like a typical company carrying out business and hence, does not amount to an 'industry' for the purposes of the Industrial Disputes Act, 1947. Hence, the Bacha F. Guzdar case was distinguished on facts.

15. *Bacha F. Guzdar vs. Commissioner of Income Tax, Bombay (1955) 1 SCR 876*
16. This argument seems to be erroneous in view of the wording of Section 2(5) of the West Bengal Sales Tax Act which reads: *"business" includes (a)any trade, commerce, manufacture, execution of works contract or any adventure or concern in the nature of trade, commerce, manufacture or execution of works contract,* ***whether or not such trade, commerce, execution of works contract, adventure or concern is carried on with the motive to make profit and whether or not any profit*** *accrues from such trade, commerce, manufacture, execution of works contract, adventure or concern; and*
17. *Cricket Club of India Ltd. vs. Bombay Labour Union [(1969) 1 SCR 600]*

Revenue arguments	*Assessee arguments*	*Findings of the Court*
Argument 8: Definition of 'consideration' under Section 2(d) of Indian Contract Act		
–	In terms of the definition of consideration under Section 2(d) of the Indian Contract Act[18], consideration must flow from one person to another. In the absence of two parties, as in the Young Men's Indian Association case, Article 366(29A) will have no application. [*Para 6 of the judgment*]	This argument of the assessees was noted with approval by the Court in *Paras 37-38* of the judgment. Hence, the Court has accepted that for valid consideration to be present, the existence of two distinct persons is a pre-requisite.
Other important observations of the Court		
1) The doctrine of mutuality has been extensively discussed in the case of Bangalore Club[19]. It has been held that any surplus arising from dealings between members and clubs is regarded as the member's own money. The identity between clubs and members is not snapped merely because surplus arising from the common fund is not distributed amongst the members. Such surplus does not come back to the members in the form of dividend as is the case of companies. The essence of this doctrine is therefore that there can be no sale transaction between two persons, as one person cannot sell goods to oneself [*Para 30 of the judgment*].		
2) Doctrine of mutuality can be specifically done away with through express provisions of the statute as is done in the case of the income tax law. For example, Section 2(24)(vii), read with Section 44 of the Income-tax Act, 1961 specifically does away with the doctrine of mutuality in the case of mutual insurance companies. Similarly, Section 45 does away with this concept when capital goods are converted into stock-in-trade for the purpose of levy of capital gains tax [*Para 45-48 of the judgment*].		

Judgment from service tax perspective

Levy of service tax in case of services rendered by a club or association to its members was also in question in several decisions. These cases dealt with a variety of associations, ranging from recreational clubs such as the Ranchi Club Ltd. and co-operative housing societies such as Tahnee Heights Co-Op. Hsg. Soc. Ltd. All these matters were tagged along with the Calcutta Club Ltd. case and the judgment deals with the service tax levy on clubs and associations as well. The levy has been analyzed for both the pre-2012 and post-2012 periods.

In the pre-2012 period, the Court noted that levy of service tax depended on the particular

18. Definition of consideration reads as: *When, at the **desire of the promisor, the promisee or any other person** has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise.*

19. *Bangalore Club vs. Commissioner of Income Tax & Anr. [(2013) 5 SCC 509]*

category of taxable service. The category under which tax was sought to be levied was that of 'services by a club or association' under Section 65(105)(zzze). 'Club or association' was defined under Section 65(25aa) to mean any association or body of persons providing services, facilities to its members. However, this definition specifically excluded anybody *established or constituted by or under any law for the time being in force.* The Court interpreted the phrase 'constituted' by applying the ratio laid down in an income tax case[20]. The phrase was interpreted in a wide manner to include creation, establishment, setting-up under the law. It was held that even registration under a law, i.e., clothing an arrangement in a legal form would be covered under the ambit of 'constituted'. Consequently, it was held that companies can be said to be constituted under the Companies Act, while societies can be said to be constituted under the Societies Registration Act. In light of this analysis, the Court held that incorporated clubs were excluded from the ambit of 'club or association' and hence, there was no question of levy of service tax. The Court does not refer to the doctrine of mutuality for the period prior to 2012.

For the period after 2012, the Court acknowledged that service tax was leviable on all services except those specifically exempted. Further, the explanation to the definition of 'service' introduces a deeming fiction whereby an unincorporated association or body of persons and its member are treated as distinct persons. The Court observed that this provision was worded in a manner identical to that of Article 366(29A)(e). Consequently, it was held that the findings with respect to the sales tax would apply on all fours.

Summary of the tax position as per the Calcutta Club Ltd. decision

The position laid down by the Calcutta Club Ltd. judgment is summarized below:

Sr. No.	*Tax*	*Period*	*Position*	
			Incorporated clubs	*Unincorporated clubs*
1	Sales Tax	All periods	Doctrine of mutuality applies even after the 46th Constitutional Amendment. Accordingly, no tax is leviable on supply of goods by a members' club to its members	Judgment does not deal with unincorporated clubs – however, concluded in para 49 that doctrine of mutuality should apply in case of all clubs, including unincorporated clubs. This conclusion seems incongruous, particularly in light of the deeming fiction introduced by the 46th Constitutional Amendment

20. *R. C. Mitter & Sons, Calcutta vs. CIT, West Bengal, Calcutta [(1959) Supp. 2 SCR 641]*

Sr. No.	*Tax*	*Period*	*Position*	
			Incorporated clubs	*Unincorporated clubs*
2	Service Tax	Pre-2012	Incorporated clubs are 'constituted' under laws for the time being in force (e.g. Companies Act, Societies Act, etc.). Consequently, such clubs do not fall within the ambit of 'club or association' for the purpose of tax levy	Judgment does not deal with unincorporated clubs – however, it may be argued that the doctrine of mutuality as applied by the Court in the case of sales tax should apply and consequently, no tax levy should sustain. However, this proposition remains untested in Court
3	Service Tax	Post-2012	Doctrine of mutuality applied. Hence, service tax levy is not sustainable on services by members' clubs to their members	Judgment does not deal with unincorporated clubs – however, the deeming fiction introduced by way of *explanation* to Section 65B(44) would mean that the doctrine of mutuality has been overridden

Concept of mutuality and GST

Supply under GST?

Goods and Services Tax (**"GST"**) is tax on 'supply' of goods or services or both. Therefore, for a transaction to be covered within the tax net of GST, it is necessary for it to first be a supply. 'Supply' is defined under Section 7 of the Central Goods and Services Tax Act (**"CGST Act"**) to include *all forms of supply such as sale, transfer, barter, exchange, license, rental, lease or disposal made or agreed to be made* ***for a consideration by a person*** *in the course or furtherance of business.*

From the definition of supply, it is clear that supply requires existence of two parties. This requirement is clear from the use of the phrase *"made or agreed to be made for a consideration"*. In other words, for a transaction to be regarded as supply there should be an agreement and flow of consideration between two persons. Consideration by its very nature requires the existence of two distinct persons to the transaction. This principle has also been acknowledged and approved in paras 37-38 of the Calcutta Club Ltd. judgment. Further, the requirement of existence of two parties for supply can also be demonstrated by examining each of the terms used to depict the scope of supply:

Term	*Parties required*
Sale	Buyer and Seller
Transfer	Transferor and Transferee
Barter	Requires two parties who agree to supply goods/services to one another.
Exchange	Exchanger and Exchangee
License	Licensor and Licensee
Rental	Landlord and Tenant or Renter and Rentee

Term	*Parties required*
Lease	Lessor and Lessee
Disposal	Disposal as such may not require existence of two parties. However as per the principle of *noscitur a sociis* meaning of the word should be judged from the company it keeps. Therefore, applying the said principle of interpretation, disposal in the context of scope of supply, would mean disposal by one party to another.

Further, place of supply provisions under the GST law envisage two persons, i.e., the supplier and the recipient. Whether a supply is an intra-State supply or an inter-State supply is determined in accordance with these provisions on the basis the location of supplier and the location of recipient.

As per the above discussion, it is clear that supply requires existence of two parties. Since the doctrine of mutuality applies even after the 46th Constitutional Amendment, members' clubs/associations and members would not be considered to be distinct persons. Hence, making available goods or services by a club/association to its members, in case of a members' club, would not be a 'supply' for the purpose of Section 7 of the CGST Act.

Position with respect to unincorporated clubs or associations

Explanation 3 to Section 65B(44) of the Finance Act, 1994 specifically introduced a deeming fiction under the service tax law with respect to unincorporated clubs or associations. As per this provision, unincorporated clubs or associations and their members were deemed to be distinct persons. This provision was similar to that of Article 366(29A) of the Constitution of India.

The GST law contains a deeming fiction to treat branches or offices of the same legal entity in different States as distinct persons (Section 25 of the CGST Act). Similarly, the Integrated Goods and Services Tax Act, 2017 (the **"IGST Act"**) introduces a deeming fiction whereby establishments of the same entity in different countries/States/UTs are treated as distinct persons. However, as opposed to the service tax law, there is no specific provision under the GST law which deems an unincorporated club/association and its members to be distinct persons. In the absence of any such specific provision, even unincorporated clubs or associations would be covered under the doctrine of mutuality for the purposes of the GST law.

Does the definition of person u/s 2(84) of CGST Act indicate that the club/association and its members are distinct persons?

The definition of 'person' under the GST law[21] includes an association of persons or a body of individuals, whether incorporated or not. Further, it also includes co-operative societies. It is observed that the definition provides for an individual, association of persons, body of individuals and co-operative societies under

21. Definition of person under Section 2(84) of the CGST Act reads as: person includes, –
(a) an individual;
(b) a Hindu undivided family;
(c) a company;
(d) a firm;
(e) a Limited Liability Partnership;
(f) an association of persons or a body of individuals, whether incorporated or not, in India or outside India;

contd. on next page

separate sub-clauses. It is true that each sub-clause provides for a different category of persons. However, as discussed above, the doctrine of mutuality would apply and a club or association and its members are to be treated as one person. Hence, the said definition of 'person' cannot be resorted to say that the club/association and its members (i.e. individuals) are to be treated as separate persons merely because the definition provides for separate categories.

The club/association and its members would however, be treated as separate persons when the club/association transacts with the member in his individual capacity or in any other capacity than that of a member. For instance, say a member lets out his private premises to the club for an agreed upon rent. In such a transaction the member and the club would be separate persons as the member acts in his individual capacity when he rents out his private premises to the club. Therefore, it can be said that that the definition of person seeks to provide for the member (i.e. individual) and the club/association to be separate persons only where the member transacts with the club acting in his capacity other than that of a member, i.e. where the doctrine of mutuality does not apply.

Further, the definition of 'person' under the Finance Act, 1994 also provided for individuals, societies and an association of persons or body of individuals, whether incorporated or not under separate categories of persons. If this definition was intended to mean that every category of persons as distinct, then there would have been no requirement for inserting *Explanation 3* to Section 65B(44) to specifically provide for unincorporated associations and their members.

Does Entry No. 7 of Schedule II to CGST Act indicate that activities by a club/association for its members is deemed to be a supply?

Entry 7 of Schedule II to the CGST Act provides that *supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration* is deemed to be a supply of goods.

The position regarding transactions covered under Schedule II to CGST Act is very clear after the retrospective amendment[22] by the Central

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(g) any corporation established by or under any Central Act, State Act or Provincial Act or a Government company as defined in clause (45) of section 2 of the Companies Act, 2013 (18 of 2013);
(h) any body corporate incorporated by or under the laws of a country outside India;
(i) a co-operative society registered under any law relating to cooperative societies;
(j) a local authority;
(k) Central Government or a State Government;
(l) society as defined under the Societies Registration Act, 1860 (21 of 1860);
(m) trust; and
(n) every artificial juridical person, not falling within any of the above

22. In section 7 of the principal Act, with effect from the 1st day of July, 2017,––
(a) in sub-section (1), ––
(i) …
(ii) …
(iii) …
(b) after sub-section (1), the following sub-section shall be inserted and shall always be deemed to have been inserted, namely:–
"(1A) where certain activities or transactions constitute a supply in accordance with the provisions of sub-section (1), they shall be treated either as supply of goods or supply of services as referred to in Schedule II."

Goods and Services Tax (Amendment) Act, 2018. Schedule II is not a deeming provision to provide for certain transactions to be treated as supply, but it only provides for whether a supply should be treated as supply of goods or supply of services.

Therefore, Schedule II will apply only if a transaction first qualifies as a supply. Consequently, it is irrelevant in cases where a transaction is not covered within the net of supply. In light of this discussion, Entry No. 7 of Schedule II to CGST Act will not be relevant for activities carried out by a club/association for its members as the concept of mutuality prevails. In the absence of two persons i.e., supplier and recipient, it fails to meet the criteria to be qualified as a supply.

Does Sr. No. 77 of exemption notification for services [Notf. No 12/2017 of Central Tax (Rate) dated 28.06.2017] indicate that activity by a club/ association for its members is a supply?

Notification Number 12/2017-Central Tax (Rate), dated 28.06.2017 exempts services by an unincorporated body or a non- profit entity registered under any law for the time being in force, to its own members subject to certain conditions.

Exemption notifications are usually issued to exempt certain transactions which are otherwise leviable to tax. However, as discussed above the activities by a club/association for its members do not qualify as a supply and are not leviable to tax. Therefore, the exemption stands to be given on the flawed premise that such transactions are chargeable to tax. It is a settled principle under the excise law that mere mention of an item in an exemption notification cannot be determinative of its excisability.

The Supreme Court, in the case of United Phosphorus Ltd.[23], held that mere mention of the item as goods in the dictionary, excise tariff and Duty Drawback Rules was not enough to satisfy the test of marketability and consequently levy under the excise law. Further, the Larger Bench of the Mumbai Tribunal[24] has held that "It is well settled that mention of an item in an exemption notification is not determinative of its excisability".

Applying the principle laid down in above judgments, it is clear that mere mention of an item in the exemption notification cannot deem an activity to be a supply.

Does definition of business u/s 2(17) of CGST Act indicate that activities by a club/association for its members is a supply?

Business has been defined under the GST law to include *provision by a club, association, society, or any such body (for a subscription or any other consideration) of the facilities or benefits to its members.* As per this definition, the provision of facilities or benefits by a club/association constitutes a business.

However, levy of GST is on 'supply' and not on business. Therefore, to be leviable under the GST law, an activity has to be a supply made for a consideration by a person in the course or furtherance of business.

Levy = Supply + Business + Consideration

23. *Collector of Excise, Baroda vs. United Phosphorus Ltd. [2000 (117) ELT 529 (SC)]*
24. *New Shurrock Mills vs. Commissioner of C. Ex. & Cus., Vadodara [2006 (202) ELT 192 (Tri.- LB)]*

Therefore, merely because the activity of club/ association gets covered by the definition of business, it cannot be said that such an activity constitutes a supply which is leviable to tax under GST law.

Summary

To sum up, we can say that in view of the Calcutta Club Ltd. judgment, the controversy as to the applicability of GST on transactions between the club/association and its members in case of a members' club has now been put to rest. In view of our discussions above, it can be said that such transactions would not be leviable to GST. The discussion is summarised below:

1. Supply requires existence of two parties i.e. the supplier and the recipient. As the club/ association and its members do not have a separate existence, there cannot be any supply among them.
2. In the absence of any provision in the GST law to deem a club/association and its members as distinct persons, the concept of mutuality continues to hold good even in case of an unincorporated members' club.
3. Definition of person under the CGST Act cannot provide for the club/association and its members to be separate persons.
4. Schedule II does not and cannot deem any transaction to constitute a supply. It only provides for whether a supply is supply of goods or supply of services.
5. Entry in the exemption notification cannot indicate that such transaction constitutes a supply.
6. GST is a levy on supply and not on business. Therefore, inclusion of an activity in the definition of business does not indicate that such an activity constitutes a supply.

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The will is not free - it is a phenomenon bound by cause and effect - but there is something behind the will which is free.

– Swami Vivekananda

Where do the evils like corruption arise from? It comes from the never-ending greed. The fight for corruption-free ethical society will have to be fought against this greed and replace it with 'what can I give' spirit.

– A. P. J. Abdul Kalam

DIRECT TAXES

Supreme Court

Keshav B. Bhujle,
Advocate

1 ***Principal CIT vs. NRA Iron and Steel (P) Ltd.***
[2019] 110 taxmann.com 491 (SC): dated 25/10/2019

Appeal before Supreme Court – The Supreme Court issued a court notice to the assessee-company but no one appeared on behalf of the company – Thereafter, a dasti notice (a notice served in person) of court proceedings was served upon the Chartered Accountant (an authorized representative of the company) but he failed to communicate the same to the company – Therefore, the Supreme Court passed an *ex parte* order as assessee remained unrepresented despite service of in-person upon its authorised representative – The grounds to re-call the judgment were devoid of any merit

In an appeal before the Supreme Court the Supreme Court issued a court notice to the assessee-company but no one appeared on behalf of the company. Thereafter, a dasti notice (a notice served in person) of court proceedings was served upon the Chartered Accountant (an authorized representative of the company) but he failed to communicate the same to the company. Therefore, the Supreme Court passed an *ex parte* order. Therefore, the assessee company filed an application for re-call of the Judgment dated 05/03/2019 passed by this Court in C.A. No. 2463 of 2019, on the ground that the Applicant -Company was not served with the Notice of the SLP at the registered office of the Company, nor was a copy of the SLP served on the Applicant – Company. Consequentially, since the Judgment was passed *ex parte*, the Applicants prayed for re-call of the Judgment and a *de novo* hearing.

The Supreme Court dismissed the application and held as under:

"(i) Mr. Sanjeev Narayan (Chartered Accountant) admittedly being the Power of Attorney holder of the Applicant – M/s. NRA Iron & Steel Pvt. Ltd. for the A.Y. 2009-10 was the agent of the Assessee – Company, and hence Notice could be served on him as the agent of the Assessee – Company in this case.

(ii) This Court is satisfied that the Applicant – Company was duly served through their authorized representative, and were provided sufficient opportunities to appear before this Court, and contest the matter. The Applicant – Company chose to let the matter proceed *ex parte*. The grounds for re-call of the Judgment are devoid of any merit whatsoever.

(iii) The Applicant – Company having failed to make out any credible or cogent ground for re-call of the judgment dated 05/03/2019, the Application for re-call is dismissed with no order as to costs."

2 ***Principal CIT vs. I-Ven Interactive Ltd.***
[2019] 110 taxmann.com 332 (SC): dated 18/10/2019

Assessment – Service of notice - Address – In absence of any intimation to Assessing Officer with respect to change in address, Assessing Officer was justified in issuing notice at address available as per PAN database. Therefore, Assessing Officer cannot be said to have committed any error and in fact Assessing Officer was justified in sending notice at address as per PAN database. Filing of Form 18 with ROC cannot be said to be an intimation to Assessing Officer with respect to intimation of change in address (A. Y. 2006-07)

For the A. Y. 2006-07, the assessee filed the return of income on 28/11/2006 declaring total income of ₹ 3,38,71,716. A notice u/s. 143(2) of the Income-tax Act, 1961 was issued on 05/10/2007 and was sent to the assessee's address available as per the PAN database. Another notice u/s. 143(2) of the Act was issued on 25/07/2008 and was also sent to the assessee at the available address as per the PAN database. Subsequently notices u/s. 142(1) of the Act were issued for hearing. The assessee's representative appeared and participated in the proceedings. The assessee challenged the notices u/ss. 143(2) and 142(1) of the Act on the ground that the said notices were not served upon the assessee as the assessee-company never received those notices and the subsequent notices served and received by the assessee-company were beyond the period of limitation prescribed under proviso to section 143 of the Act. The Assessing Officer rejected the assessee's claim and by an assessment order dated 24/12/2008 completed the assessment u/s. 143(3) of the Act by making disallowance of ₹ 8,91,17,643/- u/s. 14A of the Act, read with Rule 8 of the Income Tax Rules and computed total income at ₹ 5,52,45,930/-.

The CIT (Appeals) allowed the assessee's appeal *vide* order dated 23/12/2010 holding, *inter alia*, that the Assessing Officer completed the assessment u/s. 143(3) of the Act, without assuming valid jurisdiction u/s. 143(2) of the Act, and therefore, the assessment framed u/s. 143(3) of the Act was invalid. The CIT (Appeals) also observed that as the subsequent service of notice u/s. 143(2) of the Act was beyond the period of limitation prescribed under the proviso to section 143 of the Act and earlier no notices were served upon the assessee and/or received by the assessee as the same were sent at the old address and in the meantime company-assessee changed its address and therefore the assessment order was bad in law. The Tribunal upheld the decision of the CIT(Appeals). The Bombay High Court confirmed the decisions of the CIT(Appeals) and the Tribunal.

The Supreme Court allowed the appeal filed by the Revenue and held as under:

"(i) Mere mentioning of new address in return of income without specifically intimating Assessing Officer with respect to change of address and without getting PAN database changed, is not enough and sufficient. In absence of any specific intimation to Assessing Officer with respect to change in address and/or change in name of assessee, Assessing Officer would be justified in sending notice at available address mentioned in PAN database of assessee, more particularly when return has been filed under EModule scheme.

(ii) Thus, where there was no intimation by assessee to Assessing Officer with respect to change of address, notice u/s. 143(2) sent to assessee on available address as per PAN database can be said to be a sufficient compliance of relevant provisions of Income-tax Act, 1961, more particularly section 143(2).

(iii) Accordingly, the present appeal is allowed. The Impugned Judgment and Order passed by the High Court as well as the orders passed by the CIT (Appeals) and the Tribunal are hereby quashed and set aside. The matter is remanded to the learned CIT (Appeals) to consider the Appeal on merits on other grounds, in accordance with law."

3 *Special Leave Petitions*

3.1 Advance tax – Interest – Chargeability in case of non-resident

Supreme Court granted special leave to the Department to appeal against the judgment of the Delhi High Court whereby the High Court, dismissed the Departments appeal on the issue with regard to the chargeability of interest u/s. 234B of the Income-tax Act, 1961 in the case of a non-resident.

***CIT(IT) vs. Andritz AG*; (2019) 417 ITR *55* (st): dated 05/08/2019.**

3.2 Deduction of tax at source

Supreme Court dismissed the Department's special leave petition against the judgment of the Bombay High Court whereby the High Court held that no question of law arose from the order of the Tribunal holding that if the deductor failed to upload the correct details in form 26A the benefit should be given to the assessee on the basis of the evidence produced before the Department and directed the Assessing Officer to verify the correct facts and give credit of tax deducted at source to the assessee.

***Principal CIT vs. Tata Communications Ltd.*; (2019) 417 ITR 58 (st): dated 23/08/2019.**

3.3 Disallowance u/s. 14A of ITA, 1961 – To be restricted to exempt income

Supreme Court dismissed the Department's special leave petition against the judgment of the Delhi High Court whereby the High Court held that the Tribunal was right in restricting the disallowance u/s. 14A to the exempt income earned.

***Principal CIT vs. DLF Home Developers Ltd.*; (2019) 417 ITR 59 (st): dated 26/08/2019.**

3.4 Export – Exemption u/ss. 10A, 10B of ITA, 1961 – Interest on bank deposits and staff loans

Supreme Court granted special leave to the Department to appeal against the judgment of the Karnataka High Court whereby the High Court held that income by way of interest on bank deposits or staff loans would be entitled to 100% exemption or deduction u/ss. 10A and 10B of the Income-tax Act, 1961.

***CIT vs. Hewlett Packard Global Soft Ltd.*; (2019) 417 ITR 59 (st): dated 31/08/2019.**

3.5 Industrial undertaking – Deduction u/s. 80-IC

Supreme Court dismissed the Department's special leave petition against the judgment of the Himachal Pradesh High Court whereby the High Court dismissed the Department's appeal following 400 ITR 225 wherein it had held that as long as requirement of section 80-IC(8)(ix) is met, there can be number of multiple substantial expansions and more than one initial assessment year and that within the window period of 07/01/2003 up to 01/04/2012, an undertaking or an enterprise can be entitled to deduction at 100% for a period of more than 5 years, subject to the cap of ten years stipulated in section 80-IC(6).

***Principal CIT vs. SBS Biotech Unit I*; (2019) 417 ITR 60 (st): dated 13/08/2019.**

3.6 Offences and Prosecution – Order of penalty stayed by High Court – Prosecution cannot be permitted

Supreme Court dismissed the Department's special leave petition against the judgment of the Gujarat High Court whereby the High Court held that when the High Court was in *seisin* of the dispute and had specifically passed an order staying the judgment of the Tribunal confirming the penalty, further prosecution of the assessee-trust based on the same penalty proceedings could not be permitted.

***Principal CIT vs. IRM Trust*; (2019) 417 ITR 61 (st): dated 26/08/2019.**

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DIRECT TAXES

High Court

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

1 ***Smt. Neetaa Suneel Shah vs. ITO, WP 2961 of 2019,***

Madras High Court, order dt. 18th October, 2019

Assessment u/s 143(3) – Order giving effect consequent of remand by Appellate Tribunal – Additions made by the AO beyond subject matter of remand – AO exceed his jurisdiction and was unjustified in law in making those additions. [A.Y. 2010-2011]

The assessee before the Hon'ble Madras High Court was an Individual. The assessment of the Assessee was reopened under Section 148 of the Act for the reasons that the Assessee had evaded tax through the client modification mode with regard to brokers in futures and options business. Though Assessee filed the objections against reopening and the reasons given for the same, such objections were rejected and consequently, the assessment was completed by passing the order dated 15.09.2016 under Section 143(3) r/w 147 of the IT Act. The Assessing Officer in the said order had computed the total income as follows:

Income from House Property as per return	₹ 1,56,762
Income from Short Term Capital Gains u/s 111A as per return	₹ 59,56,614
Income from Short Term Capital Gains-other than u/s 111A	₹ 25,05,304
Income from other sources - as per return	₹ 4,107
Gross Total Income	₹ 86,22,787
Less : B/F Losses of A. Ys 2006-2007, 2007-2008, 2008-2009 & 2009-2010 as per return	₹ 56,96,224
Gross total income	₹ 29,26,563
Less : Chapter VIA deduction	₹ 54,204
Net total Income	₹ 28,72,359

The Assessing Officer made the addition to the tune of ₹ 25,05,304/- as an income from Short Term Capital Gains other than the income from Short Term Capital Gains under Section 111A. On appeal the CIT(A) upheld the assessment order. On further appeal, the Tribunal remanded the sole issue in appeal to the file of the AO, as it has found that there was violation of principles of natural justice. However after remand, the AO, gone into the issue with regard to the Short Term Capital Gains under Section 111A to the tune of ₹ 59,56,614/- as well and gave a finding that the Assessee has included profit/loss earned from trading in both the Equity and Derivatives segment under the head Short Term Capital Gains. Likewise, in respect of Set off of Capital Losses, the Assessing Officer held that the income tax does not allow loss under the head Capital Gains to be set off against any income from other heads and that this can be only set off within the

Capital Gains head. The Assessee challenged the order giving effect directly before Madras High Court. The Court held that though a statutory appellate remedy was available against the order, the writ petition could be maintained as the Assessing Officer had exceeded his jurisdiction and enlarged the scope of the remand order passed by the Appellate Tribunal. The Court observed that two issues pertaining to treatment of short term capital gains of ₹ 59,56,614/- and adjustment of losses taken up by the Assessing Officer were not the issues either raised before or considered by the Tribunal while remitting the matter therefore, reconsideration of those two issues by taking advantage of the remand order, could not be sustained legally. The Court further observed that for the issue of short term capital gains of ₹ 25,05,304/- the Assessing Officer changed the head from "Short Term Capital Gains" to "Undisclosed Sources under Section 68", without giving any notice or any opportunity of hearing to the Assessee. Consequently, the matter was remitted back to the Assessing Officer to redo the assessment only in respect of the issue relegated by the Tribunal while remitting the matter viz., income from Short Term Capital Gains other than under Section 111A and consequential addition of ₹ 25,05,304/-, after giving a notice and an opportunity of hearing to the Assessee, within a period of six weeks from the date of receipt of the High court order.

2 ***South India Minerals Corporation vs. Asst. CIT, Tax Case (Appeal) 1784 of 2008,***

Madras High Court, order dt. 04th June, 2019

Capital Gains u/s 45 – industrial sheds allotted and possessed by the assessee under lease-cum-sale agreement in 1988 – sale deed executed after payment of entire sale consideration in the year 1996 – transfer of sheds in same years – gains cannot be taxable as short term capital gain. [A.Y. 1997-98]

The assessee was allotted two industrial sheds by the Small Industries Development Corporation (SIDCO), vide allotment order dated 11-08-1988. The tentative cost of the land and building was fixed at ₹ 8.34 lakhs and the assessee was required to pay 20 per cent of the margin money being ₹ 1.66 lakhs and service charges of 5 per cent, i.e., ₹ 41,730/-. The assessee was put in possession of the sheds soon after it was allotted in August, 1988 and continued to be in possession and enjoyment of the industrial sheds. After payment of the entire sale consideration, SIDCO executed a sale deed in favour of the assessee, *vide* sale deed dated 11-01-1996. The assessee sold both the sheds to two different purchasers in the year 1996 itself. While finalizing the assessment the AO treated the capital gains earned on sale of industrial sheds as short-term capital gains by observing that the assessee became owner of the property only in the year 1996. On appeal, the Commissioner (Appeals) as well as the Tribunal also affirmed the order of the AO. On further appeal, the High Court allowed the appeal by observing that there is no allegation against the assessee that they have flouted the terms and conditions laid down by SIDCO. For all practical purposes, the assessee was treated to be the owner of the property except that he was not entitled to transfer, assign or sublet the industrial sheds. The sale deed also imposed certain conditions, but those conditions operate only for the time limit prescribed therein and there was no time limit for the assessee to obtain permission from the SIDCO. The sale deed clearly stated that the entire sale consideration of ₹ 8,34,600/- was paid by the assessee. Even as per the terms and conditions, 20% of the margin money had to be paid by the assessee and they were granted moratorium period after which they had to pay the balance amount in 10 equal half yearly installments. All these conditions were complied with by the assessee. Referring to the definition of short term capital asset the court held that the word which is of utmost significance in section 2(42A) of the Act is the word "held". The definition does not use the expression "purchase" or "owned", but specifically uses the word "held". A Court is not expected to add any words or phrases in a statute, more particularly, in a taxation statute and the same has to be read as it is. Apart from the above definition, the court referred to the definition of the word "transfer" u/s 2(47). The Court held that

a conjoint reading of section 2(42A) and section 2(47)(v), makes it evidently clear that holding of property does not essentially mean holding of a property pursuant to an absolute deed. Thus, considering the factual matrix the court held that the assessee had been holding the property ever since the date of allotment, i.e., 11.08.1988 and thus, the gains arising on transfer of industrial sheds is to be taxed under the head long term capital gain.

3 ***CIT vs. Smt. S. Gowri, Tax Case***

(Appeal) nos. 136 , 137 , 138 , 139 , 140 and 141 of 2019, Madras High Court, order dt. 21st February, 2019 / [2019] 417 ITR 45 (Mad)

Penalty u/s 271(1)(c) – death of assessee during penalty proceedings – penalty proceedings cannot be continued against his legal representative

The assessee and her husband Shri S. Shanmugam were carrying on business of petroleum products through a concern by the name M/s. Yeses International Ltd. They were also in real estate business through another concern M/s. Yeses Promoters Pvt. Ltd. On 13.2.2009, the department had conducted a 'search' in cases of her family members leading to alleged seizure of incriminating documents pertaining to real estate firm aforesaid. In all cases, the panchnamas were drawn on various dates last by 13.4.2009. Thereafter, on 29.6.2009, the assessee's husband filed a statement of assets and liabilities before the ADIT(Inv.) declaring total amount of net of assets and liabilities. The AO framed assessment under section 153A r.w.s. 143(3) by employing 'net asset' method for all assessment years i.e. 2003-04 to 2009-10 by taking all immovable and movable assets against liabilities and computed total income of impugned assessment year at ₹ 9,75,544/-. Since the assessee had not maintained any books of account and 'undisclosed' income had arisen, the AO initiated penalty proceedings under section 271(1)(c) r.w.s. 271A of the Act against the assessee for having concealed and furnished inaccurate particulars of income as well as in failing to maintain books of account. The assessee did not carry the matter in appeal and the assessments attained finality. The AO initiated penalty proceedings. During the course of penalty proceedings the husband of the assessee Shri S. Shanmugam had expired on 23.1.2011. However, the AO imposed penalty under section 271(1)(c) of the Act *vide* order dated 30.06.2011. On appeal, the first appellate authority quashed the penalty levied under section 271(1)(c) of the Act. The department carried the matter before the Appellate Tribunal. The Appellate Tribunal quashed the penalty order by observing that the assessee Shri S. Shanmugam had expired on 23.1.2011 well before imposition of penalty *vide* order dated 30.6.2011. Hence, penalty under section 271(1)(c) of the had been wrongly imposed by the AO on the legal heirs of deceased assessee. The department being aggrieved filed an appeal before the Hon'ble Madras High Court. The Court held that the provisions of section 271(1)(c) of the Act depend upon the guilty animus of *mens rea* on the part of the assessee and legal representative cannot be held liable to defend those penalty proceedings or be held guilty of any *mens rea.* Therefore, unless the penalty proceedings are concluded against a living assessee, the legal heirs cannot be held liable to face those proceedings or pay any sum determined as penalty payable under section 271(1)(c) of the Act.

4 ***Menck GMBH vs. ACIT***

Writ Petition No. 1631 of 2019, Bombay High Court, order dt. 16th August, 2019

Reopening u/s 147 – Reassessment proceedings are for benefit of revenue - dropping of reassessment proceedings by AO, is justified

Assessing Officer had initiated a re-assessment in the case of the assessee by issuing notice u/s 148 of the Act. However, the said re-assessment proceedings were dropped by the AO. The Assessee filed a writ petition challenging the order dropping the said re-assessment proceedings on the ground that once a re-assessment has been initiated by issuing notice u/s 148 and was reopening was not objected by the Assessee then it is not open to the Revenue to drop the said proceedings and it has to necessarily culminate

into an assessment order. The Hon'ble High Court held that re-assessment proceedings are for the benefit of the revenue and accordingly it is very much within the powers of the AO to drop the re-assessment proceedings even when the same are not challenged by the Assessee.

5 ***Aditya Marine Ltd. vs. DCIT (IT)***

Writ Petition no.2484 of 2019, Bombay High Court, order dt.03rd October, 2019.

Revision u/s 264 – Scope of the word 'any order' – CIT can revise order denying grant of refund - writ petition dismissed on the ground of efficacious alternate remedy

Assessee had made several requests and representations to the Revenue authorities, seeking refund of ₹ 98,97,737/- together with interest which arose out of return for AY 2005-06 filed by one UAE based company of which, the Assessee was an agent. As none of those requests / representations were disposed by the Revenue authorities, the Assessee filed writ petition before the Bombay High Court. The Court directed the Authorities to dispose of the representations within six weeks. Thereafter, the AO vide order dt. 9 April, 2019 rejected Assessee's refund application. This order was challenged by filing second writ petition before the High Court. It was argued that there was no alternate remedy available under the Act as the impugned order is not appealable under section 246A of the Act. It was also pointed out that revision under section 264 of the Act would not be available as there is no order passed under any of the provisions of the Act which would enable the Assessee to file revision application. It was further submitted that the application for refund filed by the Assessee relates to the assessment year 2005-06 and the delay by itself makes it a fit case where extra ordinary jurisdiction should be exercised by the Court and the Assessee should not be relegated to any alternate remedy under the Act. The High Court agreed that no appeal under the Act is available to the Assessee u/s 246A of the Act. However, a revision would lie to the Commissioner of Income Tax from any order passed by the authority subordinate to him in respect of any proceeding under the Act. The High Court observed that the impugned order dt. 9 April, 2019 adjudicates a *lis* between the Revenue and the Assessee. The High Court held that the lis requires an examination of facts for adjudication of the dispute. The Assessing Officer i.e. Deputy Commissioner of Income Tax can only pass an order under the Act as the Assessee was seeking refund of excess amount paid as tax under the Act. The High Court, therefore, do not find any substance in the submission of the Assessee that no revision would be available against the impugned order as it is not an order passed under the Act, as remedy of revision under section 264(1) of the Act would be available. The Court held that, if one contrasts section 264 of the Act with section 246A of the Act which provides for appeal, it would be noticed that unlike section 246A of the Act which specifies sections of the Act from which an appeal would lie, section 264 of the Act provides for revision from `any order' under the Act. This is another indication that the Commissioner of Income Tax has very wide powers to correct any order passed by an officer subordinate to him. In the above view, the court was not inclined to entertain the writ petition as an efficacious alternate remedy was available to the Assessee under the Act.

6 ***CIT (Exemption) vs. Reham Foundation Kandhari Lane Lal Bagh, Lucknow***

Income tax Appeal no. 37 of 2017, Allahabad High Court, order dt. 26th September, 2019

Powers of the Appellate Tribunal u/s. 254(1) – Where registration under Section 12(AA) has been denied by Commissioner of income tax, the Tribunal can itself pass an order directing commissioner to grant registration

Revenue had challenged the order passed by Appellate Tribunal, which directed registration of the Trust under Section 12AA (1)(b) of the Act of 1961 within a period of sixty days, failing which it would deemed to have been registered. As there were divergent views on the issue a Full Bench was constituted wherein following questions were referred:-

"(i) Whether Income Tax Appellate Tribunal while hearing Appeal in a matter where

registration under Section 12AA has been denied by Commissioner Income Tax can itself pass an order directing Commissioner to grant registration or should leave the matter to be considered by Commissioner Income Tax to consider matter afresh giving rise to further litigation in the matter;

(ii) Whether co-extensive Appellate jurisdiction conferred upon Income Tax Appellate Tribunal being a last court of fact can be read to confer upon it similar powers as been exercised by authorities below whose orders are considered in Appeals by Tribunal."

The Court held that a perusal of Section 254 of the Act of 1961 shows that the Appellate Tribunal is given power to pass such orders, as it thinks fit. The powers given under Section 254 of the Act of 1961 is to be read along with other provisions of the Act. Section 12AA of the Act of 1961 requires satisfaction about the genuineness of the activities and the objects of a Trust before its registration by the Commissioner. The Court further held that where the Commissioner has refused to accept the application for registration of Trust after recording its finding on the basis of material on record before him holding that the activities and object of the Trust are not genuine and the Appellate Tribunal on the basis of the same material on record comes to the conclusion that the order of the Commissioner is perverse since it has been passed ignoring, misconstruing or misinterpreting such evidence, then it can direct registration of the Trust without remanding the matter to the Commissioner. Remand of the case to the Commissioner in the said circumstance after recording of satisfaction by the Appellate Tribunal about the genuineness of objects and activities of the Trust, on the basis of material on record, would be an empty formality because the Commissioner in such a case cannot go against the specific finding recorded by the Appellate Tribunal. In view of the unfettered power of the Appellate Tribunal in terms of section 254 (1) of the Act, 1961 the Tribunal can very well record its satisfaction on the genuineness of the activities and object of the Trust and can very well direct registration of the Trust without remand of case to the Commissioner in case such satisfaction is recorded on the basis of documents and material already available on record at the stage of examination by Commissioner. However it would be a different matter where the Appellate Tribunal records such satisfaction on the basis of material or documentary evidence which was not available before the Commissioner while exercising his powers under Section 12 (AA) of the Act, 1961, which would require remand. Remand to the Commissioner can also be affected in a case where the Commissioner rejects the application on a technical ground without recording its opinion on facts or genuineness of the activities and object of the Trust but the Tribunal finds ground for rejection on such technical ground thereby reopening the issue of recording satisfaction in terms of Section 12 (AA) of the Act, 1961. Thus it is clear that the power and jurisdiction of the Appellate Tribunal under Section 254(1) of the Act, 1961 is unfettered thereby enabling the Appellate Tribunal to direct registration of the Trust at its level itself but the same is not open as a matter of course and such power is to be exercised only in circumstances indicated above. The said onus on the Appellate Tribunal to remand the matter in cases indicated is also in view of the strict interpretation of the powers of the Commissioner under Section 12 (AA) of the Act, 1961 because if the Appellate Tribunal is given such wide powers to direct registration of Trust in all or any circumstances, it would render the provisions of Section 12(AA) otiose, which again cannot be the intention of legislature.

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DIRECT TAXES
Tribunal

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

Reported Decisions

1 ***Adi D. Vachaa vs. ITO***
(ITA 2755/Mum/2011) [Assessment Year: 2005-06] Order dated 09.08.2019 [2019] 110 taxmann.com 260 (Mumbai – Tribunal)

Section 2(14) – "Right to receive TDR" allotted to the owner by the municipality in lieu of acquisition of an immovable property constitutes a capital asset. Cancellation of "MOU" depicting a transfer of such a right does not amount to repurchase/fresh acquisition by the Assessee and a period of holding is to be reckoned from the date of acquisition of the property by the municipality and not from the date of cancellation of "MOU"

Facts

The Assessee is an individual and filed his return of income that was selected for the scrutiny assessment. During the course of the assessment proceedings, the AO noticed that the Assessee had computed Long-Term Capital Gains and asked him to provide necessary documents and explanation. Pursuant to the same, the Assessee submitted before the AO that in year 1986, a property of the Assessee was acquired by Pune Municipal Authority entitling him to receive certain "TDR" in lieu of the said acquisition. The Assessee without receiving the said TDR transferred its right to receive the same to a third party by executing a memorandum of understanding in 1996 and accordingly paid taxes on the same. However, there was a delay in allotment of the TDR to the purchaser by the said municipal authority which resulted in cancellation of the earlier understanding. Accordingly, a deed of cancellation was entered into between the parties on 14.06.2004. As a result of cancellation, the Assessee decided to transfer the right to receive "TDR" to a new purchaser and an agreement to the said effect was entered into for the total consideration of ₹ 50 lakhs. While calculating capital gains on the said transfer, the Assessee considered the said capital asset (i.e. right to receive "TDR") as long term in nature and claimed the indexation benefit since the year in which the property of the Assessee was acquired by the said Municipal Authority. Further the Assessee claimed a benefit of section 54EC of the Act. However, the AO was of the view that a deed of cancellation entered into between the parties on 14.06.2004 resulted in fresh acquisition of a capital asset (i.e. a right to receive "TDR") by the Assessee which was transferred immediately in the same

assessment year. Thus, the AO rejected the contention of the Assessee and treated the said asset as a short-term capital asset giving rise to the short-term capital gains. Being aggrieved, the Assessee preferred an appeal before the CIT(A) who after considering the facts of the case rejected the stand of the Assessee as well as the AO. The CIT(A) directed the AO to treat the income from the sale of the said capital asset as speculative (business) income. Thereafter, the Assessee filed an appeal before the ITAT. After hearing both the sides, the ITAT held as under:

Held

The ITAT observed that a deed of cancellation dated 14.06.2009 clearly states that the purchaser was not willing to wait anymore because of delay in allotment of TDR rights and therefore, the assessee was forced to cancel the said agreement. It further observed that when, the asset transferred was cancelled for some reasons, it does not amount to repurchase of an asset for the purpose of determination of period of holding. The ITAT held that the Assessee had been holding a capital asset (i.e. right to receive "TDR" in lieu of acquisition) since the date of the acquisition of his property by Pune Municipal authority and a period of holding is to be reckoned from the said date which exceeds 36 months. Thus, the ITAT concluded that the capital asset transferred by the Assessee was long term in nature. On the aforesaid observations, the ITAT accepted the stand of the Assessee and allowed his appeal.

Unreported Decisions

2 ***M/s. Rotary Charitable Trust vs JCIT***
[ITA 2613 & 2614/Bang/2018] (Assessment Year: 2013-14 & 2014-15), Order dated 12.07.2019

Section 272A(2)(e) –As Section 139(4A) makes a reference to provisions of Section 11 and 12, no penalty u/s. 272A(2)(e) is impossible in the case of belated return filed by the trust claiming an exemption u/s. 10(23C)(iiiad) of the Act

Facts

The Assessee is a charitable trust engaged in providing primary and pre-university education to students in rural area. For both the assessment years, the Assessee filed its income tax returns belatedly by claiming an exemption u/s. 10(23C)(iiiad) of the Act. After noticing the delay in filing the said returns, the AO levied a penalty u/s. 272A(2)(e) for both the assessment year. Being aggrieved, appeals were preferred before the CIT(A) without any success. Thereafter, the Assessee filed appeals before the ITAT. During the course of the hearing, it was argued by the Assessee that since the Assessee was entitled for the exemption u/s. 10(23C)(iiiad), the president of the Assessee who was a senior citizen of more than 80 years of age was under the *bona fide* impression that the Assessee was not required to file its income tax returns in the light of the fact that the Assessee did not have any tax liability for both the assessment years. However, it was clarified to the ITAT that when the correct legal position was apprised, returns for both the years were filed by the Assessee. It was further submitted that since the Assessee had claimed exemption u/s. 10(23C)(iiiad) of the Act, there was no violation of Sec 139(4A) of the Act as the said section specifically refers to the provisions of Sec. 11 and 12 and there is no mention about Sec. 10(23C)(iiiad) of the Act. On the other hand, the DR opposed to the contentions of the Assessee and requested the ITAT to confirm the penalty levied by the AO. After hearing both the sides, the ITAT held as under:

Held

The ITAT after relying on the decision of its co-ordinate bench in the case of "*HTSL Community Service Trust vs. JDIT (Exemptions) (2012) 52 SOT 144 (Bangalore) (URO)*" came

to the conclusion that there was reasonable cause for filing income tax returns belatedly for both the assessment years. The ITAT in addition to the above-mentioned observation agreed with the legal contention of the Assessee and observed that the provisions of section 139(4A) are applicable only in case where the exemption is claimed u/s. 11 and 12 of the Act and not in case where the income of an organization does not form part of the total income under the Act by virtue of the provisions of Sec. 10(23C)(iiiad) of the Act. In the light of the aforesaid observations, the ITAT deleted the penalty levied by the AO and allowed both the appeals of the Assessee.

3 *M/s. JDC Traders Pvt. Ltd. Vs. DCIT*

[ITA 5886/Del/2015] (Assessment Year: 2007-08), Order dated 11.10.2019

Reopening - Section 147 r.w.s 154 - The Assessing Officer after completion of the assessment proceedings cannot take aid of Explanation 3 to Sec 147 to make any further addition u/s. 154

Facts

The Assessee is a Private Limited Company and engaged in the business of trading, export and printing. The Assessee filed its return of income for the previous year relevant to the impugned assessment year on 30.10.2007 declaring total income at ₹ 65,33,380/-. The said return was processed and accepted u/s. 143(1) of the Act. Subsequently, the assessment was reopening by issuing the notice dated 08.08.2011 u/s. 148(1) of the Act. The AO sought to initiate the reassessment proceedings by recording the reasons on two aspects, one is with respect to the escapement of income under the head travelling expenses on account of purchase of foreign exchange amounting to ₹ 4,78,030/- and the other is with respect to the claim of the assessee to the tune of ₹ 6,58,736/- which was disallowed in the preceding year u/s. 40A(ia) of the Act. The AO finalized the assessment vide order dated 14.11.2012 u/s. 143(3) r.w.s 147 of the Act by making disallowance of ₹ 4,78,030/- on account of travelling expenses incurred for purchase of foreign exchange. Thereafter, on perusal of the assessment records, the AO found that the Assessee had shown closing stock in the profit and loss account of a sum of ₹ 2,97,47,872/- whereas 'Annexure 1(a) Note 7(A)' to Schedule 20 of the Financial Accounts shows the same as ₹ 3,32,01,843/-. Thus, there was a difference of ₹ 34,53,971/-. The AO, therefore, issued the notice u/s. 154 of the Act seeking rectification of the assessment order. In response to the said notice, the Assessee submitted that while preparing the accounts, the Assessee had initially worked out the figure of closing stock at ₹ 3,32,01,843/-, but, at the time of finalization of accounts after reconciling the stock, the Assessee arrived at correct figure of ₹ 2,97,47,872/-. However, inadvertently the original working sheet remained attached with the statement of accounts by mistake. Assessee submitted that it has maintained proper stock records and after reconciliation, the mistake was detected and corrected. Since it is a verifiable record, the genuineness of the mistake was verified by the appropriate authorities. The AO however, vide order dated 03.01.2014 u/s. 154 of the Act made an addition of ₹ 34,53,971/- being the difference of closing stock. Being aggrieved by the said order, the Assessee preferred the appeal before the CIT(A). Before CIT(A) submitted that the scope of sec. 154 does not permit anything more than the rectification of mistake that is apparent from the record and there is no mistake in the assessment order as far as the proceedings u/s. 147 are concerned. However, CIT (A) did not accept the contention of the Assessee and dismissed the appeal. Being aggrieved, the Assessee preferred the appeal before ITAT. After considering submission of both the parties, ITAT held as under:

Held

ITAT observed that the AO proposed the reopening of the proceedings in respect of

the escapement of income under two heads, namely, on account of the expenses incurred under the head "travelling expenses" and "purchase of foreign exchange". As per sec. 147, the Ld. A.O. is empowered to assess or re-assess the income in respect of any issue which has escaped assessment and which came to his notice subsequently in the course of proceedings u/s. 147 of the Act notwithstanding that the reasons for such issue has not been included in the reasons recorded under sub-section (2) of Sec. 147 of the Act. The AO did not advert to this aspect at all in the proceedings u/s. 147. Now the question that arises is whether the AO can take the aid of Explanation 3 to Section 147 to make some other addition on the aspect in respect of which there is no whisper in the entire proceedings u/s. 147, after the conclusion of such proceedings u/s. 147 of the Act. ITAT held that a careful reading of Section 147 clearly shows that it empowers the AO to assess or re-assess the income in respect of any issue which had escaped the assessment irrespective of the fact that whether such aspect was adverted to in respect of the reasons recorded u/s. 147 of the Act. The ITAT observed that the AO is not entitled to raise any issue and make the addition u/s. 154, if the same is not raised in the reassessment proceedings u/s. 147 of the Act. Thus, the ITAT held that rectification proceedings assumed by the AO resulting in the addition of ₹ 34,53,971/- are beyond the jurisdiction of the AO and cannot be sustained. Therefore, ITAT deleted the addition made in the order u/s. 154 of the Act and allowed the appeal filed by the Assessee.

4 ***Shri Sarrangan Ashok vs. ITO***
[ITA 544/Chny/2019] (Assessment Year: 2015-16), Order dated 19.08.2019

Capital Gains – section 45(3) – the profit received on transfer of a capital asset by the partner to the partnership firm shall be chargeable to tax under the head capital gains for which, the value of consideration credited in the partnership firm shall be taken as a full value of consideration for the purpose of section 48 of the Act

Facts

The Assessee is a partner in a partnership firm named as M/s. K. G. P Builders along with Shri K G Pandian, both having equal share of profit. During the year under the consideration, the Assessee transferred the land owned by him in the said partnership firm as a capital contribution at valuation of ₹ 29,77,300/-. Subsequently, the said partnership firm was reconstituted whereby the value of land was revalued and the corresponding credit was given to the respective capital account in the profit and sharing ratio. Thereafter, on the basis of market value, the land was revalued and the same was credited to the respective partners account. Accordingly, the share of the Assessee was determined at ₹ 23,94,41,006/-. On the basis of the said valuation, the A.O. treated the market value as a full value of consideration for transfer of the said land by the Assessee in the said firm and thereby computed LTCG by deducting the cost of acquisition from the same. Thus, the Ld. A.O. computed the LTCG at ₹ 23,69,78,315/- invoking the provisions of sec. 50C of the Act. On appeal, CIT(A) held that the provisions of Sec. 45(3) and 50C of the Act are squarely applicable to the facts under consideration. Accordingly, the CIT(A) directed the AO. to compute the capital gains by adopting the proportionate value of revalued asset i.e., the land contributed by the assessee as a consideration instead of 50% of the entire value of the land. The appeal of the Assessee was partly allowed by the CIT(A). Being aggrieved, the Assessee preferred the appeal before the ITAT and submitted that the sec. 45(3) specifically provides that while computing the capital gains on transfer of capital asset by the partner in the partnership firm, the value of consideration credited in the books of the firm shall deemed to be treated as a full value of consideration. Further, it was submitted that the contribution

of an asset by the partner in the partnership constitutes a transfer, but the value recorded in the books of the firm is a conclusive evidence of consideration received towards transfer of the capital asset. It was further submitted that sec. 50C cannot be override the sec. 45(3) since one deeming provision cannot be extended to the other deeming provision. After considering the submission of Assessee as well as department, the ITAT held as under:

Held

The ITAT held that the only issue involved in the present appeal is whether the transfer of asset by a partner in the firm constitutes a transfer. As per Sec. 45(3), the profits or gains arising from the transfer of a capital asset by a partner to the firm by way of capital contribution shall be chargeable to tax in the year in which such transfer takes place and the value of consideration recorded in the books of the firm shall be deemed to be a full value of consideration accrued as a result of such transfer for the purpose of Sec 48 of the Act. The ITAT after referring to the CBDT circular No. 495 dated 22.09.1987, held that the provisions of Sec. 45(3) was introduced to overcome the decision of the Supreme Court in the case of *Karthikeya V. Sarabhai, reported in [1985] 156 ITR 509 (SC)* wherein it was observed that there is no liability to capital gains in the case of contribution of capital asset by a partner in a firm, since the value of consideration cannot be determined. It was further held by the ITAT that the credit entry made in the partner's capital account in the books of partners firm does not represent the true value of the consideration. In the present case, the partnership firm, M/s. K G P Builders has recorded the consideration at ₹ 29,77,300/-. The ITAT further, observed that the provision of Sec. 45(3) is exhaustive and does not confer any power on the AO to adopt consideration different from what is recorded in the books of account of the firm. The ITAT further, relied on the decision of The Madras High court in the case of *PCIT vs. Dr. D. Ramamurthy, [2019] 410 ITR 236 (Madras)* and held that the value to be adopted by the AO is only ₹ 29,77,300/- which was recorded in the books of accounts of the firm as on the date when the firm was constituted. The ITAT held that the provisions of Sec. 50C of the Act are applicable in the cases where there is actual receipt of consideration. The term "actual receipt" implies that there should be physical flow of money. Therefore, the provisions of Section 50C cannot be applied to the case of deeming the value of consideration like cases covered by provisions of 45(3). Further, it was observed that had it been the intention of the legislature to make Sec. 50C applicable even to the transaction of the contribution of immovable property by a partner into the firm, the Parliament could have repelled the Sec. 45(3) of the Act, while introducing the provisions of Sec. 50C. However, the Parliament in its wisdom had retained the Section 45(3) of the Act which shows that the Parliament intended to keep the provisions of Sec. 45(3). The ITAT after relying the decision of Supreme Court in the case of *D.R. Yadhav vs. R.K. Singh [2003] 7 SCC 110,* held that when there are two conflicting provisions of law in operation in the same field, the rule that specifically operates in that field would apply over the general rule. Thus, it cannot be said that provision of Sec. 50C of the Act overrides the provision of Sec. 45(3) of the Act. The ITAT, therefore, deleted the addition made by the AO invoking the provisions of sec. 50C of the Act and allowed the appeal of the Assessee.

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INTERNATIONAL TAXATION

Case Law Update

CA Tarunkumar Singhal & Dr. Sunil Moti Lala

A. HIGH COURT

1 *CIT vs. KPMG*

[TS-602-HC-2019] (Bom) – ITA No. 690 of 2017

Professional fee payments made by the assessee for services rendered to it outside India were not taxable in India in view of the DTAA. (As neither the service providers had PE in India nor did the service make available technical knowledge). Once the above was accepted by the Revenue, it could not urge taxability under the Act

Facts

i) The Assessee was engaged in the business of rendering taxation, audit and other consultancy services.

ii) The Assessee had paid fees for professional services outside India without deducting TDS. The AO had disallowed the said professional fees under Section 40(a)(i) of the Act.

iii) The Tribunal had allowed assessee's appeal and held that the assessee was not liable to deduct tax as the payments were made to service providers for services rendered outside India, which were governed by the respective DTAA's and none of the service providers had a PE in India. Also, none of the services provided had the attribute of making available of any technical knowledge to the assessee in India.

iv) Aggrieved, the Revenue filed an appeal before the High Court

Decision

i) The Court noted that there was no challenge by Revenue to the findings of the Tribunal that the payments made by the Respondent to its service providers were covered by the DTAA. In fact, the only question urged by the Revenue was taxability of the said payments under the Act. The Court held that in terms of Section 90(2) of the Act, it is open to an assessee to adopt either the DTAA or the Act as is beneficial to it. The Revenue having accepted that the service providers were not taxable in view of the DTAA, the occasion to deduct tax at source would not arise.

ii) Accordingly, it dismissed Revenue's appeal as no substantial question of law arose.

2 *PCIT vs. Microsoft Corporation India Pvt. Ltd.*

[TS-914-HC-2019(Del)] - ITA 874 of 2019

M/s. Basiz Fund Services Private Limited was held to be not comparable to a marketing support service provider

Facts

i) The Assessee was engaged in provision of marketing support services (MSS) to MS Corp and affiliated entities in return for a service fee. It had selected the TNMM as the MAM for benchmarking of the international transaction for provision of MSS with a return on total operating cost ("OP/TC") as the Profit Level Indicator (PLI) and computed the PLI of 14 Comparables at 8.95% and concluded that international transaction was at Arm's Length Price as assessee's PLI was 16.75%.

ii) The TPO rejected 5 comparables selected by assessee and thereby made an adjustment of ₹ 51.75 crores. The DRP relying on its own order for the AY 2008-09, directed the exclusion of M/s. Basiz Fund Services Private Limited from the final set of comparable companies.

iii) The Tribunal dismissed Revenue's appeal and held that M/s. Basiz Fund Services Private Limited was functionally dissimilar to the assessee in as much as it was involved in the fund accounting services and possessed significant intangible assets. Also, it had a very significant growth in the revenue - 57.61% and profits - 46.75%.

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

Decision

i) The Court held that even if the supernormal level of profit - 46.75% was not to be considered as a reason to treat the said enterprises as not comparable, the fact remained that the Tribunal concurred with the view of the DRP on functional dissimilarity.

ii) Accordingly, it dismissed Revenue's appeal as no substantial question of law arose.

3 *CIT vs. M/s. Doowon Automotive Systems Pvt. Ltd.*

[TS-942-HC-2019(MAD)] - Tax Case Appeal No.722 of 2019

TPO's order passed after the issue of Directions by DRP was invalid

Facts

i) The Assessee company was engaged in the business of manufacturing automotive components. The TPO had rejected the TNMM adopted by the assessee as the MAM and also rejected the three comparables selected by the assessee. However, the DRP had accepted the TNMM selected by the assessee as the MAM and directed the AO to apply TNMM after making working capital adjustment. But consequent to the direction of the DRP, the TPO had passed another order dated 22-01-2014 and subsequently the AO had given effect to the order of the TPO dated 22-01-2014.

ii) The Tribunal allowed assessee's appeal and remanded the issue back to the file of AO with a direction that AO shall refer the matter once again to the DRP and the DRP shall pass a clear and specific order, after calling for a remand report from the TPO, if necessary. The Tribunal observed that when the mandate of Section

144C(13) was passing of an assessment order by AO in conformity with the directions of the DRP, the TPO had no role to pass a subsequent order after the direction was given by the DRP. The AO was expected to pass an assessment order in conformity with the directions of the DRP without any intervention either by the TPO or by any authority. Therefore, there was a clear violation of the procedure prescribed u/s 144C of the Act. If the DRP found that any further investigation was required by the TPO, it was open to the DRP to keep the matter pending and call for remand report from the TPO and upon receiving such remand report, pass order u/s 144C(5) of the Act directing the Assessing Officer to make the adjustment as provided under the scheme of the Income-tax Act.

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

Decision

i) The Revenue contended that in Para 6 of the order passed by the Tribunal it had expected the DRP to pass fresh orders under Section 144(5) of the Act, but towards the end of the order, the matter was again remanded back to the AO, which was incorrect. Thus, it was unclear as to which lower authority the matter was remanded.

ii) The Court noted that the Tribunal wanted a fresh order from the DRP under Section 144(5) of the Act, but it had remanded the matter back to the AO. But, AO under the said order of the Tribunal was free to refer the matter back to the DRP in terms of the order passed by the Tribunal. Therefore, either way DRP had to pass a fresh order in terms of the order passed by the Tribunal.

iii) Nevertheless, Assessee/Revenue were free to approach the Tribunal to issue necessary clarification as to which authority they wanted the matter to be remanded back. However, no substantial question of law arose from the said order of the Tribunal.

iv) Accordingly, it dismissed Revenue's appeal.

4 ***P.D.R SOLUTIONS FZC vs. DRP***
[TS-601-HC-2019(Del)] - W.P.(C) 10387/2019

Where the directions were issued by the DRP without considering the basic contention of the assessee, the Court issued writ and set aside the same

Facts

i) The assessee, a tax resident of UAE, was engaged in the business of sale of domain names to global customers and was also providing web hosting services whereby server spaces were given on lease/hire to clients.

ii) The AO had passed a draft assessment order under Section 144C of the Act, holding that the assessee's income arising from Domain Name Registration Services and Web Hosting Services was taxable under the provisions of the Act and also under the India-UAE DTAA.

iii) The assessee being aggrieved by the said order filed its objections before the DRP, *inter alia* objecting that its income arising out of domain name registration services and web hosting services was not taxable under the India-UAE DTAA. The case of the assessee was essentially that the definition of Royalty under the Act was wider than that provided in the Treaty since under the Act "transfer of rights in property similar to trademark" was also

covered, whereas under the Treaty, only the "transfer of right to use trademark" was covered and not "rights in property similar to trademark".

iv) The DRP had not adjudicated on assessee's categorical objections on the taxability under the India-UAE DTAA and had instead followed Delhi Tribunal ruling in GoDaddy.com LLC (ITA No. No.1878/Del/2017) (A.Y 2013-14) without appreciating that the taxability in GoDaddy.com (*supra*) was decided under the provisions of the Act and not under any DTAA.

v) Aggrieved, the assessee filed a writ petition before the High Court.

Decision

i) The Revenue contended that since there was an alternate efficacious remedy available to the assessee under Section 253(1)(d) of the Act, whereby the assessment order passed by AO in pursuance of the DRP directions could be challenged in appeal before the Tribunal, the assessee could not be allowed to file the present petition. It also contended that no assessee could be aggrieved merely by the directions of the DRP, since it does not culminate into an order until the AO incorporated it and passed an assessment order.

ii) The Court noted that the power under Article 226 was to be exercised judiciously, considering the facts of the case. It observed that normally a writ petition under Article 226 was not to be entertained, if alternate statutory remedy was available.

iii) The Court noted that if the DRP had considered the relevant materials, then such a decision of the DRP even if considered by the assessee as "wrong" would not be amenable to Writ Jurisdiction and such wrongs can and should be corrected by resorting to the statutory mechanism of appeal. However, if while deciding, the DRP did not consider the relevant material, the only inference one can draw was that the DRP had failed to exercise its jurisdiction and it reflected non-application of mind. If such a situation emerged, then such an order was amenable to the writ jurisdiction of the High Court, since it would be a case of failure of the statutory authority to exercise its jurisdiction.

iv) In the facts of the present case, the DRP had blindly followed the decision of GoDaddy.com LLC wherein it was held that receipt on account of Domain Name Registration Charges was royalty u/s. 9(1)(vi) of the Act. Further, the DRP held that the Web Hosting Services were interlinked with domain name registration and thus were ancillary and subsidiary to the application or enjoyment of the right for which amount was received as royalty. Thus, the payments received for Web Hosting Services were also considered as royalty under Section 9(1)(vi) of the Income Tax Act, 1961.

v) From the above directions of the DRP, it was starkly noticeable that the main contention, or to say the basic argument, raised by the assessee with respect to the non-taxability of its income under India-UAE DTAA had not been noticed or discussed, much less adjudicated upon.

vi) Thus, if the plea of the assessee was not even looked at/ examined by the DRP, it would tantamount to a jurisdictional error. Hence, the Court held that the DRP had completely failed to exercise its jurisdiction and had rendered the entire process of the

dispute resolution as per the scheme of the Act farcical.

vii) Accordingly, the writ petition was allowed and the impugned directions of the DRP were set aside. Consequently, the matter was remitted back to the DRP for considering the objections raised by the assessee in detail, and for passing a fresh order on merits and in accordance with law by giving reasons and findings.

B. TRIBUNAL DECISIONS

5 *Lahmeyer International GmbH vs. ACIT*
[TS-630-ITAT-2019(DEL)]
[Assessment Year: 2001-02]

India-Germany DTAA – Article 12 - Taxability of Fees for Technical Services – Invocation of Force of Attraction Principle by Revenue-Rejected by the Tribunal on facts of the case – Held in favour of the Assessee

Facts

i) M/s Lahmeyer International GmbH, the assessee is a non-resident company incorporated in Germany, engaged in engineering consulting services such as planning, designing and consulting in relation to complex infrastructure projects in India. The Assessee had been rendering engineering consulting services mainly in relation to 10 power projects in India by entering into contracts with State Govt./ Semi Govt. Undertakings. During relevant AY, the assessee earned total revenues [which were classified as Fees for technical services/FTS which were offered to tax in the following manner:

a) A certain portion was offered to tax at the rate of 20% on a gross basis u/s. 115A, in respect of the contracts where a Permanent Establishment ("PE") was formed in India; and

b) The remaining portion was offered to tax at the rate of 10% on a gross basis under Article 12 of the India-Germany DTAA, in respect of the contracts where no PE was formed in India.

ii) During the course of assessment proceedings, the assessee contended that it constituted a PE in India only w.r.t Phase II of the contract with Jammu and Kashmir State Power Development Corporation ("JKSPDC")["Baglihar Project PE"] by virtue of carrying out the work from a project office in India, and accordingly, revenues earned from JKSPDC-Phase-II were offered to tax at the rate of 20% (gross basis), whereas, revenue earned from all other projects were offered to tax at 10% (gross basis).

iii) The AO rejected the plea of the assessee and passed an assessment order u/s. 143(3), wherein the entire receipts of the assessee were subjected to tax at the rate of 20% by applying the principle of "Force of Attraction [FOA]" under the Treaty.

iv) On further appeal, the CIT(A) dismissed the appeal of assessee.

Aggrieved, the assessee filed an appeal before Delhi ITAT.

Decision

The Tribunal observed and held in favour of the assessee as under:

i) The assessee argued that there was no device to avoid tax by entering into different agreements, as each agreement was different and was entered into with different parties. Moreover, the condition of involvement of PE was not met in

the present case, as there was no finding that 'Baglihar Project PE' was in any way involved in any other projects across the Indian territories.

ii) The assessee further contended that Baglihar project was in respect of hydro-power and its PE cannot be said to be involved in projects in the field of water management [E.g., a project located in Vishakhapatnam] or thermal power. Also, even on account of geographical reasons, Baglihar project PE was located in Jammu & Kashmir and, thus it could not be involved in other projects at far off places throughout India

iii) The assessee further contended that for the project located in Vishakhapatnam, the key personnel to be deputed to provide consultancy services were agreed in advance and without the prior approval of the respective contracting party, the said personnel could not have been deputed to the Baglihar PE project, and therefore, they could not be said to be involved in rendering services. Also, in the Tamil Nadu project, it was agreed that services were to be rendered either at the Tamil Nadu site or at assessee's German office.

iv) On the other hand, Revenue argued that the mere fact that the terms of contract were different or for that matter the parties or geographical locations were different was not material for deciding the applicability of the FOA rule. In this regard, Revenue contended that the twin conditions proposed by the assessee, i.e. there is a need for being 'an extension of the PE' or to be 'effected through the PE' are neither mandated in the UN Model Convention nor in the Protocol to the India-German DTAA, and thus, there an attempt being made by the assessee to misguide the Bench by artificially splitting the projects.

v) The Tribunal took note of assessee's argument that the FOA rule was inapplicable to it, owing to the fact that as per the conditions set out in the protocol 1(c) to the subject Treaty, the force of attraction rule restricted the application of the rule to a case where, the PE was involved in the transaction and the transaction is restored to avoid taxation in the source state, and that both the conditions needed to be satisfied so as to attract the rule.

vi) The Tribunal further observed that the assessee constituted PE on account of undertaking supervisory activities as provided in Article 5(2)(i) of the Treaty in relation to construction of Hydro Power Projects at Baglihar in the state of Jammu & Kashmir. Accordingly, ITAT accepted assessee's argument that in respect of the balance contracts, based on specific contract requirements, the assessee's personnel either performed service at the client's location or at its home office in Germany, wherein the assessee provided contract-wise, the location wherein the activities were undertaken.

vii) The Tribunal remarked that, "The above fact as per the assessee clearly demonstrates that owing to geographical region, the PE on account of JKSPDC Phase-II projects (executed in the state of Jammu & Kashmir) could not play a part or be involved in any project in India. These contracts have been carried out by the assessee by using different teams at a given point of time.

viii) The Tribunal held that "the details of the project managers/ project engineers who visited India in connection with the

execution of different contracts clearly shows that distinct PE of technician were involved in the execution of various projects in India."

ix) The Tribunal observed that the teams of the project managers/project engineers, in relation to various projects, visited India in connection with the execution of these projects at different points of time. Also, the scope of work, liabilities and risk involved in each of the contracts were independent of those stated in the other contracts executed with the different parties.

x) The Tribunal noted that the assessee under various independent contracts entered into by it, was required to undertake specific activities as per the terms of each contracts. The activities undertaken by the assessee were independent of the others since their performance was not interlinked with each other.

xi) The Tribunal further noted that as per RBI's stipulation, a separate project office was to be set up for each independent project. Further, the funds of the project office were to be used only to meet the expenses of the specific projects which has been approved and could not be used for any other purpose in India.

xii) Thus, the Tribunal remarked that "The location where the activities would be performed by the assessee in respect of the specific projects was dictated by the client's project site or as agreed with the clients and was undertaken outside India.... Further, restriction on the activities which may be undertaken by project office is stipulated in the approval issued by the Government. Therefore, it cannot be said that the PE constituted in India by the assessee under Phase-II of the contracts with JKSPDC was involved in any way in the earning of income from technical services rendered by the assessee and other contracts in India.

xiii) The Tribunal further enunciated that for applying force of attraction, there should be some common link to each of the contracts/projects such as the common expats, the common nature of the contract/ projects, the commonality of the location, the common contracting parties etc. "which are absent in the present case."

xiv) The Tribunal rejected Revenue's plea that the FTS received by the assessee from rendering of technical services and other contracts was directly or indirectly to the PE constituted in India under the contract with JKSPDC and hence it was formed for the purpose of deliberate avoidance of tax.

xv) The Tribunal concluded by stating that "We find force in the contention of the assessee, that the PE constitute in India by the assessee under Phase-II of the contract with JKSPDC did not play any role or contributed in any manner to the execution of the other contracts or earning of FTS under other contracts and cannot thus be said to be involved with any other projects in India."

Thus, ITAT accepted the treatment given by assessee for offering tax @20% in one project and 10% in rest of the projects.

6 ***JCIT vs. Merrill Lynch Capital Market Espana SA SV***
[TS-612-ITAT-2019(Mum)]
Assessment year: 2014-15

India-Spain DTAA – Articles 14(4) and 23(3) – Taxability of Capital Gains on sale of 7% stake in listed Indian Real Estate Companies - Based on specific facts, Tribunal held that

capital gains on sale of shares in an Indian company, carrying on real estate business, were not taxable in India under India-Spain tax treaty

Facts

i) The assessee, a tax resident of Spain and registered as a foreign institutional investor, held approximately 7% stake in six Indian real estate companies forming part of the BSE realty index.

ii) The assessee earned capital gains on sale of approximately 2% stake in such listed Indian real estate companies. Further, the assessee had also earned income on account of gain on foreign exchange transaction (i.e. gains on settlement of forward exchange contracts).

iii) The Tax Officer (TO) assessed the capital gains on sale of shares as taxable under Article 14(4) of the India-Spain tax treaty stating that the value of shares of such companies were derived from immovable properties held by it. The Commissioner of Income-tax (Appeals) [CIT(A)] allowed the appeal in favour of the assessee stating that the capital gains are not taxable in India under Article 14(4) of the India-Spain tax treaty..

iv) Article 14(4) of the India-Spain tax treaty provides that capital gains on sale of shares of company, the property of which consists, directly or indirectly, principally of immovable property situated in India, would be taxable in India.

v) Article 23(3) of the India-Spain tax treaty provides that items of income not dealt by any other Article of the India-Spain tax treaty and arising in India would be taxable in India.

Decision

On appeal, the Tribunal held in favour of the assessee, on the facts of the case as under:

i) The Revenue contended that the listed companies were dealing in real estate sector including development of properties, residential as well as commercial, and the share value was derived from the immovable properties held by it. Whether such immovable properties held as investments or stock-in-trade was immaterial.

ii) The assessee contended that the stake in such companies was approximately 7%, there was no effective right to occupy the immovable properties of such companies. As per UN Model Convention commentary, the provisions of Article 14(4) come into play only in case of indirect transfer of ownership of immovable property by transfer of shares owning these properties. The value of listed shares is based not only on the extent of immovable property held as stock-in-trade but on several other factors such as capital adequacy, projects in the pipeline, current profits and future prospects.

iii) Article 14(1) deals with the taxability of gains arising on sale of immovable property. Article 14(4) is only an extension of Article 14(1) to nullify the impact of corporate structures used for ownership of immovable properties.

iv) The Tribunal held that interpretation of Article 14(4) must essentially remain confined to the shares effectively leading to control of the company or which gives the right to enjoy the underlying immovable property owned by the company, and such property is what the company principally holds.

v) The Tribunal held that the business model of companies in question is to make commercial gains by way of real estate development rather than holding the immovable properties.

vi) In the present case, since the assessee held approximately 7% (sold approximately 2%) stake in the companies, the question of holding controlling interest or even significant interest in these companies does not arise.

vii) Further, the Tribunal held that the TO did not bring any material to prove that the Indian companies in which the assessee was holding shares were "principally" holding the immovable properties.

viii) The Tribunal observed that the expression "principally" is not specifically defined in the India-Spain tax treaty, and drawing support from various commentaries of Model Convention, interpreted threshold for the term "principally" as 50% or more of the aggregate value of assets.

ix) The Tribunal also mentioned that merely because a company is dealing in real estate development, it does not imply that over 50% of its aggregate assets consist of immovable properties.

x) Further, the Revenue's contention that every company listed on BSE realty index is a company, the property of which principally consists of immovable properties, is incorrect.

xi) The Tribunal agreed with the CIT(A)'s view and held that capital gains on sale of shares would not be covered under Article 14(4) of the India-Spain tax treaty, and thus, are not taxable in India.

xii) In connection with gains arising on foreign exchange transaction, the Tribunal held that where such gains are dealt in other Articles of the India-Spain tax treaty and not taxable under such other Articles, it does not imply that such gains would be covered under Article 23(3) of the India-Spain tax treaty.

xiii) Accordingly, such gains would not be covered under Article 23(3) of the India-Spain tax treaty and would not thus be taxable in India.

7 *M/s. BancTec TPS India Private Limited vs. Pr. Commissioner of Income Tax*

[TS-579-ITAT-2019(Mum)]

(Assessment Year : 2012-13)

Section 79 – Carry forward and set off of brought forward losses - Tribunal held that the condition under section 79 of the Income-tax Act, 1961 (Act) for carry forward and set-off of loss, is said to be satisfied if the beneficial shareholders of the company during the year when the loss was incurred, directly or indirectly holds at least 51% shares in the said company during the year of set-off – in favour of the assessee

Facts

i) The assessee had set-off brought forward loss during assessment year 2012-13. The assessee had entered into a scheme of amalgamation with a fellow subsidiary which then subsequently merged with the assessee. Pursuant to the scheme, the assessee issued shares to the shareholders of the transferor's fellow subsidiary, which also was a fellow subsidiary of the assessee. Consequently, the immediate holding company of the assessee, who was holding 100% 1ITA No. 2366/ Mum/ 2019 shares in the assessee, continued to directly hold 42.19% shares in the assessee and indirectly continued to hold balance 57.81% shares through its subsidiaries.

ii) The Assessing Officer completed the assessment without allowing set-off of the brought forward losses. However, on a rectification application, the TO allowed the set-off of the brought forward losses to the assessee.

iii) Subsequently, the Commissioner of Income-tax invoked his revisionary jurisdiction under section 263 of the Act directing the Assessing Officer to disallow the losses of earlier years on the ground that the assessee had violated the provisions of section 79 of the Act and cancelled the order under section 154 of the Act.

Decision

The Tribunal held in favor of the assessee as under:

i) The provisions of section 79 of the Act were not violated, as even after the scheme of amalgamation, the original shareholder, directly and indirectly, continued to exercise 100% voting rights over the assessee.

ii) The Revenue contended that the immediate shareholding and not the ultimate ownership of shares that needs to be considered for section 79 of the Act as held by the Mumbai bench of the Tribunal in the case of *M/s Tainwala Trading and Investments Company Limited vs. ACIT [ITA No. 5120/Mum/2009],* and the Delhi High Court in the case of *Yum Restaurants (India) Private Limited vs. ITO [2016] 237 Taxman 652 (Delhi).*

iii) The Tribunal held that the case of the assessee was fully covered by the Ahmedabad bench of the Tribunal's ruling in the case of *CLP Power India Private Limited vs. DCIT [2018] 170 ITD 744(Ahd)* and the Karnataka High Court's decision in the case of *CIT vs. AMCO Power Systems Limited [2015] 379 ITR 375 (Karnataka),* wherein it was held that beneficial ownership and not legal ownership is relevant for the purposes of satisfying the conditions prescribed in section 79 of the Act. Section 79 of the Act only mandates that the existing shareholders should beneficially hold the shares. Since, the beneficial owner pre-amalgamation continued to remain the beneficial owner of 100% shares, partially directly and indirectly through its subsidiary, even after the amalgamation, the assessee complied with the provisions of section 79 of the Act.

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CA Ashit Shah

INDIRECT TAXES

GST Gyan – Recent changes in the GST Law

We have witnessed sea changes in the GST Law, even after two years of its implementation. After every meeting of GST Council, GST Council puts recommendation suggested and then on the basis of these recommendations, laws are amended or some more provisions introduced in the existing law by issuing clarification in the existing matter and try to bring more transparency and clarity in the Law. In this article, deliberate analysis of couple of important changes carried out by the Central Government in the month of October 2019 are discussed as under –

1. Refund

1.1 Refund applications to be filed again

Registered Persons (RP) have to file refund application in Form RFD 01A/ RFD 01, whenever any refund amount has to be claimed from the GST authority. GSTIN portal provides various categories under which RP can opt to file the refund application for the particular month. If inadvertently, RP had filed NIL refund application for a particular month under a particular category of refund, such RPs are not eligible to refile or amend the refund application for that period under such category, in spite of the fact that he had a refund claim. Accordingly, trade was facing a genuine difficulty in claiming refund which was stuck because of technical glitches, as GSTIN portal does not have such facility.

Hence, now it has been clarified in Circular No. 110/29/2019-GST, dated 03-10-2019, that such RP are eligible to re-file refund applications subject to fulfilment of **following two conditions –**

a. The registered person must have filed a NIL refund claim in FORM GST RFD-01A/RFD-01 for a certain period under a particular category; and

b. No refund claims in FORM GST RFD-01A/RFD-01 must have been filed by the registered person under the same category for any subsequent period.

It may be noted that condition (b) shall apply only for refund claims falling under

the following categories:

i. Refund of unutilised input tax credit (ITC) on account of exports without payment of tax;

ii. Refund of unutilised ITC on account of supplies made to SEZ unit/SEZ Developer without payment of tax;

iii. Refund of unutilised ITC on account of accumulation due to inverted tax structure.

In all other cases, registered persons shall be allowed to reapply even if condition (b) is not satisfied.

If, RP satisfies the above conditions, he may file the refund claim under "Any Other" category instead of the category under which the NIL refund claim has already been filed. The application under the "Any Other" category shall also be accompanied by all the supporting documents which would be required to be otherwise submitted with the refund claim. On receipt of the claim, the proper officer shall calculate the admissible refund amount as per the applicable rules and in the manner detailed in para 3 of Circular No. 59/33/2018-GST dated 4-9-2018, wherever applicable, and refund may be granted.

1.2 Procedure to claim refund subsequent to a favourable order in appeal or in any other forum

At present, appeals against rejection of refund claims are being disposed of in offline manner as the electronic module for the same is yet to be made operational. Hence, pursuant to Rule 93 of the CGST Rules, 2017, where an appeal is filed against the rejection of a refund claim, recrediting of the amount debited from the electronic credit ledger, if any, is not done till the appeal is finally rejected. Therefore, such rejected amount remains debited in respect of the particular refund claim filed in FORM GST RFD-01.

Hence, it is clarified by issuance of Circular No. 111/30/2019-GST, dated 03-10-2019, that in cases where a favourable order is received by a registered person in appeal or in any other forum in respect of a refund claim rejected through issuance of an order in FORM GST RFD-06, the registered person would file a fresh refund application under the category **"Refund on account of assessment/provisional assessment/appeal/any other order"** claiming refund of the amount allowed in appeal or any other forum. There is no need to again debit from ECL as amount is not recredited on rejection of refund claim.

Upon receipt of the application for refund under the category "Refund on account of assessment/provisional assessment/ appeal/any other order" the proper officer would sanction the amount of refund as allowed in appeal or in subsequent forum which was originally rejected and shall make an order in FORM GST RFD 06 and issue payment order in FORM GST RFD 05 accordingly. The proper officer disposing the application for refund under the category "Refund on account of assessment/provisional assessment/appeal/any other order" shall also ensure recredit of any amount which remains rejected in the order of the appellate (or any other authority). However, such recredit shall be made following the guidelines as laid down in para 4.2 of Circular No. 59/33/2018-GST dated 4-9-2018.

2. Applicability of Donations received by charitable organisations, institutions or other organisations

Charitable organisations involved in advancement of religion, spirituality or yoga, receive donations or gifts, from individual donors. Hence, such organisations acknowledge, such honours/ gestures by placing name plates in the name of the individual donor. There prevails confusion amongst the charitable organisations/institutions, in respect of applicability of GST on such donations or gifts.

Hence, it is clarified by issuance of Circular No. 116/35/2019 – GST, dated 11-10-2019 that when recipient institutions place, a name plate or similar such acknowledgement in their premises to express the gratitude, in such a manner, which can be said to be an expression of gratitude and public recognition of donor's act of philanthropy and is not aimed at giving publicity to the donor in such manner that it would be an advertising or promotion of his business. Then it can be said that there is no supply of service for a consideration (in the form of donation). There is no obligation (*quid pro quo*) on part of recipient of the donation or gift to do anything (supply a service). Therefore, there is no GST liability on such consideration. Thus where all the three conditions are satisfied viz. (i) the gift or donation is made to a charitable organization, (ii) the payment has the character of gift or donation and (iii) the purpose is philanthropic (i.e. it leads to no commercial gain) and not advertisement, GST is not leviable.

3. Lending of Securities covers within the definition of "supply" and GST is applicable

Securities and Exchange Board of India (SEBI) has prescribed the Securities Lending Scheme, 1997 for the purpose of facilitating lending and borrowing of securities. Under the Scheme, lender of securities lends to a borrower through an approved intermediary under an agreement for a specified period with the condition that the borrower will return equivalent securities of the same type or class at the end of the specified period along with the corporate benefits accruing on the securities borrowed. The transaction takes place through an electronic screen-based order matching mechanism provided by the recognised stock exchange in India. There is anonymity between the lender and borrower since there is no direct agreement between them. The lenders earn lending fee for lending their securities to the borrowers. The security lending mechanism is depicted in the diagram below:–

In the above diagram –

i. Lender is a person who lends the securities;

ii. Borrower is a person who borrows the securities;

iii. Approved intermediary is a person duly registered by the SEBI

Securities as defined in Section 2(h) of the SEBI are not covered in the definition of "goods" under section 2(52) and "services"

under Section 2(102) of the CGST Act. **Therefore, a transaction in securities which involves disposal of securities is not a supply in GST** and hence not taxable. The activity of lending of securities is not a transaction in securities as it does not involve disposal of securities. Clause 4 of para 4 relating to the Scheme under the Securities Lending Scheme, 1997 doesn't treat lending of securities, as disposal of securities and therefore is not excluded from the definition of services. Hence, activity of lending of securities is not a transaction in securities as it does not involve disposal of securities. Accordingly, it was clarified by issuance of Circular No. 119/38/2019-GST, dated 11-10-2019 that the supply of lending of Securities under the Scheme is classifiable under heading 997119 and is leviable to GST@18% under Sl. No. 15(vii) of Notification No. 11/2017-Central Tax (Rate) dated 28-6-2017 as amended from time to time.

Hence, for the past period i.e., from 1-7-2017 to 30-9-2019, GST is payable under **forward charge** by the lender. Further, request may be made by the lender (supplier) to SEBI to disclose the information about borrower, to determine the nature of transaction i.e., whether transaction is intra-State or inter-State transactions, for discharging GST under forward charge. It has been further clarified that nature of transaction would be inter-State and tax payable by the lender shall be IGST. However, if the service provider has already paid CGST/SGST/UTGST treating the supply as an intra-State supply, such lenders shall not be required to pay IGST again in lieu of **such GST payments already made.**

With effect from 1st October, 2019, the borrower of securities shall be liable to discharge GST as per Sl. No. 16 of Notification No. 22/2019-Central Tax (Rate) dated 30-9-2019 under reverse charge mechanism (RCM). **The nature of GST to be paid shall be IGST under RCM.**

4. Reverse Charge Mechanism [N. No. 22/2019 – CTR, dated 01-10-2019]

4.1 Supply of copyrights by authors of original literary work

Taxes (GST) on supply of copyright services supplied by author of original literary work to a publisher were covered under Reverse Charge Mechanism (RCM) w.e.f. 1-7-2017 and onwards and covered under Entry 9 of N. No. 13/2017-CTR, dated 28-6-2017 and publishers were liable to discharge tax liability under RCM. However, w.e.f. 1-10-2019 [N. No. 22/2019-CTR, dated 1-10-2019] option is provided to such author of original literary work, to discharge tax liability under forward charge. Such authors have to select option, by filing **an application in Form Annexure-I, on or before 31-10-2019**. Further, author has to also provide **declaration in Annexure-II** on the invoice, that he will discharge tax liability under forward charge. Moreover, option once selected, it shall not be withdraw within a period of one year from the date of exercising such option.

4.2 Renting of Motor Vehicle Services

Any person, **other than body corporate**, paying tax @ 5% on **renting of motor vehicle** and not availing Input Tax Credit (ITC) except of input services in the same line of business, to body corporate

located in the taxable territory, tax (GST) liability needs to be discharged by such body corporate located in India w.e.f. 1-10-2019 and onwards under Entry No. 15 of N. No. 13/2017-CTR, dated 28-6-2017. Limited Liability Partnership (LLP) formed and registered under the provisions of LLP Act, shall be considered as partnership firm or a firm and accordingly, when such LLP's supply services of renting of motor vehicle to a body corporate (private or public limited companies) tax has to be discharged by such body corporate under RCM [*Explanation* to N. No. 13/2017-CTR]. Motor Vehicles have to be construed as defined under Section 2(28) of Motor Vehicles Act, 1988.

5. Exemptions to certain specified services from payment of taxes [N. No. 21/2019–CTR, dated 1-10-2019]

5.1 Services provided by and to Fédération Internationale de Football Association (FIFA) and its subsidiaries directly or indirectly related to any of the events under FIFA U-17 Women's World Cup 2020 to be hosted in India. [S. No. 9AA inserted in N. No. 12/2017-CTR, dated 28-6-2017]. Similar exemptions were provided at the time of hosting of FIFA U-17 World Cup 2017.

5.2 Services by way of right to admission to the events organised under FIFA U-17 Women's World Cup 2020. [S. No. 82A inserted in N. No. 12/2017-CTR, dated 28-6-2017]. Similar exemptions were provided at the time of hosting of FIFA U-17 World Cup 2017.

5.3 Services by way of **transportation of goods by an aircraft & vessels** from customs station of clearance in India, to a place outside India. These exemptions were in existence under entry 19A & 19B of N. No. 12/2017-CTR, dated 28-6-2017, till 30-9-2019. Now, exemptions have been further extended for a period of one year i.e., till 30-9-2020. Accordingly, transportation of goods by an aircraft & vessels from customs station of clearance in India, to a place outside India, is still exempted.

5.4 Services by way of **storage or warehousing** of cereals, pulses, fruits, nuts and vegetables, spices, copra, sugarcane, jaggery, raw vegetable, fibres such as cotton, flax, jute etc., indigo, unmanufactured tobacco, betel leaves, tendu leaves, coffee and tea, were included in the exemptions list by inserting entry at S. No. 24B of N. No. 13/2017-CTR, dated 28-6-2017. It is to be noted that storage or warehousing services provided on other products are also covered under exemptions list under following entries, as under –

a. Storage or warehousing of agriculture produce – Entry 54(e);

b. Storage or warehousing of rice – Entry 24;

c. Warehousing of minor forest produce – Entry 24A;

d. Fumigation in a warehouse of agriculture produce – Entry 53A.

6 Rate of taxes on certain services [N. No. 20/2019-CTR, dated 1-10-2019]

6.1 Hotel Accommodation, Restaurant and Outdoor Catering Services

Nature of Services	*Particulars*	*Taxable Amount*	*Tax Rate*	*Conditions*
Hotel Accommodation Services	Value of Room Rentals	Up to ₹ 1,000	Nil	-
		Between ₹ 1,001 and ₹ 7,500	12%	-
		₹ 7,501 and above	18%	-
Restaurant Services	Restaurant is part of specified premises	Any amount	18%	-
	Restaurant is not a part of specified premises	Any amount	5%	Input Tax Credit not eligible
Outdoor Catering Services	Supply by or at specified premises	Any amount	18%	-
	Supply by and at other than specified premise	Any Amount	5%	Input Tax Credit not eligible

- "Restaurant service" means supply, by way of or as part of any service, of goods, being food or any other article for human consumption or any drink, provided by a restaurant, eating joint including mess, canteen, whether for consumption on or away from the premises where such food or any other article for human consumption or drink is supplied.
- "Outdoor catering" means supply, by way of or as part of any service, of goods, being food or any other article for human consumption or any drink, at Exhibition Halls, Events, Conferences, Marriage Halls and other outdoor or indoor functions that are event based and occasional in nature.
- "Specified premises" means the premises providing the hotel accommodation services having declared tariff (i.e., published tariff without any discount) of any unit of accommodation above ₹ 7,500.
- "Hotel accommodation" means supply, by way of accommodation in hotels, inns, guest houses, clubs, campsites or other commercial places meant for residential or lodging purposes including the supply of time share usage rights by way of accommodation.
- "Declared tariff" means charges for all amenities provided in the unit of accommodation (given on rent for stay) like furniture, air conditioner, refrigerators

or any other amenities, but without excluding any discount offered on the published charges for such unit (published tariff without any discount) of any unit of accommodation above ₹ 7,500.

6.2 Other professional, technical and business services [HSN 9983]

Services of other professional, technical and business services relating to exploration, mining or drilling of petroleum crude or natural gas or both, have been inserted *vide* sub clause (ia) under Entry No. 21 of N. No. 11/2017-CTR, dated 28-6-2017 w.e.f. 1-10-2019 and rate of tax on such supply of services is 12%.

6.3 Job work services – Entry No. 26 – HSN 9988

Job Work means any treatment or process undertaken by a **person** on goods belonging to another **registered person** and the expression job worker shall be construed accordingly [S. 2(68)]

Job Worker	*Principal*	*Rate*	*Remark*
Registered	Registered	12%	Benefit of N. No. 20/2019 may be available subject to fulfilment of conditions
Registered	Unregistered	18%	Benefit of N. No. 20/2019 not eligible as not covered within the definition of "job worker" under GST
Unregistered	Registered/Unregistered	N. A.	GST is not applicable as job worker is not registered

Nature of Job work	*Existing Rate*	*New Rate*
Services by way of job work in relation to diamond falling under chapter 71 in the first schedule to Customs Tariff Act, 1975	5% Entry 26(1)(c)	1.5% Entry 26(ib)
Services by way of job work in relation to precious and semi-precious stones or plain and studded jewellery of gold and other precious metals, falling under Chapter 71	5% Entry 26(1)(c)	5% Entry 26(1)(c)
Services by way of job work in relation to bus body building. (**Automobile body** (**Bus Body**) **building** is an important activity. The chassis are supplied by **Automobile** manufacturers, and **body** is built by **automobile body builders** as per the requirements of the customer and specifications of the different State)	18% Rohan Coach Builder – AAR MP	18% Entry 26(ic)

Nature of Job work	*Existing Rate*	*New Rate*
Services by way of job work other than (i), (ia), (ib) and (ic) above	-	12% Entry 26(id)
Manufacturing services on physical inputs (goods) owned by others, other than (i), (ia), (ib),(ic), (id) (ii), (iia) and (iii) above.	18% Entry 26(iv)	-

7. Filing of Annual Return in Form GSTR-9 [N. No. 47/2019-CT, dated 9-10-2019]

At the 37th GST Council Meeting, relaxation in filing annual return in Form GSTR-9, for MSME Sector, has been announced. Accordingly, it has been provided that those registered persons whose aggregate turnover is up to ₹ 2.00 crore, are having options to file their annual return in Form GSTR-9 for the FY 2017-18 and 2018-19. Such provisions will help MSME sector from procedural compliances of filing annual returns, provided periodical returns which they had filed or uploaded are correct and matched with the books of accounts/financial statements. Due date for filing annual return for FY 2017-18 is 30th November, 2019 and for FY 2018-19 is 31st December, 2019. It was further provided that if such return is not filed within the due date, it is deemed that such return is deemed to be furnished on the due date.

8. Due date for filing of TRAN-1 and TRAN-2 [N. No. 49/2019-CT, dated 9-10-2019]

Due date for submitting the declaration electronically in FORM GST TRAN-1, in respect of registered persons who could not submit the said declaration by the due date on account of technical difficulties on the common portal and in respect of whom the Council has made a recommendation for such extension. Due date for filing such TRAN-1 and TRAN-II was 31st March, 2019 and now it has been further extended to 31st December, 2019. Similarly, submission of statement in FORM GST TRAN-2 has also been extended till 31st March, 2020.

If there is any mistake/error at the time of submission of TRAN-1 or TRAN-2, such errors are not covered for extension of time limit.

9. Availment of Input Tax Credit [Rule 36(4) – N. No. 49/2019-CT, dated 9-10-2019]

Pursuant to new insertion of Rule 36(4) – Documents requirement and conditions for claiming Input Tax Credit (ITC), a cap on availment of ITC to the extent of 20% of eligible input invoices or debit notes against invoices not uploaded by supplier in their respective FORM GSTR-1. This would mean that claim of ITC by the recipient would become final only when it is matched with the details uploaded by the supplier in their respect return – GSTR-1. Accordingly, tax payers can avail ITC only to the extent of invoices reflected in GSTR-2A plus 20% of eligible ITC reflected in GSTR-2A. New provisions can be understood from the following illustration –

Particulars	*ITC eligibility Pre-amendment (in ₹)*	*ITC eligibility Post-amendment (in ₹)*	
Total ITC for the month	500,000	500,000	500,000
ITC reflected in GSTR-2A	300,000	300,000	300,000
Ineligible ITC	50,000	50,000	Nil
Eligible ITC for the period	450,000	450,000	500,000
ITC to be availed	450,000	310,000 [250,000 + 20% of 300,000]	360,000 [300,000 + 20% of 300,000]

Note: At any point of time, eligible ITC to be taken in Form GSTR-3B would not exceed the eligible ITC. Further, it is to be noted that ineligible ITC as per Form GSTR-2A has no relevance in calculating the cap of 20% of eligible ITC. Hence, now trade and business houses have to do regular follow up with the suppliers for uploading the invoices within the due date in regard to invoices which are available in books of account of recipient but not reflected in GSTR-2A because of non-uploading of invoices by the supplier.

It is quite interesting to note that Government has inserted Section 43A to the CGST Act, 2017 which provides the procedure for furnishing return and availing ITC. Sub-section (4) provides that maximum ITC in respect of outward supplies not furnished by supplier in their Form GSTR-1 may not exceed 20% of the ITC available on the basis of invoices/debit notes available in Form GSTR-2A. Effective date of Section 43A is yet to be announced. In view of this an inference can be drawn that the provisions of Rule 36(4) of CGST Rules, 2017 is prescribed for Section 43A of the CGST Act, 2017 and not for Section 16 – Eligibility and conditions for availing ITC, of CGST Act, 2017. Thus a clarification is expected from the Government, at an early date, for effectiveness of this provisions if cap of 20% of ITC is applicable from date of notification i.e., 9-10-2019 or from the date when provisions of Section 43A are made applicable.

❍□❍

When an idea exclusively occupies the mind, it is transformed into an actual physical or mental state.

– Swami Vivekananda

CA Naresh Sheth & CA Jinesh Shah

INDIRECT TAXES

GST – Recent Judgments and Advance Rulings

A. Rulings by Appellate Authority for Advance Ruling

1. BENGAL PEERLESS HOUSING DEVELOPMENT COMPANY LTD – AAAR MAHARASHTRA (2019-TIOL-68-AAAR-GST)

Facts and Issue involved

Bengal Peerless Housing Development Company Ltd. ('Respondent') is developing a residential housing project named 'Avidipta II' and supplying construction service to the recipients for possession of dwelling units in the year 2023. In addition to the construction service, respondent provides services like preferential location service (PLS) which includes services of floor rise and directional advantage.

Respondent had sought advance ruling for following:

1. *Whether the supply of preferential location service which includes services of floor rise and directional advantage constitutes a composite supply with construction service as the principal supply?*
2. *If so, whether abatement is applicable on the entire value of the composite supply.*

Respondent's submissions to AAR

Supply of construction service cannot be separated from supply of services of directional advantage and benefit of floor rise associated with the unit allotted to the recipient. Supply of construction service is, therefore, naturally bundled with the supply of the services of directional advantage, benefit of floor rise and right to use allotted car parking space. Further, all of them are being supplied in conjunction with one another in the ordinary course of business. It is, therefore, a composite supply with construction supply, being the dominant element, as the principal supply. Charges for the right to use the common areas and recreational facilities are also included in the single consolidated price.

Discussions by and observations of AAR

Agreement refers to the sale of an immovable property. The buyer pays in advance for certain services that he will enjoy only after obtaining possession of the property (for eg. Preferential location services, car parking space, charges for common area and recreational facilities etc.). The buyer agrees to pay a single consolidated amount for all these supplies.

Though the actual provisioning of the construction services and other services are made at different points of time, they can be supplied in a bundle. This is because supply, as defined under section 7(1) of the GST Act, includes agreement to supply

even if actual supply is to be made at a future date, provided and to the extent, the recipient pays in advance. Services that are naturally bundled can be treated as provisioning of a single service that lends the bundle its essential character. Section 2(30) of the GST Act defines composite supply as supply by a taxable person of a combination of taxable goods or services or both, which are naturally bundled and supplied in conjunction with one another in the ordinary course of business, where one of the supplies can be identified as the principal supply. Section 2(90) of the GST Act defines principal supply as the predominant element of such a composite supply.

In the instant case, the nature of construction 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, construction services get the character of predominant supply over other supplies.

Ruling of AAR

In respect of question (1), the respondent is providing construction services bundled with services relating to the preferential location of the unit and right to use car parking space and common areas and facilities. It is a composite supply, construction service being the principal supply.

In respect of question (2), construction service being the principal supply, entire value of the composite supply is to be treated as supply of construction services taxable under Sr. No. 3 read with Para 2 of Notification No. 11/2017-Central tax (rate) dated 28.06.2017.

Appeal to the AAAR

Assistant Commissioner, State Tax (Appellant) has filed the instant appeal against the above advance ruling with the prayer to set aside/modify the ruling on the following grounds:

1. *Respondent had applied for ruling for limited purpose to know whether supply of PLS constitutes a composite supply. But ruling has been passed also for purpose of 'right to use car parking space'. PLS does not include any facility related to car parking space.*

2. *WBAAR has erred in treating PLS as a composite supply with construction service. Consequently, WBAAR has erred in law by confirming applicability of abatement prescribed for construction service under notification no. 11/2017-Central tax (rate) dated 28.06.2017.*

Appellant's submissions

Appellant relied on observations of Delhi High Court in case of ***Suresh Kumar Bansal vs. UOI*** **[2016(43) STR 3 Del.]** that preferential location charges cannot be traced directly to value of any goods or value of land but are a result of the development of the complex as a whole and the position of a particular unit in context with that of the complex.

Discussions by and observations of AAAR

As the application for Advance Ruling was only on the purpose of PLS, the discussion will also be limited to that extent.

AAR in its order accepted the claim of the builder that they are providing a composite supply, construction service being the main supply and the other ones are incidental or ancillary to the construction service. AAR also concluded that the services provided are naturally bundled. However, in the instant case, as per the respondent's own submissions, PLS is attributable to the choice of the purchaser in respect of floor rise and directional advantage. Hence, it is evident that PLS cannot be treated as naturally bundled with construction service in the ordinary course of business.

Respondent has relied on concept of bundled services (Section 66F of Finance Act, 1994) which is similar to Section 8(a) of CGST Act. Further,

they have relied on decision of CESTAT in case of *Logix Infrastructure Pvt. Ltd. vs Commissioner of C.Ex. & S.T., Noida, 2019 (25) GSTL 59 (Tri. - All).* The said legal interpretation was applicable for pre-GST era. Moreover, in the Service Tax regime, a special category of service namely Builder's Special Services having a separate tax collection head 00440616 was also in existence to take care of such services provided by the builders, which specifically included services for providing preferential location [Section 65(105)(zzzzu) of the Finance Act, I 994] on which no abatement was available.

Respondent has submitted in their submissions that they are paying CGST and SGST on the charges for floor rise and directional advantage without claiming any abatement in respect thereof. On perusal of sample invoices, it is found that respondent have raised separate invoices for unit sales, PLC Charges and Floor Rise Charges. It reinforces the conclusion that PLS can in no way be associated with land. PLS comes into being as the builder charges the buyer separately for providing a better location, which may be in relation to the direction in which the flat is constructed, the floor on which it is located, the views from the particular flat opted by the buyer etc. Thus, the abatement, which is allowed on the value of construction service as the plot of land on which construction is done is not liable to GST, cannot be deemed to be applicable in respect of PLS, which is altogether a separate service having no association with the land.

Order of AAAR

In view of above discussion, it is held that no abatement is applicable on value of preferential location services realized separately from buyers. This decision in respect of PLS will also hold good for right to use car parking space.

B. Rulings by Authority for Advance Ruling

1. MAANSMARINE CARGO INTERNATIONAL LLP – AAR MAHARASHTRA (2019-TIOL-298-AAR-GST)

Facts, Issue involved and Query of the Applicant

Applicant is engaged mainly in providing management consultancy services to ship owners, logistics services, etc. in Mumbai. Applicant has been offered outsourcing work for managing the shipping operations of Hong Kong based shipping company MSS Marine Ltd. that is engaged in worldwide shipping consultancy and logistics arrangements of cargoes.

MSS Marine will outsource the following jobs to the applicant:

- Handling all communications between vessel owners, consignees, various port agents, etc.;
- Drafting contracts of shipments and sending the same to ship owners and shippers charterers;
- Preparing reports on time used per voyage and presenting to shippers;
- Preparing invoices on behalf of clients as per contract and presenting them to charterers as per approval from principals, etc.;
- Reconciling accounts for principal.

Applicant would be entering into an agreement with MSS Marine wherein it will be clearly mentioned that the applicant will be charging management fees for the work done by them and all other expenses incurred [such as office expenses, rental expenses, salary costs, etc.] shall be reimbursed on actual basis.

Applicant has thus sought advance ruling on the following –

1. *Whether they need to apply for registration as the services provided are export of service?*
2. *Whether can they do supply of such services under LUT?*
3. *Whether GST is applicable on the reimbursement of expenses such as salaries, rent, office expenses, travelling cost, etc.?*
4. *Whether GST is applicable on management fees charged by applicant for managing the outsourced job?*

Applicant's submissions

All the services stated above are to be provided by applicant on their own account to MSS Marine. Applicant will be charging management fees for providing above stated services on its own account.

Recent Circular No. 107/26/2019-GST of CBIC dated 18.07.2019 clarifies that supplier of ITes services will not be treated as intermediary services if he supplies the services on his own account. ITes services as defined under Safe Harbour Rules for international transactions includes business process outsourcing services such as back office operations, data processing, payroll, support centers, data search integration and analysis, etc. Applicant is not arranging or facilitating supply of goods or services or both but is providing ITes services to MSS Marine on its own account.

Expenditure reimbursed by MSS Marine to applicant shall not be included in value of supply. MSS Marine will reimburse cost on actual basis as incurred by applicant in foreign convertible currency. Applicant will take prior approval of MSS Marine for incurring such expenses. Applicant will raise separate invoice for reimbursement of expenses and management fees on MSS Marine. Therefore, applicant is acting as pure agent and reimbursement of such expenses is not to be included in value of supply.

Management consultancy services provided by applicant to MSS Marine will qualify as export of services. Therefore, it is nothing but zero rated supply and not liable to GST. Further recent circular clarifies that supplier of ITes services on his own account does not qualify as intermediary services and can avail benefit of export of services if he satisfies the criteria laid down u/s. 2(6) of IGST Act (export of services).

Discussions by and observations of AAR

Applicant has withdrawn question no. 1 & 2. Applicant has submitted list of jobs that will be provided by them to their foreign clients which includes handling all communications, drafting contracts of shipments, preparing reports, preparing invoices on behalf of clients; reconciling accounts etc. It is very clear that the applicant is arranging or facilitating the business of foreign client by liaisoning with their customers for the purpose of commercial relationship between the service recipient and vessel owners, shippers, etc. They fulfil the criteria of agent as laid down u/s. 2(5) of CGST Act. In addition, nature of supply does not show that applicant on his or her own account is undertaking the supply. Travelling to various countries, meeting with port agents, shippers, discussing operational efficiency, reporting various concerns, handling communications, etc. is nothing but facilitating supply of goods or services to MSS Marine. AAR was of the view that applicant is an intermediary in the subject transaction. This view was further fortified by decision of Maharashtra AAAR in case of *Asahi Kasei India Pvt. Ltd.*

Further, applicant has contended that the reimbursements received by them are in the capacity of pure agent and is therefore not taxable under GST laws. However, the Authority observed that as per Valuation Rules, the expenditure incurred or costs incurred by the supplier as a pure agent of the recipient of supply of services shall be excluded from the value of supply provided certain conditions are satisfied.

In given case, applicant is not a pure agent and is making payment to vendors for supplies received

by them. AAR observed that the recipient of supply is not liable to make payment to third parties and therefore it can be said that the applicant is not making payments on behalf of the recipient of supply. The reimbursement costs recovered are in addition to the management fees from the clients and therefore it is an additional consideration charged for the supply done by the applicant. The reimbursements received by applicant pertains to establishments costs which would be incurred by them for running their office in India. The provisions of section 15 of the CGST Act, 2017, which deals with the transaction value are very clear that the valuation of supply will include all costs, including the employees cost provided by one entity to the other entities.

Ruling of AAR

In respect of question 3, AAR held that reimbursement of expenses is liable to GST.

In respect of question 4, AAR held that management fees charged by applicant to MSS Marine is liable to GST.

2. M/S. SANGHVI MOVERS LTD – AAR TAMIL NADU (2019-TIOL-247-AAR-GST)

Facts, Issue involved and Query of the Applicant

Appellant is a branch office of Sanghvi Movers Ltd. (SML), a public limited company engaged in the business of providing medium sized heavy-duty cranes on rental/lease/hire basis to clients without transferring the right to use the cranes.

Applicant has stated that SML operate the cranes on wet Lease basis (own, operate and maintain) and provide entire operating crew, such as crane operators, riggers, helpers, technicians, engineers, etc., whenever a crane is given on rent. These cranes are moved/transported on trailers, from one location to another, in knock down condition. As the movement of cranes involves significant time and cost, SML has set up various branches ("SML branch offices") across India at strategic locations including Tamil Nadu, to minimize transportation time and costs. Under GST, SML has obtained registration for 10 locations across India, including its head office ("SML Maharashtra") located in Pune, Maharashtra and other branch offices.

SML branch office receive enquiries from various customers for supply of cranes on hire charges. SML branch offices negotiate with customers and receive final work orders from customers. The title and ownership of all the different types of cranes along with their components vest with SML Maharashtra. Therefore, on receipt of the final work order, all the SML branch offices in turn raise internal work orders on SML Maharashtra to provide requisite cranes on hire charges along with appropriate support and assistance to various customers across India.

SML Maharashtra transports the crane and its components to the customer's location /project location on the instructions of the applicant. For each type of crane given on hire charges, the crane operator maintains a separate monthly log sheet at the customer/project location, wherein daily and hourly details of crane usage and idle time are maintained, based on which the monthly invoice is raised by the applicant on respective customers. Further, an invoice from SML Maharashtra is issued to the applicant and the value considered for levying GST is approximately 95% of the value charged to the customer by the applicant.

Applicant has thus sought an advance ruling as to whether on facts and circumstances of the case, since Integrated Goods and Services Tax ("IGST") is payable on inter-state movement of cranes by the supplier (i.e. SML Maharashtra)? Further, whether the recipient office of SML (i.e. SML Tamil Nadu) duly registered under GST, receiving such cranes for further supply on hire charges is eligible to avail input tax credit (ITC) of IGST charged?

Applicant's submissions

As per section 12(2) of Integrated Goods and

Services Tax Act, 2017 ("IGST Act), the place of supply of service of leasing/hire/renting of crane to a registered person shall be the location of such registered person. Therefore, in the said transaction, as the place of supply falls in Tamil Nadu, i.e., the location of applicant. SML Maharashtra discharges IGST on the value of hire charges recovered from the applicant treating the same as inter-state supply of service.

Consequently, the recipient i.e. the applicant avails credit of IGST charged by SML Maharashtra on the value of hire charges charged on the invoice.

Applicant submitted ruling pronounced by Maharashtra AAR in case of SML Maharashtra that the movement of tyre-mounted cranes or crawler from one GST registered office of SML to another registered office of SML would be treated as "taxable supply" under GST as per Circular No. 21/21/2017-CGST read with Circular No. 1/1/2017-IGST.

GST being a consumption based tax, the IGST paid by SML Maharashtra, would be available with the Tamil Nadu Government since the place of supply of the said transaction would fall in Tamil Nadu in terms of Section 12(2) of the IGST Act. Therefore, they have submitted that the applicant would be entitled to avail credit of IGST charged, on the following grounds:

i. Applicant receives tax invoice from SML Maharashtra on monthly basis.

ii. Applicant actually receives service from SML Maharashtra because only on receiving the cranes on hire charges from SML Maharashtra, can the applicant further Sub-lease the cranes to their ultimate customers.

iii. IGST charged by SML Maharashtra is paid in to Government treasury of Tamil Nadu.

iv. Regular GST returns as applicable are furnished by SML Maharashtra as well as the applicant.

Discussions by and observations of AAR

AAR observed that that customers of SML are placing service orders on applicant. SML in turn place a work order on SML HO with site address mentioning the address of the customer of SML. Work Order mentions that the monthly rental will be based on the underlying work-order with the customer of SML, which will be 90% of that amount. SML HO issues invoice on applicant.

Under GST, the applicant and SML HO being distinct entity has obtained registrations separately. As per Section 25(4) of CGST ACT, SML HO and SML are distinct persons.

Applicant will raise a taxable invoice and recover amounts towards cost plus mark-up for upkeepment and maintenance activity. It will be charged at the rate as per rates agreed in a respective work order. It is seen from Para 10 of MOU that lease/hire charges payable by applicant to SML HO is netted off [receivable and payable are adjusted] in books of accounts and is considered as deemed payment.

It is seen that though SML HO invoices to applicant at 90% of the underlying billing by SML to its customers, the full amount is not being paid. As per the MOU, the same is being netted off against the receivable for the upkeepment charges that SML HO has to pay to the applicant as per the MOU.

Proviso to Section 16(2) (d) states that where a recipient fails to pay to the supplier the amount towards the value of supply along with tax payable thereon within a period of one hundred and eighty days, an amount equal to the input tax credit availed by the recipient shall be added to his output tax liability along with interest thereon. The same is prescribed in Rule 37 of CGST Rules.

As per proviso to Section 16(2), the applicant will not be eligible for full input tax credit as they are not paying the full amount to their supplier SML HO as seen in the MOU where payments are netted off against receivables. The applicant in

his application has stated that as per proviso to Rule 37, the condition to make actual payment to supplier within 180 days is not applicable to the applicant. However, the proviso clearly states that the value of supplies "made without consideration" as specified in Schedule I shall be deemed to have been paid as per second proviso to Section 16(2).

In the instant case, there is a consideration to be paid by applicant to SML HO as per Para 10 of the MOU and the consideration is specified in the invoices raised by SML HO on the applicant. Hence, proviso to Rule 37 i.e. exemption from making full payment, will not be applicable to the applicant. Accordingly, the applicant will not be eligible for the full ITC as per the inward supplies received from SML HO, as they would be required to reverse such ITC, if taken, as per second proviso Section 16(2) of CGST Act and Rule 37 of CGST Rules.

Ruling of AAR

On the supplies received from M/s Sanghvi Movers Ltd., Maharashtra, the applicant is not eligible for the full Input Tax Credit but only to the extent specified in the restrictions as per second proviso Section 16(2) of CGST Act read with Rule 37 of CGST Rules.

3. SURFA COATS PRIVATE LIMITED – BENGALURU (2019-TIOL-331-AAR-GST)

Facts, Issue involved and Query of Applicant

M/s Surfa Coats Pvt. Ltd. is a manufacturer of decorative paints. They frame various incentive schemes so as to motivate their dealers to lift the products.

Applicant states that painter generally acts as an intermediary between customer and company. Customers tend to listen to painters as they are technically well versed about quality of paint. Therefore, most of paint companies incentivize painters to make their presence in the market. These incentive schemes are subject to certain conditions. These incentives are given in kind like TV, Gold coins, Rice bags, Rain coats, etc. On procurement of goods/services for giving incentives, applicant receives tax invoices wherein GST is levied.

Applicant has sought advance ruling as to whether they are eligible to claim the GST Input tax Credit on items purchased for furtherance of business?

Discussions by and Observations of AAR

AAR observed that applicant supplies paints and discharges GST liability on such supplies. Applicant claims ITC of tax paid on raw materials, other inputs and capital goods. In order to promote business, applicant gives incentives/ ifts in kind. Said goods/gifts are distributed to the dealers without any consideration. No GST is paid by the applicant on such free distribution of items.

As per section 17(5)(h) of CGST Act, 2017, one cannot claim ITC of goods distributed as gift which reads as follows:

"(h) **goods** lost, stolen, destroyed, written off or **disposed of by way of gift** or free samples;"

Further any transfer of goods/services without consideration will not be treated as supply in terms of Section 7(1)(a) of CGST Act, 2017.

Therefore, ITC of goods distributed as gifts is blocked under section 17(5) of CGST Act and services provided as incentive are not treated as supply under section 7 of CGST Act. Hence, ITC of goods or services procured for the scheme will not be allowed.

Ruling of AAR

Applicant is not eligible to avail ITC on the inward supplies of goods and services, which are attributable to the incentives provided to the painters, dealers and other persons.

4. CARNATION HOTELS PRIVATE LIMITED – (2019-TIOL-323-AAR-GST)

Facts, Issue involved and Query of the Applicant

Applicant is an unregistered dealer (located in Karnataka) engaged in providing hotel accommodation services. It proposes to provide accommodation services to employees of a company located in SEZ and the services will be entirely consumed within the hotel premises.

Applicant has sought advance ruling for below matters:

1. *Whether accommodation service proposed to be rendered by the applicant to the SEZ units are liable to CGST and SGST or IGST?*

2. *If the accommodation services to SEZ are covered under IGST Act, can these be treated as zero rated supplies and invoice be raised without charging tax after executing LUT u/s 16?*

Applicant's submissions

Applicant contended that section 12(3) of IGST Act 2017 provides that place of supply of hotel accommodation services shall be the location at which immovable property is located. In present case, both location of supplier and place of supply are location of hotel property. Services rendered by the hotels are intra-state as location of the supplier and the place of supply are in the same state. Accordingly, accommodation services attract CGST+SGST irrespective of the fact whether receiver of service is located in same state or not.

However, the supplies of goods and services to SEZ will be treated as Interstate supplies u/s 7(5)(b) of IGST Act read with proviso to section 8(2) of IGST Act which states that intra state supply of services shall not include services to SEZ developer or unit. Thus, the services rendered by hotel to a customer located in SEZ area will be considered as interstate supply liable to IGST.

Discussions by and observations of AAR

AAR observed that as per section 7(5)(b) of IGST Act, 2017, the supply of goods or services or both to a SEZ developer or SEZ unit shall be treated as inter-State supply of goods or services. As per section 12(3)(c) of IGST Act, the place of supply of services by way of accommodation shall be the location at which the immovable property is located. Thus, in such cases, if the location of supplier and the place of supply is in the same State/union territory, it would be treated as an intra state supply.

Circular no. 48/22/2018-GST dated 14th June 2018 clarified this in Issue 1 that in case of an apparent conflict between two provisions, the specific provision shall prevail over the general provision. Section 7(5)(b) of the IGST Act is a specific provision relating to supplies made to a SEZ developer/unit, which states that such supplies shall be treated as inter-State supplies. Therefore, services of short-term accommodation, conferencing, banqueting etc., provided to a SEZ developer/unit shall be treated as an inter-State supply.

AAR observed that as per section 16(1) of the IGST Act, Zero rated supplies means supplies made to a SEZ developer/unit. Whereas section 16(3) of the IGST Act provides for refund to a registered person making zero-rated supplies under bond/LUT or on payment of integrated tax. Rule 46 stipulates that invoice should carry an endorsement *"Supply to SEZ unit or SEZ developer* ***for authorized operations……*** *"*. Therefore, supplies of goods/services towards authorized operations only will be treated as Supply to SEZ Developer/unit.

Above referred circular further clarified in Issue 2 as to whether supply of services to SEZ will be treated as Zero Rated Supply. It stated that on conjoint reading of Section 16 of IGST Act and Rule 89(1) of CGST Rules, supply to SEZ developer/unit will be treated as zero rated supplies only if SEZ developer/unit receive such supplies for their authorized operations.

Ruling of AAR

In respect of question 1, accommodation service proposed to be rendered by the applicant to SEZ units is an inter-state supply u/s 7(5)(b) of IGST Act, 2017 liable to IGST.

In respect of question 2, since accommodation services supplied to an SEZ unit are covered under IGST Act, same can be treated as Zero rated supplies and invoice can be raised without charging tax after executing LUT under section 16.

5. Golden Vacations Tours and Travel – AAR West Bengal (2019-TIOL-301-AAR-GST)

Facts, Issue involved and Query of the Applicant

Applicant is a tour operator. It is engaged in booking of rooms in hotels and providing accommodation services as required by its customers. Applicant has sought ruling on following questions:

1. *How to classify the service provided by them when they arrange the client's accommodation in hotels?*
2. *Whether they can claim input tax credit of GST charged by the hotels?*

Applicant's submissions

Applicant is of the view that it is not to be classified as tour operator services. According to Explanation to Sl. No. 23(i) of Notification No. 11/2017-CT (Rate) dated 28.06.2017, "tour operator" means any person engaged in the business of planning, scheduling, organizing, arranging tours (which may include arrangements for accommodation, sightseeing or other similar services) by any mode of transport, and includes any person engaged in the business of operating tours. Furthermore, Sr. No. 23(i) applies provided inter alia the bill issued for supply of the service indicates it is inclusive of charges of accommodation and transportation required for such a tour.

As applicant seeks ruling for cases where it provides only accommodation services to the customer, Sr. No. 23(i) of said notification should not be applicable.

Applicant submitted that accommodation service is classified under SAC 996311 and covered under clauses of Sr. No. 7 of said notification. Although said SAC refers to accommodation service provided by the hotels, guest house etc., the narration under Sr. No. 7 keeps scope for the suppliers who arrange accommodation in hotels.

Applicant further argues that support services covered under Sr. No. 23(iii) of said notification include services classified under SAC 998552. Services covered under SAC 998552 includes arranging reservations for domestic and abroad accommodation services.

Department's contention

Concerned officer from the Revenue was of the view that the Applicant's service is classifiable under SAC 9985 as tour operating service procured from another tour operator.

Discussions by and observations of AAR

Applicant is admittedly a tour operator. However, the ruling sought is whether it should continue to be classified as a tour operator when it merely arranges the client's accommodation in hotels. Applicant's service under consideration is not to be treated as that of a tour operator.

The support services covered under Sr. No. 23(iii) of said Notification include services classified under SAC 998552. Services covered under SAC 998552 include arranging reservations for accommodation services for domestic accommodation, accommodation abroad etc.

Ruling of AAR

In respect of question 1, the Applicant who arranges only accommodation for clients in hotels, is a service classifiable under SAC 998552 and taxable under Sr. No. 23(iii) of said notification.

In respect of question 2, Applicant is eligible to claim the input tax credit as admissible under the law.

6. INFINERA INDIA PRIVATE LIMITED – AAR BANGALORE (2019-TIOL-319-GST)

Facts, Issue involved and Query of Applicant
Applicant is a 100% Export Oriented Unit (EOU) under Software Technology Park of India (STPI) scheme and also a wholly owned subsidiary of Infinera USA.

Infinera USA is engaged in business of supply of optical networking equipments, software products as well as installation and maintenance services. Infinera USA engaged the applicant to provide services of marketing and pre-sale activities in respect of optical networking equipments supplied by them.

Applicant and Infinera USA have entered into a "Pre-sale and Marketing Services Agreement" (hereinafter "the Agreement"). The roles and responsibilities of the applicant as per the provisions of the Agreement are as follows:

i. Conducting marketing research in order to keep Infinera USA advised and informed regarding all matters in India, which may be of reasonable business interest or concern to India; and

ii. Following up with customer leads provided by Infinera USA which in turn involves two major aspects:

   a. making sales presentations; and

   b. educating potential customers about the benefits and salient features of the optical networking equipment.

Applicant's engagement with Infinera USA has been subject to the following limitations:

i. Applicant carries out only pre-sales and marketing services for the optical networking equipment;

ii. All decisions relating to pricing or commercial terms and conditions with customers are taken solely at the discretion of Infinera USA; and

iii. Applicant gets compensated for its activities irrespective of whether such activities lead to a sales order or not.

Applicant has sought advance ruling as to *whether the activities carried out by the applicant in India will qualify as an Intermediary u/s 2(13) of IGST Act, 2017*?

Applicant's submissions
Applicant stated that there are three major aspects to qualify as an "Intermediary" u/s 2(13) of IGST Act:

i. The person should be a broker, an agent or any other person by whatever name called;

ii. The person should arrange or facilitate the supply of goods/services/securities between two or more persons; and

iii. He should not make supply of such goods/ services/securities on his own account.

Applicant claimed that services provided by the applicant are auxiliary in nature and it has no authority to negotiate prices or to enter into/ conclude contracts for or on behalf of Infinera USA. The performance and remuneration of the applicant is not linked to the purchase prices as it receives compensation on a 'cost plus basis'. Hence it cannot at be treated as an agent/ broker of Infinera USA.

Applicant stated that an "intermediary" can only be a person who actually arranges or facilitates a main service and not merely a person who markets a product belonging to the seller. A possible interpretation could be advanced that "an intermediary should mediate the actual supply of goods and not merely market the goods or services *vis-a-vis* a prospective customer".

The applicant placed reliance on following Orders of Advance Ruling issued under erstwhile Service Tax Law:

i. GoDaddy India Web Services Pvt. Ltd.; and

ii. The Universal Services India Pvt Ltd.

Applicant stated that it does not fall under the definition of "Intermediary" u/s 2(13) of IGST Act, 2017 because:

i. Broker is a person who act as a connection between customer and the supplier and charge certain percentage of sales as commission. Further agent is a person who makes contracts for principal. Here applicant is engaged in only pre-sale or marketing activities and not in direct sales with customer.

ii. All the contract and negotiation are done by Infinera USA itself, so applicant is not involved in the supply made by Infinera USA.

iii. Applicant charges Infinera USA on cost plus basis and not on percentage basis so it will be treated as supply made on own account and not in the capacity of agent or broker.

Discussions by and Observations of AAR

AAR interpreted definition of "Intermediary" [section 2(13) of IGST Act] as under:

i. The term "any other person by whatever name called " used in the definition covers a wide range of situation and applicant will be covered in in "any other person";

ii. The terms 'arrange' and 'facilitate' have not been defined in the Act. Dictionary meaning of the terms is:

Facilitate: to make (something) easier; to help cause (something); to help (something) run smoothly.

Arrange: to bring about an agreement or understanding concerning; to make preparations; to move and organise (things) into a particular order or position; to plan (something).

This conveys that the term "arrange or facilitate" covers the activities ranging from marketing or sales promotion, price negotiation, procuring sales order, and like activities;

The promotion and marketing services provided by the applicant induces the customer to buy the product of Infinera USA. Applicant acts as a conduit between the customer and Infinera USA and therefore, qualifies as an intermediary.

Ruling of AAR

Activities carried out by the applicant as mentioned in the agreement would render the applicant to qualify as an "intermediary" as defined u/s. 2(13) of the IGST Act and consequently GST will be levied.

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INDIRECT TAXES

Service Tax – Case Law Update

CA Rajiv Luthia & CA Keval Shah

1 *M/s. Foxtex Services India Pvt Ltd. vs. Commissioner of GST & C. Ex, Chennai*

2019-TIOL-3116-Madras CESTAT

Background Facts of the case

The appellants are providers of Maintenance or Repair Services. They entered into an agreement with M/s. Hewlett Packard India Sales Pvt Ltd (hereinafter referred to as 'HP') to render/provide 'part support service' to them. In view of said contract, Appellants had been supplying parts and accessories to ultimate customers during the warranty period on the sale of products by HP.

The SCN alleged that sale of computers is inclusive of after-sales warranty also, thereby it is the duty of HP to keep inventory of parts and accessories for free replacement on failure of their product during the warranty period. This involves huge operation requiring space, manpower, finance, etc., which are outsourced to the appellants. Therefore, the part of the work relates to after-sales warranty service is entrusted to the appellant for maintaining inventory stocks and distributing them as and when required for replacement. The service provided by appellant to HP is liable to be classified under Sub-Clause (iv) of Section 65(19) of the Finance Act, 1994 under the sub category of "procurement of goods or services" on behalf of the client under the service category of "Business Auxiliary Service" for the period from March, 2006 to September, 2010 covered under different SCN's.

Further, the appellants had filed a refund claim seeking refund of service tax amounts paid during the period from August 2005 to February 2006 and interest paid on 20.02.2007, owing to Notice from the sales tax Department claiming that their business would attract sales tax. The appellants therefore stopped paying service tax & claimed refund of service tax paid by them on the ground that their activity would not be covered under the purview of service tax.

Arguments put forth

The appellants submitted as under:

a) They had entered into a contract with HP for the sale of spares and accessories in course of rendition of warranty/after-sales service by their dealer Redington India to their customers. The commercial obligation which is two-fold is being contracted by HP with two different entities, i.e., the appellants and Redington India. HP had entered into a contract with Redington for warranty/after-sales service which involves two components viz., rendition of

service and usage of parts in the course of rendition of Service. The obligation on the part of the appellant is to sell the spares, components and accessories to HP and to hand over the same to Redington on the instructions of HP as per contract.

b) Section 65(19)(iv) would apply for a service provider who engaged in procurement of goods or services which are inputs for their clients. The role of a service provider under the said Sub-Clause is one where he would act as a facilitator in the procurement of goods or services, which, in turn, shall be used as inputs for their clients.

c) In the instant case, there is no service obligation attached in the whole transaction. The only commercial obligation is the sale of goods by the appellant to HP as and when required. The appellant does not procure goods to HP. It rather sells goods to HP. The appellant is not a facilitator or a service provider to HP, but is a seller to HP. Hence, a pure and simple sale/purchase transaction has been misconstrued to be a service contract under Section 65(19)(iv) of the Act.

d) The fact that the appellants are paid a fixed sum for the supply of materials in addition to the cost of the product would only indicate that the same is paid as an additional consideration to ensure uninterrupted supply.

e) The Hon'ble Apex Court in the case of *M/s. BSNL vs. UOI – 2006 (2) S.T.R. 161 (S.C.)* reversed the decision of the Hon'ble High Court of Kerala that a transaction of sale can also be a service.

f) The agreement of the appellant with HP is to provider part support service only i.e., supply of parts and accessories on sale of HP products. The authorities have been carried away by the words used in the agreement without going into the substance of the agreement itself and have thus erroneously held that the appellants have provided services to HP. The relationship between the appellants and HP is one of a seller and a buyer and not that of a service provider and a service recipient.

The Respondents submitted as under:

a) The appellants are engaged in the procurement of goods and supply of the same for the above warranty/after-sales service. As per the terms of the agreement, they are required to source and procure spare parts locally or through imports and on instructions, supply the same to Redington India to enable HP to meet out its obligation of service/warranty.

b) HP pays the appellant a fixed sum based on the sale of computers every month and not as per the spare parts supplied for the warranty/after-sales service. The agreement provides that HP will pay a fixed sum to the assessee towards each product sold to cover the service charges, whether the actual cost of spares is more or less.

c) The appellants are required to test and report all defective parts, provide current product engineering support on request and furnish various reports at various intervals to HP. In ordinary sale-purchase transactions no such liabilities and conditions can be fastened on the seller.

d) On behalf of HP, the appellant is maintaining enough inventories and on request, supply the parts to Redington India for replacement. it is their bounden duty to service/attend to the fault of the said products during the warranty period. In order to render the service, it is

essential to maintain adequate inventory of spares/accessories, which requires space, manpower, money, etc., which is outsourced to the appellant.

e) Notification No. 12/2003-ST exempts the value of goods and materials sold by the service provider from the taxable value for the purpose of levy of service tax. However, in this case, the value of goods is not determined and only a fixed sum is charged as per the agreement entered with the client.

f) Therefore, the consideration received is not in relation to the goods, but is relatable only to the service of procuring material and maintenance of inventory of computer parts for replacement.

Decision

a) The impugned orders have held that the appellants provide Business Auxiliary Service under the subcategory of 'procurement of goods or services'. A closer perusal of Section 65(19)(iv) indicates that the service that would fit into this category would be procurement of goods or services which are inputs for the client. Hence, it appears to reason that for such a service provider, any goods that may be procured for the client should be procured for the purposes of the latter using them as inputs, obviously, in the manufacture of intermediate or final products of such client.

b) The Explanation has clarified, that for the purposes of the said sub-clause, "inputs" means all goods or services intended for the use by the client. This Explanation is in sync with the definition of "input" in Rule 2(k) of the CENVAT Credit Rules, 2004 whereby "input" means all goods, with certain exclusions and inclusions, "used in or in relation to the manufacture of final products or for any other purpose", within the factory of production.

c) In a broader sense, the input for the purpose of Section 65(19)(iv) ibid could also include goods intended for use even by a service provider, for example, by an Authorized Automobile Service Station, who requires approved parts and components providing their service. An even more important requirement to fall within the fold of Section 65(19)(iv) ibid is that the ownership or title of the goods procured by the "service provider therein" will directly shift from the seller of such inputs to the client of such service provider. The title of the goods will never vest, at any point of time, with the said service provider.

d) In the instant business model, the Original Design Manufacturer (ODM) concerned will provide warranty parts and service to HP or its service partner in India to provide warranty services to HP customers in India. It appears that out of this business model, only the appellant is supplying warranty parts to Redington India, who are providing services for HP products in India.

e) As per the agreement (paragraph 11.3 (b)), for Warranty Support Charges, the ODM will invoice HP by the first week of every month for the service performed during the previous month unless a different schedule is expressly stated along with supporting documentation to identify the service rendered and the expenses incurred to HP by the ODM. HP will pay to appellant for Warranty Support Adder in India Rupees.

f) From the facts on record, it is definitely not the case that the appellants are facilitating procurement of inputs for enabling

the assembly of desktop PCs by M/s. HP India. So also, the appellant is not providing any after-sale service for repair or maintenance of HP products. That responsibility has been given to Redington India as per the agreement between HP and Redington.

g) It is also not disputed that the pieces are sold by appellant to HP and only supplied/ delivered to Redington to facilitate repair, replacement, etc., in warranty period as per the agreement of Redington with HP. It therefore appears to reason that the average cost of parts has been taken by the same method of calculation and agreement between HP and the appellant, and the equalized cost for each type of warranty supply (Warranty Adder type) has been arrived at and is being charged accordingly by appellant to HP, as agreed upon between the two.

h) From the sample trail of invoices produced by the appellants, it is clear that they are paying VAT at the rate of 4% on the entire value indicated in the invoice.

i) In the circumstances, as already discussed earlier, notwithstanding the usage of the term 'services' in the India Service Agreement entered into on 01.08.2005 between the appellant and HP as also the usage of the same word at a number of places, the fact remains that even from the same agreement it is evident that the purported services relate only to supply of warranty parts.

j) It is then evident that HP have entered into a contract with the appellants to supply warranty parts, apparently at 'equalized' per part rate termed as "Warranty Adder" cost. instead of directly supplying the parts to HP, do so to Redington India who are the authorized service organization for the impugned HP products. No doubt, the said warranty parts may well be stocked by the appellant for supply to Redington as and when warranty requirements arise. However, there cannot be any allegation that the appellant 'procures' such warranty parts on behalf of HP or, for that matter, Redington.

k) The said warranty parts are imported by the appellants themselves in their own name and the title to those goods will therefore remain with them till the goods are sold to HP under invoices and supplied to Redington.

l) In the circumstances, the decision of the adjudicating authorities holding that the impugned activities of the appellant would fall within the mischief of Section 65(19)(iv) of the Act and that they would be required to discharge service tax liability under that category on the value of the amounts received thereon, cannot be sustained.

2 *Rajasthan State Mines and Minerals Ltd. vs. CCE, Jaipur*

2019-TIOL-3117-Delhi CESTAT

Background Facts of the case

The appellant is Government of Rajasthan Undertaking formed under Companies Act, for development and extracting mines and minerals etc. in the State. Considering the acute power shortage in the State of Rajasthan, a policy decision was taken to set up thermal power plant, with Private Public Participation, and for which a bid was invited for setting up lignite (mining) based thermal power project, at Barmer.

The Government of Rajasthan selected M/s Raj West Power Limited ('RWPL' for short) for setting up a 1000 MW Thermal Power Plant. The government also decided to allot

lignite deposits at Kapurdi and Jalipa mines in Barmer to RWPL. Pursuant to the grant of bid, an Implementation Agreement (IA for short) was signed between Government of Rajasthan (GoR for short) and RWPL for implementation, operation and maintenance of lignite based thermal power plant with associated facilities based on lignite available in Barmer District.

As per the agreement, a separate company was to be formed as a Joint Venture unit (JV) the appellant and RWPL, for carrying out lignite mining. The JV company was, therefore, formed by name and style of Barmer Lignite Mining Co. Limited with appellant holding 51% of equity share and remaining 49% of stake was to be held by RWPL.

It was contained that GoR shall allot the land to the RWPL/JV company for mining operation. The GoR was also supposed to assist the JV company (BLMCL) in procuring land, required for the project in accordance with Land Acquisition Act and make available to the JV company. It was further agreed that if the Power Purchase Agreement which was entered into for a period of 35 years and was not extended, then the RWPL/ JV company would surrender the acquired land to the GoR against return of consideration paid at the time of acquiring the land under Land Acquisition Act, or retain the said land by paying the GoR, the differential between current market price and amount already paid to the GoR.

The Ministry of Coal, Government of India allocated the Jalipa, Kapurdi, Shivkar and Sachha Sauda lignite block at Barmer to the appellant, wherein it was also agreed that the lignite mining shall be carried out by the appellant through the JV company, BLMCL, with participation of the appellant.

Due to the various policy decisions taken by the GOI and GoR, the JV company was not given the title of the land. M/s BLMCL decided to record the payment made towards the acquisition of land, as having been made towards the 'grant of surface right' for Kapurdi and Jalipa land.

Pursuant to the investigation conducted by the Service Tax Department, a SCN was issued treating the acquired land, as a service under the category of renting of immovable property service on the alleged consideration of Rs. 989.92 crore for 'transfer of surface right' in favour of BLMCL. The SCN also demanded service tax on under 'Business Auxiliary Service' on amount of Rs. 10.2 crore which represented 51% of equity, which the appellant held in the JV company. The Service Tax was also demanded on the amount of Rs. 2.21 crore recovered by the appellant for deputation of their employees to the JV company on the pretext of giving technical knowledge and other expertise also under the BAS.

Arguments put forth

The Petitioners submitted as under:

a) There is no renting of immovable property by the appellant to the JV company. The appellant was only a lessee under mining lease granted by the GoR, which was transferred by the assignment, in favour of BLMCL/JV company. The assignment lease was not in the nature of grant of sub-lease/license, but all the rights and obligations that were to be discharged by the appellant were performed by the BLMCL.

b) The right of mining lease is nothing but extraction of mining ore, underlying the surface of the earth. While granting such right, incidental rights over the mining area is also granted as the 'surface right', which the revenue failed to appreciate and treated that as the primary activities, which in fact was the incidental one.

c) The deposit, which was made to the Land Acquisition Officer, was not for the grant of surface right, but was rather for the payment of land acquired from the Khatedar/ cultivator. After the acquisition of land the title of the land vested with the GoR, which is also evident from the mutation records. The mutation record showed the GoR as a land owner, but the same was mutated in favour of JV company for the purpose of conducting the required mining activities.

d) It was also submitted that renting of vacant land for mining purposes was specifically excluded from the definition of renting of immovable property services.

e) It was further submitted that even the activities as alleged in the SCN and held in impugned order, is treated to be a taxable event then the appellant is required to be treated as pure agent, as no consideration amount has been retained by the appellant nor even any mark-up has been done, while distributing the payment made towards the purchase of land by the LAO.

f) Regarding grant of 51% of equity to the appellant, the same cannot be treated as service, as the appellant had not done any promotion, marketing, sale, etc. for which they were liable to be covered under the BAS. It was further submitted that amount recovered from BLMCL towards the deputation of employees and officials on actual basis, cannot be treated as 'service' under the category of BAS.

g) It is also a fact that the money was spent towards the acquisition of land by the JV company, however, transfer of land in their name was cancelled by the Government of India and the activity was therefore considered as surface right by the JV company, in their books of account. In such a situation, there was no justification to treat the amount spent towards the acquisition of land, as consideration for grant of surface right, with an intention to evade the payment of service tax.

The Respondents submitted as under:

a) The agreement between the appellant, RWPL and BLMCL was for the purpose of generation of power through lignite power plant and for which the land was acquired, but the transfer of title was subsequently cancelled. The BLMCL treated the amount spent, for grant of surface right, which is a service to be classified under renting of immovable property service. As the transfer of surface right was reflected in the books of account of BLMCL on 30.12.2012, the transaction is required to be taken only from this date, which is after 1 July, 2012 and hence taxable.

Decision

a) As regards the taxability of acquisition of land is concerned, section 3C & 27(d) defining "Mining lease" of Mines and Minerals (Development and Regulation) Act provides that the surface right, which Revenue is contemplating as service, emerges out from the activity of mining operation, as incidental activity. The main activity remains the mining activity, which is nothing but benefit arising out of the land. Therefore, the same cannot be held to be the service *per se.*

b) It is also on record that initially appellant has only acquired the land for purpose of making it available to the JV company, for the setting up of the power plant to meet acute shortage thereof in the remote area of State of Rajasthan, in the Barmer District. The entire amount spent on the

acquisition of land was paid to the owner of the land from the said Escrow account by cheque. The land holder has, therefore, sold the land, much before the year, 2012, which is period involved in the impugned SCN. The sale was complete in the year of acquisition itself and there is no dispute on this fact.

c) In the circumstances, if due to change of policy of GOI and State Government, the transfer of land acquired was denied mutation to the JV company, by the appellant, will not retrospectively convert the sale into services of renting of immovable property.

d) Even if it is presumed that surface right is activity which could be construed as renting of immovable property, the entire sale consideration could not be treated towards the value of service provided by the appellant. The Revenue has not taken pain to segregate as to what is the value of the service component involved in the transaction. The treatment of entire amount that has been spent towards the acquisition of land, by no stretch of imagination, can be treated as value towards the alleged service.

e) The identical issue has come up for consideration though in different context regarding sale of 'developmental right' in case of *DLF Commercial Project vs. Commissioner of Service Tax, Gurgaon - 2019-TIOL-1514-CESTAT-CHD* wherein it has been held that the development right is benefit arising out of land and therefore, the same is not chargeable to service tax.

f) Similarly, a view has been expressed by the Coordinate Bench of this Tribunal in the case of *Mormugao Port Trust vs. Commissioner of Cus., C. Ex. & S.T. Goa -2017 (48) STR 69 (Tri. Mumbai) = 2016-TIOL-2843-CESTAT-MUM*., wherein it is held that amount received as royalty was not consideration for rendition of any services including renting/ leasing land and waterfront but in fact was the assessee's share of revenue arising out of joint venture between assessee and SWPL and thus, was not liable to Service Tax. Therefore, in the instant case there is no element of service involved in the transaction, undertaken by the appellant while acquiring the land and transferring the same to the JV company, for setting up of the power plant.

g) Regarding the second issue about the treatment of 51% of equity held by the appellant in the JV company under BAS, the same activity of grant of 51% share in JV is not covered in any of the sub heading under BAS.

h) Regarding the expenses recovered by the appellant on actual basis from BLMCL, the JV company, towards deputation of their employee and related expenses, cannot be categorised under the BAS. Even otherwise the deputation of employee in the JV company cannot be treated as BAS Relying on the decision of this Tribunal in the case of *Punj Llyod Ltd. vs. CST, Delhi -2019 (22) GSTL 85 (Tri. Del.)= 2018-TIOL-1442-CESTAT-DEL*. Also, in the case of *Franco Indian Pharmaceutical Pvt. Limited vs. CST, Mumbai - 2016 (42) STR 1057 (Tri. Mum.) = 2016-TIOL-885-CESTAT-MUM* it was held that the deputation of the employee to the JV company cannot be held to be service.

i) Therefore, impugned order is set aside and allow the appeal with consequential relief.

3 ***Cargocare Logistics India Private Limited vs. UOI & Others***

2019-VIL-496-BOM-ST

Background Facts of the case

The petition was filed under Article 226 of the Constitution of India challenging two Order in Original passed under the Finance Act, 1994. Both the orders passed are pertaining to the same period and are contradictory to each of them. One of the Order held that the freight payment is liable for payment of service tax and confirmed demand along with interest and penalties. The second order considered the said services as exempted and asked for reversal of CENVAT Credit along with interest and penalties.

During the preliminary hearing, the High Court asked the revenue as to which of the position they would adopt since only one of the two can be correct. The Counsel appearing for the revenue informed that the revenue would stand by both the orders.

Decision

a) The High Court held that passing such contradictory orders, only seem to suggest that the entire adjudication proceedings are mere farce. The attitude of the Revenue even at the level of Commissioner is that the demand has to be confirmed and the relief if any, the party has to obtain from the Appellate Authorities. This attitude brings to a naught to claim of the State that it is business friendly

b) Therefore, in such a case, there is no question of the Petitioner being driven to the filing of an appeal to the Appellate Authorities under the Act in respect of both the impugned orders.

The High Court further directed the registry to serve a copy of the final order upon the CBIC for its information.

4 ***Photon Interactive Private Limited (SEZ) vs. Commissioner of GST & Central Excise, Chennai***

2019-VIL-666-CESTAT-CHE-ST

Background Facts of the case

The refund claim was filed by the Appellants in Form – R dated 15.05.2018 for tax which was paid wrongly by the Assessee. Thereafter SCN was issued to which the appellant filed a reply. The refund was rejected on the ground that the refund claim was time bar i.e. beyond the period of one year from relevant date i.e. date of payment.

Arguments put forth

The Assessee as Appellants submitted as under:

a) The reference was made to the decisions of *3I Infotech vs. Customs, Excise & Service Tax Appellate Tribunal, Chennai & anor. reported in 2018 (7) T.M.I. 276 – Madras High Court - 2018-VIL-283-MAD-ST* and the order of the Mumbai Bench of the Tribunal in the case of *M/s. Edelweiss Securities Ltd. vs. Commissioner of Service Tax, Mumbai-I reported in 2016 (7) T.M.I. 424 – CESTAT Mumbai - 2016-VIL-485-CESTAT-MUM-ST.*

The Respondent relied upon the arguments made by the lower authorities. Revenue placed heavy reliance on the order of the Hyderabad Bench of the Tribunal in the case of *M/s. Oil India Ltd. 2019-VIL-269-CESTAT-HYD-ST* to buttress their contention that the officers have no jurisdiction since no provision of the Act, including Section 11B, applies to the present case. Accordingly, the matter should be pursued in Civil Court

Decision

a) Orders of the lower authorities reveal that the Revenue is not questioning the eligibility of the appellant for refund; they have only held that the application for refund was filed after the one year time-limit.

b) Reliance was placed on the decision of *M/s. Mafatlal Industries Ltd. vs. Union of India reported in 1997 (89) E.L.T. 247 (S.C.) - 1996-VIL-01-SC-CE,* which states that every refund of excise duty/service tax can be made only under and in accordance with Section 11B.

c) The authorities should not have, in the first place, accepted the payment. The Revenue, after all, is neither a collection agent nor a post box and nor even a hundi; every demand and collection is only with or under the authority of law. Hence, it is difficult to accept that the officers lacked jurisdiction to sanction the refund under the Act when under the same Act, they have accepted the payment. Consequently, it cannot be said that for accepting the payment alone the said Act applies and that the Act would not apply when it comes to sanctioning the refund.

d) The decision of the Hon'ble jurisdictional High Court in the case of *M/s. 3I Infotech (supra)* squarely applies, wherein the Hon'ble Court has even ordered for refund when the Service Tax itself was paid by mistake and that the claim for the same could never be barred by limitation

Accordingly, the appeal filed by the Appellants was allowed.

5 *Vodafone West Limited vs. Commissioner of Central Excise & ST, Ahmedabad*

2019-VIL-668-CESTAT-AHM-ST

Background Facts of the case

The issue involved in the present appeals is whether the services of tele-communication provided by the appellant to the international inbound roamer in Indian territory and payment thereof received from foreign telecommunication service provider, can be considered as export of service and consequently the appellant is entitled for rebate of service tax paid on such services.

If at all the appellant is entitled for refund, whether the same needs to be undergone the test of unjust-enrichment.

Arguments put forth

The Assessee as Appellants submitted as under:

a) At the outset submits that the international roamer who use the international telecommunication service are subscribers of foreign based telecommunication service provider. As regards the service, there is contract of the appellant with such foreign based telecommunication service provider and against the roaming service provided by the appellant and used by the international roamer in India, the payment is received by the appellant from the foreign based telecommunication service provider therefore, the service recipient is located outside India and the service was provided by the appellant to such service recipient and the payment is also received in convertible foreign exchange. Therefore, such service is export of service and the appellant is entitled for rebate.

b) This issue has been considered in the various judgments of appellant's group companies and also in other judgments

c) As regards the issue of unjust-enrichment, he submits that once the service is held to be export of service, unjust-enrichment is not applicable in terms of provisions of Section 11B.

The Revenue as Respondents submitted as under:

a) That even though the judgments cited by the appellant are directly applicable to the case in hand, the LD. Commissioner (Appeals) despite recording the fact of judgments given by the Tribunal, discarded the same on the ground that as per Circular the said service is taxable and Circular is binding on the field formations in terms of law laid down by the Hon'ble SC in the case of *CCE, Vadodara vs. Dhiren Chemicals – 2002 (139) ELT 3 (SC) - 2001-VIL-03-SC-CE*

Decision

a) As per the agreement, the appellant has agreed to provide telecom services to the customer of the foreign telecom service provider while he is in India using the appellant's telecom network. The consideration for the service rendered is paid by the foreign service provider. There is no contract/agreement between the appellant and the subscriber of the foreign telecom service provider to provide any service. Since the contract for supply of service is between the appellant and foreign telecom service provider who pays for the services rendered, it is the foreign telecom service provider who is the recipient of the service. From the provisions of law relating to GST in UK and Australia, relied upon by the appellant, this position becomes very clear. Your customer's customer is not your customer. When a service is rendered to a third party at the behest of your customer, the service recipient is your customer and not the third party. For example, when a florist delivers a bouquet on your request to your friend for which you make the payment, as far as the florist is concerned you are the customer and not your friend.

b) The service is rendered to a foreign telecom service provider who is located outside India and also other conditions as mentioned in Export of Service Rules, 2005 have been satisfied and therefore, the transaction constitutes export and we hold accordingly

c) Therefore, on merits, the appellant has a case and therefore, the appellant would be eligible for refund of the Service Tax paid on input services used in or in relation to rendering of the output service which has been exported, under Rule 5 of the Service Tax Credit Rules, 2005, read with Notification 11/2005-S.T. Further since the transaction is one of export, the principles of unjust enrichment would not be applicable to export transactions as specifically provided in Section 11B.

Accordingly the appeal of the Appellant was allowed.

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Makarand Joshi,
Company Secretary

CORPORATE LAWS

Company Law Update

Ruling of Delhi High Court – Disqualification of Directors

Writ Petition

1 ***Mukut Pathak vs. Union of India - High Court of Delhi (LSI-621-HC-2019(DEL)-Mukut Pathak vs. UoI***

Facts of The case

- MCA had taken initiatives in year 2017 to address the matter of shell companies in existence, the disqualification of directors of the companies who have failed to file financial statements or annual returns for a continuous period of 3 financial years as prescribed u/s. 164(2) of The Companies Act, 2013 (the Act) is one of them.
- Certain directors challenged this act of MCA before various High Courts i.e. Karnataka High Court, Madras High Court and Gujarat High Court and Delhi High Court (HC)
- MCA published 3 lists of disqualified directors dated 15-9-2017 and 3-10.2017.
- Directors who have been disqualified from being appointed/reappointed as directors for a period of 5 years u/s. 164(2)(a) of the Companies Act, 2013 (the Act)

A Single Judge of Delhi High Court in ***Mukut Pathak vs. Union of India*** on 4th November, 2019 pronounced its decision on various aspects relating to disqualification of director which is discussed in detail below.

Arguments

The learned council on behalf of petitioners have assailed the impugned list on four grounds

It is contended on behalf of petitioners that:

1. not providing opportunity to be heard inasmuch as no show cause notice was issued to the petitioners intimating them about their disqualification as director and such omission is in violation of principle of natural justice.
2. provision of Section 164 of the Act, being penal in nature, could not be applied retrospectively.
3. Clause (a) of Section 167(1) as it stood prior to introduction of the proviso could apply only individuals who incurred the disqualification as specified in

Section 164(1) of the Act not to those who incurred the disqualification under Section 164(2) of the Act.

4. The word 'appointed' and 're-appointed' cannot be read as synonyms. Since two separate expressions – 'appointed' and 'reappointed' – have been used by the legislature in the same statutory provision, the same must be given different meanings. Therefore a person who has incurred the disqualification under Section 164(2) of the Act, cannot be appointed in any other company but can be re-appointed in any other Company.

5. In addition, the petitioners also impugn the action of the respondents in deactivating their DINs and DSCs.

Held

While addressing the above contentions of petitioners, the Delhi High Court taken the following views.

While dealing with the **first argument**, the Delhi HC took a view that the principles of natural justice cannot be applied in a dogmatic fashion, and it depends upon the requirements stipulated in the relevant statutory provision.

While examining the issue, HC held that Section 164 sets out qualifying criteria for directors to be appointed or reappointed, in negative terms. This provision does not entail any decision-making process on the part of the Authorities administering the Act. Hence court concluded that the **exclusions of the *"audi alteram partem"* rule i.e. not providing right to be heard does not results in any procedural unfairness.**

Further court also took note that similar views were expressed by Karnataka and Gujarat High Court. However the Madras High Court has taken a contrary view.

While dealing with the **second argument** related to provisions of Section 164 of the Act applied retrospectively, the court stated that:

Erstwhile provision in the form of section 274(1) of the Companies Act, 1956 applied only to public companies, but the provision currently in operation i.e. of Section 164(2) applies to private companies as well.

The Delhi HC dealt with a specific case of computing consecutive period of 3 years for the FY 2013-14 ending on 31-3-2014. The Section 164 came into Force on 1-4-2014. Even though the financial year ending 31-3-2014 had ended prior to Section 164 of the Act coming into force, the AGM in respect of that financial year was required to be held by 20-9-2014, that is, after the Section 164 of the Act had come into force.

The question whether a law is retrospective has to be viewed in the context whether it divests a person of accrued rights, or creates new obligations, or attaches a disability in respect of transactions or actions done in the past.

This question was also dealt by Karnataka, Gujarat and Madras High Court as well and all the courts are **unanimous in their opinion that provisions of Section 164 apply prospectively.**

Considering above points Delhi HC is in respectful disagreement with the view of the Karnataka High Court, Madras High Court and Gujarat High Court in as much as the said courts have held that the defaults for the financial year ending 31-3-2014. **Concededly, section 164(2) of the Act operates prospectively. However, such prospective operation would entail taking into account failure to file the financial statements pertaining to the financial year ending 31-3-2014 on or before 30-10-2014.**

While dealing with **third argument** which relates to whether the directors disqualified

under section 164(2) would demit office as a director in all companies where they hold such position the court stated that:

A plain reading of Clause (a) of Section 167(1) of the Act indicates that a Director would demit office if he incurs the disqualification under Section 164 of the Act. The proviso to Clause (a) of Section 167(1) of the Act was introduced with effect from 7-5-2018, by virtue of the Companies (Amendment) Act, 2018.

The conditions as set out in section 164(1) which disqualify a person from being appointed as a director are directly attributable to him/her. In contrast to the above, the provisions of Section 164(2) of the Act stipulates the defaults committed by a defaulting company, which results in the directors of that company incurring the disqualification being vicariously responsible for such defaults.

The Court observed that the disqualification applies "vicariously" as the directors may not be directly responsible for the circumstances that led to disqualification. Hence, in such cases, the functioning of directors in companies where the default has occurred remains unaffected. If not, all directors would immediately demit office in defaulting companies, which would remain without a board, something that the legislation would not have intended.

The Court found that the directors "would not demit their office on account of disqualifications incurred under Section 164(2)" for the period prior to the statutory amendments in 2018. However, for the period following the amendments, the directors would demit office in all companies other than the defaulting company.

Q3. Interpretation of Provisions of Sec. 164 of the Act w.r.t. Appointment or reappointment of Directors

Further in **fourth issue** contended by petitioner, the Delhi High Court was called upon to interpret a specific portion of section 164(2) of the Companies Act, which stipulates that a defaulting director shall not "be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so"

The disqualified director contended that "if a person was a director of a defaulting company but was also a director of other companies that were not in default, he would be disqualified from being **re-appointed in defaulting company** or for **being appointed in any company other than the non-defaulting companies in which he was already a director. But he could be re-appointed in those non-defaulting companies** where he had been appointed as a director prior to incurring the disqualification under section 164(2) of the Act.

Court simply noted that a "plain reading of Section 164(2) does not indicate this legislative intent" and that "the term appointment would include any 'reappointment' as well"

While addressing the **additional issue** raised by petitioner w.r.t. whether the act of the respondents in deactivating the DIN of the directors is sustainable the Delhi High Court held that:

The disqualified directors challenged MCA's action of deactivating their Director Identification Number (DIN). After examining the provisions of the Companies Act relating to DIN, the Court found that the provisions pertaining to DIN are only to ensure that any person acting as a director has a unique identity to identify him. Plainly, this is for purposes of administering the Act in an efficient manner. He is not required to give up this identification number only because he is temporarily disqualified for being appointed as a director.

Neither any of the provisions of the Companies Act nor the Rules framed thereunder stipulate cancellation or deactivation of DIN on account

of a director suffering a disqualification under Section 164(2) of the Act.

Similarly, there is also no provision supporting the respondents' action of cancelling the DSC of various directors. The said action is therefore unsustainable.

Readers can also refer to following Judgements:

1. ***Yashodhara Shroff vs. Union of India:*** W.P No. 52911/2017 and Connected matters, decided on 12.06.2019 (Karnataka High Court)
2. ***Bhagvan Das Dhananjay Das vs. Union of India and Ors.:*** W.P. Nos. 25455/2018 and other connected matters, decided on 03.08.2018 (Gujarat HC)
3. ***Gaurang Balvantlal Shah vs. Union of India: Manu/GJ/1278/2018)***

In the matter of *CloudWalker Streaming Technologies Pvt. Ltd. (Petitioner/Operational Creditor/Cloud Walker) vs. Flipkart India Pvt. Ltd (Respondent/Corporate Debtor/Flipkart)*

Facts of the Case

- CloudWalker and Flipkart entered into a supply agreement.
- As stipulated in supply agreement CloudWalker was to bear the cost of storage, packaging, transportation, duty, taxes etc. unless the order was confirmed by Flipkart.
- CloudWalker claimed that Flipkart failed to obtain the delivery of the LED TVs as ordered pursuant to which the CloudWalker was forced to unload the uncollected LED TVs at heavily market down price so as to remain afloat. CloudWalker alleged that Flipkart failed to collect delivery of LED TVs after placing order (citing shortage of warehouse space), failed to pay excess charges and costs as promised.
- Pursuant to failure on the side of Flipkart, statutory notice was issued by CloudWalker under IBC dated 8th June, 2019 followed by filing application to NCLT due to non-receipt of any response on statutory notice.

Arguments

Allegations by CloudWalker

- It was alleged by the CloudWalker that the Flipkart was economically not viable and possessed threat to commercial morality.
- The Flipkart consistently and persistently failed, omitted and neglected to discharge its admitted and acknowledged debt and liability despite vigorous follow ups followed by receipt of statutory notice under the IBC.
- There was no prior dispute raised by Flipkart pertaining to alleged debt.
- It was prayed before the NCLT to permit CloudWalker to proceed against the Flipkart in Insolvency Resolution Proceedings.

Statement of objections by Flipkart

- Flipkart responded that the Company had built its goodwill in Indian market over the years and also highlighted its financial strength.
- Flipkart withheld certain amount towards deficiency of services. Further, the products received were in (i)damaged condition (ii) not in accordance with the Supply Agreement, the Purchase Order and/ or Invoice raised by the Petitioner iii) defective.
- It was further stated that the various purchase orders which were placed by Flipkart were not picked as promised ***causing a huge financial loss.*** Referring

Section 56 of Sale of Goods Act, 1930 it was argued -

'Where buyer wrongfully neglects or refuses to accept or pay for the goods the seller may sue him for damages for non – acceptance'

- Flipkart referred following cases in the statement of objection -

  a. In ***Greenhills Exports (Private) Limited, Mangalore and Ors. vs. Coffee Board, Bangalore 2001(4) Kar. LJ 158*** at Paras 14,15 & 16, Karnataka High Court had, while disallowing winding up of Company, that civil court is competent authority for claiming damages since amount claimed is not debt but damages.

  b. In ***Ramgad Minerals and Mining Pvt Ltd and Ors. vs. Vectra Advanced Engineering Pvt. Limited***, Karnataka High Court held that winding up petition does not lie if claim is arising out of damages for alleged breach of contract executed between parties.

- Flipkart further pleaded before NCLT that "...there were huge discrepancies with respect to the sums claimed, invoice raised and illegal demands of the CloudWalker. The disputes between the parties were to be adjudicated by a competent civil court upon appreciating the evidence placed on record...".

Held

- NCLT observed that Flipkart admittedly did not raise any dispute with regard to alleged deficiency in service or brought to the notice of CloudWalker about alleged breach of terms of supply agreement. Further that the Flipkart had power to terminate the agreement pursuant to clause 8(b) in case of breach of supply agreement by CloudWalker however the agreement was not terminated. Hence, defence raised by Flipkart is baseless and an afterthought.

- Further it was observed that multiple opportunities were given to both the parties to resolve the matter amicably but no concrete settlement had been forthcoming, moreover it was open to the parties to settle the issue even after admission of case under IBC.

- NCLT, in conclusion has now initiated CIRP under IBC against Flipkart, holding that "The above facts and circumstances... leaves no iota of doubt that the Flipkart has committed Debt and default in question... there is no payment of operational debt... the demand notice in question is delivered and no notice of dispute was received by the Cloud Walker...the instant case is fit case to admit initiating CIRP, appointing IRP, imposing moratorium etc. in respect of the Flipkart."; NCLT has further appointed Interim Resolution Professional and have asked for progress reports and posts the matter.

(i) Flipkart has proceeded to file a writ petition before the Karnataka High Court seeking relief and has obtained a Stay against the order of NCLT.

(ii) The cases referred by Flipkart as mentioned above are decided before introduction of Insolvency and Bankruptcy Code, 2016.

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OTHER LAWS

FEMA – Update and Analysis

CA Mayur Nayak, CA Natwar Thakrar & CA Pankaj Bhuta

In this article, we have discussed recent amendments through FAQs issued by RBI and the recent Notifications. In addition few selected recent compounding orders issued by RBI are also discussed:–

A. Updated through FAQs

1. Overseas Direct Investments

RBI update on FAQs on Overseas Direct Investments as on 19th September 2019 contains the following Changes:

- **Answer to Question No. 64 has been updated.** (*update is highlighted in bold & italics*)

  Q.64 Can an Indian Party (IP) set up a step-down subsidiary/ joint venture in India through its foreign entity (WOS/JV), directly or indirectly through step-down subsidiary of the foreign entity?

  Ans: No, the provisions of Notification No. FEMA 120/RB-2004 dated July 7, 2004, as amended from time to time, dealing with transfer and issue of any foreign security to Residents do not permit an IP to set up Indian subsidiary(ies) through its foreign WOS or JV nor do the provisions permit an IP to acquire a WOS or invest in JV that already has direct/indirect investment in India ***under the automatic route. However, in such cases, IPs can approach the Reserve Bank for prior approval through their Authorised Dealer Banks which will be considered on a case to case basis, depending on the merits of the case***.

2. Money Changing Activities

RBI update on FAQs on Money Changing Activities as on 23rd October, 2019 contains the following Changes:

- **Question No. 23 has been newly inserted.**

  Q.23 What is the position of old generation '1000 shillings (Ksh)' banknotes in Kenya?

  Ans: With the issuance and launch of the New Generation banknotes,

Central Bank of Kenya has advised that in terms of Gazette Notice No. 4849 dated May 31, 2019 from Central Bank of Kenya available at: *(http://kenyalaw.org/kenya_gazette/gazette/volume/MTk2Mg/Vol.CXXI-No.69)*, and the Press Release dated June 6, 2019 available at: *(https://www.centralbank.go.ke/uploads/press_releases/696932423_Press%20Release%20%20New%20Generation%20Banknotes.pdf)*, all the currency notes of denomination '1000 shillings (Ksh)' shall cease to be legal tender, and shall no longer be exchanged, with effect from October 1, 2019.

B. Recent Notifications issued by RBI

RBI issued Notification No. 395/2019 dated 17th October, 219 titled "Foreign Exchange Management (Mode of Payment and reporting of Non-Debt Instruments) Regulations, 2019" and Notification No. 396/2019 dated 17th October, 2019 titled "Foreign Exchange Debt Instruments Regulations, 2019" which respectively correspond to the existing provisions contained under Regulation 13 and Schedule 5 of the Notification No. 20 (R) dated November 07, 2017.

Link: http://egazette.nic.in/ (S(jecuquigltqi0vq0krbrhi3n))/EnhancedSearch.aspx

C. Analysis of recent compounding orders issued by RBI

1) Borrowing and Lending in Rupees Regulation (FEMA 4/2000-RB) Borrowing in rupees from NRI other than by way of issue of Non-Convertible Debenture.

Applicant	Orient Box Movers Private Limited (OBM)
Compounding Application Number	C.A. 4904/2019
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 71,593/-
Date of order	09th August, 2019
Facts of the case	The applicant (OBM) had incurred huge losses from the contract with MSWC and accordingly was not in a financial position to repay the secured loans availed from Citizen Credit Co-op Bank and was classified as Non Performing Asset (NPA) in December 2012. In order to keep the company afloat, OBM decided to avail unsecured rupee loan from the son-in-law of the Director of the company after passing a Board resolution to this effect.

	The loan of ₹ 28,79,100/- was sent by wire transfer from Australia by the son in law of the Director. The proceeds of the loan were utilized towards repayment of overdue bank loan and towards miscellaneous payments for keeping the company afloat. On application, RBI granted approval to the company for repayment of loan and advised to immediately unwind the transaction. The principal amount of loan of ₹ 28,79,100/- was repaid on 09th July 2018 and the interest of ₹ 13,92,211.25 was paid on 27th February 2019.
Contravention	Borrowing in rupees from NRI other than by way of issue of Non-Convertible Debenture: Regulation 5(1)(i) of Notification No. FEMA 4/2000-RB states that "…. a company incorporated in India may borrow in rupees on repatriation or non-repatriation basis, from a non-resident Indian or a person of Indian origin resident outside India, by way of investment in Non-Convertible Debentures (NCDs) issue of which is made by public offer." Since the applicant had raised loans through borrowings from NRI without making public offer, it resulted into contravention of Regulation 5(1)(i) of Notification No. FEMA 4/2000-RB.
Comments	It may be noted that a new Notification FEMA.3(R)/2018-RB dated 17th December 2018 has been issued in supersession of the Notification No. FEMA 4/2000-RB mentioned above. Under the new Notification an Indian company is not permitted to borrow from NRI in Indian rupees through NCD route. ECB in Indian rupees is permitted subject to conditions.

2) **Transfer or Issue of Security by a Person Resident Outside India (Inbound Investment) (FEMA 20/2000-RB)**
(i) prior approval was not sought from Reserve Bank for transfer of shares from resident to non-resident by way of gift; (ii) the face value of the shares transferred by way of gift exceeded 5% of the paid up capital of the Indian Company and (iii) the value of security to be transferred by the donor to a person residing outside India as gift in the calendar year exceeded the rupee equivalent of USD 25000/-

Applicant	S Namasivayam
Compounding Application Number	C.A. 915/2019
Compounding Authority Name	Foreign Exchange Department, Chennai
Amount imposed under Compounding Order	₹ 10,01,560/-
Date of order	27th August, 2019

Facts of the case	The applicant is an individual Shri S Namasivayam, a resident shareholder in M/s Iminsight Software Private Limited. On 16th May, 2010, the applicant transferred by way of gift, equity shares of face value ₹ 100/- each to the Non-Resident Shri N Senthil Kumar at a notional share value of ₹190.93/- without RBI approval. The transfer of equity shares by way of gift exceeded 5% of the paid-up capital of the Indian company. Also, The transfer of equity shares by way of gift exceeded the rupee equivalent of USD 25000/-.
Contravention	Transfer of security as a gift by a person resident in India to the person resident outside India: As per regulation 10A(a)(i) of Notification No. FEMA 20/2000-RB a person resident in India who proposes to transfer to a person resident outside India any security by way of gift shall make an application to Reserve Bank for its approval. Since in the present case the applicant being a person resident in India has transferred shares by way of gift to a person resident outside India, without the prior approval of the RBI, it was held that the applicant had contravened provisions of FEMA 20/2000-RB.
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 10(5) of extant FEMA 20(R)/2017-RB dated 07/11/2017 corresponds to Regulation 10A(a)(i), Regulation 10A(a)(ii)(b), Regulation 10A(a)(ii)(e) of erstwhile FEMA 20/2000- RB dated 03/05/2000.

3) **Transfer or Issue of any foreign Security (Outbound Investment) (FEMA 120/2004-RB) Undertaking disinvestment without obtaining valuation certificate of the overseas company**

Applicant	Match – IT Consultants Pvt Ltd
Compounding Application Number	C.A. No. 4936/2019
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 1,52,375/-
Date of order	20th September, 2019
Facts of the case	The applicant made an investment in an overseas JV in Tanzania. Despite receiving money as remitted by the applicant, the foreign JV did not respond positively in fulfilling their obligations including submitting the statutory requirements like financial statements, share certificates etc. to

	the Indian Party (IP) in order to comply with ODI requirements despite best attempts. The applicant filed a Police Case in Tanzania against the management of the Tanzanian JV. The applicant was unable to file APRs in the absence of access to JV's financials. The Indian company written off the entire investment in its books.
Contravention	Undertaking disinvestment without obtaining valuation certificate of the overseas company: As per regulation 15(iii) of Notification No. FEMA 120/2004-RB, Form APR needs to be submitted within the time prescribed by the RBI. Further, according to Regulation 16(1)(iii), an Indian party may disinvest any share or security held by him in a JV/WOS provided that the share price is not less than the value certified by a CA/CPA as the fair value of the shares based on the latest audited financial statements of the JV/WOS. Since in the present case the applicant had written-off entire investment from its books of account without obtaining valuation certificate, it resulted into contravention of provisions of FEMA 120/2004-RB.
Comments	The applicant was punished despite its efforts to obtain necessary documents from the overseas JV. It means Indian party investing abroad must be extremely careful in documentation and compliances.

4) Export of Goods and Services (FEMA 23/2000-RB)

Failure to ship goods within a period of one year from the date of receipt of advance payment

Applicant	Suncity Sheets Private Limited
Compounding Application Number	C.A. No. 4923/2019
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 1,56,082/-
Date of order	26th September 2019
Facts of the case	The applicant company during the year 2011 had received an advance payment from one of its overseas buyers. The overseas buyer cancelled the order and as per the contract, certain amount was adjusted as cancellation charges and the remaining amount was remitted to the overseas buyer after one year of receipt of advance payment without prior permission of RBI.

Contravention	Failure to ship goods within a period of one year from the date of receipt of advance payment: As per regulation 16 of Notification No. FEMA 23/2000-RB, an exporter should ship the goods within 1 year from the date of receipt of advance payment. However, in the event of exporter's inability to ship the goods, no remittance towards the unutilized portion of advance shall be made without the prior RBI permission. Since in the present case the applicant had failed to ship the goods within the prescribed time period as well as remitted the unutilized amount without the prior RBI permission, it was held that the applicant had contravened provisions of FEMA 23/2000-RB.
Comments	Though Foreign Exchange Management (Export of Goods and Services) Regulations, 2000 has been replaced by revised regulations; Regulation 15 of extant FEMA 23(R)/2015-RB dated 12/01/2016 corresponds to Regulation 16 of erstwhile FEMA 23/2000- RB dated 03/05/2000.

5) Borrowing or Lending in Foreign Exchange (FEMA 3/2000-RB)
Drawdown of ECB before obtaining Loan Registration Number (LRN)

Applicant	Pi Digital Media Network Private Limited
Compounding Application Number	C.A. No. 4948/2019
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 1,18,039/-
Date of order	26th September 2019
Facts of the case	Drawdown of the ECB amount before obtaining the Loan Registration Number (LRN).
Selected Contravention	Drawdown of ECB before obtaining LRN: As per paragraph 1(xi) of schedule I Drawdown of the ECB amount to be made only after obtaining LRN from RBI. Since in the present case drawdown of the ECB was made before obtaining LRN, it was held that the applicant had contravened provisions of FEMA 3/2000-RB.
Comments	Though Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000 has been replaced by revised regulations; Paragraph 11 of Schedule I of extant FEMA 3(R)/2018-RB dated 17/12/2018 corresponds to paragraph 1(xi) of schedule I of erstwhile FEMA 3/2000-RB dated 03/05/2000.

6) Transfer or Issue of any foreign Security (Outbound Investment) (FEMA 120/2004-RB) Non-reporting of shares acquired by the employees and directors of the applicant company under the ESOP scheme of its parent company

Applicant	July Systems & Technologies Limited
Compounding Application Number	C.A. No. 4932/2019
Compounding Authority Name	Foreign Exchange Department, Mumbai
Amount imposed under Compounding Order	₹ 38,125/-
Date of order	27th September 2019
Facts of the case	The applicant company failed to report the shares being acquired by its employees and directors under the ESOP scheme of its parent company on an annual basis within the prescribed time period. Indian employees paid the funds for acquisition of the shares under the ESOP scheme to the applicant company instead of remittance to parent company, which the applicant company remitted to the parent company later on behalf of its employees.
Contravention	Delay in reporting shares acquired by employees under ESOP scheme: Regulation 22(2) states that "A person resident in India, being an individual, who is an employee or a director of Indian office or branch of a foreign entity or of a subsidiary in India of a foreign entity or of an Indian company in which foreign entity has direct or indirect equity holding, may accept the shares offered by such foreign entity provided that: (i) the shares under the ESOP Scheme are offered by the issuing company globally on uniform basis, and (ii) an Annual Return is submitted by the Indian company to the Reserve Bank through the Authorised Dealer bank giving details of remittances/beneficiaries etc." Since in the present case the applicant company failed to report the shares acquired by its employee under ESOP scheme within the prescribed time period, it was held that the applicant had contravened provisions of FEMA 120/2004-RB.
Comments	Reporting to RBI assumes significance as any delay may attract penalty and compounding under FEMA.

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CA Ashutosh Pednekar

In Focus - Accounting & Auditing

Issue of Audit Reports and Certificates for Special purposes – Process and Documentation Aspects

Introduction and Purpose of the GN

The Institute of Chartered Accountants of India (ICAI/the Institute) issued a Guidance Note on Reports and Certificates for Special Purposes in 2016 (Guidance Note/GN). This revised guidance note superseded the one issued in 1984. The purpose of the GN was to provide guidance on engagements which require a 'professional accountant in public practice' (hitherto known as "practitioner") to issue reports other than those which are issued in audits or reviews of historical financial information. The reports which are issued pursuant to audits or reviews of historical financial information are dealt with in Standards on Auditing (SAs) and Standards on Review Engagements (SREs) and hence, not covered by the GN. So, if one is conducting an audit, annual or interim or otherwise or a limited review then the requirements of the relevant SAs and SREs need to be adhered to by the practitioner. In all other cases this GN applies. These cases would be requirements of any law or regulation or even a contractual arrangement between parties.

In these requirements, of an authority or a contract the wordings normally required are "certify" or " true and correct". This implies that level of assurance expected is absolute. An absolute assurance indicates that a practitioner has performed procedures as considered appropriate to reduce the engagement risk to zero. The GN defines engagement risk to mean the risk that the practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated. Readers may also refer to paras 47, 48 and 51 of the Framework for Assurance Engagements issued by the ICAI which defines an Assurance Engagement Risk. **The GN states that a practitioner is not expected to reduce the engagement risk to zero.** This is due to the fact that the procedures that a practitioner performs is subject to the following inherent limitations:-

(a) the nature of financial reporting;

(b) the use of selective testing;

(c) the inherent limitations of internal controls;

(d) the fact that much of the evidence available to the practitioner is persuasive rather than conclusive;

(e) the nature of procedures to be performed in a specific situation;

(f) the use of professional judgment in gathering and evaluating evidence and

forming conclusions based on that evidence;

(g) in some cases, the characteristics of the underlying subject matter when evaluated or measured against the criteria; and

(h) the need for the engagement to be conducted within a reasonable period of time and at a reasonable cost.

As practitioners, each one of us would relate to these limitations. They manifest themselves either individually or together in the assignments we do. Hence, what a practitioner can provide is either a reasonable assurance or a limited assurance. A reasonable assurance is about whether the subject matter of examination is materially misstated while a limited assurance mentions that nothing has come to the practitioner's attention that causes the practitioner to believe that the subject matter is materially misstated. Hence, depending upon the nature, timing and extent of procedures that can be performed based upon the facts and circumstances of the case, **a report or certificate issued by a practitioner can provide either reasonable or limited level of assurance.**

Scope & Objectives of the GN

The GN applies to assurance engagements other than audits and reviews. It does not apply to assurance engagements for which subject specific Standards on Assurance Engagements have been issued. It can also be applied on reports and certificates historical non-financial information. GN principles can be applied to certain assurance engagements on which ICAI has issued subject specific guidance.

The objectives of the practitioner in an assurance engagement are spelt out in the GN as under:-

- Obtain either a reasonable assurance or limited assurance about whether the subject matter information is free of material misstatement
- Express in writing along with the basis for conclusion i.e., an opinion in case of reasonable assurance or a conclusion in case of a limited review
- If subject matter information has many aspects, each of them can have a different opinion. The GN recognizes that such opinions need not be on same level of assurance
- To communicate further as required by the GN
- Opinion/conclusion can be qualified or disclaimed in appropriate circumstances
- Practitioner can withdraw or resign from engagement where it is possible under applicable law or regulation

Engagement Requirements

A practitioner is required to conduct the engagement in accordance with the GN. One of the primary requirements is compliance with the paras 4 and 5 of Framework of Assurance Engagements, which *inter-alia* are the requirements of the CA Act, 1949, the Code of Ethics, including Integrity/objectivity/ professional competence and due care/ confidentiality/professional behaviour, other relevant pronouncements of ICAI as well as the Standards on Quality Control (SQC).

In addition, the broad engagement requirements are:–

- Engagement Acceptance and Continuance
- Preconditions for the Assurance Engagement
- Limitations on Scope Prior to Acceptance of the Engagement
- Agreeing on Terms of the Engagement
- Acceptance of a Change in the Terms of the Engagement

Let us look at each one of them.

Engagement Acceptance and Continuance

The practitioner needs to have a comfort that the ethical requirements, including independence will be satisfied. Further, the persons who are to perform the engagement have the appropriate competence and capabilities to perform. Moreover, the practitioners and the engaging party have to agree upon the basis of performing the engagement. This could be done through ensuring the preconditions of the engagement are present and there is a common understanding between practitioner and engaging party, including practitioner's reporting responsibilities.

Preconditions for the Assurance Engagement

The practitioner has to determine whether all the preconditions necessary for the assurance engagement are present. This is done on the basis of preliminary knowledge of the engagement circumstances and discussions with the engaging party. These include: -

- Suitableness in the given circumstances the of roles & responsibilities of appropriate parties
- Determine whether the engagement exhibits all of the following characteristics:-
  - Appropriateness of underlying subject matter
  - Criteria that practitioner expects to apply is suitable for engagement & available for intended users. These include the characteristics mentioned in para 35 of the Framework for Assurance Engagements i.e. relevance, completeness, reliability, neutrality and understandability
  - Criteria that the practitioner expects to obtain evidence to support the opinion/conclusion

If the preconditions are not met or not expected to be met then the practitioner needs to discuss the same with the engagement party. If changes cannot be made, then the practitioner is advised by the GN not to accept the engagement unless required by law or regulation.

Limitations on Scope Prior to Acceptance of the Engagement

In case the practitioner believes that the limitations to the scope would lead to a disclaimer of opinion/conclusion he should not accept the engagement unless required by law or regulation.

Agreeing on Terms of the Engagement

The GN is clear that it is in interest of both parties to have the agreement in writing. At a minimum following should be specified in the agreement:-

(a) the objective and scope of engagement;

(b) the responsibilities of the practitioner;

(c) the responsibilities of engaging party;

(d) the responsibilities of the responsible party (if different from the engaging party);

(e) identification of the suitable criteria to be used;

(f) identification of the subject matter including reference to the law or regulation or the contracts;

(g) Unrestricted access to whatever records, documentation and other information requested in connection with the engagement;

(h) The fact that the engagement cannot be relied upon to disclose errors, illegal acts or other irregularities, for example, fraud or defalcations that may exist;

(i) reference to the expected form and content of report to be issued by the practitioner; and

(j) a statement that there may be circumstances in which a report may differ from its expected form and content.

The agreement can include general terms so long as they are not inconsistent with applicable laws and regulations. If Engagement is recurring then the practitioner needs to determine whether the terms need to change and if so, remind the engaging parties.

Acceptance of a Change in the Terms of the Engagement

The GN recognizes that there can be a change to the terms of the engagement. However, such there has to be a reasonable justification for the change. In case the change is agreed to by the parties then the practitioner should not disregard the evidence gathered before the change has happened. It may be noted that an inability to obtain sufficient appropriate evidence to form a reasonable assurance opinion/conclusion is not an acceptable reason to change from a reasonable assurance engagement to a limited assurance engagement.

Assurance Report prescribed by Law or Regulation

Many a times the layout and wordings of the certificate or report are prescribed by law or regulation. In such circumstances the practitioner needs to evaluate whether intended users might misunderstand assurance conclusion and if so, whether additional explanation in assurance report can mitigate possible misunderstanding. In case the practitioner evaluates misunderstanding cannot be mitigated, then, subject to requirements of law and regulation, should not accept the engagement.

The practitioner is required to discuss with the engaging party and provide it draft of the assurance report that includes wording as per GN. If the engaging party does not agree, then practitioner has to consider withdrawing from the engagement. Once the engagement party agrees the report is issued in the updated format and submitted to the authorities. In case concerned authorities reject the format, then the practitioner needs to obtain evidence of rejection and make it part of engagement documentation. Thereafter, the report is to be issued in format prescribed by law & regulation. The practitioner can also consider enclosing a statement incorporating the requirements of the GN. The enclosure should include a para that report submitted earlier has been rejected.

Execution of the Engagement

Like in every assurance engagement the practitioner is required to possess professional skepticism, use professional judgment and apply appropriate assurance skills and techniques.

Planning is an important part of the engagement and the practitioner needs to factor it in the scope and timing so that the objectives of the engagement are achieved. If after acceptance the practitioner determines that circumstances have changed then he should discuss with concerned parties and decide course of action, including, if necessary, withdrawal from the engagement. This is an area where the judgment of the practitioner needs to be exercised with due professional skepticism.

Materiality needs to be factored during planning stage itself. It may be noted that materiality is not affected by level of assurance – reasonable or limited; materiality is the same. Both qualitative and quantitative factors are to be considered in determining materiality.

Having done the above the next execution steps involve making inquiries for an understanding of the underlying subject matter. These incude, any knowledge of actual, suspected or alleged intentional mis-statement, any knowledge of non-compliance of law and regulations affecting subject matter, existence of internal audit & work done by them with regard to the subject matter and whether work was done by experts. Basis the above findings the practitioner needs to determine the kind of evidences required to be obtained. The practitioner also needs to determine if any additional procedures are required to be done. In doing so the quality of evidence is to be determined by considering the consistency between evidences from different sources as well as the reliability of the evidence.

The practitioner can engage an expert to perform some tasks. In such a case the practitioner needs to be satisfied with the capability of the expert to deliver the task. The terms with the expert need to be agreed upon in writing. Once the task is executed the practitioner needs to evaluate the work done by the expert and determine whether sufficient objectivity is involved therein. Similarly, if the work is performed by someone other than the practitioner's expert then the steps to be followed are on lines similar to the ones if the practitioner had engaged his own expert. These others could be another practitioner, the responsible party's or measurer's or evaluator's expert or the internal auditor.

The practitioner needs to obtain written representations. The representations should expressly state that all information relevant to the engagement has been provided and confirming the measurement or evaluation of the underlying subject matter. The material representations are to be evaluated against evidences obtained. The practitioner should also determine that the persons making representations are well informed on the subject matter. If written representations are not provided or not reliable, then practitioner should re-evaluate and if necessary re-perform some or all of the tasks.

The practitioner also needs to determine whether any subsequent events have an impact on the subject matter and the assurance report. The practitioner needs to respond appropriately to the facts that become known after the date of the assurance report, that, had they been known to the practitioner at that date, may have caused the practitioner to amend the report or reach a different conclusion. However, once assurance report is issued there is no responsibility of performing any procedures.

In case the subject matter information is accompanied by other information (OI) then the practitioner has to read the same and determine whether there is any material inconsistency between OI and the assurance report or material misstatement of facts in OI. If he finds there is material inconsistency then he needs to discuss with appropriate parties and take further appropriate action.

The practitioner is also required to determine whether the subject matter information adequately refers to or describes the applicable criteria. Such description advises intended users of the framework on which subject matter information is based. Such description is considered adequate only if the subject matter information complies with all relevant requirements of those applicable criteria that are effective. A substantial compliance or a qualified compliance is not adequate description of compliance.

The final step before issuance of report for the practitioner is to form the assurance opinion or the conclusion, as the case may be. The practitioner needs to evaluate the sufficiency and appropriateness of the evidence obtained as also evaluate whether uncorrected mis-statements are material, individual or in aggregate. The evidence has to emanate from the procedures performed by the practitioner as also placing reliance on information from other sources, such as prior engagements. It may be noted that evidence comprises both information that supports and corroborates aspects of the subject matter information, and any information that contradicts aspects of the subject matter information. Based on all these procedures the practitioner has to form the assurance opinion/reach the conclusion.

The Report

Once all the above procedures are performed the practitioner commences preparing the report. The GN requires the report to be written and containing a clear expression of the practitioner's opinion/conclusion. The GN does not prescribe a format but identifies the basic elements necessary to be included in the report and permits the usage of headings, paragraph numbers, bold or italics text to enhance clarity & readability.

The basic elements of a report are:-

- Title
- Addressee

- Identification or description of level of assurance, subject matter information and when appropriate, the underlying subject matter
- Identification of the applicable criteria
- Any significant inherent limitations
- Identify the responsible party and the measurer or evaluator, if different and describe their responsibilities and the Practitioners
- State that engagement was performed in accordance with the GN
- State that SQC 1 has been applied
- State that Practitioner is independent and complies with Code of Ethics
- Informative summary of work performed
- Opinion/Conclusion → Forms of expression which may be useful for underlying subject matters include, for example, one, or a combination of, the following:–
  - For compliance engagements– **"in compliance with"** or **"in accordance with."**
  - For engagements when the applicable criteria describe a process or methodology for the preparation or presentation of the subject matter information–**"properly prepared."**
  - For engagement when the principles of fair presentation are embodied in the applicable criteria–**"fairly stated."**

In case the opinion/conclusion is modified then the report needs to describe the modification and clearly state the modified opinion/conclusion. The modification could be a qualified, adverse or disclaimed opinion. There may also be an EoM included in the report, which also needs to be distinct from the opinion/conclusion.

In case the report carries a reference to the practitioner's expert then it should not imply that practitioner's responsibility is reduced.

Finally, the signature block of the report should include the practitioner's signature – firm name, partner name, firm registration number, partner membership number, UDIN and the date of the report.

The practitioner has to determine whether, pursuant to the terms of engagement and other engagement circumstances, any matter that come to attention that needs to be communicated to the recipient of the report.

Documentation

The GN requires the practitioner to maintain adequate documentation of the procedures performed. The documentation needs to include the nature, timing and extent of the procedures performed to comply with the GN and applicable legal and regulatory requirements; results of the procedures performed, and the evidence obtained; and significant matters arising during the engagement, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. The documentation should comply with SQC 1 – timely completion of the assembly of engagement files, which is ordinarily 60 days and needs to be retained for no shorter than 7 years from completion of the engagement.

The GN ends with a glossary of terms (Appendix 1) and illustrative formats (Appendix 2).

All in all, the GN encapsulates in detail the requirements on the practitioner while issuing reports and certificates for special purposes and not covered by any SA or SRE. In substance the GN has captured the principles of the various SAs, SREs and the Framework for Assurance Engagements. It is up to us, the practitioners, to apply the GN in word and in spirit and produce reports and certificates that can be placed reliance upon by the intended users to take economic decision.

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BEST OF THE REST

Rahul Sarda,
Advocate

Whether the parties can adduce additional evidence to prove the specified grounds in an application for setting aside the Award under section 34 of the Arbitration Act?

Respondent Nos. 1 & 2 had obtained loan from the Appellants. They failed to repay the loan amount. Certain disputes arose between them. The same were referred to arbitration. The Ld. Arbitrator passed an award and directed the Respondents to repay the loan amount along with interest thereon.

The Respondents challenged the Award before the Trial Court and filed an application under Section 151 of CPC to adduce additional evidence. The Trial Court by its order rejected the said application and held that there was no necessity of adducing fresh evidence as the grounds stated in the said application were already dealt with in the arbitration proceedings and the Award.

The Respondents challenged the order before the High Court. The Court relied upon certain authorities and on the basis of the same allowed the writ petitions filed by the Respondent. The Court directed the Trial Court to recast the issues and permit Respondent Nos. 1 & 2 to file their affidavits to place their evidence.

The Appellants challenged the said order in the Apex Court. The arguments advanced on behalf of the Appellants were that the proceedings under Section 34 are summary in nature and the scope of the said proceedings is limited. Further, the scope for adducing fresh evidence does not arise as the validity of the Award has to be decided on the basis of the materials produced before the arbitrator.

The argument advanced on behalf of the Respondents was that in order to prove the ground stated in the application it was necessary to adduce additional evidence. They will have to plead and prove the grounds mentioned in Section 34(2) of the Act for which adducing additional evidence was necessary. The rule of the High Court that the all the proceedings of CPC shall apply to such proceedings was pointed out by the Counsel.

The Apex Court observed that the rule of the High Court was only procedural in nature and if the same was taken into consideration the same will defeat the very purpose of the Act. In a previous decision of the Apex Court, it was

held that an opportunity has to be afforded to prove existence of any grounds u/s. 34(2). Further, Section 34(5) & (6) provides that the application under this section can be filed by the aggrieved party only after giving proper notice to the other party and the said application has to be disposed off within a period of one year. Also, Section 34 has been amended in 2019 which now reads as 'establishes on the basis of the record of the Arbitral Tribunal that' instead of 'further proofs that'. It is settled position that Section 34 application will not require anything beyond the record that was before the arbitrator. Further cross-examination of the persons should not be allowed unless necessary. In the present case the Respondent did not mention any grounds that it is an exceptional case in order to permit them to adduce evidence. There is no disclosure of specific documents by the Respondent. A conjoint reading of the previous authorities' along with Sections 34(5) & 34(6) and the amendment to Section 34 was taken into consideration by the Apex Court. Accordingly, the impugned order of the High Court was set aside in view of the aforesaid observations.

M/s. Canara Nidhi Limited vs. M. Shashikala & Ors., Civil Appeal No. 7544-45 of 2019, dated 23-9-2019, Supreme Court.

Whether specific performance of an illegal Agreement to sell can be enforced?

One Mr. Venkatramanappa was granted a piece of property i.e. suit property. As per the grant certificate there was bar of 15 years on alienation of suit property. Mr. Venkatramappa obtained a loan by mortgaging the suit property through a registered mortgage deed. However, he entered into an agreement to sell the property with the Plaintiff on 15-5-1990. The plaintiff filed a suit for specific performance of the said agreement. The Trial Judge held that the agreement was entered into between the parties in the period when the bar on alienation was operative. It was held that the agreement was void and non-executable and hence the suit filed was not maintainable.

Plaintiff challenged said order before the First Appellate Court. The Court observed that the Plaintiff had already paid entire consideration in respect of the suit property. The Plaintiff was already put into the possession of the suit property. The appeal was allowed by holding that the non-alienation clause prohibits alienation is not apt.

The wife, son and daughter of Mr. Venkatramanappa filed appeals before the Second High Court. The two grounds of appeal raised by the Defendants were that the suit was barred by limitation and the agreement was not enforceable as per the provisions of Section 61 of the Karnataka Lands Reform Act. *The said section starts with a non-obstante clause and it provides that no land of which the occupancy has been granted to any person shall within period of 15 years from the date of the final order of the Tribunal be transferred by sale, gift, exchange, mortgage, lease or assignment but the land may be partitioned among members of the holder's joint family.*

The High Court held that the Trial Court ought to have framed an issue with regard to readiness and willingness of the Plaintiff to perform his part of the contract. Moreover the Defendants did not contest the suit either by appearing in the matter or filing their written statement, therefore the finding of the First Appellate Court was right in law.

Being aggrieved by the order, the Defendants approached the Supreme Court. It was argued on behalf of the Defendants that in view of the provisions of the Section 61 of the Act, the predecessor-in-interest could not have transferred

the suit property and hence the agreement to sell was void in law. Therefore, the same was not enforceable. It was submitted that the finding of the Trial Court was correct in law.

Whereas, on behalf of the Plaintiff, it was argued that the said section would only prohibit sale, gift, exchange, mortgage, lease or assignment and would not prohibit an agreement to sell. It was also pointed out that though the agreement to sell was executed during the bar of 15 years, the same would become enforceable after the expiry of the said period. The limited question before the Court was whether the agreement to sell was valid or not. The Court minutely observed the provisions of Section 61 of the Act. The Court considered various ratios on a latin maxim *'ex turpi causa non orituraction'* i.e., a plaintiff will be unable to pursue legal remedy if it arises in connection with his own illegal act. According to one of the ratios, the correct position in law is that one has to see whether the illegality goes so much to the root of the matter that the Plaintiff cannot bring his action without relying upon the illegal transaction into which he had entered. ***The right of action cannot arise out of fraud or out of transgression of law.***

The Court also observed that when both the parties are confederates in the fraud, the Court will have to find out which approach would be less injurious to public interest. Further, where both the parties are equally guilty and fraud intended by them had been carried out, the party raising the defence is not asking the Court's assistance in any active manner. *It was observed by this Court in one authority, that although illegality is not pleaded by the Defendant nor relied upon him by way of defence, the court itself, upon illegality appearing upon the evidence will take notice of it and dismiss the action.*

Therefore, it was held by the Court that the claim of the Plaintiff was entirely based upon the agreement to sell which was hit by Section 61 of the Act. The Court held that the Trial Court rightly dismissed the suit filed by the Plaintiff.

Smt. Narayanamma & Anr. etc. etc. vs. Sri Govindappa & Ors. etc. etc., Civil Appeal Nos. 7630-31 of 2019, dated 26th September 2019, Supreme Court.

Whether an NGO substantially financed by Government is covered under the purview of the Right to Information Act, 2005?

The question before the Court was whether a non-governmental organisation substantially funded by the Government was covered under public authority as mentioned in section 2(h) of the RTI Act, 2005. For considering the said question the Court carefully observed the definition of public authority as contained in Section 2(h) of the Act which reads as "public authority" means any authority or body or institution of self-Government established or constituted – (a) by or under the Constitution; (b) by any other law made by Parliament; (c) by any other law made by State Legislature; (d) by notification issued or order made by the appropriate Government, and includes any – (i) body owned, Controlled or substantially financed; (ii) non-government organisation substantially financed directly or indirectly by funds provided by the appropriate Government.

The arguments advanced on behalf of the Appellants were two fold firstly that all colleges and associations running the colleges and/or schools and it was their contention that NGO are not covered under the Act. Secondly, the appellants were not substantially financed. Also, unless a notification is issued notifying that an authority, body or institution of self-Government is brought within the ambit of the Act, the said Act would not apply.

The arguments advanced on behalf of the Respondents were that the reading of section 2(h) clearly shows that in addition to four categories referred in the first part there is an inclusive portion in the second part.

The Court observed the definition and relied upon ratios of this Court which decided when a definition can be termed as exhaustive or restrictive. ***When a word is defined to "mean" something, the definition is prima facie restrictive and where the word is defined to "include" some other thing, the definition is prima facie extensive.*** But when both the expressions "means" and "includes" are used, the categories mentioned there would exhaust themselves. It is a well-settled statutory rule of interpretation that when in the definition clause a meaning is given to certain words then that meaning alone will have to be given to those words. The definition was therefore exhaustive and complete.

The Court observed that after the end of clause (d) there is a comma and a big gap and then the definition goes on to say 'and includes any –' and thereafter the definition contains the second part. The second part of the definition is an inclusive clause which indicates the intention of the Legislature to cover bodies other than those mentioned in clauses (a) to (d) of Section 2(h). As far as sub-clause (ii) is concerned, it is only a question of financing that is relevant.

The Court also observed that the provision should be construed in such a manner to ensure that the object of the Act is fulfilled. If the language of the Act is clear then the language has to be followed, and the Court cannot give its own interpretation. However, if the language admits of two meanings then the court can refer to the Objects and Reasons, and find out the true meaning of the provisions as intended by the authors of the enactment. The Court thoroughly observed the word substantially on the basis of various ratios.

The Court held that Section 2(h) deals with six different categories and the two additional categories are mentioned in sub-clauses (i) and (ii). Any other interpretation would make clauses (i) and (ii) totally redundant because then an NGO could never be covered. Further, majority of the funding of the Appellants were through the Government hence it was safely concluded that it was sufficiently funded by government. It was held therefore that an NGO substantially financed, directly or indirectly, by funds provided by the appropriate government would be a public authority amenable to the provisions of the Act.

D. A. V. College Trust and Management Society & Ors. vs. Director of Public Instructions & Ors., Civil Appeal Nos. 9828, 9844-45, 9846-57, 9860 of 2013, dated 17th September 2019, Supreme Court.

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My 2020 Vision for India is to transform it into a developed nation. That cannot be abstract; it is a lifeline.

– A. P. J. Abdul Kalam

THE CHAMBER NEWS

CA Ketan L. Vajani & CA Haresh P. Kenia,
Hon. Jt. Secretaries

Important events and happenings that took place between 1st October 2019 to 31st October, 2019 are being reported as under:

I. ADMISSION OF NEW MEMBERS

1) The details of new members which were admitted in the Managing Council Meeting held on 15th October, 2019 are as under:–

Type of Membership	No. of Members
Life Member	15
Ordinary Member	20
Student Member	4
Associate Member	2

II. PAST PROGRAMMES

1. INTERNATIONAL TAXATION COMMITTEE

Four days MLI Course – Implementation & Beyond and Impact on Indian Treaties was held on 4th, 5th, 11th & 12th October, 2019 at Hotel West End, Churchgate. Shri Shahi Sanjay Kumar, CIT (International Taxation-4) delivered Keynote address at the Course. The course was addressed by CA T. P. Ostwal, CA Vispi Patel, CA Hariharan Gangadharan, CA Rashmin Sanghvi, CA Karishma Phatarphekar, CA Naresh Ajwani, Dr. Vinay Kumar Singh, CA Geeta Jani, CA Vishal Gada, CA Nilesh Kapadia, CA Gautam Doshi, CA Anish Thacker, CA Yogesh

Thar, CA Radhakishan Rawal, CA Vishal J. Shah and Mr. Himanshu Tanna. The course was chaired by CA H. Padamchand Khincha and the panelists were Mr. Rahul Navin, CA Vishal J. Shah.

2. DIRECT TAXES COMMITTEE

Lecture Meeting on "Tackling the Assessment proceedings pertaining to Demonitisation" was held on 11th October, 2019 at Walchand Hall, 4th Floor, IMC, Churchgate. The meeting was addressed by CA Jagdish Punjabi. The meeting was live web cast for the benefit of members at large.

Half day Workshop on Prosecution under the Income Tax Act was held on 19th October, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churchgate. The workshop was addressed by Mr. Beni Chatterji, Senior Advocate, Mr. Mandar Vaidya, Advocate and Mr. Gautam Tambe, Advocate.

(For details of the future programs, kindly visit www.ctconline.org or refer The CTC News of November, 2019)

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What difference does it make to the dead, the orphans, and the homeless, whether the mad destruction is wrought under the name of totalitarianism or the holy name of liberty or democracy?

– Mahatma Gandhi

Where can we go to find God if we cannot see Him in our own hearts and in every living being.

– Swami Vivekananda

Teaching is a very noble profession that shapes the character, caliber, and future of an individual. If the people remember me as a good teacher, that will be the biggest honour for me.

– A. P. J. Abdul Kalam

Indirect Taxes Committee

IDT Study Circle Meeting on "Issues in Input Tax Credit under GST Law" was held on 3rd October, 2019 at AV Room, 4th Floor, Jai Hind College, Churchgate

Mr. Bharat Raichandani (Session Chairman) addressing the delegates

CA Parth Shah addressing the delegates

Webinar on "Recent developments in GST" was held on 22nd October, 2019

CA Rajiv Luthia addressing the delegates

International Taxation Committee

FEMA Study Circle Meeting on "Discussion on Master Direction on ECB Regulations with case studies" was held on 10th October, 2019 at Chamber's Conference Room

CA Shabbir Motorwala (Session Chairman) addressing the delegates

CA Mitali Pakle addressing the delegates

Study Circle & Study Group Committee

Study Circle Meeting on "Impact of the Taxation Laws (Amendments) Ordinance 2019 and exploring avenues for Restructuring Business" was held on 9th October, 2019 at Walchand Hall, 4th Floor, IMC, Churchgate

CA Yogesh Thar (Session Chairman) addressing the delegates

CA Abhitan Mehta addressing the delegates

Direct Taxes Committee

Lecture Meeting on "Tackling the Assessment proceedings pertaining to Demonitisation" was held on 11th October, 2019 at Walchand Hall, 4th Floor, IMC, Churchgate

CA Vipul K. Choksi (President) giving his opening remarks. Seen from L to R: Mr. Devendra Jain, Advocate (Chairman), CA Jagdish Punjabi (Speaker) and CA Viraj Shah (Convenor)

Mr. Devendra Jain, Advocate welcoming the speaker

CA Jagdish Punjabi addressing the delegates

ISG on "Recent important decisions under Direct Taxes" was held on 14th October, 2019 at Chamber's Conference Room

Mr. Jitendra Singh, Advocate addressing the delegates

Pune Study Group

Pune Study Group meeting on "Prosecution under Income Tax, Theory and practice including new Compounding Guidelines" was held on 12th October, 2019 at ELTIS, Plot No. 419, Model Colony, Gokhale Cross Road, Next to Atur Centre, Pune-411 016

Mr. Ajay Singh, Advocate addressing the delegates

Commercial & Allied Laws Committee

SC on "Issues arising in registration of Intellectual property rights & law on infringement of intellectual property rights" was held on 18th October, 2019 Chamber's Conference Room

Mr. Hiren Kamod, Advocate addressing the delegates

Bengaluru Study Group

Bengaluru SG Meeting on "Case studies on MLI" was held on 23rd October, 2019 at FKCCI, 3rd Floor, Hall No. 4, K. G. Road, Bengaluru-560 009

CA H. Padamchand Khincha addressing the delegates

CA K. K. Chythanya addressing the delegates

Direct Taxes Committee

Half day Workshop on Prosecution under the Income-tax Act was held on 19th October, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churchgate.

CA Anish Thacker (Vice-President) giving his opening remarks.

Mr. Devendra Jain, Advocate (Chairman) welcoming the speakers

Mr. Beni Chatterji, Senior Advocate addressing the advocates

Mr. Mandar Vaidya, Advocate addressing the advocates

Mr. Gautam Tambe, Advocate addressing the advocates

International Taxation Committee

Four days MLI Course – Implementation & Beyond and Impact on Indian Treaties was held on 4th, 5th, 11th and 12th October, 2019 at West End Hotel, Churchgate

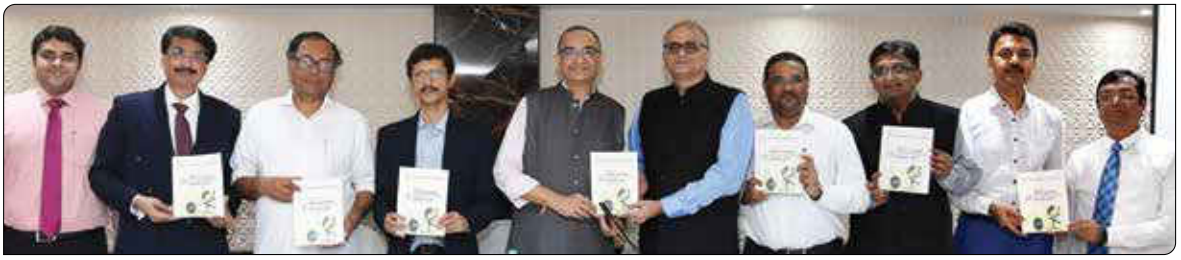
Inaugural session. Seen from L to R: CA Siddharth Parekh (Member), Shri Shahi Sanjay Kumar, Commissioner of Income Tax – International Taxation, Mumbai (Key Note Speaker), CA Rajesh L. Shah (Chairman), CA Anish M. Thacker (Vice President), CA Vipul K. Choksi (President) and CA Haresh P. Kenia (Hon. Jt. Secretary)

CA Vipul K. Choksi (President) giving his opening remarks. Seen from L to R: CA Rajesh L. Shah (Chairman), Shri Shahi Sanjay Kumar, Commissioner of Income Tax – International Taxation, Mumbai (Key Note Speaker) and CA Anish M. Thacker (Vice President)

CA Rajesh L. Shah (Chairman) welcoming the Speakers

Shri Shahi Sanjay Kumar, Commissioner of Income Tax – International Taxation, Mumbai delivering his key note address. Seen from L to R: CA Rajesh L. Shah (Chairman), CA Vipul K. Choksi (President), CA Anish M. Thacker (Vice President) and CA Siddharth Parekh (Member)

Publication Release



Dr. Vinay Kumar Singh releasing the publication "Analysis of Sabka Vishwas (Legacy Dispute Resolution) Scheme, 2019". Seen from L to R: CA Sunit Jhunjhunwala, CA Pranav Kapadia, CA Rashmin Sanghvi, CA Vipul K. Choksi (President), CA Anish M. Thacker (Vice-President), CA Naresh Sheth, CA Atul Mehta, CA Manoj Shah and CA Haresh Kenia (Hon. Jt. Secretary)

Faculties– MLI Course

CA T. P. Ostwal

CA Vispi Patel

CA Hariharan Gangadharan

CA Karishma Phatarphekar

CA Naresh Ajwani

Dr. Vinay Kumar Singh

CA Rashmin Sanghvi

CA Geeta Jani

CA Vishal Gada

CA Nilesh Kapadia

Panelist CA Anish Thacker and Panelist CA Yogesh Thar addressing the panel discussion. Seen from L to R: CA Namrata Dedhia (Member), CA Rajesh L. Shah (Chairman) and CA Ronak Doshi (Convenor)

CA Radhakishan Rawal

CA Himanshu Tanna

CA Vishal J. Shah

Session Chairman CA H. Padamchand Khincha, Panelist CA Vishal J. Shah and Panelist Mr. Rahul Navin and addressing the panel discussion. Seen from L to R: CA Jimit Devani (Member), CA Rajesh L. Shah (Chairman) and CA D. S. Sharma (Member)

Dussehra Puja

Dussehra Puja was organised at Chamber's office on 7th October, 2019

Chamber's Diwali Celebration

THE CHAMBER'S JOURNAL
Posted at the Mumbai Patrika Channel Sorting Office, Mumbai 400 001.
Date of Posting: 15th-16th of Every Month
No. MCS/149/2019-21
R.N.I. No. MAHENG/2012/47041
Date of Publishing 12th of Every Month

Printed and Published by Shri Kishor D. Vanjara on behalf of The Chamber of Tax Consultants, 3 Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai - 400 020 and Printed at Finesse Graphics & Prints Pvt. Ltd., 309 Parvati Industrial Premises, Sun Mill Compound, Lower Parel (W), Mumbai - 400 013. Tel.: 4036 4600 and published at The Chamber of Tax Consultants, 3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai - 400 020. Editor : Vipul B. Joshi