KARNATAKA STATE OPEN UNIVERSITY

Mukthagangothri, Mysore – 570 006

M.B.A.

MASTER OF BUSINESS ADMINISTRATION

FOURTH SEMESTER

CORPORATE TAXATION LAW

COURSE: MBSC-4.3F **BLOCK: 1 TO 4**

DEPARTMENT OF STUDIES AND RESEARCH IN MANAGEMENT

KARNATAKA STATE OPEN UNIVERSITY

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CORPORATE TAXATION LAW

BLOCK-3

BLOCK-4

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Course Name : Corporate Taxation Law **Credit : 04** **Units No: 1 to 20**

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Developed by the Department of Studies and Research in Management, KSOU, under the guidance of Dean (Academic), KSOU, Mysuru

Karnataka State Open University, November-2022

Further information on the Karnataka State Open University Programmes may obtained from the University's office at Mukthagangothri, Mysuru-570006

Printed and Published on behalf of Karnataka State Open University. Mysuru-570006 by **Registrar (Administration)-2022**

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BLOCK-1

UNIT – 1: CONCEPT OF TAXATION – HISTORICAL EVOLUTION OF TAX LAW IN INDIA – REASONS FOR TAXATION – CLASSIFICATION OF TAXING SYSTEMS

Structure:

1.0 Objectives

1.1 Introduction

1.2 Classification of tax

- 1.2.1 Ideologies of taxation
- 1.2.2 Cannons of taxation

1.3 Historical Evaluation of tax Law in India

- 1.3.1 Taxation in Ancient India
- 1.3.2 Taxation in the Per-Independence/ British Administration
- 1.3.3 Taxation In the Post- Independence ERA
- 1.3.4 Salient features of the Indian taxation Policy

1.4 Summary

1.5 Key Words

1.6 Self Assessment Questions

1.7 Reference

1.0 OBJECTIVES

- To Understand the concept of Taxation
- To learn the History and Evolution of Taxation in India
- To know the characteristics of various kinds of tax
- To gain an insight to the various Taxing Systems

1.1 INTRODUCTION

Tax is a financial charge imposed by the Government on Income, Commodity or Activity. Taxation in India is primarily comprised of two policy-structures, viz. Direct Tax and Indirect Tax. Revenue raised from the taxes are utilized for meeting the expense of Government like, provision of education, infrastructure facilities such as roads, dams etc. It plays a pivotal role in removal of economic disparities and also takes primacy as a prominent source of revenue to the Government. Taxes are collected for serving the primary purpose of providing sufficient revenues to the State; taxes have come to be recognised as an instrument through which the social and economic objectives of a welfare State could be achieved. They are utilized now for providing incentives for larger earnings and more savings, fostering industrial development by selective concessions, restraining ostentatious expenditure, checking inflationary pressures and achieving social objectives like inequalities and the enlargement of opportunities to the common man.

For a strong administration by the Government, the government needs to collect funds and generate revenue from various sources from the public and the people. Thus over the period of years, the Indian Government has established various Acts, schemes to raise revenue. Taxation is the process of collecting taxes and revenue by the sovereign machinery, the central and State Governments in order to raise public funds to meet the needs of the taxpayer.

Taxes may be broadly divided into two parts i.e. direct taxes and indirect taxes. The tax that is levied directly on the income or wealth of a person is called direct tax. Direct tax is one where burden of tax is directly on the payer e.g income tax, wealth tax etc. Indirect tax is paid by the person other than the person who utilizes the product or service e.g Excise duty, Custom duty, Service tax, Sales Tax, Value Added Tax.

1.2 CLASSIFICATION OF TAX

Taxes are levied from the people or taxpayers on various commodities and services. This practice started since the ancient times and some of the commodities from which taxes were being levied on since the ancient times are salt, liquor, tobacco etc. Government also raises revenue from taxes levied on imported and exported goods and services. The largest and second largest revenue received by the Government is contributed through excise duty and customs duty. At present times, taxes are being levied to not only meet the revenue purposes but also to achieve the planned objectives of economic development.

With the emergence of sovereign states, constitutional requirements for a mandatory taxation system, changing social and economic conditions impacted by the norms, and ethics of society, planned economic development; the scope and purpose of taxation has varied from time to time. As a result, it is essential to learn the nature of the system of tax followed in India with particular reference to the Income Tax.

GENERAL CLASSIFICATION

A. **DIRECT TAXES:** These are the taxes imposed by the Government directly on the individual or organization. Direct tax cannot be shifted to another individual or entity. This tax is payable only by the individual or organization on who it is imposed. Incidence and impact of tax is on the same person. Some direct taxes paid by taxpayers are, personal property tax, property tax , taxes on assets, income tax etc.

The Direct Taxes are further sub-divided into various divisions on the basis of charge, as provided hereunder:

i. TAX ON INCOME- Income tax is governed by the Income Tax Act, 1961.
ii. TAX ON CAPITAL: It may take either of the following forms:
    - Wealth tax- Possessing the capital or tax payable on net wealth of all household assets. It is regulated by Wealth Tax Act, 1957.
    - Gift Tax- Tax imposed on an individual who gives cash or property to another individual. The gift tax is paid by the individual who parts with the wealth. Gift tax is regulated by The Gift Tax Act, 1958.
    - Estate duty- Tax levied based on the total market value of the individuals assets at the date of the individual’s death. It is regulated under The Estate Duty Act, 1953.
iii. TAX ON EXPENDITURE- Taxes based on consumption. Governed by Expenditure Tax Act, 1987.

B. **INDIRECT TAXES**: These are the taxes imposed by the Government on transactions. It is levied from an intermediary, such as, a restaurant owner, but paid by the taxpayer, such as, the customer who visits the restaurant. Indirect taxes can be shifted to another taxpayer. The intermediaries increase the price of the good so that the customers pay for the tax along with payment for good. Incidence of tax is on the intermediary and impact of tax is on taxpayer, thus incidence and impact are on two different persons. Some indirect taxes paid by taxpayers are sales tax paid by the buyer in a retail business, service tax, customs duty, value added tax etc.

This form of tax is also classified under various compartments on the basis of charge or levy, as provided hereunder:

i. **CUSTOMS DUTY**- Tax on the goods imported from abroad - Governed by the Customs Act, 1962 and Customs Tariff Act, 1975.

ii. **EXCISE DUTY-** Tax on manufacture or production of goods)– Excise duty is governed by the Central Excise Act,1944; Central Excise Tariff Act, 1985 and Rules like Central Excise Rules, Central excise Valuation Rules etc., made under this Act.

iii. **SALES TAX-**Tax on selling or sale of good: It is regulated by Central Sales Tax Act, 1956 and Rules made under this Act.

CLASSIFICATION BASED ON CHARACTER:

This form of classification is purely practical in nature. It takes into consideration the effect of the tax policy on the economy and classifies taxes as either Progressive, or Regressive or Proportionate.

A. Progressive Tax- Under this form of tax, Government imposes a higher percentage of tax from the individual who receives a greater income. This form of tax follows the common ideology of the rich paying more than the poor. E.g.: Graduated rates of tax slab system i.e., 10 percent up to ₹ 10,000 income; 20 percent from ₹ 10,000 to ₹ 30,000; 30 percent from ₹ 30,000 to ₹ 50,000 etc.

B. Regressive Tax-Under this form of tax, Government imposes a higher percentage of tax from the individual who receives a low income. E.g. Taxes on match boxes, groceries etc.

C. Proportionate Tax- Under this form of tax, Government imposes tax which is proportionate to the individual’s income. There will be an increase in the rate of tax when the income of the individual increases. This tax is levied irrespective of whether the person is rich or poor. E.g. Flat rate of 15% taxable income.

1.2.1 Ideologies of taxation

Several Authors, in explaining the principles of taxation have referred to the various ideologies on basis of which tax is collected.

I. IDEOLOGY IN DIRECT TAXES[1]

A. IDEOLOGY OF ABILITY- This principle states that taxes must be levied from taxpayers in accordance with their ability to pay and this ability to pay is measured in terms of their income or wealth. The progressive taxation policy wherein more tax should be levied from taxpayers with greater income or wealth. The 'units' of economic power (income and wealth, viz.Ability) can be measured as the sum of the following:

- The market value of the goods or services used up by the tax unit during the year to satisfy the wants (consumption).
- The market value of goods or services given to other tax units during the year (gifts).
- The change over the year in the market value of the total net assets held by the tax unit (current saving change in net worth = change in wealth).

The progressive taxation policy is justified on the grounds that it will reduce economic inequality, as such it is treated as an objective in itself. Adam Smith, in his treatise, 'An Enquiry into the Nature & Causes of Wealth of Nations', observed that, in favour of Progressive Taxation, "The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state."[2]

According to Henry Simons, the need for a progression in taxation is a primary step against inequality on the ethical or aesthetic judgement that the prevailing, distribution of wealth and income reveals a degree of inequality which is distinctly evil. Apart from the aesthetic and ethical reasons, reduction in inequality or the prevention of excessive growth of inequality' has long been regarded as desirable as a means of avoiding concentration of political power, envy and unrest and as helpful in the maintenance of a democratic society.[3]

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[1] Frank Sander and David Westfall: 'Readings in Federal Taxation'. The foundation Press. New York, p- 61- 63.
[2]Smith, An Enquiry into the Nature & Causes of Wealth of Nations p-347.
[3] Richard Goode, The Corporation Income Tax, 23 (1951), p- 200.

B. IDEOLOGY OF BARRIERS AND DETERRENTS- this principle states that progressive income tax would diminish the motivation and desire to work, would fail to provide and incentive for investment and would obstruct the resources of new capital. Thus these barriers and deterrents should be removed. This ideology states that individuals need to be levied proportionately and on the basis of the benefits they get from the Government.

Eisenstein provides that the progressive rates of taxation is dangerous to the economy as it dangerously reduces the motivation to work, discourages the incentive to invest and earn greater rewards and lastly impairs the source of capital.[4]

C. IDEOLOGY OF EQUITY- This ideology speaks of the principle of equality. Individuals in similar situations should be taxed similarly and those who are in different situations should be treated differently. Thus people who are wealthy should pay more but not at a higher rate than levied from others of the same kind. Taxation equity may be classified into horizontal equity, where people who are in the same economic position should be taxed the same, and vertical equity, where those who differ economically should be treated differently. Horizontal equity in taxation underlies the basic principle of equality so that ‘like people are treated alike’ by imposing similar tax burdens on taxpayers with similar means. It is to be borne in mind when considering horizontal equity is who is being compared and under what circumstances, whereas, Vertical equity refers to taxation on the basis of ability to pay.

II. IDEOLOGY IN INDIRECT TAXES

Similarly various ideologies play a role in the collection of indirect taxes as well. Indirect taxes are essentially collected without the knowledge of the person paying it, thus the term ‘indirect tax’. It is also known as ‘Consumption Tax’ and hence one who consumes more, pays more taxes. The objection to this ideology of ability of consumption determines ability for paying taxes, is that, people with lesser income spend a substantial portion of their income for subsistence than richer people. Another ideology is efficiency in collecting taxes. Comparatively speaking the collection cost of indirect taxes is insignificant in comparison with direct taxes, although it is argued upon that economy by itself cannot be an ideology.

Governments adopt the different ideologies in their taxation system, while keeping in mind that the fundamental principle in a strong taxation system is that the tax must be neutral.

1.2.2 <u>Cannons of taxation</u>

[4] Mathew, Making People Pay: The Economic Sociology of Taxation, p- 77.

Adam Smith, founding father of classical economics has prescribed the following four canons of taxation:

A. CANNON OF ABILITY- According to Adam Smith, “Everyone should have to support the Government, according to his ability, that is, in proportion to the revenue (income) which he enjoys.” Thus the ability to pay is measured by the person’s income or wealth. It follows the progressive income tax theory wherein more tax should be levied from taxpayers with greater income or wealth.
B. CANNON OF CERTAINTY- This cannon states that taxes must be certain and well defined and not arbitrary. Thus the individual should know how much, for what purpose and when he is to pay the tax. It causes great burden on both the individuals as well as the Government if the taxes are not certain.
C. CANNON OF CONVENIENCE- The principle states that taxes must be imposed on the taxpayers at utmost convenience, when the burden of paying taxes is not noticed or felt by them. For example land revenue in India is imposed after the harvest has been collected by the cultivators.
D. CANNON OF ECONOMY- This principle states that the costs incurred while collecting taxes should be minimum. If the costs of collection are more, the State receives very less revenue although it imposes higher taxes from the taxpayers.

Neo-classical and modern economists have added more cannons of taxation apart from the cannons by Adam Smith taking into account the changing economy and active participation by the Government. The following cannons are:

A. CANNON OF PRODUCTIVITY-The principle states that taxes should be imposed and categorized in a way such that it brings back maximum revenue and it does not discourage production.
B. CANNON OF ELASTICITY- This cannon state that taxation must be flexible so as to adapt and adjust accordingly to the Governments requirements.
C. CANNON OF SIMPLICITY-The principle states that tax laws must be simple and clear. This helps the taxpayers pay taxes promptly and quickly without any harassment.

The cannons that are chiefly practiced by most Governments for its economic development are those of Equity and Productivity. The Government uses income tax as the ideal tax to achieve these two cannons. Cannon of equity forms the basis for progressive taxation to become the main policy of the Government. For example if ‘A’ receives an annual income of 10000 ₹ and ‘B’ receives an annual income of ₹ 20000. Then the

Government should impose a higher rate of tax on ‘B’ as compared to ‘A’, say, 10% for ‘A’ and 20% for ‘B’. According to cannon of equity ‘B’ will pay a higher income tax and also a progressively higher fraction of income as compared to ’A’. This allows equal treatment to both ‘A’ and ‘B’. This principle also helps the Government to reduce inequalities of income. In regards to this principle, Prof. Henry C. Simons, eminent economist quotes ‘The case of drastic progress in taxation must be rested on the case against inequality, on the ethical or aesthetic judgment that the prevailing distribution of wealth and income reveals a degree (and or kind) of inequality which is distinctly evil or unlovely”.[5] To conclude people with similar income should pay similar taxes and people with different income should pay different taxes.

1.3 HISTORICAL EVOLUTION OF TAX LAW IN INDIA

The system of taxation is pertinent for the development of a country. The fundamental nature of instituting tax policies is to generate funds and finance which the government requires to maintain and facilitate the public goods and services like street lighting, pavements of footpaths, clean roads etc. The development of a system of taxation in India dates back to as early as 4th century B.C.

Therefore the study of its evolution can be better understood under three stages, viz. Firstly, The Ancient Age; Secondly, The Pre-Independence Era and Lastly, The Post-Independence Era.

1.3.1. Taxation in Ancient India

In India, the tradition of taxation finds its roots traced back to the ancient times. Most of the taxes of Ancient India were highly productive. The admixture of direct taxes with indirect taxes secured elasticity in the tax system, although more emphasis was laid on direct tax. The tax structure was a broad-based one and covered most people within its fold. The taxes were varied and the large variety of taxes reflected the life of a composite population.[6] References of the practice of levying taxes from the people have been illustrated and found in various ancient texts like the Manusmriti and Kautilya’s ‘Arthashastra’.

A. Scriptures and Commentaries

The Manusmriti has laid down the principle behind tax ,he states “ As the leech, the calf, and the bee take their food little by little, even so must the King draw from his realm moderate annual taxes. ‘He emphasized that the taxes collected from the people should not be

[5] Herbert J. Kiesling: Taxation and Public Goods: A Welfare-economic Critique of Tax Policy Analysis, University of Michigan Press. p-68

[6] K.R. Sarcar, Public Finance in Ancient India, p-78.

excessive as to become a burden. He laid down that traders and artisans should pay 1/5th of their profits in silver and gold, while the agriculturists were to pay 1/6th, 1/8th and 1/10th of their produce depending upon their circumstances.

Ancient texts and sources also prove that taxes were being levied from all kinds of people and classes such as from the farmers, actors, dancers, singers, caravans and even dancing girls. It was paid in the form of cattle, gold and silver coins, personal service, gains, other materials useful etc.

B. Taxation in the Mauryan Era

Kautilya in his Artha Shastra, talks about "Kosha Moolo Danda", meaning that the treasury and revenue of a king is the backbone of administration. He believed that the power of the Government arose from its treasury.[7] Although, Kautilya advocated that the King did not mandate an order for the subjects to pay taxes to the sovereign, but nevertheless, he regarded that the king being the trustee of the land, was under a bounded duty to make taxes, a primary source of revenue.

His work, the 'Arthashastra' provided a detailed study on the model taxation system that prevailed during the Mauryan Empire. The code provided for the collection of land revenue which was one sixth of the agricultural produce, besides which, the State also levied water rates, octroi duties, tolls and customs duties. Salt tax was an important source of revenue in the Mauryan Era and the same was collected at the place of its extraction.

The Mauryan Empire collected taxes on forest produce and other economic activities. Exports and Imports too were subject to taxation policy of the Mauryan Empire. Goods that were imported from China, Ceylon and other countries wherein these countries paid a tax called 'vartanam' for all the goods imported in the country. Similarly, where goods were imported by Business Men for sale within the kingdom, what is similar to the prevalent Octroi-Duty, a tax in the name of 'Dwarodaya' was collected.

1.3.2. <u>Taxation in the Pre-Independence/ British Administration Era</u>

The advent of the British, despite its drawbacks, was successful in initiating a uniform taxation policy in the entire territory of India. In 1758, a tax of 10% on the produce of the landed estates in Bombay was imposed by the EIC to meet its extravagant expenses, to build fortifications and other works for maintaining its war with the French in India, and for extending its occupation in India. The Treaty of Allahabad of 1765, a milestone event,

[7] Sunil Mithra "Indian Tax System And Its Reform", ASCI Journal of Management, 40(2):p- 128–138

wherein, the British and the French Administration got the right to collect taxes on behalf of the then Emperors.

In the British era, the superintendence and control of public revenues were devolved separately in each of the presidency. The Governor General could use his financial powers only during war time. But in 1833 the Governor General was vested with additional financial powers.

In 1860, the concept of 'Income Tax' was introduced in India, by the British to curb the effects of the financial crisis that was rampant after the Revolt of 1857. The Tax rates were based on the income-levels and the people were to follow the same. The tax rate was 2 percent on income between ₹ 200 to Rs.500 and it was 4 per cent on income above ₹ 500 upto ₹ 2,000; and lastly a standard rate of 5 pies per rupee was applicable to all income above ₹ 2,000.

The following were the different heads under which the tax, for the first time, on income was levied:

i) Income from landed property;

ii) Income from professions and trade;

iii) Income from securities, annuities and dividends; and

iv) Income from salaries and pensions.

The EIC levied a tax on all salt produced in India, obtaining a revenue of more than £ 1 million per year, during the last years of its rule. In South India, the taxes were raised from 12 to 16% of the gross agricultural produce to 50%. The tax was calculated on what the farmer obtained in a good agricultural year. If, for any reason, he had a bad crop he would almost surely make a loss because the amount of tax remained fixed. The Act of 1860 however was in force for a period of 5 years, after which the Act of 1886, was, enacted which put forth an exemption in case of Agricultural Incomes. This feature has been an essential element of the subsequent tax legislations.

By the Act of 1918, there was a gradation that was created for the taxation system, unlike the erstwhile policy wherein the tax was calculated in a uniform manner, and for incomes in different brackets, different rates of tax were prescribed. It also provided for aggregation of income from all sources to cast the tax-net.

In the year 1922, the then Government enacted a new legislation, viz. Income Tax Act, 1922 which brought significant changes to the country's taxation system. The Act of 1922 created a systematic mechanism of computation of charge of the Previous Year in the year of assessment, rather than following the erstwhile manner of taking the previous years' income as the income for the assessment year. The Act also made a departure from specifying the rates of tax in its schedule, to be announced by subsequent Finance Acts. It further paved for set-off of loss earned under one head of Income, against the revenue from other sources, so as to ensure that only the Net-Income is made taxable. This Act continued to be in force throughout the end of the British Administration.

1.3.3. <u>Taxation in the Post-Independence Era</u>

The Act of 1922 continued to be in force even after Independence, but however had become very complicated on account of innumerable amendments. The Government of India therefore referred it to the law commission in 1956 so as to simplify the taxation policy and prevent the evasion of tax. The Law Commission submitted its report in 1958. The government also appointed a Direct Taxes Administration Enquiry Committee to suggest measures in the said Act to overcome the inconvenience caused to the taxpayers and also to bring about effective solutions to problems like tax evasion. The enquiry committee gave in its report in the year 1959.

On the basis of the recommendation in the report the Income Tax bill 1961 was presented and was later passed by the Lok Sabha in 1961. The Income Tax Act, 1961 has also been amended drastically.

Indian Taxation Policy is based on assigning separate taxation rights to the Centre and the State, i.e., to Parliament and State Legislatures respectively. A systematic policy of taxation is created by bifurcation of the subjects of tax, to both the State and the Centre, by means of a Constitutional Scheme under the Seventh Schedule.

1.3.4. <u>Salient Features of the Indian Taxation Policy</u>

- Federal Taxation Policy: The Constitution of India bifurcates the subjects of taxation and clearly demarcates the power and authority to collect tax between the Centre and the State Legislature.
- Complex Tax Structure: The System is complex due to its rapidly changing provisions and charges, that are subject to change, every year by subsequent Finance Acts.
- Deductions: The Taxation System is bound by various deductions and Exemptions, the computation of which is a hurdle.
- Widespread Evasion of Tax: Indirect Taxes comprise a substantial portion of the Revenue system. They are regressive in nature and cause widespread distortion in the allocation of resources.

- Developmental Policy by way of Tax Exemptions: Several Legislations have created exemptions from Taxes, to various Individuals and Organisations. As such, the taxable sources are being diverted, in order to realise the developmental goals. E.g. SEZs
- Multiplicity of Taxes: There are several kinds of taxes that are collected by the Centre and the States respectively. Thus, making it complex with regard to the multiplicity of records and authorities to be communicated by the Assesse.
- Finance Act: Every year a Budget is presented before the parliament by the Finance Minister. One of the important components of the Budget is the Finance Bill. The Bill contains various amendments such as the rates of income tax and other taxes. When the Finance Bill is approved by both the houses of parliament and receives the assent of President, it becomes the Finance Act.

1.4.1 SUMMARY

Tax is a financial charge imposed by the Government on Income, Commodity or Activity. Under Direct Taxes, the incidence and impact of tax is on the same person. Imposition of tax is based on the following Rules:

  - CANON OF ABILITY
  - CANON OF CONVENIENCE
  - CERTAINITY
  - ECONOMY

- The system of taxation is pertinent for the development of a country.

1.5 KEY WORDS

- Federal Taxation Policy
- Assessee.
- Finance Minister
- Parliament

1.6 SELF ASSESSMENT QUESTIONS

1. Briefly Explain the Canons of Taxation.

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2. What is Tax? Explain the various kinds of Taxes that are levied.

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3. State in brief the Reasons behind Collection of Taxes.

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4. Explain the Evolution of Tax Regime In India.

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UNIT – 2: CONSTITUTIONAL PROVISIONS RELATING TO TAXES- DIVISION OF TAXING POWERS UNDER SCHEDULE VII OF THE CONSTITUTION – DISTRIBUTION OF REVENUE BETWEEN STATE AND CENTRE

Structure:

2.0 OBJECTIVE

- This chapter aims to comprehend the source of the power and authority to collect taxes.
- It aims to give insight to the Central and State Taxes that are Levied
- The Constitutional provisions that pertain to the power of taxation are discussed. And lastly the Centre-State Relations in regard to Revenue is ascertained.

2.1 INTRODUCTION

Constitution is the foundation and source of powers to legislate all laws in India. Parliament, as well as State Legislatures gets the power to legislate various laws from the Constitution only and therefore every law has to be within the vires of the Constitution. Talking about the taxation laws and the interpretation of taxation laws, every lawyer or a tax professional practicing taxation laws must understand the basic provisions of Constitution relating to taxation including the powers of Parliament and State Legislatures to legislate regarding levy and collection of tax, the restrictions imposed by our Constitution on such powers, entries concerning taxation in Central List i.e. List-1 and State List i.e. List-2 of Seventh Schedule to Constitution of India. All laws and executive actions are subordinate to the Constitution. To form clear understanding of the basic concepts relating to taxation laws one must understand the relevant provisions of the Constitution, as the power to levy and collect tax by State Governments or Union Government comes from the Constitution only. One thing must be kept in mind that there is always an object behind every law and that object ultimately exists to achieve the objects enumerated in the Preamble of our Constitution, which runs as under:

2.2 TAXATION POLICY UNDER THE CONSTITUTION OF INDIA

The Constitution has enumerated three categories of legislative subjects. The Union List that comprise subjects that are within the exclusive jurisdiction of Parliament, the State' List comprising those that are within the exclusive jurisdiction of the State Legislatures and the 'Concurrent List' comprising of those on which both the Parliament and the State Legislatures have the power, subject to the supremacy of the Parliament.

The justification for this policy of taxation is based on the principle that the taxes of local nature are anointed to the power of the States, whilst the taxes that have the involvement of more than one State, or that which can be conveniently collected by the Centre, or that which has to be collected in a uniform manner, are vested within the powers and purview of the Central Government. It is essential that widest amplitude should be given to the language of these entries, but some of these entries in different lists or in the same list may overlap and sometimes may also appear to be in direct conflict with each other. Then, it is the duty of the court to find out its true intent and purpose and to examine a particular legislation in its pith and substance to determine whether it fits in one or the other of the lists. Each general word should be held to extend to all ancillary or subsidiary matters which can fairly and reasonably be comprehended in it.[8]

This form of bifurcation of the power to collect taxes also entails along with it the benefits of avoidance of multiple or double taxation. But, however, there is no rule against Double Taxation under the Constitution and the Supreme Court of India observed, "There is nothing under Article 265of the Constitution from which one can spin out the constitutional vice called Double taxation."[9]

2.3 POWER TO IMPOSE TAX

Finance is a sine qua non for a Government to function effectively and efficiently. The Parliament is encompassed with the powers to manage and control Public Finance. Such power extends to grant of money for the purpose of administration, levy of taxes and authorisation of loans. The Parliament thus exercises broad control over the Executive, as the discussion on financial matters, makes it imperative that the Government's policies are brought into focus.

The Constitution of India provides for a comprehensive mechanism to secure the Parliamentary control, over financial matters. Primarily, the Executive is not authorized to collect or levy taxes without the authority of the Parliament. Secondly, the Lower House, viz. Lok Sabha, is bestowed with the exclusive power in control of Financial Matters, and the Rajya Sabha plays merely a subordinate and a cooperative role, rather than a coordinative role with the Lok Sabha, as for the reason that the Upper House does not have the power to revise, alter or initiate any grant. The sole controlling power vests with the Lok Sabha. The exercise of these powers is subject to certain limitations, viz. the Parliament may exercise this power only on recommendation of the Executive.

The property and income of a State are exempted from taxation by the Central Government except to the extent that the State derives income from a trade or business or uses its property for the purposes of trade or business.

A tax whose proceeds are specifically appropriated for the expenses of promoting or maintaining any particular religious denomination is invalid. In Khazan Chand v. State of

[8] India Cement Ltd vs State Of Tamil Nadu, 1989 SCR Supl. (1) 692
[9] Union of India v. Azadi Bachao Andolan, (2004) 10 SCC 1

Jammu & Kashmir, the Supreme Court of India observed that the power to make a law with respect to taxes, comprehends with it the power to levy that tax and determine the persons who shall be liable to pay such tax, the rates at which the tax shall be levied and the event that would attract liability in respect of such tax.

2.3.1. No Levy of Tax, save under Authority of Law

The Chapter I of Part XII to the Constitution of India provides for the power to collect taxes. Article 265 expressly states, “No tax shall be levied or collected except by authority of law.” The existence of this provision enables the protection of citizens from unlawful or wrongful levy of taxes. Under Article 265, the term ‘LEVY’ refers to the assessment or imposition of tax and ‘COLLECT’, means the actual realisation of tax that is imposed or levied.

2.3.2. Doctrine of Inter-Governmental Immunities

This Doctrine provides that, wherein there are two-tiers of government, there shall be no technical impediments that shall be imposed on Government transactions, by the other; as such this Doctrine restricts the power of taxation to a certain extent. However its scope in India is very restricted, as it is confined to the provisions contained under Articles 285, 287, 288 and 289.

Article 285 provides for the exemption of Union Property from State Taxation.

Article 289 on the other hand, exempts the State property from union taxation, wherein the state income derived from a non-governmental or a commercial activity is exempt from the taxes to be collected by the Union. But however, the exemption under Article 289, is merely a general rule and the Parliament may collect taxes in respect of state property when indulged in trade or commercial practices, provided the collection of tax is authorised by a law passed by the Parliament in respect of the same.[10]

2.4 CENTRAL TAXES

The Union List includes the, power to impose the taxes on the items listed below: (Article 246 (1) and Seventh Schedule List I Entries 82- 92A)

1. **Taxes on income other than agricultural income (entry 82):** The power of levy of tax on Agricultural Income is given to the State, vide Entry 46 of List II. The Principles of Interpretation have enabled the courts to define the term ‘INCOME’ in a very elaborate and self-sufficing manner. It embraces within it all kinds of receipts or gains, capital or revenue in nature. The power of the parliament to tax under this entry extends to all those gains, that can rationally be construed to be ‘INCOME’ and as such, a loan advanced to a

[10] See, New Delhi Municipal Committee v. State of Punjab, AIR 1997 SC 2847.

shareholder of a Company, was treated as Income and the same was held taxable.[11] The Income Tax Act, 1961 is a legislation enacted in exercise of the powers under this entry.

The term Agricultural Income is defined under Article 366(1) as an income defined for the purposes of the enactments relating to Indian income-tax. The definition of the term varies from time to time on the will of the legislature.

In Assam Company Ltd. v. State of Assam [2001] 248 ITR 567 the Supreme Court held that entry 46 of List II of the Seventh Schedule to the Constitution relates to tax on agricultural income. There-fore, in view of article 246(3) of the Constitution power to legislate in regard to levy of agricultural income-tax is with the State Legislature. However, Article 366(1) provides that the expression “agricultural income” in the Constitution means “agri-cultural income” as defined for the purpose of the enactments relating to the Indian Income-tax Act. Therefore, the agricultural income regarding which the State Legislature may enact law under entry 46, List II would be such income as defined in the Indian Income-tax Act and the laws relating to the said Act. Section 2(1A) of the Income-tax Act, 1961 defines “agricultural income”. So far as the income from cultivation, manufacture and sale of tea is concerned, the same comes within the said defini-tion and rule 8 of the Income-tax Rules, 1962 (the Central Rules), which provides for computation of income derived from sale of tea grown and manufactured by the sellers in India. It provides that 40 per cent of such income shall be deemed to be the income liable to income-tax under the Central Act. Therefore, the balance 60 per cent of the said income would be agricultural income for the purpose of levying agricultural income-tax under the State laws. A reading of the above provisions shows that the computation of agricultural income even for the purpose of the State enactments will have to be that which is made under the provisions of the Income-tax Act and Rules made there under.

2. Duties of customs including export duties (entry 83)

The Customs Act 1962, a pioneer legislation, inter alia, has been enacted under the power vested by virtue of this entry. Section 12 of the Act provides for the levy of duties on goods imported into or exported from India. The items and the rates of duties that can be levied thereon are specified in two Schedules to the Customs Tariff Act, 1975. The First Schedule enlists the various import items amenable to taxation in categories, in accordance with an international scheme of classification of internationally traded goods known as

[11] Navnit Lal v. Income Tax Commissioner, AIR 1965 SC 1375.

'Harmonised System of Commodity Classification' and specifies the varied rates of Import duties thereon, as prescribed by the relevant Finance Act. The Duties are levied either on a uniform or an ad-valorem (based on value) basis, or in some cases, a specific-cum-ad-valorem duties are also levied. The Second Schedule to the 1975 Enactment provides for the items and the respective rates of export duties that are to be levied thereon.

The Entry allows for collection of various customs duties such as: Anti-Dumping Duties collected under Section 9A of the Customs Tariff Act, 1975; Import Duties, etc.

Duty-Free Shops And Tax Liability

In M/s Hotel Ashoka Vs. Assistant Commissioner of Commercial Taxes [(2012) 03 VIL (SC)], the Court held that since duty free shops were located in the customs airports of the country, sales there from to both inbound & outbound passengers were made before/after the goods had crossed the customs frontiers and hence such sales were exempt from tax under the CST Act.

M/s Ashoka Hotels had imported goods from foreign countries and stored these in customs bonded warehouses. These goods were subsequently transferred to duty free shops situated within Bengaluru airport, as and when stocks of such goods lying at these shops were exhausted, and were subsequently sold therefrom. On the above facts, the Supreme Court has observed that when the goods are stored in the bonded warehouses, they cannot be said to have crossed the customs frontiers of India. Accordingly, the Court has concluded that sales from the duty free shops are exempt from tax, without appearing to distinguish between bonded warehouses and duty free shops.

It is to be noted that the term "bonded warehouses" extend to those treated as such under the Customs Act such as in 100% Export Oriented Units (EOUs)/Software Technology Parks (STPs) etc, as well as units in the Special Economic Zones (SEZs), besides those operated as such for the sole purpose of storage of goods.

2. Duties of excise on tobacco and other goods manufactured or produced in India except (a) alcoholic liquors for human consumption; (b) opium, Indian hemp and other narcotic drugs and narcotics; but including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry. (entry 84)

The duties of excise of the 'goods', exempted hereunder, are under the exclusive domain of the State under List II: Entry 51. The Central Government vide this entry is entitled, generally, to collect excise duties on all goods, apart from those specifically excluded.

The term ‘Manufacture’ used under this entry, has been described by the Supreme Court as follows, “the moment there is transformation into a new commodity commercially known as a distinct and separate commodity having its own character, name and use, whether it be the result of one or several processes, ‘manufacture’ is said to have occurred and as such the liability towards taxes has also arisen”[12]

In 2010, the Supreme Court while holding that the process of twisting and texturing of Partially Oriented Yarn, was not a ‘manufacture’, defined that, “The term ‘manufacture’ implies a change, but, every change is not a manufacture, despite the fact that every change in an article is the result of a treatment of labour and manipulation. However, this test of manufacture needs to be seen in the context of the above process. If an operation/process renders a commodity or article fit for use for which it is otherwise not fit, the operation/process fall6 s within the meaning of the word manufacture.”[13]

The Courts have held the extraction of Coal and other minerals also to be liable to the tax under this entry, although one may argue that coal and other minerals are natural elements, the Supreme Court justified the tax collected on them on ground that the operations required to bring the minerals to the surface, and make it usable are so elaborate.

In Hyderabad Industries Limited v. Union of India[14], the Supreme Court concluded that separation of asbestos fibre from the parent rock was not result of process of manufacture and was not a new and commercially viable article and was therefore not liable to excise duty. Therefore, it may be said that in order to identify whether a process is one of ‘manufacture’ or not, the test is of ‘commercial viability’ of the outcome of the process in question. If the test is in affirmative, it is a Manufacturing Process, and hence taxable.

3. Corporation tax (entry 85)

Article 366(6) to the Constitution of India defines the term “corporation tax” as being, any tax on income, so far as that tax is payable by companies. The provision provides that to be construed as Corporation Tax, it is essential that the Tax fulfills the following conditions, viz.:

(a) it is not chargeable in respect of agricultural income;

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[12] Union of India v. Delhi Cloth & General Mills Ltd. AIR 1963 SC 791.
[13] C.I.T. Mumbai v. M/S.Emptee Poly-Yarn Pvt. Ltd., 2010 (1) O.J.R. (363)
[14] 1995 (78) E.L.T. 641.

b) that no deduction in respect of the tax paid by companies is, by any enactments which may apply to the tax, authorised to be made from dividends payable by the companies to individuals;

(c) that no provision exists for taking the tax so paid into account in computing for the purposes of Indian income-tax the total income of individuals receiving such dividends, or in computing the Indian income-tax payable by, or refundable to, such individuals.

4. Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies. (entry 86)

The power conferred under this Entry to the Parliament paved way for the enactment of the Wealth Tax Act 1957. In Sudhir Chandra Nawn vs Wealth-Tax Officer,[15] the Constitutional validity of the said Act was challenged on ground that the Act, was a colourable legislation as it purported to collect taxes on land and buildings that are an aspect covered under Entry 49, List II and thereon entrusted to the State Government. The Supreme Court observed that, the tax which is imposed by entry 86 List I of the Seventh Schedule is not directly a tax on lands and buildings. It is a tax imposed on the capital value of the assets of individuals and companies, on the valuation date. The tax is not imposed on the components of the assets of the assessee; it is imposed on the total assets which the assessee owns, and in determining the net wealth not only the encumbrances specifically charged against any item of asset, but the general liability of the assessee to pay his debts and to discharge his lawful obligations have to be taken into account.

5. Estate duties, except on agricultural land (entry 87).

6. Duties in respect of succession to property other than agricultural land (entry 88)

7. Terminal taxes on goods or passengers and Taxes on freight by Rail, sea or air (entry 89).

8. Taxes other than stamp duties on stock exchange and futures market transactions (entry 90)

9. Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts. (entry 91)

10. Taxes on the sale or purchase of newspapers and on advertisements published in newspapers (entry 92)

11. Taxes on the sale or purchase of goods in the course of international trade (entry 92A)

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[15] 1969 SCR (1) 108

12. Taxes on the consignments of goods (whether the consignment is to the person making it or to any other person), where such consignment takes place in the course of inter-State trade or commerce. (Entry 92B)

13. Taxes on services. (Entry 92C)

14. Fees in respect of any of the matters in this List, but not including fees taken in any court. (Entry 96)

15. Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists. (Entry 97)

The Central Government has exclusive power to impose taxes not enumerated in the State List or the Concurrent List. Such power includes the power to make any law imposing a tax not mentioned in either of those lists.[16] These taxes are also known as Residuary Taxes. There is an inherent power vested with the Parliament vide Article 248, wherein Parliament is conferred, "exclusive power to make any law with respect to any matter not enumerated in the Concurrent List or the State List." This Entry is explained and dealt in detail under the head 'Residuary Taxes'.

2.5 STATE TAXES

List II of the VII Schedule confers power to legislate on the items mentioned therein, to the respective State Legislatures. Entries 45 to 63 deal with the items of taxation and are hereby addressed in this study.

1. **Entry 45: Land revenue, including the assessment and collection of revenue.**

It is a general consensus of opinion that land revenue should be regarded as a tax and not a rent. It is merely a portion of the profits of agriculture compulsorily appropriated by the State without any consideration. It is a tax which is no more than a compulsory exaction of money by the State in the exercise of its sovereign power for public purposes. All portions of income or profit taken by the State in the exercise of its sovereign powers are in reality taxes no matter under what name they appear.[17]

The term "land" assumes significance under this entry. In R.S. Rekchand Mohote Spinning Mills Ltd. v. State of Maharashtra, the Supreme Court held that the States are entitled to collect taxes on the use of flowing water in a river. In the said case, there was a factory owner who made use of the water by means of installation of water pumps, for industrial purposes. The State Government collected impost on the same under the State Land Revenue Code, which was challenged by the Assessee. The Court, giving a broad

[16] Article 248 of the Constitution of India

[17] Girijananda v. State of Assam, AIR 1958 Assam 33.

interpretation to the term 'land', observed that the Code covered 'flowing water' as it was an integral part of the land.

2. Entry 46: Taxes on agricultural income.

Collection of taxes on income other than that of agricultural income is vested under the realm of the powers of the Parliament, vide Entry 82, List I, as discussed above. The Constitution of India, under Article 366(1), defines Agricultural Income as the one for the purposes of legislation of Income Tax. f

Entry 46 of List II of the Seventh Schedule to the Constitution relates to tax on agricultural income. Therefore, in view of article 246(3) of the Constitution power to legislate in regard to levy of agricultural income-tax is with the State Legislature. However, article 366(1) provides that the expression "agricultural income" in the Constitution means "agricultural income" as defined for the purpose of the enactments relating to the Indian Income-tax Act. Therefore, the agricultural income regarding which the State Legislature may enact law under entry 46, List II would be such income as defined in the Indian Income-tax Act and the laws relating to the said Act. Section 2(1A) of the Income-tax Act, 1961 defines "agricultural income". So far as the income from cultivation, manufacture and sale of tea is concerned, the same comes within the said definition and rule 8 of the Income-tax Rules, 1962 (the Central Rules), which provides for computation of income derived from sale of tea grown and manufactured by the sellers in India. It provides that 40 per cent of such income shall be deemed to be the income liable to income-tax under the Central Act. Therefore, the balance 60 per cent of the said income would be agricultural income for the purpose of levying agricultural income-tax under the State laws. A reading of the above provisions shows that the computation of agricultural income even for the purpose of the State enactments will have to be that which is made under the provisions of the Income-tax Act and Rules made thereunder. [18]

In Commissioner of Income Tax v. Raja Benoy Kumar Sahas Roy,[19] the Supreme Court laid down the following three propositions to decide as to what constitutes agricultural income – **(a)** some basic operation, prior to germination, involving expenditure of human skill and labour on the land itself and not merely on the growths from the land, is essential to constitute agriculture. Illustrative instances of such basic operations are tilling of the land, sowing or disseminating of seeds, and planting; **(b)** subsequent operations, i.e., operations performed after the produce sprouts from the land, e.g. weeding, digging the soil around the

[18] [2001] 248 ITR 567
[19] 32 ITR 466

growth, removal of undesirable undergrowths, tending, pruning, cutting, felling and preservation of the plants from insects, pests and other animals by themselves would not constitute agriculture. However, in cases where the subsequent operations are combined with basic operations, the subsequent operations would also constitute part of the integrated activity of agriculture; **(c)** activities not involving any basic operation on the land would not constitute agriculture merely because they have relation to or connection with the land.

If the Income falls under the propositions as above, such income is to be treated as 'Agricultural Income' and the same may be taxable under this Entry.

3. **Entry 47: Duties in respect of succession to agricultural land.**
4. **Entry 48: Estate duty in respect of agricultural land.**

The term 'Estate Duty' has been defined under Article 366 (9) as, "estate duty" means a duty to be assessed on or by reference to the principal value, ascertained in accordance with such rules as may be prescribed by or under laws made by Parliament or the Legislature of a State relating to the duty, of all property passing upon death or deemed, under the provisions of the said laws, so to pass.

5. **Entry 49: Taxes on lands and buildings.**

The inert nature of the tax collected under this Entry is a Property Tax and not a Personal Tax. The Water Charges, as a percentage of annual rateable value of buildings and land, levied by the Municipality is a tax falling under Entry 49, List II.[20]

The State Governments are also vested with the power to collect taxes in respect of lands and buildings. To be a valid tax under this Entry, it is essential that the following criteria be fulfilled:

- It must be a tax on units that is lands and buildings separately as units.
- The tax cannot be a composite tax on the value of all lands and buildings.
- The tax is not concerned with the division of interest in respect of the property, viz. the tax is not concerned with whether one or several person(s) hold such property in joint or co-ownership.

6. **Entry 50: Taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development.**
7. The essence of this entry is that it is a tax on the 'right to extract a mineral' and not on the extracted mineral itself. It is different from the tax on minerals extracted, as the latter would be in the form of Excise Duty.[21]

[20] Kendriya Nagarik Samiti v. Jal Sansthan, AIR 1982 Allahabad 406.

The Parliament has deprived the State legislatures of the power to levy tax on minerals by making the declaration contained in Section 2 of the Mines and Minerals (Regulation and Development) Act, 1957 [M.M.R.D. Act]. The said declaration remains intact which means that the States have no power to levy any tax or cess on minerals so long as the said declaration remains in force. The parliament, therefore, adopted the only legislative course open to it in the circumstances. The Supreme Court ruled that by virtue of the declaration contained in Section 2 of the M.M.R.D. Act and the provisions of the said Act, the State legislatures are denuded of their power to levy and tax on minerals. Entry 50 in List-II became practically a dead letter.[22]

8. **Entry 51: Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India-**

    (a) alcoholic liquors for human consumption

    (b) opium, Indian hemp and other narcotic drugs and narcotics but not including medicinal and toilet preparations containing alcohol or any substance in-cluded in sub-paragraph (b) of this entry.

The substantial difference between the Entries 81, List I and Entry 51, List II is that although they both provide for collection of Excise-Duties on Alcohol, the latter viz. Entry 51 of List II allows the State to collect such duty only on the Alcohol, suitable for Human Consumption. Thereby, if the Alcohol is an item that is not for Human Consumption then the right to collect taxes on the same vests with the Parliament and not the State Legislatures.[23]

9. **Entry 52: Taxes on the entry of goods into a local area for consumption, use or sale therein.**

This type of tax, also known as Octroi Duty, cannot be levied with mere physical entry of the goods sans "consumption, sale or use therein." However, the terms "Consumption, Sale or Use" are not limited to the end-use products like motor-vehicles or "umbrella", the terms are wide in ambit to even include those products that are subjected to some process wherein the product is converted to a different commercially viable commodity.[24]

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[21] Hingir Rampur Coal Company v. State of Orrissa, AIR 1961 SC 459.
[22] India Cement v. State of Tamil Nadu, 1989 SCR Supl. (1) 692
[23] State of U.P. v. Vam Organic Chemicals Ltd, 2003 Supp(4) SCR 957
[24] The Bengal Immunity Company v. State of Bihat, decided on 4 December, 1954, available at: http://indiankanoon.org/doc/608874/, [Accessed on 20th August 2014: 23:31]

Octroi Duty collected under this entry has a similarity with regard to the Terminal Tax collected under Entry 89, List I by the Parliament. They are: (a) both taxes are collected on the basis of destination; and (b) on arrival at the local area. The two taxes can be levied simultaneously as there is no constitutional bar on double taxation. Upon the same object and person separate taxes may be levied for different purposes by the same or different authorities.[25]

10. Entry 53: Taxes on the consumption or sale of electricity.

A levy of tax or duty on 'Consumption' of Electricity is not an excise duty, as for the reason that Excise, is a duty that is levied on 'production' and not 'consumption'. The Supreme Court has observed that 'Electricity' is Goods that can be sold and is further covered under Entry 54, List II, and as a result the two entries must be read in harmony as far as Electricity is concerned. However in case of sale of Electricity for consumption outside the State, is subject to Entry 92-A of List I.[26]

11. Entry 54: Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of Entry 92-A of List I.

The power of the State Governments to collect Sales Tax, under Entry 54 has been expounded extensively. Article 366 (29A) explains, "tax on the sale or purchase of goods" to include:

(a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;

(b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;

(c) a tax on the delivery of goods on hirepurchase or any system of payment by instalments;

(d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;

(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, and such transfer, delivery or supply of any goods shall be

[25] Jaika Automobiles (Private) v. State Of Maharashtra, AIR 1993 Bombay 123; 1992 (2) MhLj 1658.
[26] State of Andhra Pradesh v. NTPC Ltd. AIR 2002 SC 1895.

deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made to have a better understanding of this Entry, it becomes essential to understand the key term, viz. 'Goods', as provided therein. Article 366(12) defines 'goods' to include, all materials, commodities, and articles. Electricity has been held to be included under 'goods' and has been described to fall under both Entries 53 and 54.[27] The expression Sale of Goods, is interpreted in the same manner as defined under the Sale of Goods Act and therefore imposition of taxes on a transaction not to be contemplated as 'Sale' under the Sale of Goods Act, are to be held unconstitutional.[28]

12. **Entry 55: Taxes on advertisements other than advertisements published in the newspapers and advertisements broadcast by radio or television.**
13. **Entry 56: Taxes on goods and passengers carried by road or on inland waterways.**
14. **Entry 57: Taxes on vehicles, whether mechanically propelled or not, suitable for use on roads, including tram-cars subject to the provisions of Entry 35 of List III.**
15. **Entry 58: Taxes on animals and boats.**
16. **Entry 59: Tolls.**
17. **Entry 60: Taxes on professions, trades, callings and employments.**
18. **Entry 61: Capitation taxes.**
19. **Entry 62: Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.**
20. **Entry 63: Rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty.**

[27] State of Andhra Pradesh v. NTPC, (2002) 5 SCC 203.
[28] State of Madras v. Gannon Dunkerley, AIR 1958 SC 560

2.6 CONCURRENT TAXES

The Concurrent List comprises of a few tax entries. The Concurrent List provides the power to both the Parliament and the State Legislatures to collect taxes on the items provided therein.

1. **Entry 35: Mechanically propelled vehicles including the principles on which taxes on such vehicles are to be levied.**

This entry vests the power with the Parliament and the State Legislatures to collect taxes on Mechanically Propelled Vehicles.

This Entry is similar to the Entry 57, List II of the Seventh Schedule. However the difference between the two is that under this entry, tax can be levied on -mechanically propelled vehicles alone. Whereas under Entry 57, List II, the State Government can collect taxes on vehicles, whether, or not, mechanically propelled.

This Entry should be read with Entry 57, List II of the Seventh Schedule, wherein the State Government is entitled to collect taxes on any vehicle, whether mechanically propelled or not. The two entries deal with different matters, but allied ones. The Supreme Court in Jayaram v. Union of India, observed that, the power of levy of taxes on vehicles vests solely with the state government, however the Parliament is empowered to legislate the principles on which the taxes may be levied on Mechanically propelled vehicles by the State Governments.[29]

It has been observed that this entry does not confer a power to collect a tax, albeit, it only confers the authority to provide for guidelines on which the tax shall be collected, so as to ensure uniformity.

2. **Entry 44: Stamp duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duty.**

The Rates of stamp duty are under the domain of the Parliament and the State Legislature under Entry 91, List I and Entry 63, List II respectively.

3. **Entry 47: Fees in respect of any of the matters in this List, but not including fees taken in any court.**

The prohibition under Article 265 is in respect of taxes, and not fee. Although there is no generic distinction between fee and taxes, as they are both compulsory exactions of money, it is attempted that the distinction lies in the fact that the payment of tax is enforceable by law, irrespective of the unwillingness of the person. Generally, it is considered that Tax forms a part of Common burden, whereas Fee is a payment collected on receipt of

[29] 1983 SCR (3) 624

special privilege or benefit, in public interest. The true test of determination lies as to whether a levy is a fee or a tax in the fact that, if the levy is for the grant of special service or privilege, then it is Fee, if otherwise, it is tax.

The distinction between a tax and a fee lies primarily in the fact that a tax is levied as part of a common burden, while a fee is a payment for a special benefit or privilege.

A payment made to an authority would qualify as Fee, provided it fulfils the following two essentials:

- Levy as a Consideration for specific service:

The amount is to be collected as a consideration for certain services that are rendered to the individuals by some governmental agency; and

- Use of such collection for a Specific Purpose and not Generally:

Payments demanded for rendering such services should be kept apart, or specifically appropriated for that purpose, and not be merged with the general revenue, or be used for a general purpose.

In a particular case, wherein a sum of money was collected as 'fee' under Section 76 of the Madras Hindu Religious and Charitable Endowments Act, 1951, the Court held the sum so collected to not be under the head 'fee' on the reason that the said amount that was collected was not ear-marked or specified for defraying the expenses that the Government has to incur in performing the services. The Supreme Court observed, "All the collections go to the consolidated fund of the State and all the expenses have to be met not out of these collections but out of the general revenues by a proper method of appropriation as is done in case of other Government expenses. That in itself might not be conclusive, but in this case there is total absences of any co-relation between the expenses incurred by the Government and the amount raised by contribution under the provision of section 76 and in these circumstances the theory of a return or counter-payment or quid pro quo cannot have any possible application to this case. In our opinion, therefore, the High Court was right in holding that the contribution levied under section 76 is a tax and not a fee and consequently it was beyond the power of the State Legislature to enact this provision."[30]

2.7 RESIDUARY TAXES

Entry 97, List I as provided above enables the Parliament to collect taxes on any matter not provided for under either of the Lists under the Seventh Schedule. For instance, transfers by way of Gift are taxable under this entry, in the manner of Gift-Taxes. It may be

[30] Commissioner, H.R.E. Madras v. Swamiar, 1954 SCR 1005

argued that the said tax is collected on lands and buildings, under Entry 49, List II. However it is to be noted that the tax is collected on the transfer as such and not on land and buildings, as individual units of taxation, as required by Entry 49, List II.

In Satpal & Co. v. Lt. Governor of Delhi[31], the Supreme Court observed that With the advancement of society, expanding horizons of scientific and technical knowledge, probe into the mystery of creation, it is impossible to conceive that every imaginable head of legislation within human comprehension and within the foreseeable future could have been within the contemplation of the founding fathers and was, therefore, specifically enumerated in one or the other of the three Lists, meaning thereby that three Lists were exhaustive of Governmental action and activity."

The Court further observed that in the increasingly complex modern governance raises circumstances that a subject of legislation may not squarely fall in any specific entry in List I or II. In such a situation Parliament would have power to legislate on the subject in exercise of residuary power under Entry 97, List I and it would not be proper to unduly circumscribe, corrode or whittle down this power by a process of interpretation by saying that subject of legislation was present to the mind of the framers of the Constitution because apparently it falls in one of the entries in List II and thereby deny power to legislate under Entry 97.[32]

2.8 FINANCE COMMISSION

The Indian Constitution provides for the establishment of an institutional mechanism to facilitate such transfers. The institution assigned with such a task under Article 280 of the Constitution is the Finance Commission, which is to be appointed at the expiration of every five years or earlier. The Finance Commission was established under the Finance Commission Act, 1951. The source for this body lies under Article 280 which provides that the Parliament by law may provide for the same.

The Finance Commission has to make recommendation with regard to the following:

(i) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under this Chapter and the allocation between the States of the respective shares of such proceeds;

(ii) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India;

[31] AIR 1979 SC 1950
[32] Ibid.

(iii) the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats in the State on the basis of the recommendations made by the Finance Commission of the State;]

(iv) the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State;]

(v) any other matter referred to the Commission by the President in the interests of sound finance.

2.9 SHARING OF TAX-REVENUE

The Constitution assigned taxes with a nation-wide base to the Union to make the country one common economic space unhindered by internal barriers to the extent possible. States being closer to people and more sensitive to the local needs have been assigned functional responsibilities involving expenditure disproportionate to their assigned sources of revenue resulting in vertical imbalances. Horizontal imbalances across States are on account of factors, which include historical backgrounds, differential endowment of resources, and capacity to raise resources. Unlike in most other federations, differences in the developmental levels in Indian States are very sharp. In an explicit recognition of vertical and horizontal imbalances, the Indian Constitution embodies the following enabling and mandatory provisions to address them through the transfer of resources from the Centre to the States:

- Levy of duties by the Centre but collected and retained by the States (Article 268)
- Taxes and duties levied and collected by the Centre but assigned in whole to the States (Article 269).
- Sharing of the proceeds of all Union taxes between the Centre and the States under Article 270. (Effective from April 1, 1996, following the eightieth amendment to the Constitution replacing the earlier provisions relating to mandatory sharing of income tax under Article 270 and permissive sharing of
- Union excise duties under Article 272).
- Statutory grants-in-aid of the revenues of States (Article 275)
- Grants for any public purpose (Article 282).
- Loans for any public purpose (Article 293).

Although the Constitution of India provides for division of taxing-authority and power, there are certain stances where although the Union collects the tax, it may be vested or used for the benefit or to the credit of the State Government. As M.P. Jain puts it, “All revenue accruing to the State Government is used by them, but all taxes levied by the Centre are not meant for its exclusive use."[33]

The Constitution provides for a scheme of tax sharing under Part XII. Article 268 provides that the stamp duty of excise on medicinal and toilet preparations that is entrusted to the Parliament under List I shall be collected and kept by the State Government. Article 268 A provides for the appropriation of Service tax, collected by the Union, between the Union and the State Governments. Article 269 provides for the assignment of The Tax on Sale of Goods to the concerned States, w. e. f. 1st April 1996.

2.10 GRANTS-IN-AID

Grants-In-Aid are payments made by the Central government to the State governments, either according to the provisions of the constitution or by legislative decision. Under Article 275, grants-in-aid are to be given to States as they are in need of financial assistance, and these grants may vary in nature. Grants are primarily intended to correct Inter-State disparities in financial resources and to coordinate the maintenance and expansion of the welfare schemes of the State Governments on a uniform basis. The general power of providing grants is left to Parliament, but the Constitution lays down the specific grants in the provisos to Article 275. The first proviso relates to Grants necessary for the welfare of Scheduled Tribes and for raising the standard of administration of Scheduled Areas. The second proviso relates to the Grants to the Government of Assam for the development of the State Tribal areas.

The Finance Commissions are mandated to recommend the principles as well as the quantum of grants to those States which are in need of assistance and that different sums may be fixed for different States. Thus one of the pre-requisites for grants is the assessment of the needs of the States. The First Commission had laid down five broad principles for determining the eligibility of a State for grants. The first was that the Budget of a State was the starting point for examination of a need. The second was the efforts made by States to realize the potential and the third was that the grants should help in equalizing the standards of basic services across States. Fourthly, any special burden or obligations of national concern, though within the State's sphere, should also be taken into account. Fifthly, grants might be given to further any beneficent service of national interest to less advanced States. By and large, these principles have guided the grants recommended by all the Finance Commissions.

[33] M.P. Jain, Indian Constitutional Law, Lexis Nexis Butterworths Wadhwa Nagpur, Sixth Edition 2010, p- 700.

2.11 SUMMARY

- The Constitution has enumerated three categories of legislative subjects
- There is nothing under Article 265 of the Constitution from which one can spin out the constitutional vice called Double taxation.
- The prohibition under Article 265 is in respect of taxes, and not fee. Although there is no generic distinction between fee and taxes, as they are both compulsory exactions of money, it is attempted that the distinction lies in the fact that the payment of tax is enforceable by law, irrespective of the unwillingness of the person.
- The Finance Commission was established under the Finance Commission Act, 1951.
- Grants-In-Aid are payments made by the Central government to the State governments, either according to the provisions of the constitution or by legislative decision.

2.12 KEY WORDS

- Grants-In-Aid
- Residuary taxes
- Finance Commission
- Concurrent List

2.13 SELF ASSESSMENT QUESTIONS

1. Explain the power to impose and levy tax in light of the Constitution of India.

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2. Describe the Inter-Governmental Financial Relations.

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3. Distinguish between Tax and Fee.

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   ....

4. What is the Finance Commission? Explain its Duties under the Constitution

   ....

   ....

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UNIT – 3: BASIC CONCEPTS OF INCOME TAX – INCOME, PERSONS, TOTAL INCOME, ASSESSEE, DIVIDENDS, SECURITIES

Structure:

3.0 OBJECTIVES

- To know the basic concepts in Income Tax
- To understand the Difference between Assessment year and Previous Year.
- To know the Taxable Income
- To understand the aspects of Tax Liability
- To Learn the Computation of Accumulated Profits

3.1 INTRODUCTION

Tax is that part of our income which the Government of India takes from us for providing us numerous facilities like, water and drainage system, protection against internal and external enemies, developing infrastructure. In simple words Tax is a source of revenue for the Government. There are two types of taxes –

1. Direct Tax
2. Indirect Tax

Direct tax is the tax which can't be shifted to others. Income tax is a direct tax (and we all try to save it to the best possible limit!) Now while talking about tax saving, three relevant concepts are tax planning, tax omission & tax evasion that we will discuss later. Indirect Tax on the other hand is a tax that causes rise in the price of goods and is ultimately borne by the customer. That means, if I and Mr. Ambani enjoy Parle- G with the morning tea, both of us are bearing the same amount of tax (that's soo unfair, isn't it!). But still we don't crib about it because the amount of indirect tax can't be seen by us, the customers. And this is one of the reasons why, Indirect tax is the main source of revenue for the Government.

3.2 INCOME & TAX ON INCOME

The definition of Income as given in Section 2(24) of the Act starts with the word includes therefore the list is inclusive not exhaustive. The definition enumerates certain items, including those which cannot ordinarily be considered as income but are treated statutorily as such. Income includes not only those things which the interpretation clause declares. It shall also include all such things the word signifies according to its natural import. Entry 82 of List I to the Seventh Schedule of the Constitution of India confers power on Parliament to levy taxes on income other than agricultural income.

As per section 2(24), the term income means and includes:

1. Profits and gains.
2. Dividend:

This component has been briefly dealt with under Paragraph 3.5. [Infra]

3. Voluntary contributions received by:

- – A trust created wholly or partly for charitable or religious purposes
- – A scientific research association;
- – An electoral trust;
- – A fund or trust or institution established for charitable purposes and notified under section 10(23C) (iv)(v);
- – any university or other educational institution or by any hospital referred to in Section 10(23C)(ii)(vi)(iii)(iv).

4. The value of any perquisite or profit in lieu of salary taxable.

5. Any special allowance or benefit specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.

6. City Compensatory Allowance/ Dearness allowance: Any allowance granted to the assesse either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.

7. Benefit or Perquisite to a Director: The value of any benefit or perquisite, whether convertible into money or not, obtained from a company by: (a) a director, or (b) a person having substantial interest in the company, or (c) a relative of the director or of the person having substantial interest, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid.

8. Any Benefit or perquisite to a Representative Assesse: the value of any benefit or perquisite (whether convertible into money or not) obtained by any representative assesse under Section 160(1) (iii) /(iv) or beneficiary, or any amount paid by the representative assesse in respect of any obligation which, but for such payment, would have been payable by the beneficiary.

9. Any sum chargeable under section 28, 41 and 59: Any sum chargeable to tax as business income under Section 28(ii), any amount taxable in the hands of a trade, professional or similar association (for specific services performed for its members) as its income from business under Section 28(iii), and deemed profits which are taxable under Sections 41 and 59 of the Act.

10. Capital Gain: Any capital gains chargeable to tax under Section 45; since the definition of income in Section 2(24) is inclusive and not exhaustive capital gains chargeable under Section 46(2) are also assessable as income.
11. Insurance Profit: The profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society computed in accordance with the provisions of Section 44 or any surplus taken to be such profits and gains by virtue of the profits contained in the First Schedule to the Income-tax Act;
12. Banking Income of a Co-operative Society: The profits and gains of any business of banking (including) providing credit facilities carried on by a cooperative society with its members.
13. Winnings from Lottery: Any winnings from lotteries, crossword puzzles, races, including horse-races, card-games and games of any sort or from gambling or betting of any form.

    (i) "lottery" includes winnings, from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;

    (ii) "card game and other game of any sort" includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game;
14. Employees Contribution Towards Provident Fund: Any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set-up under the provisions of the Employees State Insurance Act, 1948 (34 of 1948) or any other fund for the welfare of such employees.
15. Amount Received under Keyman Insurance Policy: Any sum received under a Keyman Insurance Policy including the sum allocated by way of bonus on such policy. Keyman Insurance Policy means a life insurance policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected with the business of the first mentioned person in any manner whatsoever.
16. Amount received for not carrying out any activity: Any sum referred to in Section 28(va), i.e. any sum, whether received or receivable in cash or kind, under an agreement for –

    (i) Not carrying out any activity in relation to any business; or

    (ii) Not sharing any know-how, patent, copyright, trade-mark, license, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.

17. Gift received for an amount exceeding ` 50,000: Any sum of money or value of property referred to in clause (vii) or clause (vii a) of sub-section (2) of Section 56. Provided that the said amount received from the Category of persons below is not to be treated as Income. Those received:

(a) from any relative; or

(b) on the occasion of the marriage of the individual6a; or

(c) under a will or by way of inheritance; or

(d) in contemplation of death of the payer; or

(e) from any local authority as defined in the Explanation to clause (20) of section 10; or

(f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10; or

(g) from any trust or institution registered under section 12AA.

Explanation.—For the purposes of this clause, “relative” means—

(ii) brother or sister of the individual;

(iii) brother or sister of the spouse of the individual;

(iv) brother or sister of either of the parents of the individual;

(v) any lineal ascendant or descendant of the individual;

(vi) any lineal ascendant or descendant of the spouse of the individual;

(vii) spouse of the person referred to in clauses (ii) to (vi);]

18. Consideration received for issue of shares: Any consideration received for issue of shares as exceeds the fair market value of the shares referred in section 56(2)(vii b).

3.2. GROSS TOTAL INCOME AND TOTAL INCOME

It is the aggregate taxable income under the different heads of income such as income from salary, income from house property, income from profits or gains of business, capital gains and income from other sources.

Total Income is arrived after making various deductions from Gross Total Income under section 80 C to 80 U:

Section 4 of the Act imposes a charge of tax on the total or taxable income of the assessee. The meaning and scope of the expression of total income is contained under Section 5. The total income of an assessee cannot be determined unless we know the residential status in India during the previous year. The scope of total income and consequently the liability to income-tax also depends upon the following facts:

- Whether The Income Accrues Or Is Received In India Or Outside
- The Exact Place And Point Of Time At Which The Accrual Or Receipt Of Income Takes Place
- The Residential Status Of The assesse:

The residential status of the assesse is categorised as follows under Section 5:

(A) Resident and Ordinarily Resident

According to Sub-section (1) of Section 5 of the Act the total income of a resident and ordinarily resident assesse would consist of:

(i) income received or deemed to be received in India during the accounting year by or on behalf of such person;

(ii) income which accrues or arises or is deemed to accrue or arise to him in India during the accounting year;

(iii) income which accrues or arises to him outside India during the accounting year.

It is important to note that under clause (iii) only income accruing or arising outside India is included. Income deemed to accrue or arise outside India is not includible

(B) Resident but Not Ordinarily Resident In India

Proviso to section (1) of section 5 the total income in case of resident but not ordinarily resident in India

(i) income received or deemed to be received in India during the accounting year by or on behalf of such person;

(ii) income which accrues or arises or is deemed to accrue or arise to him in India during the accounting year;

(iii) income which accrues or arises to him outside India during the previous year if it is derived from a business controlled in or a profession set up in India.

(C) Non-Resident

Sub-section (2) of Section 5 provides that the total income of a non-resident would comprise of:

(i) income received or deemed to be received in India in the accounting year by or on behalf of such person;

(ii) income which accrues or arises or is deemed to accrue or arise to him in India during the previous year.

Tax Incidence vis-à-vis Residential Status

TAX INCIDENCE FOR	Resident & Ordinarily Resident	Resident but not Ordinarily Resident	Non-Resident
Income received in India	Taxable	Taxable	Taxable
Income deemed to be received in India	Taxable	Taxable	Taxable
Income accruing or arising in India	Taxable	Taxable	Taxable
Income deemed to accrue or arise in India	Taxable	Taxable	Taxable
Income received and accrued outside India from a business controlled or a profession set up in India	Taxable	Taxable	Taxable
Income received and accrued outside India from a business controlled from outside India or a profession set up outside India	Taxable	Not-Taxable	Not-Taxable
Income earned and received outside India but later on remitted to India	Not-Taxable	Not-Taxable	Not-Taxable
Past untaxed profits (not taxable as relates to past years)	Not-Taxable	Not-Taxable	Not-Taxable
Gifts from relatives or on marriage or under will etc. (or gifts from others upto ` 50,000 in a year)	Not-Taxable	Not-Taxable	Not-Taxable
Dividend from a Domestic Company [Exempt u/s 10(34)] or Income from Mutual funds specified u/s 10(23D) [Exempt u/s 10(35)]	Not-Taxable	Not-Taxable	Not-Taxable
Long term capital gain [on STT paid shares or on shares sold through stock exchange] Exempt u/s 10(38)	Not-Taxable	Not-Taxable	Not-Taxable
Agricultural Income in India [Exempt under Section 10(1)]	Not-Taxable	Not-Taxable	Not-Taxable

3.4 PERSONS

Section 2(34) of the Income Tax Act 1961, defines the term 'Persons' to include either of the following:

1. Individual
2. Hindu undivided family
3. Company
4. Firm
5. Association of persons or body of individual
6. Local authority
7. Artificial juridical person

3.5 ASSESSEE

The word 'Assessee' has been defined in Section 2(7) of the Act according to which assessee means a person by whom any tax or any other sum of money (i.e. interest, penalty etc.) is payable under the Act and includes:

(a)Every person in respect of whom any proceeding under this Act has been taken for the assessment of his income or assessment of fringe benefits or of the income of any other person in respect of which he is assessable or to determine the loss sustained by him or by such other person or to determine the amount of refund due to him or to such other person.

(b) Every person who is deemed to be an assessee under any provision of this Act.

(c) Every person who is deemed to be an assessee in default under any provision of this Act.

Accordingly, assessee is a person by whom tax or any other sum is payable under the Act.

The expression "other sum of money" includes

– fine, interest, penalty and tax or

– person to whom any refund of tax etc. is due under the Act or

– if any proceeding under the Act has been taken against any person, he is also an assessee.

The term Assessee is used under the following circumstances:

- **Ordinary Assessee** is used to denote:
  - Any person against whom some proceedings under this Act are going on. It is immaterial whether any Tax or other amount is payable by him or not ;
  - Any person who has sustained loss and has filed return of Loss u/s 139(3).

- Any person by whom some amount of Interest , Tax or Penalty is payable under this Act ; or
- Any person who entitled to refund of Tax under this Act.

- **Representative Assessee or Deemed Assessee**is used to denote a person who may be for the income or loss of other persons e.g. Guardian of Minor or Lunatic, Agent ofa Non-Resident etc. In such case the persons responsible for the assessment of Income of such persons are called Representative Assessee. Such person is deemed to be an Assessee.
- **Assessee-in-default**is used to denotea person if he does not fulfil his statutory obligations to pay tax. In case of an employer paying Salary or a person who is paying interest it is their duty to deduct tax at source and deposit the amount of tax so collected in Government treasury. If he fails to deduct tax at source or deducts tax but does not deposit it in the treasury, he is considered an Assessee-in-default.

3.6 ASSESSMENT YEAR & PREVIOUS YEAR

Assessment Year is defined under Section 2 (9) as, "assessment year" means the period of twelve months commencing on the 1st day of April every year. Under Section 3, "previous year" is defined to be the financial year immediately preceding the assessment year, provided that, in the case of a business or profession newly set up, or a source of income newly coming into existence, in the said financial year, the previous year shall be the period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly comes into existence and ending with the said financial year.

3.7 DIVIDENDS

The definition provided under The Income Tax Act, 1961 in respect of the term ‘Dividend’, is exhaustive in nature. It illustrates the items that form a part of the Dividend and those that are excluded from it.

3.7.1 Inclusive Part

Section 2 (22), provides that "dividend" includes—

(a) any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company;

(b) any distribution to its preference shareholders of shares by way of bonus, to the extent to which the company possesses accumulated profits, whether capitalised or not;

(c) any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not ;

(d) any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits, whether such accumulated profits have been capitalised or not ;

(e) any payment by a company, not being a company in which the public are substantially interested, of any sum, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares holding not less than ten per cent of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest, to the extent to which the company in either case possesses accumulated profits.

- **Deemed Dividend: Sec. 2(22) (e)**

Section 2(22) (e) purports to cover circumstances that are generally not construed as Dividend under the Companies Act, so as to make them amenable to the tax that is levied on 'Dividend' and thus the usage of the term 'Deemed Dividend'.

It was observed by the Supreme Court in CIT v. Raj Kumar[34], that the object behind this Section was to bring within the tax net accumulated profits which are distributed by closely held companies to its shareholders in the form of loans. The purpose being that persons who manage such closely held companies should not arrange their affairs in a manner that they assist the shareholders in avoiding the payment of taxes by having these companies pay or distribute, what would legitimately be dividend in the hands of the shareholders, money in the form of an advance or loan.

Section 2(22) (e), covers two scenarios, viz.:

- **Loans and Advances to a shareholder or payment on behalf of or for the benefit of a shareholder**

To fall under this category, the following conditions need to be fulfilled:

1. payment by way of loan or advance is given by a company in which the public are not substantially interested;
2. payment is made after May, 31, 1987 by way of loan or advance to a shareholder (being a person who is a registered shareholder as well as the beneficial owner of at least 10 percent equity shares):

[34](2009) 181 Taxmann 155 (Delhi)

3. the company should possess accumulated profits (excluding capitalized profits) at the time it makes payment of loan or advance.

   If the above conditions are fulfilled the amount so given as loans/advances to the shareholder is treated as Dividend, to the extent of Accumulated Profits available.

- **Loans or Advances to a concern**

Loan and Advances to a Concern [being either a Hindu Undivided Family/ firm/ company/ Association Of Persons/Body Of Individuals] are treated as Dividend, provided the following conditions are met:

1. loan or advance is given by a company in which the public are not substantially interested;
2. loan or advance is given after May, 31, 1987;
3. the company should possess accumulated profits (excluding capitalized profit) at the time it makes payment of loan or advance; and
4. loan or advance is given to a concern (i.e. a Hindu Undivided Family or a Firm or an Association of Persons or a Body of Individuals or a Company) in which a shareholder (which is a registered shareholder as well as beneficially holding at least 10 percent equity share capital) of the company (giving loan or advance) has substantial interest.[35]

3.7.2. Exclusive Part

Section 2(22) also provides that the term ‘Dividend’ does not include the following: but "dividend" does not include—

(i) a distribution made in accordance with sub-clause (c) or sub-clause (d) in respect of any share issued for full cash consideration, where the holder of the share is not entitled in the event of liquidation to participate in the surplus assets ;

(ii) a distribution made in accordance with sub-clause (c) or sub-clause (d) in so far as such distribution is attributable to the capitalised profits of the company representing bonus shares allotted to its equity shareholders after the 31st day of March, 1964, [and before the 1st day of April, 1965;

(ii) any advance or loan made to a shareholder [or the said concern] by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company ;

[35]A person shall be deemed to have a substantial interest in a concern, if he is at any time during the previous year, beneficially entitled to at least 20% of income of such concern (if such concern is a company, then he should beneficially hold at least 20 percent equity share capital of the company).

(iii) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e), to the extent to which it is so set off;

(iv) any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956 (1 of 1956);

(v) any distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

3.7.3. Profits

- **Accumulated Profits**

The undistributed income, when accumulated from year to year, generates what is known as "accumulated profit". Accumulated profits shall include all profits of the company till the date of distribution or payment referred to in sub-clause.

- **Current Profits**

Current profits are included in "accumulated profits" in section 2(22)(e) of I.T. Act 1961. The expression "accumulated profits" was defined in the 1961 Act so as to include current profit upto date of distribution or payment.

- **Computation of Accumulated Profits**

The phrase "accumulated profits" does not mean aggregate of the assessed profits but rather indicates commercial profits. In computation of Commercial Profits, all the disbursements made and expenditure incurred for the purpose of carrying out the business activities are to be taken into consideration. The following are the items which are to be included or to be excluded in computing accumulated profits:

Sl. No.	Items to be excluded	Items to be included
a)	Provisions made in respect of taxation and dividend[36]	Development-Rebate
b)	Depreciation	Refund of income-tax
c)	The Difference between Depreciation as per the Income Tax Act and the Depreciation as per the Rate adopted in the Book of Account	Development rebate reserve

[36]CIT v Damodaran (1972) 85 ITR 59 (Ker.).

d)	Balancing charge[37]	General Reserve[38]
e)	Capital gains not chargeable to tax[39]	Capital gains chargeable to tax

It has been observed by the Supreme Court in P. K. Badiani v. CIT[40], that in determination of Accumulated Profits, the amount treated as deemed dividend under section 2(22)(e) in past have to be excluded, irrespective of the fact that no adjustment is made in the books of accounts.

3.8 SECURITY

Explanation two to Section 2(42A), makes a passing reference of the term "Security", providing that the term shall have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 [hereinafter, SCRA].

Section 2(h) of the SCRA, provides that the term "securities" shall include:

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate; a derivative;

(ii) units or any other instrument issued by any collective investment scheme to the investors in such schemes;

(iii) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(iv) units or any other such instrument issued to the investors under any mutual fund scheme;

(v) Government securities;
such other instruments as may be declared by the Central Government to be securities; and

(vi) rights or interest in securities.

In the case of Sudhir Shantilal Mehta vs C.B.I[41], the Supreme Court of India observed that the definition of `securities' is an inclusive one. It is not exhaustive. It takes within its purview not only the matters specified therein but also all other types of securities as commonly understood. The term `securities', thus, should be given an expansive meaning.

[37] CIT v. Urmila Ramesh (1998) 96 TAXMAN 533 (SC)
[38] CIT v. Srinnivasan K. (1963) 50 ITR 788 (Mad.)
[39] Explanation 1 to Section 2(22)
[40](1976) 105 ITR 642 (SC)
[41] [2009] INSC 1421

3.8 SUMMARY

- The definition of Income as given in Section 2(24) of the Act starts with the word includes therefore the list is inclusive not exhaustive.
- The scope of total income and consequently the liability to income-tax also depends upon the following facts:
    - Whether The Income Accrues Or Is Received In India Or Outside
    - The Exact Place And Point Of Time At Which The Accrual Or Receipt Of Income Takes Place
    - The Residential Status Of The Assessee
- The word 'Assessee' has been defined in Section 2(7) of the Act according to which assessee means a person by whom any tax or any other sum of money (i.e. interest, penalty etc.) is payable under the Act
- "assessment year" means the period of twelve months commencing on the 1st day of April every year.
- "previous year" is defined to be the financial year immediately preceding the assessment year

3.9 KEY WORDS

- Assessee
- Financial year
- Accumulated Profits
- Deemed Dividend

3.10 SELF ASSESSMENT QUESTIONS

1. Explain the Concept of 'Income' and State its various Components.

....

....

2. Briefly elucidate the Tax Incidence of Persons.

....

....

3. Explain the expressions "person" and "Assesse" under the Income Tax Act 1961. Does the Term 'Assesse' denote all the persons?

....

....

4. Write Short Notes on the following:

a. Assessment Year and Previous Year.

b. Security

3.11 REFERENCES

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UNIT – 4: HEADS OF INCOME – TAX FREE INCOMES - ALLOWANCES, DEDUCTIONS – REBATES AND RELIEFS

Structure:

4.0 Objectives

4.1 Introduction

4.2 Non-Taxable income

4.3 Deductions

4.4 Rebates & Reliefs

4.4.1 Rebates

4.4.2 Reliefs

4.5 Summary

4.6 Key Words

4.7 Self Assessment Questions

4.8 Reference

4.0 OBJECTIVES

- To understand the concept of of Tax-Free Incomes.
- To know the various kinds of Allowances that are exempted from tax liability.
- To gain insight into the Rebate and other Reliefs under the Income Tax Act 1961.

4.1 INTRODUCTION

In accordance to Section 14 under Chapter IV to the Income Tax Act 1961, there are broadly five heads under which Income is classified for the purpose of Income Tax Act 1961. The total income is first assessed under heads of income and then it is charged for Income Tax as under rules of Income Tax Act. They are:

I. Income from Salary.
II. Income from House-Property.
III. Income from Profit or Gains from Business or Profession
IV. Income from Capital Gains
V. Income from Other Sources.

4.2 NON-TAXABLE INCOMES

Chapter III to the Income Tax Act 1961 deals with Non-taxable Incomes. Section 10 provides for various categories of income that are exempt from tax. Section 10AA, deals with the exemption in case of income of industrial units in Special Economic Zones. Section 11 provides exemption in respect of income derived from property held under trust wholly for charitable or religious purposes and section 13A exempts income derived by a political party. Section 10 provides that in computing the total income of a previous year of any person, any income that falls therein shall not be included in the total income, provided the assessee proves that the particular item is exempt and falls within a particular clause of Section 10. The onus to prove that the income falls under Section 10 lies on the Assessee. A few of the exempted ones are discussed below.

I. AGRICULTURAL INCOME

The reason for exemption of agriculture income from Central Taxation is that the Constitution gives exclusive power to make laws with respect to taxes on agricultural income to the State Legislature.

An Agricultural Income comprises of the following:

(i) Any rent received from land which is used for agricultural purpose:

The land must be used for agricultural purposes. There must be some measure of cultivation on the land, some expenditure of skill and labour upon it, to have been used for agricultural purposes within the meaning of the Act.[42] he operations on the land for agricultural purposes can be:

a. Basic operation: These include tilling of the land, sowing of seeds, planting or an operation of a similar kind (digging pits in the soil to plant a sapling).
b. Subsequent operations: These include weeding, digging the soil around the growth, nursing, pruning, cutting, etc.

(ii) Any income derived from such land by agricultural operations including processing of agricultural produce, raised or received as rent in kind so as to render it fit for the market, or sale of such produce.

(iii) Income attributable to a farm house subject to the condition that building is situated on or in the immediate vicinity of the land and is used as a dwelling house, store house etc. Income from such farm houses is considered agricultural income. The definition of `farm houses' covers buildings owned and occupied by both cultivators of agricultural land and assessees who receive rent or revenue from agricultural land. The sole purpose of such farmhouses should be for use as dwellings for the cultivators or use as store houses

(iv) Income earned from carrying nursery operations is also considered as agricultural income and hence exempt from income tax.

- **Income Connected with Land but not Agricultural Income**

There are certain incomes which are derived from land but they are not agricultural incomes because the requisite conditions land must be used for agricultural purposes and it must be the primary source of income are not satisfied in such cases. In Bacha F. Guzdar v. CIT [43], the Supreme Court held that dividend received from a company earning agricultural income is not an agricultural income in the hands of the shareholders and therefore does not qualify for exemption under Section 10 (1) which grants exemption to agricultural income.

Few other examples of such incomes are as follows:

(a) Income from spontaneous growth of grass, trees or bamboos;

(b) Dividend from a company engaged in agriculture;

(c) Salary of a farm manager;

(d) Income from mines;

(e) Income from stone quarries;

[42] Mustafa Ali Khan v. CIT (16 ITR 330)
[43] (1955) 27 ITR 1(SC)

(f) Income from fisheries;

(g) Income from brick making;

(h) Income from supply of water for irrigation purposes;

(i) Profit accruing from the purchase of a standing crop and resale thereof after harvest;

(j) Income from animal kingdom.

- **Partly-Agricultural Income**

According to Rule 7 of the Income-tax Rules, 1962- in case of income which is partially agricultural income as defined under section 2 and partially income chargeable to income-tax under the head "Profits and gains of business", in computation of that part that is taxable, the market value of any agricultural produce that has been received or raised by the assessee either in cash or kind and which has been utilized as a raw material in such business or the sale receipts of which are included in the accounts of the business shall be deducted, and no further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator. For this purpose "market value" shall be deemed to be:

(a) where agricultural produce is ordinarily sold in the market in its raw state, or after application to it of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render it fit to be taken to market, the value calculated according to the average price at which it has been so sold during the relevant previous year;

(b) where agricultural produce is not ordinarily sold in the market in its raw state or after application to it of any process aforesaid, the aggregate of:

(i) the expenses of cultivation;

(ii) the land revenue or rent paid for the area in which it was grown; and

(iii) such amount as the Assessing Officer finds, having regard to all the circumstances in each case, to represent a reasonable profit.

i. **Income From Manufacture of Rubber [Rule 7A]**

(1) Income derived from the sale of centrifuged latex or cenex or latex based crepes (such as pale latex crepe) or brown crepes (such as estate brown crepe, remilled crepe, smoked blanket crepe or flat bark crepe) or technically specified block rubbers manufactured or processed from field latex or coagulum obtained from rubber plants grown by the seller in India shall be computed as if it were income derived from business, and thirty-five percent of such income shall be deemed to be income liable to tax.

(2) In computing such income, an allowance shall be made in respect of the cost of planting rubber plants in replacement of plants that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of clause (31) of Section 10, is not includible in the total income.

ii. Income From Manufacture of Coffee [Rule 7B]

(1) Income derived from the sale of coffee grown and manufactured by the seller in India, with or without mixing of chicory or other flavouring ingredients, shall be computed as if it were income derived from business, and twenty five percent of such income shall be deemed to be income liable to tax. Income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India, with or without mixing chicory or other flavouring ingredients shall be computed as if it were income derived from business, and fourty per cent of such income shall be deemed to be income liable to tax.

(2) In computing such income, an allowance shall be made in respect of the cost of planting coffee plants in replacement of plants that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of clause (31) of Section 10, is not includible in the total income.

iii. Income From Manufacture of Tea [Rule 8]

Out of the income derived from the sale of tea grown and manufactured by the seller in India, sixty per cent is treated as agricultural income and forty per cent as business income. In computing the income, with all other costs, the cost of planting bushes in replacement of bushes that have died or become permanently useless shall be deducted.

This method of computation is to be applied only if the following conditions are satisfied:

i. The seller must himself have grown the tea plants.

ii. The tea plants must have been grown in India.

II. MONEY RECEIVED BY AN INDIVIDUAL AS A MEMBER OF H.U.F. [SECTION 10(2)]

Any sum received by an individual in his capacity as a member of H.U.F. is wholly exempt from income-tax where such sum has been paid out of the income of the family, or out of the income of an impartible estate belonging to the family, because that has been taxed in hand of H.U.F.

This section is however subject to the provisions of Section 64(2), where the income from self acquired assets that are converted into property of the H.U.F. are to be clubbed with the income of the person who makes the conversion subject to certain conditions.

III. SHARE OF PROFIT FROM PARTNERSHIP FIRM [SECTION 10(2A)]

The income earned by a person being a partner of a firm (including Limited Liability Partnerships) which is separately assessed as such is exempt from tax. For the purposes of this clause, the share of a partner in the total income of a firm separately assessed as such shall be an amount which bears to the total income of the firm the same proportion as the amount of his share in the profits of the firm in accordance with the partnership deed bears to such profits.

IV. INTEREST INCOME OF NON-RESIDENTS [SECTION 10(4)]

(i) In the case of non-residents any income from interest on such securities or bonds as the Central Government may by notification in the Official Gazette specify in this behalf including income by way of premium on the redemption of such bonds.

(ii) In the case of an individual, any income by way of interest on moneys standing to his credit in a Non-resident (External) Account in any bank in India in accordance with the Foreign Exchange Management Act, 1999 and the Rules made thereunder.

V. INTEREST INCOME OF NON-RESIDENTS FROM SPECIFIED SAVINGS CERTIFICATES [SECTION 10(4B)]

In the case of an individual being a citizen of India or a person of Indian origin, who is a non-resident, any income from interest on notified savings certificates issued before the 1st day of June, 2002 by the Central Government will be exempt taxes, provided that he subscribes to such certificates in foreign currency or other foreign exchange remitted from a country outside India in accordance with the provisions of the Foreign Exchange Management Act, 1999 and such other rules made thereunder.

VI. TRAVEL CONCESSION OR ASSISTANCE TO A CITIZEN OF INDIA [SECTION 10(5)]

In the case of an individual, the value of any travel concession or assistance received by, or due to, him,

(a) from his employer for himself and his family, in connection with his proceeding on leave to any place in India ;

(b) from his employer or former employer for himself and his family, in connection with his proceeding to any place in India after retirement from service or after the termination of his service, subject to such conditions as may be prescribed shall be exempt from taxes.

The exemption is subject to the condition that in no case, the exemption shall exceed the amount of expenses actually incurred for the purpose of such travel. The exemption is not just for the individual but also for his family. For the purposes of this clause, "family", in relation to an individual, means—

(i) the spouse and children of the individual ; and

(ii) the parents, brothers and sisters of the individual or any of them, wholly or mainly dependent on the individual.

VII. EXEMPTIONS TO AN INDIVIDUAL WHO IS NOT A CITIZEN OF INDIA [SECTION 10(6)]

(i) **Remuneration of Diplomats etc. [Section 10(6)(ii)]**: In case of Individual who is not a citizen of India, any remuneration received by him as an official, by whatever name called, of an embassy, high commission, legation, commission, consulate or the trade representation of a foreign State, or as a member of the staff of any of these officials, for service in such capacity: However, the remuneration received by him as a trade commissioner or other official representative in India of the Government of a foreign State (not holding office as such in an honorary capacity), or as a member of the staff of any of those officials, shall be exempt only if the remuneration of the corresponding officials or, as the case may be, members of the staff, if any, of the Government of India, resident for similar purposes in the country concerned enjoys a similar exemption in that country. However it is subject to the condition that such members of the staff are subjects of the country represented and are not engaged in any business or profession or employment in India otherwise than as members of such staff.

(ii) Remuneration received by foreign individual [Section 10(6)(iv)]: The remuneration received by a foreign individual in his capacity as an employee of a foreign enterprise for the services rendered by him during his stay in India would be exempt if the following conditions are fulfilled:

- The foreign enterprise is not engaged in any trade or business in India.
- The total period of stay of the individual in India during the previous year does not exceed 90 days.

- Such remuneration is not liable to be deducted from the income of the employer chargeable to tax in India under the Income-tax Act.

(iii) Non-resident employee on a foreign ship[Section 10(6)(vii)]: Income chargeable under the head 'Salaries' received by or due to any non-resident individual as remuneration for the services rendered by him in connection with his employment on foreign ship is exempt from tax where the total period of his stay in India does not exceed a period of 90 days during the previous year.

(iv) Remuneration of employee of foreign Government during his training in India [Section 10(6)(xi)]: The remuneration received by an individual being a foreign citizen as an employee of the government of a foreign State during his stay in India in connection with his training in any establishment or office of, or in any undertaking owned by:

(a) The government; or

(b) Any company in which the entire paid-up capital is held by the Central Government, or any State Government or Governments; or partly by the Central Government and partly by one or more State Governments; or

(c) Any company which is a subsidiary of a company referred to in (b); or

(d) Any corporation established by or under a Central, State or Provincial Act; or

(e) Any society registered under the Societies Registration Act, 1860, or under any other corresponding law for the time being in force and wholly financed by the Central Government, or any State Government or partly by the Central Government and partly by one or more State Governments.

VIII. TAX PAID ON BEHALF OF FOREIGN COMPANIES IN RESPECT OF CERTAIN INCOME [SECTION 10(6A)]

In the case of a foreign company deriving income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or the Indian concern after the 31st day of March, 1976 but before the 1st day of June, 2002 and,

(a) where the agreement relates to a matter included in the industrial policy, for the time being in force, of the Government of India, such agreement is in accordance with that policy ; and

(b) in any other case, the agreement is approved by the Central Government, the tax on such income is payable, under the terms of the agreement, by Government or the Indian concern to the Central Government, the tax so paid.

IX. INCOME DERIVED BY A FOREIGN COMPANY [SECTION 10(6B)]

In the case of a non-resident (not being a company) or of a foreign company deriving income (not being salary, royalty or fees for technical services) from Government or an Indian concern in pursuance of an agreement entered into before the 1st day of June, 2002 by the Central Government with the Government of a foreign State or an international organisation, the tax on such income is payable by Government or the Indian concern to the Central Government under the terms of that agreement or any other related agreement approved before that date by the Central Government, the tax so paid

X. INCOME OF FOREIGN AIRCRAFT BUSINESS FROM LEASE [SECTION 10(6BB)]

In case of a foreign enterprise deriving income from an Indian company engaged in the business of operation of aircraft, as a consideration of acquiring an aircraft or an aircraft engine (other than payment for providing spares, facilities or services in connection with the operation of leased aircraft) on lease under an Agreement made after 31st March, 1997 but before 1.4.99 or after 31st day of March 2007 and approved by the Central Government in this behalf will be exempt from tax provided the tax thereon is paid by the Indian company on behalf of the foreign government or foreign enterprise.

XI. INCOME OF ANY MEMBER OF THE FAMILY [SECTION 10(9)]

The income of any member of the family of any such individual referred to in the preceding, accompanying him to India which accrues or arises outside India and is not deemed to accrue or arise in India, is also exempt from tax provided that the member is required to pay any income-tax or social security tax to the Government of that foreign State on such income or as the case may be to the country of origin of such member.

XII. DEATH-CUM-RETIREMENT GRATUITY [SECTION 10(10)]

Any payment in commutation of pension received under the Civil Pensions (Commutation) Rules of the Central Government or under any similar scheme applicable 36[to the members of the civil services of the Union or holders of posts connected with defence or of civil posts under the Union (such members or holders being persons not governed by the said Rules) or to the members of the all-India services or to the members of the defence services or to the members of the civil services of a State or holders of civil posts under a State or to the employees of a local authority] or a corporation established by a Central, State or Provincial Act ;

However, any payment in commutation of pension received under any scheme of any other employer, shall be exempt, to the extent it does not exceed:

(a) in a case where the employee receives any gratuity, the commuted value of one-third of the pension which he is normally entitled to receive, and

(b) in any other case, the commuted value of one-half of such pension, provided that such commuted value being determined having regard to the age of the recipient, the state of his health, the rate of interest and officially recognised tables of mortality.

Where the employees are covered under the Payment of Gratuity Act, 1972, the amount of any gratuity received under The Payment of Gratuity Act, 1972, it shall be exempt from tax to the extent of least of the following:

- fifteen days' wages (seven days' wages in case of seasonal establishments) for each completed year of service or part thereof in excess of six months on the basis of salary last drawn for every completed year of service or part thereof in excess of six months; or
- the gratuity actually received; or
- Rupees 10,00,000

XIII. RETRENCHMENT COMPENSATION [SECTION 10(10B)]

Any compensation received by a workman under the Industrial Disputes Act, 1947 or under any other Act or rules, orders or notifications issued thereunder or under any standing orders or under any award, contract of service or otherwise, at the time of his retrenchment. The amount is exempt under this clause to the extent of least of the following limits:

- Actual amount received.
- Amount specified by Central Government i.e. ` 5,00,000.
- An amount calculated in accordance with the provisions of clause (b) of Section 25F of the Industrial Disputes Act, 1947 i.e. 15 day's average pay for every completed years of services or part thereof in excess of 6 months.

XIV. HOUSE RENT ALLOWANCE [SECTION 10(13A)]

Any special allowance specifically granted to an employee by his employer to meet expenditure actually incurred on payment of rent in respect of residential accommodation occupied by the assessee, is exempt to the extent of least of the following:

(i) Actual amount of such allowance received in respect of the relevant period; or

(ii) Rent paid over 10% of salary [Rent paid – 10% of salary]

(iii) an amount equal to:

- where such accommodation is situated at Mumbai, Kolkatta, Delhi or Chennai, one-half of the amount of salary due to the assessee in respect of the relevant period; and
- where such accommodation is situated at any other place, two-fifth of the amount of salary due to the assessee in respect of the relevant period.

XV. SPECIAL ALLOWANCE [SECTION 10(14)]

(a) Any special allowance in cash or the value of any benefit granted by the employer to an employee with the specific object of enabling the employee to meet expenses 'wholly', 'necessarily' and 'exclusively' incurred by him in the performance of the duties of his office or employment of profit, is exempt from tax to the extent to which such expenses are actually incurred for that purpose. This allowance may include travelling allowance to agents, conveyance allowance, transfer allowance, etc., but it does not include entertainment allowance, perquisites and the allowance to meet personal expenses (i.e. City Compensatory Allowance) at the place where the duties of office are performed by him or at the place where he ordinarily resides.

(b) The allowances granted to the assessee to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at the place where he resides, or to compensate him for the increased cost of living, as the Central Government may, by notification in the Official Gazette specify, shall not form part of the total income of the assessee to such notified extent.

XVI. SCHOLARSHIPS [SECTION 10(16)]

Scholarships granted to meet the cost of education would be exempt in every case regardless of the residential status or citizenship of the scholar and the person from whom the scholarships are received.

XVII. INCOME FROM PROPERTY HELD FOR RELIGIOUS OR CHARITABLE PURPOSES [SECTION 11]

- **Asset held wholly for Religious or Charitable purposes**

A capital asset held under trust wholly for charitable or religious purposes is transferred resulting in a capital gain. The net consideration received on such transfer may be utilised wholly or in part in acquiring another capital asset to be so held wholly for religious or charitable purposes. In such cases the capital gains arising from the transfer shall be deemed to have been applied for charitable or religious purposes to the extent stated here in below:

(i) Where the whole of the net consideration is utilised for acquiring the new capital assets, so much of the

capital gains.

(ii) Where only a part of the net consideration is utilised for acquiring the new capital asset, so much of the capital gain as is equal to the amount by which the amount so utilised exceeds the cost of the transferred asset.

- **Assets held partly for religious or charitable purposes**

Where a capital asset, held partly for religious or charitable purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset, the appropriate fraction of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified here under:

(i) 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;

(ii) 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.

- **Income of Trusts [Section 11(2)]**

The Income from trust property held for charitable purpose is permissible up to 25 per cent without attracting any liability to tax. Where the rest 75 percent is not applied, or is not deemed to have been applied, to charitable or religious purposes in India during the previous year but is accumulated or set apart, either in whole or in part, for application to such purposes in India, such income so accumulated, or set apart shall not be included in the total income of the previous year of the person in receipt of the income, provided the following conditions are complied with, namely:

(i) the assessee gives a notice to the Assessing Officer, in the prescribed manner, specifying the purpose for which the income is being accumulated or set apart and the period for which income is to be accumulated or set apart which shall in no case exceed 10 years.

(ii) the money so accumulated or set apart is invested or deposited in the forms or modes specified in Subsection (5).

However, in respect of any income accumulated or set apart on or after the 1st day of April, 2001 the provisions of this sub-section shall have effect as if for the words “ten years” at both the places where they occur, the words “five years” has been substituted.

Section 11(3) provides that:

(i) if the income accumulated for the specific purpose under Section 11(2) is applied to purposes other than charitable or religious, or ceases to be accumulated or set apart for application thereto, it will be chargeable to tax as income of that year. Further, such accumulated income will become liable to be taxed if,

(ii) it ceases to remain invested in any security or deposited in the manner provided under Section 11(5), or

(iii) it is not utilised for the purpose for which it is so accumulated or set apart during the specified period, or in the year immediately following the expiry thereof;

(iv) is credited or paid to any trust or institution registered under Section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical insitution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of Section 10 , It shall be deemed to be the income of the previous year in which it ceases to remain so invested or deposited or is not so utilised, as the case may be.

Section 11(3A) provides that where due to circumstances beyond the control of the person in receipt of the income, any income invested or deposited in accordance with the provisions of Section 11(2) cannot be applied for the purpose for which it was accumulated or set apart, the Assessing Officer may, on an application made to him in this behalf allow such person to apply such income for such other charitable or religious purpose in India, as is specified by the person in the application subject further to the condition that it is in conformity with the objects of the trust. Provided that the Assessing Officer shall not allow application of such income by way of payment or credit made for the purposes referred to in clause (d) of Sub-section (3) of section 11.

The forms and modes for investing funds of charitable and religions trusts and institutions are given hereunder, as provided under Sub-section (5) of Section 11:

(i) investment in saving certificates as defined in clause (c) of Section 2 of the Government Savings Certificates Act, 1959 (46 of 1959), and any other securities or certificates issued by the Central Government under the Small Savings Schemes of that Government. Investments in Indira Vikas Patra and Kisan Vikas Patra also qualify for the purpose of this Section;

(ii) deposit in any account with the Post Office Savings Bank;

(iii) deposit in any account with a scheduled bank or a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank);

Explanation: In this clause, “scheduled bank” means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959), a corresponding new bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), or under Section 3 of theBanking Companies (Acquisition and Transfer of Undertaking Act, 1980 (40 of 1980), or any other bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);

(iv) investment in units of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);

(v) Investment in any security for money created and issued by the Central Government or a State Government;

(vi) Investment in debentures issued by, or on behalf of, any company or corporation both the principal whereof and the interest whereon are fully and unconditionally guaranteed by the Central Government or by a State Government;

(vii) Investment or deposit in any public sector company;

Provided that where an investment or deposit in any public sector company has been made and such public sector company ceases to be a public sector company:

(A) such investment made in the shares of such company shall be deemed to be an investment made under this clause for a period of three years from the date on which such public sector company ceases to be a public sector company;

Investment in debt instruments issued by and infrastructure Finance Company registered with RBI.

(B) such other investment or deposit shall be deemed to be an investment or deposit made under this clause for the period up to the date on which such investment or deposit becomes repayable by such company;

(viii) deposits with or investment in any bonds issued by a financial corporation which is engaged in providing long-term finance for industrial development in India and which is eligible for deduction under clause

(viii) of Sub-section (1) of Section 36;

(ix) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance or construction or purchase of houses in India for residential purposes and which is approved by the Central Government for the purposes of clause (viii) of Sub-section (1) of Section 36;

(ixa) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

Explanation: For the purpose of this clause:

(a) "long-term finance" means any loan or advance where the terms under which moneys are loaned or

advanced provide for repayment along with interest thereof during a period of not less than five years;

(b) "public company" shall have the meaning assigned to it in Section 3 of the Companies Act, 1956 (1 of 1956);

(c) "urban infrastructure" means a project for providing potable water supply, sanitation and sewerage,

drainage, solid waste management, roads, bridges and flyovers or urban transport.

(x) investment in immovable property.

Explanation: "Immovable property" does not include any machinery or plant (other than machinery or plant installed in a building for the convenient occupation of the building) even though attached to, or

permanently fastened to, anything attached to the earth;

(xi) deposits with the Industrial Development Bank of India established under the Industrial Development

Bank of India Act, 1964 [(18 of 1964)];

XVIII. INCOME OF TRUSTS FROM VOLUNTARY CONTRIBUTIONS (SECTION 12)

(1) The income of a trust by way of voluntary contributions would also be treated for all purposes as income deemed to have been derived by the trust from property held by it under trust except, however, in case where the voluntary contribution is received with a specific direction that it shall form part of the corpus of the trust. As a result, voluntary contribution received by a trust should also be applied for charitable purposes before the end of the accounting year or within 3 months following so that income-tax exemption

could be availed of. However, voluntary contributions could be accumulated for future obligation for charitable purposes in the same manner as specified earlier.

(2) The value of any services, being medical or educational services, made available by any charitable or religious trust running a hospital or medical institution or an educational institution, to any person referred to in Clause (a) or Clause (b) or Clause (c) or Clause (cc) or Clause (d) of Sub-section (3) of Section 13, shall be deemed to be income of such trust or institution derived from property held under trust wholly for charitable or religious purposes during the previous year in which such services are so provided and shall be chargeable to income-tax notwithstanding the provisions of Sub-section (1) of Section 11.

(3) Notwithstanding anything contained in Section 11, any amount of donation received by the trust or institution in terms of Clause (d) of Sub-section (2) of Section 80G which has been utilised for purposes other than providing relief to the victims of earthquake in Gujarat or which remains unutilised in terms of Sub-section 5(C) of Section 80G in respect of which accounts of income and expenditure have not been rendered to the authority prescribed under clause (v) of sub-section (5C) of that section, in the manner specified in that clause, and not transferred to the Prime Minister’s National Relief Fund on or before the 31st day of March, 2004 shall be deemed to be the income of the previous year and shall accordingly be charged to tax.

XIX. TAX EXEMPTIONS TO POLITICAL PARTIES (SECTION 13A)

Political Parties are assessed as ‘An association of persons’. However, the income derived by these parties as income by way of voluntary contributions, Income from House Property; and Income from Other Sources or Capital Gains are exempt from subject to the following conditions:

(i) the party keeps and maintains such books of account and other documents as would enable the Assessing Officer to properly deduce the income;

(ii) in respect of each such voluntary contribution in excess of ` 20,000, the party keeps and maintains a record of the contributions and names and addresses of the persons who have made such contribution; and

(iii) the accounts of the party are audited by a Chartered Accountant or other qualified accountant.

The Chief Executive Officer of the political party is required to file a return of income if the total income (computed under this Act without giving effect to the provisions of Section

13A) exceeds the maximum amount which is not chargeable to income-tax. In this connection, the provisions of Section 139(1) shall apply.

XX. VOLUNTARY CONTRIBUTIONS RECEIVED BY AN ELECTORAL TRUST (SECTION 13B)

Any voluntary contributions received by an electoral trust shall not be included in the total income of the previous year of such electoral trust, if

(a) such electoral trust distributes to any political party, registered under section 29A of the Representation of the People Act, 1951, during the said previous year, ninety-five per cent of the aggregate donations received by it during the said previous year along with the surplus, if any brought forward from any earlier previous year; and

(b) such electoral trust functions in accordance with the rules made by the Central Government.

'Electoral Trust' means a trust so approved by the Board in accordance with the scheme made in this regard by the Central Government.

4.3 DEDUCTIONS

In computing the total income of an assessee, there shall be allowed from his gross total income, in accordance with and subject to the provisions of this Chapter, the deductions specified in sections 80C to 80U, contained in Chapter VI A to the Income Tax Act 1961.The Deductions are however subject to the condition that the aggregate amount of the Deductions shall not, in any case, exceed the gross total income of the assessee.

SECTION	NATURE OF DEDUCTION/ AMOUNT OF DEDUCTION
80C	This section provides for deduction from income in respect of various investments/ expenditures/payments in respect of which tax rebate u/s 88 was earlier available. The total deduction under this section is limited to INR 1 lakh only.
80CCC	The Payment of premium for annuity plan of LIC or any other insurance, the Deduction is available upto a maximum of INR 10,000/-
80CCD	Deposit made by an employee in his pension account to the extent of 10% of his salary.
80CCF	Subscription to long term infrastructure bonds

80D	Payment of medical insurance premium. Deduction is available upto INR15,000/ for self/ family and also upto INR 15,000/- for insurance in respect of parent/ parents of the assessee. In case of senior citizens, a deduction upto INR20,000/- shall be available under this Section.
80DD	Deduction of INR50,000/ — in respect of (a) expenditure incurred on medical treatment, (including nursing), training and rehabilitation of handicapped dependent relative. (b) Payment or deposit to specified scheme for maintenance of dependent handicapped relative. Further, if the dependent is a person with severe disability a deduction of INR1,00,000/- shall be available under this section
80DDB	Deduction of INR40,000/ or the amount actually paid, whichever is less, in respect of medical expenditure incurred. In case of senior citizens, a deduction upto INR60,000/- shall be available under this Section.
80E	Deduction in respect of payment in the previous year of interest on loan taken from a financial institution or approved charitable institution for higher studies.
80EE	Deduction in respect of interest on loan taken for residential house property
80G	Donation to certain funds, charitable institutions etc.
80GG	Deduction available is the least of either of the following: i Rent paid less 10% of total income ii. INR2000 per month iii. 25% of total income
80TTA	Deduction in respect of interest on deposits in savings account
80U	Deduction of INR50,000/- to an individual who suffers from a physical

	disability (including blindness) or mental retardation. Further, if the individual is a person with severe disability, deduction of INR1,00,000/- shall be available u/s 80U.
87A	Rebate Of Rs 2000 For Individuals Having Total Income upto INR 5 Lakh
80RRB	Deduction in respect of any income by way of royalty in respect of a patent registered on or after 01.04.2003 under the Patents Act 1970 shall be available as:-INR 3 lakh or the income received, whichever is less.
80QQB	Deduction in respect of royalty or copyright income received in consideration for authoring any book of literary, artistic or scientific nature other than text book shall be available to the extent of INR 3 lakhs or income received, whichever is less.

4.4 REBATES & RELIEFS

Chapter VIII contained under the Income Tax Act 1961 provides for the provisions on rebates and reliefs.

4.4.1. <u>REBATES</u>

Section 87 as a general rule provides that the rebate is to be provided for the purpose of computation of Income Tax in accordance with the provisions of Chapter VIII. However the amount of rebate shall under no circumstances exceed the amount of income-tax (as computed before allowing the deductions under this Chapter) on the total income of the assessee with which he is chargeable for any assessment year.

- **Rebate Of Income-Tax In Case Of Certain Individuals [Section 87A]**

Section 87A of the Income Tax Act, 1961 was introduced in Finance Act, 2013 to give benefit to a large number of people whose net total income is less than Rs. 5,00,000/-. The rebate under this section is available to resident individuals from A.Y. 2014-15. The rebate available is the lesser of the following:

- 100% of tax payable on total income or
- Rs. 2,000/-.

Accordingly, an Assessee, being an individual resident in India, whose total income does not exceed 5 lakh rupees, shall be entitled to a deduction, from the amount of income-tax on his total income with which he is chargeable for any assessment year, of an amount equal to 100% of such income tax or an amount of 2,000 rupees, whichever is less.

Consequently any individual having income up to ` 2,20,000 will not be required to pay any tax and every individual having total income above ` 2,20,000/- but not exceeding `5,00,000/- shall get a tax relief of ` 2000/-.

- **Rebate On Life Insurance Premia, Contribution To Provident Fund, Etc. (Section 88)**

An assessee, being an individual, or a Hindu undivided family, shall be entitled to a deduction, from the amount of income-tax (as computed before allowing the deductions under this Chapter) on his total income with which he is chargeable for any assessment year, of an amount equal to—

(i) in the case of an individual or a Hindu undivided family, whose gross total income before giving effect to deductions under Chapter VI-A, is one lakh fifty thousand rupees or less, twenty per cent of the aggregate of the sums referred to in sub-section (2):

Provided that an individual shall be entitled to a deduction of an amount equal to thirty per cent of the aggregate of the sums referred if his income under the head "Salaries" —

(a) does not exceed one lakh rupees during the previous year before allowing the deduction under section 16; and

(b) is not less than ninety per cent of his gross total income, as defined in sub-section (5) of section 80B;

(ii) in the case of an individual or a Hindu undivided family, whose gross total income before giving effect to deductions under Chapter VI-A, is more than one lakh fifty thousand rupees but does not exceed five lakh rupees, fifteen per cent of the aggregate of the sums referred to in sub-section (2);

(iii) in the case of an individual or a Hindu undivided family, whose gross total income before giving effect to deductions under Chapter VI-A, exceeds five lakh rupees.

- **Rebate in respect of securities transaction tax [Section 88E]**

No deduction under this section shall be allowed in, or after, the assessment year beginning on the 1st day of April, 2009.

Where the total income of an assessee in a previous year includes any income, chargeable under the head "Profits and gains of business or profession", arising from taxable securities transactions, he shall be entitled to a deduction, from the amount of income-tax on such income arising from such transactions, computed in the manner provided in sub-section (2), of an amount equal to the securities transaction tax paid by him in respect of the taxable securities transactions entered into in the course of his business during that previous year. This is subject to the condition that:

- no deduction under this sub-section shall be allowed unless the assessee furnishes along with the return of income, evidence of payment of securities transaction tax in the prescribed form; and
- the amount of deduction under this sub-section shall not exceed the amount of income-tax on such income computed in the manner provided in sub-section (2).

For the purposes of sub-section (1), the amount of income-tax on the income arising from the taxable securities transactions, referred to in that sub-section, shall be equal to the amount calculated by applying the average rate of income-tax on such income.

4.4.2. RELIEFS WHEN SALARY IS PAID IN ADVANCE [Section 89]

Where an assessee is in receipt of a sum in the nature of salary, being paid in arrears or in advance or is in receipt, in any one financial year, of salary for more than twelve months or a payment which under the provisions of clause (3) of section 17 is a profit in lieu of salary, or is in receipt of a sum in the nature of family pension, being paid in arrears, due to which his total income is assessed at a rate higher than that at which it would otherwise have been assessed, the Assessing Officer shall, on an application made to him in this behalf, grant such relief as may be prescribed.

Provided that no such relief shall be granted in respect of any amount received or receivable by an assessee on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or in the case of a public sector company referred to in sub-clause (i) of clause (10C) of section 10, a scheme of voluntary separation, if an exemption in respect of any amount received or receivable on such voluntary retirement or termination of his service or voluntary separation has been claimed by the assessee under clause (10C) of section 10 in respect of such, or any other, assessment year.

4.5 SUMMARY

- Section 10 provides for various categories of income that are exempt from tax.
- Section 14 under Chapter IV to the Income Tax Act 1961, there are broadly five heads under which Income is classified for the purpose of Income Tax Act 1961.

- The reason for exemption of agriculture income from Central Taxation is that the Constitution gives exclusive power to make laws with respect to taxes on agricultural income to the State Legislature.
- Any special allowance in cash or the value of any benefit granted by the employer to an employee with the specific object of enabling the employee to meet expenses ‘wholly’, ‘necessarily’ and ‘exclusively’ incurred by him in the performance of the duties of his office or employment of profit, is exempt from tax to the extent to which such expenses are actually incurred for that purpose.
- Deductions are however subject to the condition that the aggregate amount of the Deductions shall not, in any case, exceed the gross total income of the assessee.

4.6 KEY WORDS

- Rebate
- Deduction
- Exemptions
- Income trusts

4.7 SELF ASSESSMENT QUESTIONS

1. Explain the Taxation of Agricultural Income.

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2. Does the Income Tax Act, 1962 provide for exemptions to an individual who is not a citizen of India, in respect of Taxation of the Income earned by such persons.

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3. Explain the provision relating to Taxing of Religious and charitable Trusts.

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4. Explain the concept and procedure of Rebate.

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UNIT – 5: COMPUTATION OF TOTAL INCOME UNDER DIFFERENT HEADS

Structure:

5.0 OBJECTIVES

- To provide insight into Computation of Income from salaries
- To learn the Computation of Income from house property
- To understand the Taxation of Profits and gains from business or profession
- To compute Income from Capital gains
- To understand the concept of Income from other sources

Total income of an assessee may be defined as gross total income as reduced by the amount permissible as deducted under section 80C to 80U.

5.1 INTRODUCTION

The taxable income can be calculated after aggregating the incomes from all sources and deducting the deductions under section 80C to 80U. We are giving here the detail how to compute taxable income and tax liability/payable thereon.

After calculating the taxable income the second step is to calculate income tax on that taxable income. The following step should be considered to compute income tax liability.

First calculate tax at special rates such as long-term capital gains, short-term capital gains.

Second: Calculate tax on normal rates on the balance of taxable income.

Total the tax under step first and second

Add: Education Cess @2% and Secondary & Higher Education Cess @1% on the tax liability.

Deduct: TDS/TCS if any

Deduct: Advance Tax if any

Balance is the tax payable or the Refund amount.

5.2. HEADS OF INCOME

Income of a person is classified into 5 categories. Thus, income belonging to a particular category is taxed under a separate head of income pertaining to that category. Section 14 under Chapter IV of the Income Tax Act 1961 has classified five different heads of income for the purpose of computation of total income.

The five heads of income are:

I. Income from salaries (Section 15 – 17)

II. Income from house property (Section 22 – 27)

III. 3.Profits and gains from business or profession (Section 28 – 44)

IV. Income from Capital gains (Section 45 – 55)

V. Income from other sources (Section 56 – 59)

Format for Computation of Total Income:

Sl.No	Heads of Income	Amount (Rupees)	Amount (Rupees)
1	**Income from Salaries**		
	Basic salary	xx	
	(+)Taxable Allowances	xx	
	(+)Taxable Perquisites	xx	
	GROSS SALARY	XX	
	Less: Deductions under Sec 16		
	Entertainment allowance[sec16(ii)]	(xx)	
	Professional Tax[sec16(iii)]	(xx)	
	Income from Salaries		**XX**
2	**Income from House Property**		
	Gross Annual Value	xx	
	Less: Municipal Taxes	(xx)	
	Adjusted Net Annual Value	XX	
	Less: Standard Deduction u/s 24(a)	(xx)	
	Interest on Borrowed Capital u/s 24(b)	(xx)	
	Income from House Property		**XX**
3	**Profits and Gains of Business or Profession:**		
	Net Profit as per Profit and Loss account		
	(as per working note 1)	xx	
	Profit and gains of Business or Profession		**XX**
4	**Income from Capital Gains**		
	Amount of capital gains	xx	
	Less: Amount exempt u/s 54,54B,54D,etc	(xx)	
	Income from Capital Gains		**XX**
5	**Income from Other Sources**		
	Gross Income	xx	
	Less: Deduction u/s 57	(xx)	
	Income from Other Sources		**XX**

	Total (i.e 1+2+3+4+5) Less: Adjustments on Account of Set Off and Carry Forward of Losses. **Gross Total Income**	XX (xx)	 **XX**
	Deductions under Section 80C to 80U **TOTAL INCOME OR NET INCOME** [rounded off u/s 288A]	(xx)	 **XX**X

5.3 INCOME FROM "SALARY"

Meaning of Salary: Any remuneration paid by an employer to an employee in consideration of his services is called salaries. It includes monetary value of those benefits and facilities, which are provided by the employer and are taxable.

Income forming part of salary: They include basic salary, advance salary, fees, commission, and bonus, taxable value of cash allowances, perquisites and retirement benefits. **Section 17** of the Act gives an inclusive definition of salary. Broadly, it includes:

- Basic salary
- Fees, Commission and Bonus
- Taxable value of cash allowances
- Taxable value of perquisites
- Retirement Benefits

Allowances:

On the basis of its nature they are categorised under the following heads:

I. **Taxable Allowances:** Dearness allowance, Medical allowance, Servant allowance, Warden Allowance, Family allowance, City Compensatory allowance etc.

II. Allowances exempt upto specified limit:

a. **House Rent Allowance:**

Under sections 10(13A) of Income Tax Act, 1961 allowance is defined as an amount received by an employee paid by his/ her employer as a rent of his/her house. It is a taxable income. There is no exemption in tax if he is living in his own house or house for which he is not paying rent. There are following amount which are exempt from tax:

- Actual house rent paid by that individual

- Rent paid for the accommodation over 10% of the salary
- 50% of the salary if house is placed at Delhi, Mumbai, Kolkata, Chennai or 40% of the salary in it is placed in any other city

b. **Entertainment Allowance:**

It is the amount paid by employer for availing entertainment services. Under section 16(ii) of Income Tax Act, 1961 it is entitled to deduction in tax from is salary. But in this case deduction is given to his gross salary which also includes entertainment allowance. Deduction in tax against this allowance can be divided into two parts :

In case of Government employee entitled to minimum deduction of

- a sum equal to onefifth of his salary (exclusive of any allowance, benefit or other perquisite) or
- five thousand rupees, whichever is less

III. **Fully exempted allowances**: Foreign allowance, sumptuary allowance to High Court / Supreme Court Judges, Allowances from U.NO.

5.4 INCOME FROM HOUSE PROPERTY

Conditions for Chargeability:

- The property should consist of any building or land appurtenant thereto.
- Assessee must be the owner of the property.
- The property may be used for any purpose, but it should not be used by the owner for the purpose of any business or profession carried on by him, the profit of which is chargeable to tax.

Meaning of composite rent:

The owner of a property may sometimes receive rent in respect of building as well as –

(1) Other assets like say, furniture, plant and machinery.

(2) For different services provided in the building, for E.g. – Lifts, Security,etc

Where composite rent includes rent of building and charges for different services (lifts, security etc.), the composite rent is has to be split up in the following manner -

(a) The sum attributable to use of property is to be assessed under section 22 as income from house property;

(b) The sum attributable to use of services is to charged to tax under the head "Profits and gains of business or profession" or under the head "Income from other sources".

Determination of Annual Value [Section 23]

This involves three steps:

Step 1 - Determination of Gross Annual Value (Hereinafter, GAV).

Step 2 – From GAV computed in step 1, deduct municipal tax paid by the owner during the previous year.

Step 3 – The balance will be the Net Annual Value (Hereinafter, NAV), which as per the Income-tax Act is the annual value.

Deemed to be let out property [Section 23(4)]

(a) Where the assessee owns more than one property for self-occupation, then the income from any one such property, at the option of the assessee, shall be computed under the self-occupied property category and its annual value will be nil. The other self-occupied/unoccupied properties shall be treated as "deemed let out properties".

(b) This option can be changed year after year in a manner beneficial to the assessee.

Thus, under this head of income, there are circumstances where notional income is charged to tax instead of real income. For example –

Where the assessee owns more than one house property for the purpose of self-occupation, the annual value of any one of those properties, at the option of the assessee, will be nil and the other properties are deemed to be let-out and income has to computed on a notional basis by taking the ALV as the GAV.

In the case of let-out property also, if the ALV exceeds the actual rent, the ALV is taken as the GAV.

Property taxes (Municipal taxes)

(1) Property taxes are allowable as deduction from the GAV subject to the following two conditions:

(a) It should be borne by the assessee (owner); and

(b) It should be actually paid during the previous year.

Deductions from Annual Value [Section 24]

There are two deductions from annual value. They are –

- 30% of NAV; and
- interest on borrowed capital

(a) Interest payable on loans borrowed for the purpose of acquisition, construction, repairs, renewal or reconstruction can be claimed as deduction.

(b) Interest payable on a fresh loan taken to repay the original loan raised earlier for the aforesaid purposes is also admissible as a deduction.

(c) Interest relating to the year of completion of construction can be fully claimed in that year irrespective of the date of completion.

(d) Interest payable on borrowed capital for the period prior to the previous year in which the property has been acquired or constructed, can be claimed as deduction over a period of 5 years in equal annual instalments commencing from the year of acquisition or completion of construction.

Deduction in respect of one self-occupied property where annual value is nil (1) In this case, the assessee will be allowed a deduction on account of interest (including 1/5th of the accumulated interest of pre-construction period) as under –

(a)Where the property has been acquired, Actual interest payable subject constructed, repaired, renewed or reconstructed to maximum of ` 30,000. With borrowed capital before 1.4.99.

(b) Where the property is acquired or constructed Actual interest payable subject with capital borrowed on or after 1.4.99 and such to maximum of ` 1,50,000, if acquisition or construction is completed within 3 certificate mentioned in (2) years from the end of the financial year in which below is obtained the capital was borrowed.

(c) Where the property is repaired, renewed or Actual interest payable subject reconstructed with capital borrowed on or after 1/04/1999 to a maximum of 30,000.

For the purpose of claiming deduction of ` 1,50,000 the assessee should furnish a certificate from the person to whom any interest is payable on the capital borrowed, specifying the amount of interest payable by the assessee for the purpose of such acquisition or construction of the property.

The ceiling prescribed for one self-occupied property as above in respect of interest on loan borrowed does not apply to a deemed let-out property. Deduction under section 24(b) for interest is available on accrual basis. Therefore interest accrued but not paid during the year can also be claimed as deduction. Interest on unpaid interest is not deductible.

5.5 INCOME UNDER THE HEAD "PROFITS AND GAINS FROM BUSINESS AND PROFESSION"

NATURE OF INCOME

Business, Vocation and Profession carried on by the assessee of whatsoever nature.

METHOD OF ACCOUNTING:

As Regularly Employed can be "Cash" Basis or "Accrual" Basis Subject to Provisions of Section 43B.

RENT, RATES, TAXES, INSURANCE FOR BUILDING (Sec. 30): -

Any rent, rates, taxes, insurance premium paid by the assessee during the previous year in respect of the place for business purpose would be allowed as a deduction.

REPAIRS AND INSURANCE OF PLANT, MACHINARY, FURNITURE (Sec. 31): -

Any amount spent on repairs, insurance or hire charges, etc. On Plant, machinery, furniture by a business organisation is allowed as a deduction.

DEPRECIATION (Sec. 32):

Depreciation can be classified into 3 parts to deal in the subject of income tax

- Normal Depreciation
- Additional Depreciation
- Depreciation on SLM basis in case of electricity companies

Normal depreciation is provided on block of assets method on WDV of the block as on every 31 March

Block of assets means group of assets having same rate of depreciation and falling under a specific class of assets. These assets are grouped together and depreciation is provided on the block.

Depreciation is provided for whole year except when, Asset is Acquired and put to use during the year for less than 180 days during the year , in this case the depreciation is limited to 50% of total depreciation, but if same asset acquired during earlier years but put to use this year and usage period less than 180 days during current year then depreciation for whole year.

When all the assets of block are sold, in such a case no depreciation is allowed and short term capital/gain or loss would be attracted as per provisions of section 50 discussed in capital gains.

PART OF BLOCK SOLD BUT MONEY PAYABLE EXCEEDS WDV:- In such a case no depreciation is allowed and also short term capital gain provision as per section 50 is attracted.

ADDITIONAL DEPRECIATION:

Additional depreciation is only to manufacturing concerns. Additional depreciation on certain assets: 20% or 10% (for <180days). Only factory machinery and equipments .

Assets on which additional depreciation is not allowed:

Not second hand machinery

Not on ships, aircrafts and road transport vehicles

Not allowed on equipments installed in office

In case an enterprise is engaged in electricity business it has option to charge depreciation on SLM basis but such an option is available once only and can’t be changed

UNABSORBED DEPRECIATION:

There cannot be loss under business head due to depreciation. If such depreciation could not be set off under business head then it can be set off from any other head except salary in the same year, and if still it could not be set off it can be carried forward indefinitely to succeeding years for set off in the similar manner.

License to operate telecommunication services:

Deduction in equal instalments over remaining useful life of licence on paid basis. If licence is sold, WDV of licence is reduced by the amount of money recovered and remaining WDV is allowed as deduction in equal instalments over remaining life of asset.

If sold for price exceeding WDV, no deduction is allowed in remaining years instead capital gain is charged as per capital gain provisions.

AMORTIZATION OF CERTAIN PRELIMINARY EXPENSES SEC 35D

Company assessee: 5% of cost of project or 5% of cost of capital whichever is beneficial to the assessee.

Others: 5% of cost of project

Before commencement of business: For setting up any Business

After setting up of business: Extension or setting up of new undertaking.

List of specified expenditure including documents like feasibility report, project report, market survey, engineering services, legal charges , Drafting and printing of MOA and AOA, registration fees, issue of shares and debentures, underwriting commission, expenditure on prospectus have to be submitted.

Deduction for amalgamation/ demerger and VRS

Quantum: -1/5 of expenditure in each successive year but it is to be noted that VRS is allowed only when amount is actually paid which is not a case Amalgamation demerger.

OTHER DEDUCTIONS (section 36)

- Insurance premium on stocks
- Bonus or commission to employees: deduction subject to section 43B
- Insurance on health of employees by any mode other than cash
- Interest on borrowed capital, if for use of business
- Discount on issue of zero coupon bonds to be allowed as deduction on pro-rata basis.
- Employer’s contribution to recognized provident fund or approved superannuation fund subject to section 43B
- Employer’s contribution to approved gratuity fund subject to section 43B

Bad debts subject to conditions:

Income from sale recognized. If any amount has been subsequently recovered in respect of above then it shall be taxable under business head even if business is discontinued.

Provision for bad and doubtful debts: NO deduction in general but deduction available to Scheduled or non-scheduled cooperative banks Foreign banks or State Finance Corporation

STT paid: Deduction if income earned included in PGBP

GENERAL DEDUCTIONS UNDER SECTION 37(1) BASIC CONDITIONS FOR DEDUCTION:

- Not of personal nature
- Not of capital nature
- Incurred during PY .

Wholly or exclusively for business or profession:

Remuneration to Employees

Payment of penalty/ damages of compensatory nature. Penalties paid to custom, sales tax authorities, excise authorities, Income tax authorities not allowed.

EXPENSES NOT DEDUCTIBLE

Section 40A (2): AO may disallow payment made to relative if in his opinion it is excess of the market value.

Section 40A (3):

Any payment exceeding **Rs. 20000 or Rs.35000** (in case of payment to a transporter engaged in plying, hiring, transporting etc.) in a day by a assessee will be allowed as a deduction only when payment is made by a account payee cheque.

EXCEPTIONS: - This section is not applicable when

- Payment is made to bank or financial institution, Govt.
- Under required law
- Payment on a Banking Holiday
- Payment to employees not exceeding Rs.50,000 - Payment in a village not served by a bank
- Book Adjustment
- Payment for purchase of agriculture produce, Poultry farm produce, Dairy items, cottage industry (working without aid of power

SALARY AND INTEREST ON CAPITAL TO PARTNERS (SECTION 40(b):

Interest, salary: Deduction as per provisions in partnership deed.

Interest on capital: Rate specified in partnership deed or 12% whichever is lower.

Salary: Allowed only to working partners.

It should be lower of amount specified in partnership deed or following amount:-

On First Rs.300,000 Of Book Profits	90% of book profits or Rs.150,000 whichever is more
On Balance Of Book Profits	60% of book profits

DEDUCTION UNDER SECTION 43B:-

Section 43 B mentions some cases where deduction will be allowed only when amount is actually paid by the assessee before due date of filing return. In all these cases deduction of the expense is allowed on "paid" basis. However when expenditure is disallowed in one year, it will be allowed as a deduction in the previous year in which such expenses are actually paid.

- Any sum payable by way of tax, cess, duty or fee under any law and by whatever name called.
- Any sum payable by employer by way of contribution to provident fund or superannuation fund or any other employee benefit fund.
- Any sum payable as bonus, commission to employees for services rendered.
- Any sum payable as interest on loan borrowed from public financial institution or state financial institution.
- Any sum payable as interest on loan taken from scheduled bank including co-operative societies.
- Any sum payable by employer in lieu of leave salary to employee.

5.6 INCOME UNDER THE HEAD CAPITAL GAINS

Capital Asset .Sec.2 (14) means property of any kind held by an assessee whether or not connected with his business or profession, but does not include the following:

i. Stock in trade, Raw materials and consumables stores held for the purpose of business or profession.

ii. Personal effects of movable nature, such as furniture, utensils and vehicles held for personal use by the assessee or any dependent member of his family.

iii. Agricultural land in India which is not situated in any specified area.

iv. Gold Bonds issued by the government of India including gold deposit bond issued under the gold deposit scheme notified by the central Government.

CAPITAL ASSETS ARE TWO TYPES LONG TERN & SHORTERM

Capital gain arises from the transfer of any capital asset.

- Short-term capital gain is a gain arising from the transfer of an asset which is held by the assessee **for not more than: 12 months** from the date of its acquisition **in case of shares,** units and any other listed securities and **for not more than 36 months** in the case of **other** assets .

- Otherwise it is long term capital gain

Distribution of assets by a company at the time of liquidation shall be regarded as a transfer and subject to capital gain in the hands of the shareholders. Transfer by the holding company to its subsidiary company or by a subsidiary company to its holding company shall not be regarded as transfer if the holding company owns: 100 % shares of the subsidiary company. Amalgamation of company as per the scheme of amalgamation shall not be regarded as transfer provided the amalgamated company is: an Indian company. Transfer of capital asset in the scheme of demerger shall not be regarded as transfer for the purpose of capital gain if the resulting company is an Indian company

The assessee is allowed to opt for market value as on 1.4.1981 in case of: all capital assets other than depreciable assets, goodwill of a business, right to manufacture, etc.

Where the capital asset became the property of the assessee in any mode given under section 49(1), the cost of acquisition of such assets shall be: cost for which the previous owner of the property acquired it .

Period of holding would be considered from the date of which property was held by the previous owner but index would be available the year in which the property is acquired by the assessee

In computing capital gain arising from transfer of a long term capital asset deduction can be claimed for the cost of acquisition and cost of improvement after indexing the same.

Indexed cost of acquisition means an amount which bears to the cost of acquisition the same proportion as cost inflation index for the year in which the assets is transferred bears to the cost on inflation index for the first year in which the asset was held by the assessee or for the year beginning on the 1St day of April 1981, which is later.

The benefit of indexation can be availed either from the year of acquisition of the asset by the assessee or from the base year 1981-82, whichever is later. if an asset is acquired prior to 01-04-1981 and if the cost is higher than market value as on 01-04-01981 then the assessee can adopt the cost and be entitled indexation with effect from 1981-82. In the alternative, if the market value as on 01-04-1981 is higher than the cost the assessee may be choose to adopt the market value as on 01-04-1981and entitled to indexation of such value of the asset from 1981-82.

Indexation Benefit is not available in the following cases:

I. Short term Capital Assets

II. Bonds and debentures

III. Where option of 10% tax rate is availed u/112

IV. Slump sale u/s50B

V. Sale of shares by non resident

Tax on Short Capital Gain Sec.111A

a. Any short term capital gain arising from the transfer of an equity share in a company or a unit of an equity oriented fund shall be liable to tax @15% if the following conditions are satisfied:

i. The Transaction of sale should take place through a recognized stock exchange.

ii. Such transaction is chargeable to Securities Transaction Tax.

b. If the total income of an assessee includes such short term capital Gain and other income, the tax payable by the assessee in such a case shall be the aggregate of-

i. The amount of income Tax calculated on such short term capital gain (15%)

ii. The amount of income tax payable on the balance amount of the total income as if such balance amount were the total income of the assessee.

c. In the case of an individual or HUF, being a resident, where the total income as reduced by such short term capital gain is below the basic exemption limit then the short term capital gain shall be reduced by the amount of basic exemption limit not exhausted by any other income and only the balance short term capital gain shall be chargeable @15%. For a non resident assessee adjusting of basic exemption limit against short term capital gain shall not be applicable .Hence the entire amount of STCH shall be subject to tax @15%.

d. Assessee is not entitled to claim any deductions provided under Chapter VI-A in respect of such Short Term Capital Gain.

Tax on Long Term Capital Gain Sec.112.

a. Where the total income of an assessee includes any income, arising from the transfer of a long-term capital asset, which is chargeable under the head Capital gains, such long term capital gain shall be charged to tax at 20% rate.

b. Any L.T.C.G arising from transfer of equity share of a company or a unit of equity oriented fund which are listed in a recognized stock exchange is exempt from tax u/s 10(38). The possibility of Applying 10% or 20% tax rate shall arise only in case where the listed shares are not traded through a recognized stock Exchange and not chargeable Securities Transaction Tax.

5.7 INCOME FROM OTHER SOURCES

Income from Other Sources is a residuary head of income. Any item of income chargeable to tax but does not fall within the ambit of the other four specific heads of income shall be included under this head of income.

Chargeability – Section 56

The following income shall be charged to tax only under the head "Income from Other Sources":

a. Dividend income covered by sub-clause (a) to (e) of clause (22) of Section 2.

b. Income by way of winnings from lotteries, cross word puzzles, races including horse race, card games and other games of any sort, gambling, betting, etc. It requires mention here that such winnings are chargeable to tax u/s 115BB at a flat rate of 30%.

c. Any sum of money, the aggregate value of which exceeds **Rs.50, 000** received from any person without consideration by an individual or Hindu Undivided Family.

However, exemption is granted in respect of any sum of money received –

- from any relative; or
- on the occasion of marriage of individual; or
- under a Will or by way of inheritance; or
- in contemplation of death of the payer or
- from a local authority; or
- from any fund, foundation, university, other educational institution, hospital, medical institution, any trust or institution referred to in Section 10(23C); or
- From charitable institutions registered u/s 12AA.

In respect of above gifts, there is no ceiling limit and therefore, entire amount is exempt from chargeability.

The **definition of the term 'relative'** for this purpose is as under:

a. husband or wife of individual;

b. brother or sister of the individual;

c. brother of husband of the individual;

d. brother of wife of the individual;

e. sister of husband of the individual;

f. sister of wife of the individual;

g. brother of father of the individual;

h. brother of mother of the individual;

i. sister of father of the individual;

j. sister of mother of the individual;

k. lineal ascendant of the individual (say, grandfather)

l. lineal descendant of the individual (say, son, grandson, daughter)

m. lineal ascendant of the husband of the individual

n. lineal descendant of the husband of the individual

o. lineal ascendant of the wife of the individual (say, wife's father)

p. lineal descendant of the wife of the individual;

q. wife or husband of the relatives listed at serial numbers (b) to (p)

INCOME CHARGEABLE UNDER THIS HEAD, ONLY IF NOT CHARGEABLE UNDER THE HEAD 'PROFITS AND GAINS OF BUSINESS OR PROFESSION.

The following income shall be chargeable to tax under this head of income only if it is not taxable under the head "Profits and Gains of Business or Profession":

- Interest on securities (State and Central Government securities and debentures);
- Any sum collected from employees towards their share of contribution to any Welfare Fund Account :
- Income from letting of machinery, plant and furniture; and
- Income from letting of machinery, plant and Furniture together with building, if the letting of the building is inseparable to the letting of other assets.

INCOME CHARGEABLE UNDER THIS HEAD ONLY IF NOT CHARGEABLE UNDER THE HEAD "PROFITS AND GAINS OF BUSINESS OR PROFESSION" OR UNDER THE HEAD "SALARIES"

Any sum received under a Keyman insurance policy including bonus is chargeable under this head when it is received by any person other than the employer who took the policy and the employee in whose name the policy was taken.

- **DIVIDEND**

Section 2(22) defines 'Dividend' to include –

Any distribution by a company to its shareholders to the extent of accumulated profits whether capitalized or not resulting in the release of all or any part of the assets of the company,

b)any distribution to its shareholders by a company –

i. Of debentures, debenture-stock or deposit-certificates with or without interest;

ii. Distribution of bonus shares to the preference shareholders by the company, to the extent of accumulated profits, whether capitalized or not, any distribution made to the shareholders by a company on its liquidation to the extent to which the distribution is attributable to the accumulated profits of the company, whether capitalized or not,

Any distribution by a company to its shareholders on account of reduction of share capital to the extent of which the company possesses accumulated profits, whether capitalized or not.

Any payment to the extent of accumulated profits by a company, not being a company in which public are substantially interested, of any sum by way of: Sec.2(22)(e)

- Loan or advance to a shareholder who holds the beneficial ownership of equity shares carrying not less than 10% voting power,
- loan or advance to any concern (HUF, firm, AOP, Body of Individuals or a company) in which such shareholder is a member or partner holding substantial interest (20% or more beneficial interest at any time during the previous year),
- Any payment on behalf of or for the individual benefit of any such shareholder made to any person.

Exceptions:

- Any advance or loan to a shareholder or the concern in which the shareholder has substantial interest by a company will not be deemed as dividend, if the loan or advance is given during the normal course of its business provided the lending of money is a substantial part of the business of the company.
- Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of Section 77A of the Companies Act, 1956, shall not be regarded as dividend. Such buyback of shares attracts capital gains tax liability in the hands of the shareholder u/s 46A.
- Any distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company) shall not be treated as dividend.

- **WINNINGS FROM LOTTERY, ETC. – SECTION 115BB**

Where the total income of an assessee includes any income by way of winnings from any lottery or crossword puzzle or race including horse race or card game and other game of any sort or from gabling or betting of any form, tax shall be calculated at the rate of 30% of such income plus surcharge.

5.8 SUMMARY

- Income of a person is classified into 5 categories.
- Determination of Net Annual Value:
  - Step 1 - Determination of Gross Annual Value (Hereinafter, GAV).
  - Step 2 – From GAV computed in step 1, deduct municipal tax paid by the owner during the previous year.
  - Step 3 – The balance will be the Net Annual Value (Hereinafter, NAV), which as per the Income-tax Act is the annual value.
- Income from Other Sources is a residuary head of income.
- Section 43 B mentions some cases where deduction will be allowed only when amount is actually paid by the assessee before due date of filing return.In all these cases deduction of the expense is allowed on "paid" basis.
- Capital gain arises from the transfer of any capital asset.
- Where the capital asset became the property of the assessee in any mode given under section 49(1), the cost of acquisition of such assets shall be: cost for which the previous owner of the property acquired it.

5.9 KEY WORDS

- Dividend
- Amalgamation
- Deduction
- Bonus
- Allowances

5.10 SELF ASSESSMENT QUESTIONS

1. Write a note on the computation of Income from House Property.

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2. Write a note on the computation of Income from Salary.

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3. Write a short note on the following:

   a. Short Term Capital Gain b. Long Term Capital Gain.

4. What are the circumstances in which Income is Taxable under the Head 'Income From Other Sources'?

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BLOCK-2

UNIT 6: RETURNS – TYPES OF RETURNS - ASSESSMENT – TYPES OF ASSESSMENT – CONSEQUENCES OF NON-RETURN – PENALTIES AND PROSECUTION

Structure:

6.0 OBJECTIVES

- To understand the Procedure of Filing of Returns
- To know the various Types of Assessment
- To provide insight into the consequences of Non-filing of Returns

6.1 INTRODUCTION

In finance, **return** is a profit on an investment. It comprises any change in value, and interest or dividends or other such cash flows which the investor receives from the investment. Ambiguously, **return** is also used to refer to a profit on an investment, expressed as a proportion of the amount invested. This is also called the **holding period return**. A loss instead of a profit is described as a negative return. **Rate of return** is a profit on an investment over a period of time, expressed as a proportion of the original investment.[2] The time period is typically a year, in which case the rate of return is referred to as annual return. Return, in the second sense, and rate of return, are commonly presented as a percentage.

ROI is an abbreviation of return on investment, i.e. return per dollar invested. It is a measure of investment performance, as opposed to size (c.f. return on equity, return on assets, return on capital employed).

6.2 FILING OF RETURNS

As per Taxation Rules, it is mandatory for an earning individual/entity to file a return irrespective of the fact that tax has been deducted at source(TDS) by his/her employer or not, and whether he/she is eligible for a refund or not. Tax Deduction at Source (TDS) is one of the modes of collection of taxes, by which a certain percentage of amounts are deducted from a person at the time of making/crediting certain specific nature of payment to the other person and the deducted amount is remitted to the Government account. It is similar to "pay as you earn" scheme also known as Withholding Tax in many other countries.

Every person responsible for making payment of nature covered by TDS provisions of Income Tax Act shall be responsible to deduct tax. However, in case of payments made under sec. 194A, 194C, 194H, 194I and 194J in respect of individual and HUF, only if the turnover or professional receipt exceeds sum of **Rs.**40 lakh or **Rs.**10 lakh respectively (the limits are **Rs.**60 Lakh or **Rs.**15 Lakh respectively w.e.f. 01.07.2010) in previous year, he is required to deduct tax at source

Note: The CBDT has, vide notification dated 1-05-2013, made E-filing of Return compulsory for Assessment Year 2013-14 for persons having total assessable income exceeding Five lakh rupees.

The CBDT vide its earlier notifications had exempted salaried employees having total income upto ₹5 lakhs including income from other sources upto ₹10,000/- from the requirement of filing return of income for assessment year 2011-12 and 2012-13 respectively. The exemption was available only for the assessment year 2011-12 and 2012-13. The exemption was giving considering 'paper filing of returns' and their 'processing through manual entry' on system.

To file Income Tax Returns (ITRs), one needs to submit the ITRs belonging to the particular assessment year. The ITR forms to file income returns for AY 2013-14 are as follows:

Persons liable to furnish return of income	**Minimum income during the relevant previous year to attract the provisions**
Company	Any amount of income or loss
Firm	Any amount of income or loss
Individual, HUF, AOP, BOI or artificial jurisdiction person	If the total income of such person or the total income of any person in respect of which such person is assessable under the Act (before giving exemptions and deductions under section 10A, 10B, 10BA and sections 80C to 80U) exceeds the maximum amount not chargeable to tax.
Co-operative society or local authority	Any amount of income
A person in receipt of income derived from property held under charitable or religious trust	If the total income of such person (without giving effect to the provisions of section 11 and 12) exceeds the maximum amount not chargeable to tax
Chief executive officer of every political party	If the total income in respect of which the political party is assessable (without giving effect to the provisions of section 13A) exceeds the maximum amount of chargeable to tax.
Scientific research association, news agency,	If the total income in respect of which such

specified professional institutions , institutions established for development of Khadi and village industry, specified FUNDor institutions referred to in section 10(23C)(iv) and (v). University or other educational institutions, hospitals or other medical institutions, TRADE unions or associations.	association, institution, etc. is assessable (without giving effect to the provisions of section 10) exceeds the maximum amount not chargeable to tax.
Every university, college or other institution referred to in section 35(1)(ii)	Any income or loss (furnishing of return is compulsory even if it is not required to furnish return under any other provision of this section)

Consequences: If the assessee is required to furnish return of income under section 139(1) but fails to furnish such return the assessee will be liable to interest under section 234A, penalty under section 2741F and prosecution under section 276CC. Thus, one can very well know the need to furnish such return accurately and timely; else will have to face the unpleasant situations of penalty, prosecution and interest.

6.3 RETURNS FORM

The Income Tax Department has come out with all Return Form applicable for AY 2014-15. The below table will give you details of usage of forms by Assessee.

- **ITR-1 SAHAJ Indian Individual Income Tax Return**

This Return Form is to be used by an individual whose total income for the assessment year 2012-13 includes:-

(a) Income from Salary/ Pension; or

(b) Income from One House Property (excluding cases where loss is brought forward from previous years); or

(c) Income from Other Sources (excluding Winning from Lottery and Income from Race Horses)

Further in case of income of another person like spouse, minor child, etc is to be clubbed with the Assessee, this return form can be used only if income being clubbed falls into above form category.

However, This return form should not be used by individual whose total income includes:

a) Income from more than one house property

b) Income from winning lottery or income from race horses

c) Income under head capital gains

d)Income from Agriculture / Exempt income of more than ₹ 5000/- .

e) Income from Business or Profession

f) Loss under income from Other Sources

g) Person Claiming relief under Section 90 ot 91

h) any resident having any asset (including FINANCIAL interest in any entity) located outside India or signing authority in any account located outside India.

- **ITR-2 For Individuals and HUFs not having Income from Business or Profession**

This Return Form is to be used by an individual or a Hindu Undivided Family whose total income for the assessment year 2014-15 includes:

a) Income from Salary / Pension;

b) Income from House Property

c) Income from Capital Gains

d) Income from Other Sources (including Winning from Lottery and Income from Race Horses)

Further, in a case where the income of another person like spouse, minor child, etc. is to be clubbed with the income of the assessee, this Return Form can be used where such income falls in any of the above categories.

However, this Return Form should not be used by an individual whose total income for the assessment year 2014-15 includes Income from Business or Profession.

NOTE:

A resident assessee having any assets (including FINANCIAL interest in any entity) located outside India or signing authority in any account located outside India, shall fill out schedule FA and furnish the return in return electronically under digital signature or transmit data electronically and submit ITR V

- **ITR-3**

This Return Form is to be used by an individual or an Hindu Undivided Family who is a partner in a firm and where income chargeable to income tax under the head “Profits or gains of business or profession” does not include any income except the income by way of any interest, salary, bonus, commission or remuneration, by whatever name called, due to, or received by him from such firm. In case a partner in the firm does not have any income from the firm by way of interest, salary, etc. and has only exempt income by way of share in the profit of the firm, he shall use this form only and not Form ITR-2.

However, This Return Form should not be used by an individual whose total income for the assessment year 2013-14 includes Income from Business or Profession under any proprietorship.

- **ITR-4S SUGAM**

This Return Form is to be used by an individual or a Hindu Undivided Family whose total income for the assessment year 2014-15 includes:

a) Business income were income is computed in accordance with the special provision under section 44AD and 44AE

b) Income from Salary / Pension

c) Income from other source (Excluding Income from Lottery and income from race horse)

Further, in a case where the income of another person like spouse, minor child, etc. is to be clubbed with the income of the assessee, this Return Form can be used where such income falls in any of the above categories.

However, this return form should not be used to file following incomes

a) Income from more than one house property

b) Income from winning lottery or income from race horses.

c) Income under head capital gains

d) Income from Agriculture / Exempt income of more than Rs 5000/- .

e) Income from Speculative Business

f) Income from Profession

g) Person Claiming relief under Section 90 to 91

h) any resident having any asset (including FINANCIAL interest in any entity) located outside India or signing authority in any account located outside India.

- **ITR-4**

This Return Form is to be used by an individual or a Hindu Undivided Family who is carrying out a proprietary business or profession.

- **ITR-5**

This Form can be used a person being a firm, LLPs, AOP, BOI, artificial juridical person referred to in section 2(31)(vii), cooperative society and local authority. However, a person who is required to file the return of income under section 139(4A) or 139(4B) or 139(4C) or 139(4D) shall not use this form.

However, this return form should not be used by individual and HUF and Companies.

- **ITR -6**

This Form can be used by a company, other than a company claiming exemption under section 11 and this return form should not be used by person other than Companies.

- **ITR- 7**

This Form can be used by persons including companies who are required to furnish return under section 139(4A) or section 139(4B) or section39 (4C) or section 139(4D). This return form should not be used by person other than Companies.

6.4 MANNER OF FILING OF RETURNS

The abovementioned Returns may be filed in either of the following modes:

a) By furnishing the return in paper form

b) By furnishing return electronically with digital signature

c) By transmitting the data in the return electronically and there after submitting ITR V to be send by speed post to Bengaluru.

A resident assessee having any assets (including FINANCIAL interest in any entity) located outside India or signing authority in any account located outside India, shall fill out schedule FA and furnish the return in the manner provided at either B) or c) above.

From the assessment year 2013-14 onwards all the assessees having total income more than 5 lakh rupees are required to furnish the return in the manner provided at B) or c) Also in case of an assessee claiming relief under section 90, 90A or 91 to whom Schedule FSI and Schedule TR apply, he has to furnish the return in the manner provided at either B) or c)

From assessment year 2013-14 onwards in case an assessee who is required to furnish a report of audit under sections 10(23C)(iv), 10(23C)(v), 10(23C)(vi), 10(23C)(via), 10A, 12A(1)(b), 44AB, 80-IA, 80-IB, 80-IC, 80-ID, 80JJAA, 80LA, 92E or 115JB he shall file the report electronically on or before the date of filing the return of income. Further, the assessee who is liable to file the above reports electronically shall file the return of income in the manner provided at either B) or c)

Where the Return Form is furnished in the manner mentioned at c), the assessee should print out two copies of Form ITR-V. One copy of ITR-V, duly signed by the assessee, has to be sent by ordinary post to Post Bag No. 1, Electronic City Office, Bangaluru–560100 (Karnataka). The other copy may be retained by the assessee for his record.

Sec 139(1): submission of return of income

* Being a company or a firm (even those co's whose entire income is exempt u/s 10, etc)

* Being a person other than company, firm

1) if his total income or

2) total income of any other person in respect of which he is assessable exceeds maximum amount not chargeable to tax.

NOTE : even a public limited Company though incorporated but has not received certificate of commencement has to file return.

Sec 139(1B): Return may be filed on a specific computer readable media, same shall be deemed to be return furnished u/s 139(1).

Sec 139(1) Explanation 2: Due date of furnishing return

a) Company

b) Person whose a/c's required to be audited under IT Act or any other act.

c) Working partner of firm – if firm required to be audited

d) 1 by 6 scheme

e) Any other case

For a) to d) 31st September

For e) 31 July

Sec 139(3): Return of loss

The loss return to be furnished in time if such loss or any party thereof should be carried forward u/s 72/73/74 or 74A. Not applicable for Sec 71B ie. Carry forward and set off of loss of house property Unabsorbed depreciation can also be Carry forward if loss return is not filed in time. Although the loss cannot be Carry forward if return not filed in time, but losses of earlier year can be carried forward.

Sec 139(4): Belated Return (Max time limitation)

a) any time before expiry 1 yr from end of relevant AY

b) before completion of assessment (ie. Sec 144, because in any other section assessment cannot be completed before filing of return)

NOTE: It the return of income is not filed u/s 139(1), AO can issue notice u/s 142(1), requiring him to file ITR. The return so filed shall be Belated Return, if the assessee was required to file return u/s 139(1) or Prov. To Sec 139(1)

Sec 139(4A): Return of Income of charitable trust and institutions ITR to be filed if such income before allowing exemption u/s 11 & 12 exceeds the maximum amount not chargeable to tax. If income of trust (before exemption u/s 11 & 12 exceeds max. amt chargeable to tax, a/c's are required to be audit.

If no exemption is desired to be claimed due date = 31 July Sec 272A(2): penalty if return of charitable trust/ religious trust not filed in time – Rs. 5000. Here Sec 271F is not applicable.

Sec 139(4B): Return of income of political party ITR to be furnished if total income (before allowing exemption u/s 13A) exceeds the maximum amount chargeable to tax.

Due date – 31 September

Audit compulsory

If no exemption is claimed, due date is 31 July.

Sec 139(4C): Return of income of certain associations and institutions

ITR if income exceeds maximum amount not chargeable to tax:

a) scientific research association – sec 10(21)

b) news agency – sec 10(22B)

c) association/institutions Referred u/s 10(23A) having object to control, supervise, regulate or encourage profession of law, medicine, accounts, engineering, architecture, other notified profession.

d) Khadi or village industry u/s 10(23B)

e) Funds, institution referred u/s 10(23C)

f) Trade union u/s 10(24)

Sec 272A (2): Penalty for failure to file return u/s 139(4C) – Rs 100 for every day during which the default continues.

Sec 139(4D): Every university, collage or other institution referred u/s 35(1) shall furnish compulsory ITR (irrespective of whatever)

Sec 139(5): Revised Return When: after furnishing ITR u/s 139(1) or in pursuance to notice u/s 142(1) in case of discovery of any omission or any wrong statement. (Should be bonafide inadvertence or mistake on part of assessee discovered by assessee not by AO)

Time limit:

* Before expiry of 1 year from end of relevant AY

* OR before completion of assessment (u/s 143(3)/144)

Whichever is earlier Note: assessment here does not mean u/s 143(1) (SRKoshti v/s CIT (2005))

Belated return cannot be revised:

Because it is specifically provided that only return filed u/s 139(1) or in pursuance to notice u/s 142(1) can be revised.

If CBDT extends time to file return, then also such return can be revised

Can a revised return be revised further? Yes the prescribed time limit applies

Revised return shall substitute original return Can a return be revised after receipt of notice u/s 143(2)/ show cause notice u/s 144? – Yes, because assessment is not yet completed.

But penalty u/s 271(1)(c) for concealment shall be levied on additional income disclosed in revised return. Revised return after detection of concealed income offers no immunity from penalty.

Sec 139(6)/ (6A): Particulars to be furnished with ITR.

Sec 139(9): Defective Return AO intimate defect to assessee and give him an opportunity to rectify the defect within 15 days from date of intimation. If not rectified, it shall be treated as INVALID RETURN and consequences of the same will be as if no return is filed. AO can treat the return by assessee as valid return and make the assessment even if it contains any of the defects. If a return is filed without a tax audit report and such failure is not on account of any fault of the assessee, the AO should condone the delay for removing the defect u/s 139(9) Defects are prescribed.

Sec 139A: PAN No apply in form 49A

a) If total income exceeds limit (apply before 31 May of AY)

b) Total sales, turnover, gross receipt is likely to exceed Rs. 500000/- in any PY (apply before end of Accounting Year)

c) Return u/s 139 (4A) trusts or charitable institution

d) if he is employer and required to file FBT return AO has powers to allot PAN No having regard to nature of transactions as my be prescribed.

Sec 139A(1A): Compulsory PAN No.

i) exporter and importer

ii) Assessee defined under rule 2(3) of Central Excise Rule 1944

iii) Traders, etc requiring registration under Central Excise

iv) Those assessed to Service Tax (should have PAN No. before making application for reg. under Service Tax)

v) Person registered under Sales Tax laws.

Sec 139A: CG (Central Govt.) may for the purpose of collecting any information which may be useful for or relevant to the purpose of Act, by way of notification specify any class or classes of persons and such person shall within prescribed period apply AO for PAN No.

Sec 139A(5): Compulsory quoting of PAN No.

Any person not allotted PAN no., entering into prescribed transaction has to fill Form 60 Where a person making application for opening a/c (as prescribed) is minor, shall quote PAN no. of father/mother/guardian

Form 61: Declaration by a person who has ‘agricultural income’ and no other income.

Sec 139A(5A): Obligatory to intimate PAN NO to person who deducts tax at source.

Sec 139A(5B): Obligatory on person who deducts TDS to quote PAN No of deductee.

Sec 139A(5C) & 139A(5D):

5C- obligation of buyer or licensee or lessee

5D obligation of seller

- of alcoholic liquor, timber or any other forest products referred in Sec 260C to quote PAN no. in relevant correspondence.

Sec 272B(1): Failure to comply

With provision of Sec 139A penalty of Rs. 10000/-

Sec 272B(2): Quoting false PAN No. which he either knows or believes to be false or does not believe to be true, penalty Rs. 10000/-

Sec 272B(5): - opportunity of being heard to be given

Sec 139B - Provision relating to Scheme of TAX RETURN PREPARERS

Sec 140 – Who should sign return individual – himself/authorized person (POA) if he is mentally incapable then his parent/guardian

HUF – Karta

CO – MD (liquidator in case of winding up)

Firm – managing partner (or any other partner)

Local authority/ other association – Principal Officer

Return if not signed is an invalid return

Sec 140A – Self assessment

Mandatory for every assessee

If assessee fails to pay self assessment tax, he shall be deemed to be an assessee in default in respect of tax or interest or both – all prov. Of Act shall apply, penalty u/s 221

1.4. PROCEDURE OF ASSESSMENT:

Sec 143(1): on the basis of return of income

Sec 143(3): scrutiny assessment

Sec 142(1) – Service of notice

Sec 142(1)(i) –Assessment Officer(AO) may require the assessee to furnish ITR, if he has not filed ITR within time allowed u/s 139(1) or before the end of relevant AY.

Notice u/s 142(1) shall be valid if it is issued after end of relevant AY to a person who has not made ITR before end of relevant AY

Sec 142(1)(ii) – Notice to any person who has filed ITR/ or return of fringe benefits. Accounts of period more than 3 year prior to previous year cannot be called for.

Sec 142(1)(iii) - service of notice to a person who has filed ITR or in whose case time allowed u/s 139(1) is expired. Here AO can call for statement of assets and liabilities of any no. of pervious year with prior approval of Jt. Comm. of IT.

Time: Notice u/s 142(1)(i) to file return can be given only after the time allowed u/s 139(1) has expired. It is not mandatory to issue notice u/s 142(1)(i) if AO wants to make Best Judgment Ass. 144

Sec 142(2) – Sec 142(1) empower AO to collect information from assessee himself, Sec 142(2) empowers him to collect information From sources other than assessee.

Sec 142(2A) to (2D): At any stage of proceedings AO may direct the assessee to get the accounts audited by CA nominated by Chief Comm/Comm of IT

If i) having regard to nature and complexity of a/c; or ii) interest of revenue; direction of audit can be given even if accounts are audited.

Sec 142(2C):

CA shall submit report in Form 6B

Max Period including extended period – 180 days from date on which direction of audit received by assessee.

Sec 142(2D): Audit expense Shall be paid by assessee as decided by Chief comm. No appeal is possible against the orders u/s 142(2A) for audit of accounts Opportunity Of being heard should be given before issue of direction

Approval of special audit cannot be given by Comm. mechanically.

Sec 142(3): Opportunity of being heard No opportunity in case of assessment u/s 144 Consequence of non-compliance of notice u/s 142(1) & 142(2A)

Best judgment ass. 144

Penalty u/s 271(1)(b) – Rs. 10000/-

Prosecution u/s 276D (max.)

- 1yr. imprisonment OR

- Fine not less than Rs. 4 or not more than Rs. 10 per day during which default continues Search u/s 132

Sec 142A: Estimates by valuation officer in certain cases.

Where an estimate of value of any investment referred to in Sec 69/Sec 69B or value of bullion/jewellery or other valuable article u/s 69A/Sec69B, is required for purpose of making an assessment or re-assessment AO may require valuation officer to make estimate Sec 143(1): Summary Assessment.

Intimation of tax due u/s 143(1) shall be deemed to be notice of demand u/s 156. If he does not pay in 30 days, he shall be liable for interest (Sec220) & penalty (Sec221) No intimation shall be send after 1 year form end of FY in which ITR filed The said period of intimation is not applicable for issue of cheque for refund (strange) NO NOTICE U/S 143(2) after expiry of 12 months form the end of month in which return filed. If no ITR furnished (not filed) by assessee, assessment u/s 143(3) cannot be done (meaning thereby 144
shall apply)

If AO feels that personal attendance of assessee is necessary, notice u/s 131 (summons) can be issued. A fresh notice u/s 143(2) must be served if he furnishes revised return. The Burden lies on the revenue to prove that notice u/s 143(2) was served to assessee within prescribed 12 months.

Sec 271(1)(b): Failure to comply with notice u/s 143(2) – Rs. 10000 per failure.

Assessment u/s 143(3) of those institutions which is required to furnish ITR u/s 139(4C) cannot be made without giving effect of prov. of Sec 10 unless –

i) intimated to CG or prescribed authority

ii) notification or approval granted is withdrawn

assessment is completed only when tax is computed by AO under his signature

Protective Assessment: Taxing the same income in hands of two assessee, to protect the interest of revenue. This matter can be resolved at level of ITAT or High court (such should be expressed in order) Under law, a protective order of assessment can be passed but not the protective order of penalty. Reference to wrong section in assessment order does not vitiate the assessment

Ass Order should be speaking order ie. It should give reasons in support of conclusions. Assessment on the basis of invalid return shall remain in effect and continue to operate until its validity is declared by court.

LAW APPLICABLE: in case of assessment of income and determination of tax liability Relevant law to be applied is law as in force on first day of AY.

Sec 144: Best jusgement assessment

i) where person fails to make the return u/s 139(1) or has not made return or revised return u/s 139(4) & 139(5)

ii) where person fails to comply with notices issued u/s 142(1)/ or direction u/s 142(2A)

iii) where any person, having made a return fails to comply with all terms of notice issued u/s 143(2) an application should be given before applying sec 144

AO cannot assess income u/s 144 for an assessment below returned income or cannot assess loss higher than returned loss Best judgment ass. Should accord with fair play and justice considering local knowledge, repute in regard

to assessee's circumstances, his own knowledge of previous returns, all other matters which he thinks will assist him in arriving at a fair and proper estimate.

Sec 145(3) – Assessment on Rejection of accounts:

If books are false, unreliable, incorrect or incomplete

a) he is not satisfied about the correctness of accounts of assessee

b) although a/c of assessee are complete and correct, to satisfaction of AO but method of accounting employed is such that in opinion of AO profit cannot be correctly arrived at.

c) where method of accounting has not been regularly followed

d) where Accounting standards notified by CG form time to time has not been regularly followed by assessee He can reject books for any assessment ie. 144/143(3)/147 etc.

Sec 144A: Power of Joint Commissioner to issued direction:

a) on his own motion

b) on reference by AO

c) on application by Assessee to call for and examine the record of any proceeding in which an assessment is pending if he considers that having regard to:

- nature of case
- amt. involved
- for any other reason it is necessary to expedient so to do, he may issue direction to AO as he thinks fit to enable him to complete assessment.

Power u/s 144A can be evoked only if, notice u/s 143(2) is issued and assessment proceedings are pending.

Sec 147: Income escaping assessment (subject to provision of Sec 148 & 153)

If AO has reason to believe, that income chargeable to tax has escaped assessment he may

a) Assess or reassess such income

b) Recomputed loss or depreciation allowance or any other allowance as the case may be belief must be reasonable and honest based on reasonable grounds. He cannot act based on suspicion. During course of proceedings, if any other income chargeable to tax has also escaped assessment; he can assess or reassess that income also

DEEMED ESCAPEMENT:

a) where no return filed despite income exceed max limit

b) where ITR filed, no assessment (scrutiny/best judgement) made & it is noticed that income is understated or excessive loss claimed

c) where assessment u/s 1434(3) or 144 made but

- income under assessed
- taxed at low rates
- excess relief
- excess dep. Or any other allowance claimed

Re-assessment proceedings can be taken more than once u/s 147

Sec 148: Issue of notice where income has escaped assessment (Sec147):

The return filed in response to notice u/s 148(1) shall be treated as if such return was a return required to be furnished under Sec 139 and therefore the AO shall have to issue notice u/s 143(2) within 12mth from end of month in which return is furnished by assessee u/s 147 read with Sec 143(3) (He has to file ITR again even if he has filed it once – he can write a letter that ITR filed u/s 139 may be treated as ITR for this notice)

Before issuing notice u/s 148, AO has to record his reasons for doing so.

1) Otherwise notice issued becomes illegal

2) reasons need not be mentioned in notice, but it should be on record 3) assessee can request for the reasons, if AO refuse, the notice can be quashed

4) on receipt of reasons the assessee can file his objections against the issuance of notice ie. Notice is challenged, n AO is bound to pass speaking order (called interim order) before he commence the proceedings.

5) Assessee can challenge the Interim order in a writ petition.

Assessee shall be liable to pay interest u/s 234A(3) for late filing of return or for not filing the return. Separate notice to be issued for each AY in which income has escaped. Where reasons recorded are not relevant to issues involved in reopening the assessment, proceedings were held to be invalid. Reason to believe:

Eg: 1) where in a case chief mining officer has issued letter to ITO informing him that there was under reporting of income

2) Where ITO while examining one of the creditor of assessee, came to know that the advances were bogus.

Sec 149/151:

Sec 149(1) provide that notice u/s 148 can be issued only:

a) within 4 yrs. from the end of relevant AY (whatever may be the amount)

b) within 6 yrs from end of relevant AY in cases where amount of income escaping assessment is likely to be Rs. 100000 or more for that yr.

Sanction to issue notice has to be obtained from higher authority.

Notice u/s 148 has to be issued n not served within the time period prescribed.

Where assessment u/s 143(3)/147 has already been made, no action u/s 147 is possible after 4 years from the end of relevant AY unless income chargeable to tax has escaped assessment by reason of failure on part of assessee to

a) make return u/s 139 or in response to notice u/s 142(1)/148

b) disclose fully and truly all material facts necessary for assessment.

After expiry of 4 years and if already assessed u/s 143(3)/147, AO in addition of "recording the reason" has to establish the fact that such escapement is on account of omission or commission attributable to the assessee concern.

Sec 149(9): If a person on whom notice is served is an agent of a NR, no notice can be served after the expiry of period of 2 years form the end of relevant AY.

Sec 150(1): No time limit for issuance of notice in pursuance of order on appeal, etc ie. Consequences of or to give effect to any finding or direction contained in an order passed

a) by any authority in proceedings by way of appeal or revision u/s 250 (CIT)/254 (ITAT)/260A (High court)/262 /263 (revision of order prejudicial to revenue) /264 (revision of order in favour of assessee)

b) by court in any proceeding under any other law.

Sec 150(1) relates to an AY in respect to which an assessment or reassessment could not have been made at the time the order which was the subject matter of appeal, reference or revision as the case may be. Purpose of Sec 147 is to charge income which has escaped assessment and is only for the benefit of the revenue.

Proceedings u/s 147 can be dropped if the following conditions are satisfied

1) assessee did not file any appeal to Comm. (appeals) or an application of revision u/s 264 to CIT against the original AO.

2) Assessee can show that

a) he has been already assessed on an amount not lower than what he would be rightly liable to even if the escaped amt is considered

b) the original assessment of income has been properly made.

Sec 153: Time limit for completion of all assessment and reassessment:

1) 143/144/115WE/115WF – 21 months from the end of relevant AY

2) 147/115WG – 9 months from the end of FY in which notice u/s 148 was served

3) Fresh assessment where original assessment has been set aside or cancelled by appellate authority u/s 250/254/263/264 – 9 months from end of FY in which such order of set aside etc issued.

NOTE – Demand note u/s 156 can be issued after the expiry of period but order should be passed within limit.

Sec 153(3): No time limit in following cases where assessment/reassessment, etc is made on the assessee or to give effect to any findings or directions contained in order u/s 250/254/260/262/263 and 264 or order of court under any other law and

b) where in case of a firm an assessment is made on a partner of the firm in consequences of an assessment made on the firm u/s 147 IF in above case original assessment is set aside or cancelled the period for fresh assessment will be 9 months.

Period of limitation to exclude certain period:

i) time taken in reopening the whole or any part of proceeding or in giving an opportunity to assessee to reheard u/s 129 relating to change of incumbent of an office

ii) period when order is stayed or injunction of any court.

iii) period of audit u/s 142(2A)

iv) in case where an application made before IT settlement commission u/s 245C is rejected, period from application to rejection.

v) period commencing from date on which application is made before Advance Ruling Authority.

If after the exclusion of the above said period, if the period of limitation available to AO for making order is less than 60 days, it may be extended to 60 days.

Sec 154: Rectification of mistake (apparent from records)

The concerned authority

i) On its own motion

ii) Or on application made by assessee.

Rectification can be done for any matter other than the matter considered and decided in appeal/revision.

Opportunity of being heard is necessary if rectification results into enhancement or reduction of refund or otherwise liability of assessee is increased.

Time limit: only within 4 years from the end of FY in which the order sought to be amended was passed. Order to be passed within 6 months from the end of month in which application is received Rectification is possible even if matter is in appeal and not decided as yet. Non consideration of order of High Court of Apex court would constitute mistake apparent form record regardless of the judgment being rendered prior to or subsequent to the order proposed to be rectified.

Sec 156: Notice of demand

Amount to be deposited within 30 days of service of notice u/s 156 is mandatory to initiate recovery proceedings. Where demand is enhanced, an additional notice is mandatory.

Sec 157: Intimation of loss

Where in course of assessment of total income of any assessee, it is established that loss has taken place which the assessee is entitled to carry forward, AO notify by an order in writing the amount of such loss computed by him.

6.5 SUMMARY

- Tax Deduction at Source (TDS) is one of the modes of collection of taxes, by which a certain percentage of amounts are deducted from a person at the time of making/crediting certain specific nature of payment to the other person and the deducted amount is remitted to the Government account.
- Every person responsible for making payment of nature covered by TDS provisions of Income Tax Act shall be responsible to deduct tax.
- To file Income Tax Returns (ITRs), one needs to submit the ITRs belonging to the particular assessment year**.**
- The loss return to be furnished in time if such loss or any party thereof should be carried forward u/s 72/73/74 or 74A.

6.6 KEY WORDS

- Return
- Liabilities
- Assessment

6.7 SELF ASSESSMENT QUESTIONS

1. Write a note on the Filing of Returns.

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2. What are the various forms for filing of the Returns?

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3. What is the procedure of Assessment?

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4. Write a note on Re-Assessment.

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UNIT 7: INCOME TAX AUTHORITIES – HIERARCHY - POWERS AND FUNCTIONS AND JURISDICTION OF AUTHORITIES

Structure:

7.0 Objective

7.1 Introduction

7.2 Income tax Authorities

7.3 Jurisdiction of income tax Authorities (Section 130)

7.4 Assessing officer (Sections 2[7A] and 124)

7.4.1 Power to transfer cases section (127)

7.4.2 Power to income tax Authorities (Section 132-136)

7.5 Summary

7.6 Key words

7.7 Self Assessment Questions

7.8 References

7.0 OBJECTIVES

- To study about the Income tax Authorities and their hierarchy
- To know the Jurisdictional Limits of Income Tax Authorities
- To provide insight of the powers and functions of the Income tax authorities

7.1 INTRODUCTION

There shall be income-tax authorities for the purposes of this Act

(1) The Central Government may appoint such persons as it thinks fit to be income-tax authorities.

(2) Without prejudice to the provisions of sub-section (1), and subject to the rules and orders of the Central Government regulating the conditions of service of persons in public services and posts, the Central Government may authorise the Board, or a Director-General, a Chief Commissioner or a Director or a Commissioner to appoint income-tax authorities below the rank of an Assistant Commissioner or Deputy Commissioner.

(3) Subject to the rules and orders of the Central Government regulating the conditions of service of persons in public services and posts, an income- tax authority authorised in this behalf by the Board may appoint such executive or ministerial staff as may be necessary to assist it in the execution of its functions.

The Board may, from time to time, issue such orders, instructions and directions to other income-tax authorities as it may deem fit for the proper administration of this Act, and such authorities and all other persons employed in the execution of this Act shall observe and follow such orders, instructions and directions of the Board.

7.2 INCOME TAX AUTHORITIES

Chapter XIII to the Income Tax Act 1961 provides for the Authorities entrusted with the enforcement of the Act. According to Section 116 of the Income tax Act, 1961, there shall be the following classes of income-tax authorities for the purposes of this Act, namely:

(a) The Central Board of Direct Taxes constituted under the Central Boards of Revenue Act, 1963 (54 of 1963),

(b) Directors-General of Income-tax or Chief Commissioners of Income-tax,

(c) Directors of Income-tax or Commissioners of Income-tax or Commissioners of Income-tax (Appeals),

(cc) Additional Directors of Income-tax or Additional Commissioners of Income-tax or Additional Commissioners of Income-tax (Appeals),

(cca) Joint Directors of Income-tax or Joint Commissioners of Income-tax,

(d) Deputy Directors of Income-tax or Deputy Commissioners of Income-tax or Deputy Commissioners of Income-tax (Appeals),

(e) Assistant Directors of Income-tax or Assistant Commissioners of Income-tax,

(f) Income-tax Officers,

(g) Tax Recovery Officers,

(h) Inspectors of Income-tax.

7.3 JURISDICTION OF INCOME TAX AUTHORITIES (SECTION 120)

Income tax authorities exercise such powers and perform such functions in accordance with directions issued to them by the Board. An Income tax authority, higher in rank, may be directed by the Board to perform the functions of an income tax authority lower in rank.

An income tax authority may be authorised by the Board to issue orders in writing for the exercise of the powers or performance of the functions by all or any of the income tax authorities who are subordinate to it.

In issuing such directions or orders, the Board or other income-tax authority authorised by it may have regard to any one or more of the following criteria, namely:-

(a) Territorial area;

(b) Persons or classes of persons;

(c) Income or classes of income; and

(d) Cases or classes of cases.

The Board may authorise any Director General or Director to perform such functions of any other income tax authority as may be assigned to him, by way of general or special order and subject to specified conditions. The Board may empower the Director General or Chief Commissioner or Commissioner to delegate the powers of the Assessing Officer to Joint Commissioner or Joint Director. Such delegation order should be mandatorily passed in writing.

The Board or any other Income tax authority authorised by it may confer concurrent jurisdiction on the Assessing Officers. The Board is empowered to regulate jurisdictional matters for the purposes of furnishing of the return of income or the doing of any act or thing under the Act.

7.4 ASSESSING OFFICER [SECTIONS 2(7A) AND 124]

Section 2(7A) enumerates the meaning of “Assessing Officer” as the Assistant Commissioner or Deputy Commissioner or Assistant Director or Deputy Director or Income Tax Officer who is vested with the relevant jurisdiction by virtue of directions or order issued under Section 120(1) or Section 120(2) or any other provisions of this Act and the Joint Commissioner or Joint Director who is directed under Section 120(4)(b) to exercise or perform all or any of the powers and functions conferred on or assigned to, an Assessing Officer under this Act. Section 124 deals with the jurisdiction of the Assessing Officer. Section 124(1) says where by virtue of any direction or order issued under Section 120(1) or under Section 120(2). The Assessing Officer has been vested with jurisdiction over any area, within the limit of such area, he shall have jurisdiction in respect of any person carrying on a business or profession, if the place at which he carries on his business or profession is situated within the area, or where his business or profession is carried on in more places than one, if the principal place of his business or profession is situated within the area, and according to Section 124(2), where a question arises under this section to ascertain whether an Assessing Officer has jurisdiction to assess any person, the question shall be determined by the Director General or the Chief Commissioner or the Commissioner; or where the question is one relating to areas within the jurisdiction of different Directors General or Chief Commissioners or Commissioners, by the Directors General or Chief Commissioners or Commissioners concerned are, if they are not in agreement, by the Board or by such Director General or Chief Commissioner or Commissioner, as the Board may, by notification in the official Gazette, specify.

Though the Assessing Officer is an executive officer in the administration of the Act, his function is fundamentally quasi judicial. While holding assessment proceedings, the Assessing Officer does not perform the functions of a Court.

7.4.1. Power to transfer cases (Section 127)

The power to transfer cases from one Assessing Officer to another subordinate Assessing Officer or Officers is vested with the Director General or Chief Commissioner or Commissioner of Income Tax. However, this power can be exercised only after giving the assessee a reasonable opportunity of being heard and after recording the reasons for doing so, wherever possible. The power should not be exercised for extraneous or irrelevant considerations.

In case the Assessing Officer from whom the case is transferred and the Assessing Officer to whom the case is transferred fall under the control of different Directors General or Chief Commissioners or Commissioners of Income Tax, the Director General or Chief Commissioner or Commissioner of Income tax from whose jurisdiction the case is transferred shall pass an order, if such concerned higher authorities mutually agree for such transfer. In case such higher authorities do not agree, the Board or any authority authorised by the Board may pass the order.

The transfer of the case may be made at any stage of the proceedings and it is not necessary to reissue any notice already issued.

7.4.2. <u>Powers of Income Tax Authorities (Section 131-136)</u>

- **Power regarding discovery, production of evidence, etc. (Section 131)**

The Assessing Officer, Deputy Commissioner (Appeals), Joint Commissioner, Commissioner (Appeals), and Chief Commissioner and Dispute Resolution Panel referred to in Section 144C have the powers vested in a Civil Court under the Code of Civil Procedure, 1908 while dealing with the following matters:

a) Discovery and inspection

b) Enforcing attendance of any person including an officer of a bank and examining him on oath

c) Compelling the production of books of account and other documents

d) Issuing commissions

If the Director General or Director or Deputy Director or Joint Director or Assistant Director or the authorised person referred to in S. 132(1), before he takes action under the said sub-section, has reason to suspect that any income has been concealed or is likely to be concealed, by any person or class of persons, within his jurisdiction, then for the purposes of making an enquiry or investigation thereto, it shall be competent for him to exercise the powers conferred in section 131(1) on the income tax authorities referred to therein, even if no proceedings with respect to such person or class of persons is pending before him or any other income tax authority.

For facilitating quick collection of information on request from tax authorities outside India, notified Income tax authorities (not below the rank of Assistant-Commissioner of Income tax), as may be notified by the Board, to now have powers under section 131(1) to make an enquiry or investigation in respect of any person or class of persons relating to an agreement for exchange of information under Section 90 or 90A even if no proceeding is pending before it or any other income tax authority with respect to the concerned person or class of persons. [Section 131(2)]

The said income tax authority is vested with the power to impound or retain in its custody, for such period as it thinks fit, any books of account or document produced before it in any proceeding under this Act. The powers are unrestricted in case of all authorities except the Assessing Officer or an Assistant Director or Deputy Director whose powers are subject to two restrictions:

1. He must record his reasons for impounding books of accounts or other documents
2. If he desires to retain in his custody any such books or documents for a period exceeding 15 days (excluding holidays), he may obtain the prior approval of the Chief Commissioner or Director General or Commissioner or Director, as the case may be, for the purpose. [Section 131(3)]

- **Search and seizure (Section 132)**

Income Tax Department has been granted power to carry out search under section 132 of the Income Tax Act, 1961, for detecting and preventing tax evasion. The court held that, even a non-resident Indian can be subjected to a search under this section if the department has definite information that the person concerned has income earned in India which may be taxable under the Act and which might not have been disclosed or would not be so declared. Though the reasons to grant such powers is avowed, the department ought to use the power sparingly and in deserving cases and after complying with necessary guidelines and safeguards. A search is violation of personal privacy and rights of a citizen and its use should only be in rarest of rare cases.

The authorisation to carry out the search can be given by the Director General, Director of Income Tax, Chief Commissioner of Income Tax and Commissioner of Income Tax only. A Joint Director or a Joint Commissioner can authorise a search, only if he is specifically so authorised by Central Board of Direct Taxes.

Under Section132(1), the authorized officer who is duly empowered by the Board to carry out the exercise of search and seizure, has in his possession any information through which he has reason to believe that –

132(1)(a) A person to whom a summon under section 131(1) or a notice under section 142(1) has been served to produce books of accounts or other documents has failed or omitted to produce or cause to be produced the said books of accounts or other documents, or

132(1)(b) A person to whom a summon under section 131(1) or a notice under section 142(1) has been or might be issued is not likely to produce or caused to be produced any books of account or other document which will be useful for or relevant to any proceedings under the Act; or

132(1) (c) A person is in possession of money, bullion, jewellery or other valuable article or thing and such property represents wholly or partly income or property which has not been disclosed or would not be disclosed, can conduct the power of search and seizure in respect of such person.

The powers available to an authorised officer while carrying out search can be briefly summarised as follows:

a) To enter and search any building, place, etc. where he has reason to suspect that books of accounts, other documents, money, bullion, jewellery or other valuable article or thing representing undisclosed income is kept;

b) To break open the locks, where the keys thereof are not available;

c) To carry out personal search of the person who is suspected to have secreted any item as mentioned in a) above;

d) Seize the items as mentioned in a) above;

e) Place marks of identification and take extracts or copies of the books of accounts and other documents; and

f) Make a note or inventory of the valuables found during the search.

The authorised officer is also permitted to pass order placing prohibition on the person in possession or control of the valuable article or thing from removing, parting with or otherwise dealing with such article or thing without prior permission. The authorised officer also has the right to demand the services of any Police officer or any officer of the Central Government.

- No power to seize stock in trade: With effect from 1st June, 2003, law has been amended by Finance Act, 2003, whereby the authorised officer cannot seize valuables if they form part of stock in trade of a business and he can only make a note or inventory of such stock in trade. Irrespective of nature of business and stock held for such business, whether it is jewellery, bullion or any other valuable article or thing, if such material is held by person searched as stock in trade of his business, the same cannot be seized. Also, bar on seizure applies irrespective of whether the person searched is able to explain the source of acquisition of such stock. In common parlance, whether stock is disclosed or undisclosed is immaterial and the same cannot be seized in any circumstance. However, bar from seizure does not apply to cash even if it is stock in trade of business. Bar against seizure applies only to any other asset or valuable and cash can be seized, if sources thereof cannot be explained, even if it forms part of stock in trade of business.
- Guidelines for seizure of jewellery and ornaments in course of search: The CBDT has vide instruction No. 1916 dated 11th May, 1994, issued guidelines for seizure of

jewellery and ornaments in course of search. The guidelines, as reported in (1994) 120 Taxation (St.) 98, is as follows:

'Instances of seizure of jewellery of small quantity in course of operations under section 132 have come to the notice of the Board. The question of a common approach to situations where search parties come across items of jewellery, has been examined by the Board and following guidelines are issued for strict compliance:-

i. In the case of a wealth-tax assessee, gold jewellery and ornaments found in excess of the gross weight declared in the wealth-tax return only need be seized.
ii. In the case of a person not assessed to wealth-tax, gold jewellery and ornaments to the extent of 500 gm. per married lady, 250 gm. per unmarried lady and 100 gm. per male member of the family, need not be seized.
iii. The authorised officer may, having regard to the status of the family and the custom and practices of the community to which the family belongs and other circumstances of the case, decide to exclude a larger quantity of jewellery and ornaments from seizure. This should be reported to the Director of Income-tax /Commissioner authorising the search at the time of furnishing the search report.
iv. In all cases, a detailed inventory of the jewellery and ornaments found must be prepared to be used for assessment purposes.

- **Recording of statements under sections 131 and 132(4):**

The authorised officer may examine on oath any person who is found to be in possession of books of accounts, etc. or valuable article or thing. A statement on oath may be used as evidence in any proceedings under the Act. Recently a circular has been issued directing officers carrying out search to desist from recording confessional statements offering income in such statements.

The Chief Commissioner or Commissioner, Director-General or Director cannot authorise the retention of the books of accounts or other documents for a period exceeding 30 days after all the proceedings under this Act in respect of the years for which the books of account and documents are relevant, are completed. If a person legally entitled to the books of accounts or other documents seized in course of search, objects to the extension of retention period, he may make an application to the Board, stating the reasons for such objection and request for the return of books of accounts and other documents. After giving an opportunity of being heard to the applicant, the Board may pass such orders as it may think fit.

- **Power to call for Information (Section 133)**

The Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals) may, for the purposes of this Act,

1. require any firm to furnish him with a return of the names and addresses of the partners of the firm and their respective shares ;
2. require any Hindu undivided family to furnish him with a return of the names and addresses of the manager and the members of the family ;
3. require any person whom he has reason to believe to be a trustee, guardian or agent, to furnish him with a return of the names of the persons for or of whom he is trustee, guardian or agent, and of their addresses;
4. require any assessee to furnish a statement of the names and addresses of all persons to whom he has paid in any previous year rent, interest, commission, royalty or brokerage, or any annuity, not being any annuity taxable under the head Salaries amounting to more than one thousand rupees, or such higher amount as may be prescribed, together with particulars of all such payments made;
5. require any dealer, broker or agent or any person concerned in the management of a stock or commodity exchange to furnish a statement of the names and addresses of all persons to whom he or the exchange has paid any sum in connection with the transfer, whether by way of sale, exchange or otherwise, of assets, or on whose behalf or from whom he or the exchange has received any such sum, together with particulars of all such payments and receipts;
6. require any person, including a banking company or any officer thereof, to furnish information in relation to such points or matters, or to furnish statements of accounts and affairs verified in the manner specified by the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), giving information in relation to such points or matters as, in the opinion of the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), will be useful for, or relevant to, any enquiry or proceeding under this Act.

Provided that the powers referred to in clause (6), may also be exercised by the Director General, the Chief Commissioner, the Director and the Commissioner.

Provided further that the power in respect of an inquiry, in a case where no proceeding is pending, shall not be exercised by any income-tax authority below the rank of Director or Commissioner without the prior approval of the Director or, as the case may be, the Commissioner.

- **Power of Survey (Section 133A)**

The power of survey under section 133A of the Income Tax Act, though not as wide as powers of search, are wide enough to effectively detect evasion of tax on business income earned. No preconditions have been prescribed which need to be satisfied by the Income Tax Authority before exercising the power of survey.

Any income tax authority having jurisdiction over the assessee can carry out survey. Such jurisdiction may either be because of assessment jurisdiction or because of jurisdiction over the place of business. Even Assessing Officer having charge of TDS circle or a Tax Recovery Officer can carry out survey. These Income tax authorities shall carry out survey only after approval from Joint Commissioner or Joint Director.

In exercise of powers of survey, income tax authority can only visit place at which business or profession is carried out, whether principal or otherwise. They can also visit any other place, where the person surveyed states those books of accounts, cash or stock in trade or other valuable or article or thing relating to business or profession is kept.

An income-tax authority can exercise only following powers during the course of survey:

i. To inspect books of accounts and other documents,
ii. To place marks of identification on books of accounts or documents examined,
iii. To make extracts or copies of books of accounts or documents,
iv. To check, verify and prepare inventory of cash, stock or other valuable article or thing found.

Survey can be carried out and commence, at a place where business or profession is carried on, when it is open for business. The restriction is only as regards when the income tax authority can enter premises to survey. As regards any other place where books, etc are stated to have been kept, income tax authority can enter only after sunrise and before sunset.

Survey party can merely survey and cannot seize cash or valuables. The Finance Act, 2002 has given power to the income-tax authority to impound and retain in his custody books of account or other documents inspected by him during survey, after recording his reasons for doing so. However the power to impound is restricted to only books and documents and does not extend to cash, valuables and other assets found.

Sub-section (5) of section 133A provides that an Income Tax Authority may make enquiries as regards expenditure incurred in a function, etc. organised by an assessee. The powers under sub-section (5) are different from other provisions of section 133A. Enquiry can be made and information can be sought not only from the person who has incurred the expense but also from any other person, who in the opinion of the Income-tax Authority is likely to possess the information.

The power of survey can be exercised only after the event and the officers cannot visit the event itself for survey.

- **Power to inspect register of Companies (Section 134)**

The Assessing Officer or the Deputy Commissioner (Appeals) or the Joint Commissioner or the Commissioner (Appeals) or any subordinate authority, authorised by any of them in writing may inspect any register of the members, debenture holders or mortgagees of any company and may take their copies or copy of any entry therein.

- **Other Powers (Sections 135 and 136)**

The Director General or Director, the Chief Commissioner or Commissioner and the Joint Commissioner are competent to make any enquiry under this Act and for all purposes they shall have powers vested in an Assessing Officer in relation to the making of enquiries.

If the investigating officer is denied entry to the premises, the Assessing Officer shall have all the powers vested in him under Section 131(1) and (2). All the proceedings before the Income tax authorities are judicial proceedings for purposes of Section 196 of the Indian Penal Code, 1860, and fall within the meaning of the Sections 193 and 228 of the Code.

An Income tax authority shall be deemed to be a Civil Court for the purposes of Section 195 of the Code of Criminal Procedure, 1973.

7.5 SUMMARY

Chapter XIII to the Income Tax Act 1961 provides for the Authorities entrusted with the enforcement of the Act. Income tax authorities exercise such powers and perform such functions in accordance with directions issued to them by the Board. Income Tax Department has been granted power to carry out search under section 132 of the Income Tax Act, 1961, for detecting and preventing tax evasion. An Income tax authority shall be deemed to be a Civil Court for the purposes of Section 195 of the Code of Criminal Procedure, 1973.

7.6 KEY WORDS

- Authority
- Commissioner
- Performance
- Concurrent jurisdiction

7.7 SELF ASSESSMENT QUESTIONS

1. Write a note on the various Authorities under the Income Tax Act.

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2. What are the Powers and Functions of an Assessing Officer?

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3. Write a note on the Power to Transfer Cases.

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UNIT – 8: ADVANCE RULING – SEARCH, SEIZURE AND SURVEY – IT TRIBUNALS -APPEALS AND REVISIONS

Structure:

8.0 OBJECTIVES

- To briefly understand the concept of Advance Ruling
- To study the Procedure of Appeal before Income Tax Commissioner(Appeals)
- To study the power of Revision
- To Know the Procedure of Appeal to the High Court and To the Supreme Court

8.1 INTRODUCTION

The scheme of advance rulings was introduced by the Finance Act, 1993. Chapter XIX-B of the Income-tax Act, which deals with advance rulings, came into force with effect from 1-6-1993. Under the scheme the power of giving advance rulings has been entrusted to an independent adjudicatory body. Accordingly, a high level body headed by a retired judge of the Supreme Court has been set-up. This is empowered to issue rulings, which are binding both on the Income-tax Department and the applicant. The procedure prescribed is simple, inexpensive, expeditious and authoritative.

8.2 ADVANCE RULING

Advance Ruling means written opinion or authoritative decision by an Authority empowered to render it with regard to the tax consequences of a transaction or proposed transaction or an assessment in regard thereto. The concept of advance rulings under the Act was introduced by the Finance Act, 1993, Chapter XIX-B of the Act, came into force with effect from 1.6.1993.

The term advance ruling has been defined in section 245N of the Act. As, "Advance ruling" means, :

(i) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant; or

(ii) a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident,

(iii) a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal.

An advance ruling may be either for both the question of law or fact.

8.2.1. <u>Authority For Advance Ruling</u>

The authority for advance ruling consists of the following:

1. A chairman who is the retired Judge of Supreme Court.

2. Two members of the rank of additional Secretary to the Government of India, one each from the Indian Revenue Service and Indian Legal Service.

8.2.2. <u>Application For Advance Ruling</u>

Under section 245N an advance ruling can be obtained by the following persons:-

a. A non-resident
b. A resident-undertaking proposing to undertake a transaction with a non-resident can obtain advance ruling in respect of any question of law or fact in relation to the tax liability of the non-resident arising out of such transaction.
c. A notified public sector company.
d. Any person, being a resident or non-resident, can obtain an advance ruling to decide whether an arrangement proposed to be undertaken by him is an impermissible avoidance arrangements and may be subjected to General Anti Avoidance Rules or not.

Application can be made for the advance ruling by the above mentioned persons under Section 245Q.

8.2.3. Questions on Which Ruling Can Be Sought

i. Even though the word used in the definition is "question", it is clear that the non-resident can raise more than one question in one application. This has been made amply clear by Column No. 8 of the form of application for obtaining an advance ruling (Form No. 34C)
ii. Though the word "question" is unqualified, it is only proper to read it as a reference to questions of law or fact, pertaining to the income tax liability of the non-resident qua the transaction undertaken or proposed to be undertaken.
iii. The question may be on points of law as well as on facts; therefore, mixed questions of law and fact can also be included in the application. The questions should be so drafted that each question can be replied in brief answer. This may need breaking-up of complex questions into two or more simple questions.
iv. The questions should arise out of the statement of facts given with the application. No ruling will be given on a purely hypothetical question. A question not specified in the application cannot be urged. Normally a question is not allowed to be amended but in deserving cases the Authority may allow amendment to one or more questions.
v. Subject to the limitations, the question may relate to any aspect of the non-resident's liability including international aspects and aspects governed by double tax agreements. The questions may even cover aspects of allied laws that may have a

bearing on tax liability such as the law of contracts, the law of trusts and the like, but the question must have a direct bearing on and nexus with the interpretation of the Indian Income-tax Act.

vi. Advance Rulings can be obtained to determine whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not (General Anti Avoidance Rules).

- **Time limit for advance ruling**

The Authority shall pronounce it advance ruling within 6 months of receipt of the application.

- **Binding nature of advance ruling**

The effect of the ruling is stated to be limited to the parties appearing before the authority and the transaction in relation to which the ruling is given. This is because the ruling is rendered on a set of facts before the Authority and cannot be for general application.

8.2. 4 Restrictions

Under section 245R, certain restrictions have been imposed on the admissibility of an application, if the question concerned is pending before other authorities. According to it, the Authority shall not allow an application where the question raised by the non-resident applicant (or a resident applicant having transaction with a non-resident) is already pending before any income-tax authority or appellate Tribunal or any Court of law. Further, the authority shall not allow the application where the question raised in it:—

i. Involves determination of fair market value of any property; or

ii. It relates to a transaction or issue which is designed, prima facie for the avoidance of income-tax.

8.2.5. Procedure On Receipt Of Application (Section 245r)

(1) On receipt of an application, the Authority shall cause a copy thereof to be forwarded to the Principal Commissioner or Commissioner and, if necessary, call upon him to furnish the relevant records:

Provided that where any records have been called for by the Authority in any case, such records shall, as soon as possible, be returned to the Principal Commissioner or Commissioner.

(2) The Authority may, after examining the application and the records called for, by order, either allow or reject the application:

Provided that the Authority shall not allow the application where the question raised in the application,—

3. (i) is already pending before any income-tax authority or Appellate Tribunal except in the case of a resident applicant falling in sub-clause (iii) of clause (b) of section 245N or any court;
4. (ii) involves determination of fair market value of any property;
5. (iii) relates to a transaction or issue which is designed prima facie for the avoidance of income-tax except in the case of a resident applicant falling in sub-clause (iii) of clause (b) of section 245Nor in the case of an applicant falling in sub-clause (iiia) of clause (b) of section 245N

Provided further that no application shall be rejected under this sub-section unless an opportunity has been given to the applicant of being heard:

Provided also that where the application is rejected, reasons for such rejection shall be given in the order.

(3) A copy of every order made under sub-section (2) shall be sent to the applicant and to the Principal Commissioner or Commissioner.

(4) Where an application is allowed under sub-section (2), the Authority shall, after examining such further material as may be placed before it by the applicant or obtained by the Authority, pronounce its advance ruling on the question specified in the application.

(5) On a request received from the applicant, the Authority shall, before pronouncing its advance ruling, provide an opportunity to the applicant of being heard, either in person or through a duly authorised representative.

Explanation.—For the purposes of this sub-section, "authorised representative" shall have the meaning assigned to it in sub-section (2) of section 288, as if the applicant were an assessee.

(6) The Authority shall pronounce its advance ruling in writing within six months of the receipt of application.

(7) A copy of the advance ruling pronounced by the Authority, duly signed by the Members and certified in the prescribed manner shall be sent to the applicant and to the **[**Principal Commissioner or**]** Commissioner, as soon as may be, after such pronouncement.

8.2.6. <u>Applicability Of Advance Ruling (Section 245s)</u>

(1) The advance ruling pronounced by the Authority under section 245R shall be binding only—

6. (a) on the applicant who had sought it;
7. (b) In respect of the transaction in relation to which the ruling had been sought; and
8. (c) On the Principal Commissioner or Commissioner, and the income-tax authorities subordinate to him, in respect of the applicant and the said transaction.

(2) The advance ruling referred to in sub-section (1) shall be binding as aforesaid unless there is a change in law or facts on the basis of which the advance ruling has been pronounced.

8.2.7. Powers of Authority (Section 245u)

(1) The Authority shall, for the purpose of exercising its powers, have all the powers of a civil court under the Code of Civil Procedure, 1908 (5 of 1908) as are referred to in section 131 of this Act.

(2) The Authority shall be deemed to be a civil court for the purposes of section 195, but not for the purposes of Chapter XXVI, of the Code of Criminal Procedure, 1973 (2 of 1974) and every proceeding before the Authority shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purpose of section 196, of the Indian Penal Code (45 of 1860).

8.2.8. Procedure of Authority (Section 245v)

The Authority shall, subject to the provisions of this Chapter, have power to regulate its own procedure in all matters arising out of the exercise of its powers under the Income Tax Act.

8.3 SEARCH, SEIZURE AND SURVEY

The Finance Act, 1985 has added that w.e.f. 1.4.1973 every income-tax authority shall be deemed to be a Civil Court for the purposes of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973. The powers granted are generally quasi-judicial. In particular, the powers of income-tax authorities relate to discovery, production of evidence etc., searches and seizures, application of retained assets, power to call for information from various parties, authorities and bodies, powers of survey, powers relating to the inspection of the registers of companies etc.

In accordance to Section 132(1), Where the Director- General or Director or Chief Commissioner or Commissioner in consequence of information in his possession has reason to believe that (a) any person to whom notice has been issued in respect of discovery and inspection etc. [under Section 131(1)] or (b) any person to whom notice has been issued to produce accounts or documents [under Section 142(1)], has failed to do so far he is not likely to produce such accounts or documents, or (c) any person is in possession of undisclosed income or property, he is empowered [under Section 132(1)] to authorise any Deputy Director, Deputy Commissioner, Assistant Director (Assistant Commissioner w.e.f. 1.4.1989) or Assessing Officer to enter and search any building, place, vessel, vehicle or aircraft, where he has reason to suspect about their availability and seize any such books of accounts, other documents, money, bullion, jewellery or other valuable article or thing found as a result of such search.

Appeal may be preferred against an order of assessment made by an assessing officer under clause (c) of Section 158BC, in respect of search initiated under Section 132 or books of account, other documents or any assets requisitioned under Section 132A;

Under Section 133A, An income-tax authority (i.e. Commissioner, Joint Commissioner, Deputy Commissioner, Director, Joint Director, Deputy Director, Assistant Director or an Assessing Officer is empowered to enter any place, within the limits of the area assigned to him, where business is carried on or where any books of accounts/documents, cash, stocks or other valuable articles relating to business are kept. An income-tax authority may (a) place marks of identification on the books of accounts or other documents inspected by him and make or cause to be made extracts or copies there from, or (b) make an inventory of any cash, stock or other valuable articles or things checked or verified by him, or (c) record the statement of any person which may be useful or relevant to any proceeding under this Act. Books of accounts or other documents, any cash, stock or other valuable articles cannot be removed by the income-tax authority from such place. The entry (a) to a business place should be made during the hours at which such place is open for the conduct of the business, and (b) to any other place only after sun rise and before sun set. An entry to a place not falling within the jurisdiction of an income-tax authority, should be made with the prior approval of that income-tax authority who exercises jurisdiction over that place. And where an assessee incurs an ostentatious expenditure on any function, ceremony, the income-tax authority is empowered to collect information about such expenditure from the assessee or any other person who is likely to possess information in this connection and may record their statement which may be used thereafter as evidence. This may be done at time such function or ceremony is over.

Appeal

The right of appeal arises where the taxpayer is aggrieved by the order passed by the income-tax authority. Where the Assessing Officer accepts the return filed by the tax payer and passes an order making no modification, an appeal does not lie against that order as the taxpayer cannot be said to be aggrieved of that order.

8.4 APPEALABLE ORDERS BEFORE COMMISSIONER (APPEALS) (SECTION 246A)

Any assessee or any deductor aggrieved by any of the following orders may appeal to the Commissioner (Appeals):

(a) against an order passed by a Joint Commissioner under Clause (ii) of Sub-section (3) of Section 115VP or an order against the assessee where he denies his liability to be assessed under the Income Tax Act, or an intimation under section 143 (1) or (1B) or section 200A(1) where the assessee or deductor objects to making of adjustment or any order of assessment under section 143(3) except an order passed in pursuance of directions of Dispute Resolution Panel or Section 144 where assessee object to the amount of income assessed or amount of tax determined or amount of loss computed or status under which he is assessed;

(aa) an order of assessment under Sections 115WE or 115WF where the assessee being an employer objects to the value of fringe benefits assessed;

(b) against an order of assessment, re-assessment or re-computation under Section 147 except an order passed in pursuance of directions of dispute resolution panel or Section 150;

(ba) an order of assessment or reassessment under Section 153A except an order passed in pursuance of directions of dispute resolution panel;

(bb) an order of assessment or re-assessment under section 92CD(3);

(c) against an order of rectification of mistake under Section 154 or Section 155 having effect of enhancing assessment or reducing refund or order refusing to allow claim made by assessee under these sections;

(d) against an order under Section 163 treating the assessee as the agent of a non-resident;

(e) against an order under Section 170(2) or 170(3) relating to succession of business otherwise on death;

(f) against an order made under Section 171;

(g) against an order under Section 185;

(h) against an order cancelling the registration of firm under section 186(1) or (2);

(i) against an order under Section 237;

(j) against an order under Section 201 or 206 (C)(A);

(k) A person deemed to be an assessee in default for not collecting the whole or any part of tax or after collecting the tax, failing to pay the same, may appeal before Commissioner (Appeals) on or after April 1, 2007.

(l) against an order imposing a penalty under Section 221, 271, 271A, 271AAA, 271AAB, 271F, 271FB, 272AA, Section 272, 272B, 272BB or Section 273;

(m) an order of imposing or enhancing penalty under Section 275(1A);

(n) against an order of assessment made by an assessing officer under clause (c) of Section 158BC, in respect of search initiated under Section 132 or books of account, other documents or any assets requisitioned under Section 132A;

(o) against an order imposing a penalty under Sub-section (2) of Section 158BFA;

(p) against an order imposing penalty under Section 271B or Section 271BB;

(q) against an order made by a Joint Commissioner imposing a penalty under Section 271C, Section 271CA, Section 271D or Section 271E;

(r) against an order made by a Joint Commissioner imposing a penalty under Section 272AA and by a Joint Commissioner or Joint Director under Section 279A;

(s) against an order imposing a penalty under Chapter XXI of Income tax Act;

(t) against an order made by an Assessing Officer other than a Joint Commissioner under the provisions of this Act, in case of specified person or classes of persons.

- **Procedure of Appeal:**

  SECTION 249(1) provides that the appeal should be filed in the prescribed form and verified in the prescribed manner. In case of an appeal made to the Commissioner (Appeals) on or after the 1st day of October, 1998, it shall be accompanied by a fees irrespective of the date of initiation of the assessment proceedings. The rates of fees are as follows:

  - INR 250 when the assessed income is one hundred thousand rupees or less (income/loss) compute.
  - INR 500 when the assessed income is more than one hundred thousand rupees but not more than two hundred thousand rupees.
  - INR 1000 when the assessed income is more than two hundred thousand rupees.
  - INR 250 in any other case.

  Section 249(4) restricts that no appeal against any order passed by the Assessing Officer can be admitted by the Commissioner (Appeals) unless at the time of filing of the appeal the assessee has paid tax due on the income returned by him, and where the assessee has not furnished the return of income, he has paid an amount equal to the amount of advance tax which was payable by him. If the appellant wants exemption from the payment of such tax he has to make an application to the Commissioner (Appeals) who is empowered to waive this requirement in appropriate cases if he is satisfied that there are good and sufficient reasons for doing so. In such cases, the Commissioner (Appeals) is required to record such reasons in writing. It may be noted that Income-tax law requires only the payment of tax before the filing of the appeal and not the payment of any penalty or any other sum payable by the assessee on the basis of the order appealed against.

Period of Limitation to File an Appeal

In computing the period of limitation, under the following circumstances, for an appeal or an application, the day on which the order is served has to be excluded. If the assessee was not furnished with a copy of the order along with the notice of the order, or demand, the time required for obtaining a copy of such order is also to be excluded and the date will be extended by that period. It may be noted that even where the assessee has not been supplied with copy of the order concerned, the time taken in making an application which does not comply with all the legal requirements cannot be excluded under the provisions of Section 268. If the application for obtaining the copy of the order has not been properly stamped or has been made by a person not authorised to do so, the time which has elapsed between the making of the invalid application and putting the application in order would not be excluded in computing the period of limitation.

1. Appeal by person denying liability to deduct tax in respect of payments payable to non-resident or a foreign company [Section 249(2)(a)] : Where the appeal relates to any tax deducted at source from payment made to a non-resident, (other than a company) or to a foreign company, any interest, other ‘than interest on securities or any other sum chargeable under the provisions of the Income Tax Act (not being salaries), within 30 days from the date of payment of tax deducted at source to the credit of the Central Government.

2. Appeal against assessment to penalty [Section 249(2)(b)] : Where the appeal relates to any assessment or penalty order the appeals have to be presented within 30 days of the date of service of the notice of demand relating to that assessment or penalty order.

3. Other appeals [Section 249(2)(c)] : In any other case, the appeal has to be presented within 30 days of the date on which intimation of the order sought to be appealed against is served on the appellant.

- **Powers of the Commissioner (Appeals)**

  According to section 251, in disposing of an appeal, the Commissioner (Appeals) shall have the following powers:

  1. In an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment.
  2. In an appeal against an order imposing a penalty, he may confirm or cancel such order or vary it so as to either enhance or reduce the penalty.
  3. In any other case, he may pass such orders in the appeal as he deems fit.

  However, it is to be noted that the Commissioner (Appeals) shall not enhance an assessment or a penalty or reduce the amount of refund unless the appellant has had a reasonable opportunity of showing cause against such enhancement or reduction. While disposing an appeal, the Commissioner (Appeals) may consider and decide the facts arising out of the proceedings which in respect of order appealed against were carried notwithstanding that such matter was not raised before the Commissioner (Appeals) by the appellant.

8.5 REVISION BY THE COMMISSIONER OF INCOME TAX

The Right to Appeal is not available against the orders of the Assessing Officer. As such the Commissioner has been vested with revisional powers under Section 263, where the order of the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the revenue. But such revisional power can be exercised only in respect of orders which are not the subject matter of appeals. Briefly the Revisional Power extends to the following:

i. Order of Assessing Officer

Under Section 263(1), The Commissioner of Income-tax can revise only the orders of Assessing Officer. An order passed by the Assessing Officer includes an order of assessment passed on or before or after 1.6.1988, including:

- an assessment order made by the Assistant Commissioner or the Income Tax Officer on the basis of the directions issued by the Joint Commissioner under Section 144A,
- an order made by the Joint Commissioner in exercise of the powers or in performance of the functions of an Assessing Officer conferred on, or assigned to him under the orders or directions issued by the Board or by the Chief Commissioner or Director General or Commissioner authorised by the Board in this behalf under Section 120

ii. Order erroneous and prejudicial to the interest of revenue

As per Section 263(1), if the Commissioner of Income-tax considers that the order of the Assessing Officer is erroneous in so far as it is prejudicial to the interest of the revenue, such order can be revised after giving the assessee an opportunity of being heard. The term "erroneous" includes cases where there has been a failure to make the necessary enquiries. The Commissioner of Income-tax may consider an order of the Assessing Officer to be erroneous not only if it contains some apparent error of reasoning or of law or of fact on the face of it. The phrase "Prejudicical to the interests of revenue" "prejudicial to the interests of revenue" appearing under Section 263(1) has not been defined in the Act, but they must mean that the order of the Assessing Officer is such, that it is not in accordance with law in consequence whereof the lawful revenue due to the State has not been realised or cannot be realised.

In Tara Devi Aggarwal v. CIT[44], the Supreme Court observed that the words 'prejudicial to the interests of the revenue' are of wide import and they should not be limited to a case where the order passed by the Income-tax Officer (now Assessing Officer) can be considered to be one prejudicial to the revenue administration as such. The question whether an order of the Income Tax Officer is prejudicial to the interests of revenue would depend on the facts of each case and there can be no universal formula applicable to finding out any such prejudicial error.

- **Circumstances In Which No Revision Can Be Made**

Section 264(4) provides that The Commissioner of Income-tax cannot revise the order of his subordinate authority in the following cases:

(i) If the order is appealable to the Commissioner (Appeals), such order cannot be revised until the time within which such appeal may be made expires. If an appeal has been made to the Commissioner (Appeals), the revisional power cannot be exercised while the appeal is pending but it may be exercised after the appeal has been disposed of. The Commissioner (Appeals) for the purpose of Section 264 is an authority subordinate to the Commissioner of Income-tax. Hence, the order of the Commissioner (Appeals) can be revised.

(ii) If the order is appealable to the Commissioner (Appeals) or the Appellate Tribunal, revisional power cannot be exercised until the time within which such

[44] (1973, 88 ITR 523)

appeal may be made expires. But, in such cases, the assessee waives his right of appeal, the Commissioner may revise the order even before the time for appeal has expired. But once the order has been made the subject of an appeal the revisional powers come to an end. An order can be said to be made the “subject of an appeal” only when it is the subject of an effective appeal. If the Commissioner (Appeals) or the Appellate Tribunal refuses to entertain an appeal on the ground that it is time barred, or grants permission to the appellant to withdraw the appeal, the order cannot be said to be the “subject of an appeal” and the assessee would be entitled to apply to the Commissioner for revision.

- **Procedure of Revision**

  The process of revision is completed in three stages:

  (i) Call for Examination of Records

  (ii) Opportunity to Hear the Parties

  (iii) Passing of Necessary order.

  Section 263(2) provides that the revisional order can be passed within two years from the end of the financial year in which the order sought to be revised was passed. However it is to be noted that the limit of two years does not apply to a revisional order which had been passed in consequences of or to give effect to, any finding or direction contained in an order of the Appellate Tribunal, the High Court or the Supreme Court. Such revisional order may be passed at any time.

  An order of the Commissioner passed under Section 264 is not appealable to the Tribunal. Nor does a reference lie against such an order to the High Court since a reference to the High Court lies only against an order passed by the Tribunal. Since the order of the Commissioner is judicial or quasi-judicial in character, it is within the ambit of the High Court’s jurisdiction under Article 226 of the Constitution and a petition for a writ of certiorari to quash an unjust or illegal order of the Commissioner is maintainable.

8.6 INCOME TAX APPELLATE TRIBUNAL

In accordance to Section 252, The Central Government shall constitute an Appellate Tribunal consisting of as many judicial and accountant members as it thinks fit to exercise the powers and discharge the functions conferred on the Appellate Tribunal by this Act. The ITAT is constituted and works under the Ministry of Law. It is thus a body outside the administrative control of the Central Board of Direct Taxes.

In CIT v. Lalchand Bhabutmal Jain, it was observed that, The Tribunal is the final Authority and ordinarily, if after considering the matters in the proper perspective and after surveying all material which is available to it, the Tribunal arrives at some conclusion one way or the other, that conclusion would have to be respected, unless it can be regarded as impossible or perverse.[45]

8.6.1. <u>Appeallable Orders</u>

Any assessee aggrieved by any of the following orders may appeal to the Appellate Tribunal against the following:

1. An order passed by Commissioner (Appeals) under Section 154 ordering a rectification of mistake, or under Section 250 in connection with the disposal of an appeal or Section 271 imposing a penalty for failure to furnish return etc. or Sections 271 A or 272A.
2. An order passed by an assessing officer under Clause (c) of Section 158BC, in respect of search initiated under Section 132 or books of account other documents or any assets requisitioned under Section 132A, after the 30th day of June, 1995 but before the 1st day of January, 1997.
3. An order passed by a Commissioner under Section 12AA relating to registration of trust or under Section 263 relating to revision of orders prejudicial to revenue or under Section 272A penalty for failure to answer question, sign statements, allow inspection etc., on or under Section 154 rectifying a mistake, or an order passed by a Chief Commissioner, or a Director General or a director under Section 272A.
4. An order passed by an Assessing Officer under Sub-section (1) of Section 115VZC.
5. An order passed by a Commissioner for rejection of approval under Section 80G(5)(vi).
6. An order passed by an Assessing Officer under section 143(3) or section 147 or section 153A or section 153C with the approval of the commissioner or an order passed under section 154 or section 155.

The Commissioner may, if he objects to any order passed by Commissioner (Appeals) under Section 154 or 250, direct the Assessing Officer to appeal to the Appellate Tribunal against the order.

[45] (1985) 151 ITR 360 (Bom.)

8.6.2. <u>Procedure for Appeal</u>

As per Section 253, An appeal to the Appellate Tribunal shall be in the prescribed form and shall be verified in the prescribed manner and shall, in case of an appeal made on or after the 1st day of October, 1998, irrespective of the date of initiation of the assessment proceedings be accompanied by a fine of :

(a) INR 500 where the assessed income/loss is 1,00,000 rupees or less.

(b) INR 1,500 where the assessed income/loss is more than one hundred thousand rupees but not more than two hundred thousand rupees.

(c) One percent of the assessed income, subject to a maximum of ten thousand rupees where the assessed income is more than two hundred thousand rupees,

(d) INR 500 in any other case, except in case of an appeal filed by the department or a memorandum of cross objections.

An application for stay of demand has to be accompanied by a fee of INR 500. In making an appeal to the Tribunal, the following documents shall be sent in triplicate, viz.:

(a) The memorandum of appeal.

(b) The grounds of appeal.

(c) Copy of the order of the Commissioner (Appeals).

(d) Copy of the grounds of appeal and statement of facts filed before the Commissioner (Appeals).

(e) Copy of the order of the Assessing Officer.

(f) Challan for payment of requisite fee.

Under Section 254, The Appellate Tribunal may, after giving both the parties to appeal an opportunity of being heard, pass such orders thereon as it may think fit. The Appellate Tribunal may, at any time within four years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it and shall make such amendment if the mistake is brought to its notice by the assessee or the Assessing Officer. But, any amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee shall not be made unless the Appellate Tribunal has given notice to the assessee of its intention to do so and has allowed the assessee a reasonable opportunity of being heard.

8.7 APPEALS TO THE HIGH COURT

Sections 260A and 260B are inserted w.e.f. October 1, 1998. Section 260A provides that an appeal shall lie to the High Court from every order passed in appeal by the Appellate

Tribunal only if the High Court is satisfied that the case involves a substantial question of law. Therefore if there is no involvement of a substantial question of law, then there can be no appeal to the High Court. If the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate that question. The appeal shall be heard only on the question so formulated, and the respondents shall at the hearing of the appeal, be allowed to argue that the case does not involve such question. However, the High Court may for reasons to be recorded, hear the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question.

8.8 APPEALS TO THE SUPREME COURT

As per Section 261, The aggrieved party is entitled to appeal to the Supreme Court against the judgment delivered by the High Court on the reference application made to it by the Tribunal (under Section 256) against an order made under Section 254 before the 1st day of October, 1998 or an appeal made to High Court in respect of an order passed under Section 254 on or after that date provided the High Court certifies the case to be fit for appeal to the Supreme Court. The right of appeal is, therefore, conditional and may be availed of only if the High Court gives a certificate of such fitness.

The High Court could certify the case as a fit one for appeal and grant leave to the Supreme Court if a substantial question of law is involved or if the question is likely to come up in successive year or if the question is otherwise of great public or private importance. An application of fitness for appeal to the Supreme Court has to be made within 60 days from the date of High Court's judgment and the time required for taking a certified copy of the High Court's judgment is to be excluded in computing such period of limitation.

8.9 SUMMARY

- Advance Ruling means written opinion or authoritative decision by an Authority empowered to render it with regard to the tax consequences of a transaction or proposed transaction or an assessment in regard thereto.
- The Authority shall pronounce it advance ruling within 6 months of receipt of the application.
- Appeal may be preferred against an order of assessment made by an assessing officer under clause (c) of Section 158BC, in respect of search initiated under Section 132 or books of account, other documents or any assets requisitioned under Section 132A;
- The right of appeal arises where the taxpayer is aggrieved by the order passed by the income-tax authority.

- In accordance to Section 252, The Central Government shall constitute an Appellate Tribunal consisting of as many judicial and accountant members as it thinks fit to exercise the powers and discharge the functions conferred on the Appellate Tribunal by this Act.
- Section 260A provides that an appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal only if the High Court is satisfied that the case involves a substantial question of law.
- The right of appeal to the Supreme Court is conditional and may be availed of only if the High Court gives a certificate of such fitness.

8.10 KEY WORDS

- Advance rule
- Tax
- Liability
- Assessing
- Appeal
- Revisional

8.11 SELF ASSESSMENT QUESTIONS

1. Explain the Concept of Advance Ruling.

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2. What are the questions that can be presented before the Authority for Advance Ruling?

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3. State the Procedure of Revision by the Income Tax Commissioner.

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4. What are Appealable Orders under the Income Tax Act, 1961?

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UNIT – 9: ASSESSMENT OF BUSINESS ORGANIZATIONS – AOP, BOI, FIRMS AND COMPANIES- CORPORATION TAX- MAT _ DIVIDEND DISTRIBUTION OF TAX – ADVANCE PAYMENT OF TAX- DOUBLE TAXATION RELIEF UNDER INCOME TAX ACT

Structure:

9.0 OBJECTIVES

- To briefly understand the Procedure of Assessment of Firms, Body of Individuals and Companies.
- To understand the Aspects of Corporate Taxation
- To study the concept of Minimum Alternate Tax
- To study the Reliefs to Double Taxation under the Income Tax Act, 1961

9.1 INTRODUCTION

In Assessment of Firms topics covered are (i) Residential status of firms (i) Key features of assessment of firms(iii) Conditions to be fulfilled U/s 184(iv) Remuneration paid to partners (v)Interest paid to partners(vi) Chargeability of interest and remuneration in hands of partner

9.2 ASSESSMENT OF FIRMS (SECTION 184)

Under Section 2(23) of the Income-tax Act, the terms “firm”, “partner”, and “partnership” have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008.

As per the scheme of Assessment, a partnership firm in the first year of Assessment shall be assessed as a “firm” provided the following conditions are satisfied:

i. The partnership is evidenced by an instrument i.e. partnership deed.

ii. The individual shares of the partners are specified in that instrument.

iii. A copy of the partnership deed certified by all the partners in writing (other than the minors) is submitted along with the return of income in respect of which assessment as a firm is first sought.

Where the firm is assessed as such for any assessment year, it shall be assessed in the same capacity for every subsequent year if there is no change in the constitution of the firm or the shares of the partners as evidenced by the partnership deed on the basis of which the assessment as a firm was first sought.

Where any change in constitution takes place in the previous year, the firm shall furnish a certified copy of the revised partnership deed along with the return of income for the assessment year relevant to such previous year. Where a firm does not comply with the provisions of section 184 for any assessment year, the firm shall be so assessed that no deduction by way of any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by such firm to any partner of such firm shall be allowed in computing the income chargeable under the head “Profits and gains of business or profession" and such interest, salary, bonus, commission or remuneration shall not be chargeable to income-tax under clause (v) of section 28.

- **Change in Constitution of the Firm (Section 187)**

Where at the time of making an assessment under section 143 or section 144 it is found that a change has occurred in the constitution of a firm, the assessment shall be made on the firm as constituted at the time of making the assessment.

For the purposes of this section, there is a change in the constitution of the firm—

(a) if one or more of the partners cease to be partners, otherwise than by reason of Dissolution on the death, or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change ; or

(b) where all the partners continue with a change in their respective shares or in the shares of some of them.

- **Succession of One Firm by Another (Section 188)**

Where a firm carrying on a business or profession is succeeded by another firm, and the case is not one covered by section 187, separate assessments shall be made on the predecessor firm and the successor firm in accordance with the provisions of section 170.

In **CIT v. K.H. Chambers**[46], the Supreme Court laid down the following requisites of succession:

(i) There is a change of ownership.

(ii) The whole business is transferred.

(iii) Substantially the identity and the continuity of the business are preserved.

- **Joint and Several Liability of Partners towards Tax Payable by Firm(Section 188A)**

Every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of this Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.

[46] (1965) 55 ITR 674

The Supreme Court has held that if a notice of demand is served on the firm, a further notice to be served upon the partners to render them liable for recovery of the amount is not necessary.[47]

- **Dissolution of Partnership or Discontinuation of Business (Section 189)**

Every person who was at the time of such discontinuance or dissolution a partner of the firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable for the amount of tax, penalty or other sum payable, and all the provisions of this Act, so far as may be, shall apply to any such assessment or imposition of penalty or other sum.

Where any business or profession carried on by a firm has been discontinued or where a firm is dissolved, the Assessing Officer shall make an assessment of the total income of the firm as if no such discontinuance or dissolution had taken place, and all the provisions of this Act, including the provisions relating to the levy of a penalty or any other sum chargeable under any provision of this Act, shall apply, so far as may be, to such assessment.

In the course of Assessment, if the Assessing-Officer or Commissioner (Appeals), in the course of any proceeding under this Act in respect of any such firm as is referred to in that subsection is satisfied that the firm was guilty of any of the acts specified in Chapter XXI, he may impose or direct the imposition of a penalty in accordance with the provisions of that Chapter. Where such discontinuance or dissolution takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against the person referred to in sub-section (3) from the stage at which the proceedings stood at the time of such discontinuance or dissolution, and all the provisions of this Act shall, so far as may be, apply accordingly.

- **Carry-Forward of Losses (Section 75)**

Where the assessee is a firm, any loss in relation to the assessment year commencing on or before the 1st day of April, 1992, which could not be set off against any other income of the firm and which had been apportioned to a partner of the firm but could not be set off by such partner prior to the assessment year commencing on the 1st day of April, 1993, then, such loss shall be allowed to be set off against the income of the firm subject to the condition that the partner continues in the said firm and to be carried forward for set off accordingly.

Section 78 of the Income Tax Act alters the position, in respect of cases of change in constitution of firm or on succession to the effect that where a change has occurred in the

[47] Sahu Rajeswar Nath V. Income-tax Officer(1969) 72 ITR 617 (S.C.)

constitution of a firm, nothing in this Chapter shall entitle the firm to have carried forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year. And where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by inheritance, nothing in this Chapter shall entitle any person other than the person incurring the loss to have it carried forward and set off against his income.

9.3 ASSESSMENT OF BODY OF INDIVIDUALS OR ASSOCIATION OF PERSONS

The term, 'Association of Persons', has not been defined under the Income Tax Act 1961. However we may distinctly say that it means an association in which two or more persons join in for a common purpose or common action to produce income, profits or gains.[48]

The Supreme Court in G. Murugesan and Bros. v. Commissioner of Income-tax[49], observed that, in order to acquire the status of an association of persons, the persons must join in a common purpose or action and the object of the association must be to produce income. It is not enough that the persons receive the income jointly.

In order to constitute an association of persons, there must be joining together in a common purpose or in a common action, the object of which is to produce income, profits and gains. Though a body of individuals is not identical with an association of persons, they have some similarities. An association of persons may consist of non-individuals also but a body of individuals has to consist only of human beings. The word 'body' would require an association for some common purpose or for a common cause or there must be unity under some common tie or occupation. A mere collection of individuals without a common tie or common aid cannot be taken to be a body of individuals failing under Section 2(31) of the Income-tax Act, 1961.

9.3.1. Scheme of Taxation for Association of Persons (Section 167B)

Section 167 B provides for the mode of taxation of the Association of Persons. It operates under two scenarios:

- **Where shares of members are indeterminate**

In cases where the shares of the members of an Association of Persons is indeterminate, tax shall be charged on the total income of the association or body at the maximum marginal rate, subject to the condition that where the total income of any member of such association or body is chargeable to tax at a rate which is higher than the maximum marginal rate, tax shall

[48] CIT v. Indira Balkrishna [(1960) 39 ITR 546]
[49] 1973, 88 ITR 432

be charged on the total income of the association or body at such higher rate. The shares of the members of an Association of Persons shall be deemed to be indeterminate or unknown if such shares are indeterminate or unknown on the date of formation of the AOP, or at any time thereafter.

- **Where shares of members are determinate**

In cases of Association of Persons other than a company or a co-operative society or a society registered under the Societies Registration Act, 1860, where:

i. the total income of any member of the association of persons for the previous year (excluding his share of income from the association of persons) exceeds the maximum amount not chargeable to tax in the case of an individual, tax will be charged on the total income of the AOP at the maximum marginal rate as determined by the relevant Finance Act, i.e. the highest slab applicable to an individual.
ii. any member or members thereof is or are chargeable to tax at a rate or rates which is or are higher than the maximum marginal rate, tax shall be charged on that portion or portions of the total income of the association or body which is or are relatable to the share or shares of such member or members at such higher rate or rates, as the case may be, and the balance of the total income of the association or body shall be taxed at the maximum marginal rate.

9.3.2. <u>Computation of a share of Member's Income</u>

Section 67A seeks to provide for the method of computing a member's share in the income of an association of persons or a body of individuals, wherein the shares of the members are determinate. It provides the following methods of computing a member's share:

(a) Any interest, salary, bonus, commission or remuneration, by whatever name called, paid to any member in respect of the previous year shall be deducted from the total income of the association or body and the balance ascertained and apportioned among the members in the proportion in which they are entitled to share the income of the association or body.

(b) Where the amount apportioned to a member under (a) hereinabove is a profit, any interest, salary, bonus, commission or remuneration paid to the member by the AOP in respect of the previous year shall be added to that amount - the result shall constitute the member's share in the income of the association or body.

(c) Where the amount apportioned to a member under (a) is a loss, any interest, salary, bonus, commission or remuneration aforesaid paid to the member by the association or body in respect of the previous year shall be adjusted against that amount, the result shall be adjusted against that amount, and the result shall be treated as the member's share in the income of the association or body.

It is also provided that any interest paid by a member on capital borrowed by him for the purposes of investment in the association or body shall, in computing his share chargeable under the head "Profits and gains of business or profession" in respect of his share in the income of the association or body, be deducted from his share.

- **Taxability of the Share in Income**

Section 87 provides that, if an Assessee is a member of an association of persons or a body of individuals other than a company or a Co-operative society or a Society registered under the Societies Registration Act, 1860, or any law corresponding to that Act in force in any part of India, his share in the income of the association or body, computed in the manner provided in Section 67A shall not be liable to tax. And where the association or body is chargeable to tax on its total income at the maximum marginal rate or any higher rate, under any of the provisions of the Income-tax Act, his share computed in the manner stated above shall not be included in his total income.

It however provides that where no income-tax is chargeable on the total income of the association or body, the member's share shall be chargeable to tax as part of his total income and Section 86 shall not be applicable to such case.

9.3.3. <u>Assessment in case of Dissolution of an Association of Persons (Section 177)</u>

Where any business or profession carried on by an AOP has been discontinued or an AOP is dissolved, the Assessing Officer shall make an assessment of the total income of the AOP as if no such discontinuance or dissolution had taken place, and all provisions of this Act, including the provisions relating to the levy of penalty or any other sum chargeable under any provisions of the Income-tax Act shall apply.

Every person who was at the time of such discontinuance or dissolution a member of the AOP and the legal representative of any such person who is deceased, shall jointly and severally be liable for the amount of tax, penalty or other sum payable.

Where such discontinuance or dissolution takes place after any proceeding in respect of an assessment year have commenced, the proceedings may be continued against the members from the stage at which the proceedings stood at the time of such discontinuance or dissolution.

9.4 ASSESSMENT OF CORPORATIONS

A Company is also defined as person and liable to pay taxes on the income earned in the previous year.. As per section 2(17), company means:

(i) any Indian company, or

(ii) anybody corporate incorporated by or under the laws of a country outside India, or

(iii) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income Tax Act, 1922 (11 of 1922) or was assessed under this Act, as a company for any assessment year commencing on or before April 1, 1970; or

(iv) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the CBDT to be a company.

Provided that such institution, association or body shall be deemed to be a company only for such assessment year or assessment years (whether commencing before the 1st day of April 1971, or on or after that date) as may be specified in the declaration.

Residential Status of a Company

An Indian Company for the purposes of this Act is always treated as a Resident in India. But, in case of a Foreign Company the residential status depends upon place of Control and Management of its business affairs. If such Control and Management of the business affairs is wholly in India, it is a Resident Company. If Control and Management of its business affairs is wholly or partly outside Indi, then it is treated as a non-resident.

According to Section 5(1) of the Act, the total income of a resident company would consist of:

(i) Income received or deemed to be received in India during the previous year by or on behalf of such company;

(ii) Income which accrues or arises or is deemed to accrue or arises to it in India during the previous year;

(iii) Income which accrues or arises to it outside India during the previous year;

Under Section 5(2) of the Act, the total income of a non-resident company would consist of:

(i) Income received or deemed to be received in India during the previous year by or on behalf of such company;

(ii) Income which accrues or arises or is deemed to accrue or arises to it in India during the previous year;

For the purposes of Income Tax Act, Companies are divided into the following five categories:

- **Indian Company:**

An Indian Company is entitled to certain special tax benefits under the Act. Section 2(26) of the Act, Indian Company means a company formed and registered under the Companies Act, 1956 and includes:

(a) A company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu & Kashmir, and the Union Territories specified in (e) below);

(b) Any corporation established by or under a Central, State or Provincial Act;

(c) Any institution, association or body declared by the Board to be a company under section 2(17) of the Act;

(d) In the case of Jammu & Kashmir, any company formed and registered under any law for the time being in force in that State; and

(e) In the case of any of the Union Territories of Dadra and Nagar Haveli, Daman and Diu and Pondicherry, a company formed and registered under any law for the time being in force in that Union Territory;

Provided that the registered or as the case may be, principal office of the company, corporation, institution, association or body in all cases is in India.

- **Domestic Company:**

As per Section 2(22A) all Indian Companies are Domestic Companies. However, a non-Indian company would be a domestic company only if it makes the following prescribed arrangements for the declaration and payment of dividends in India:

(a) The share register of the company concerned, for all its shareholders, shall be regularly maintained at its principal place of business within India in respect of any assessment year from a date not later than the first day of April of such year;

(b) The general meeting for passing the accounts of the previous year relevant to the assessment year declaring any dividends in respect thereof shall be held only at a place within India;

(c) The dividends declared, if any, shall be payable only within India to all shareholders.

- **Foreign Company:**

  Section 2(23A) defines a foreign company as one which is not a domestic company. However, all non-Indian companies are not foreign companies as a non-indian company can be a domestic company if it satisfies the condition stated above.

- **Widely Held Company:**

  In accordance to Section 2(18), a company is said to be one in which public are substantially interested [**widely held company**] in the following cases, namely:

  (i) If it is a company owned by the Government or RBI or in which at least 40% of the shares, whether singly or taken together, are held by the Government or RBI or a corporation owned by RBI; or

  (ii) If it is a company registered under Section 25 of the Companies Act, 1956; or

  (iii) If it is a company, having no share capital and if, having regard to its objects, the nature and composition of its membership and other relevant considerations, it is declared by an order of the Central Board of Direct Taxes (CBDT) to be a company in which the public are substantially interested;

  (iv) If it is a company which carries on its as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under Section 620A of the Companies act, 1956 to be a Nidhi or Mutual Benefit Society; or

  (v) If it is company in which shares carrying atleast 50% of the voting power have been allotted unconditionally to or acquired unconditionally by, and are throughout the relevant previous year beneficially held by, one or more cooperative societies; or

  (vi) If it is company which is not a private company as defined in Section 3 of the Companies Act, 1956 and equity shares of the company were, as on the last day of the relevant previous year, listed in a recognised stock exchange in India;

  (vii) If it is a company which is not a private company and the shares in the company (other than preference shares) carrying atleast 50% (40% in case of an Industrial company) of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant accounting year beneficially held by (a) Government, or (b) a corporation establishment by a Central or State or Provincial Act, or (c) any company in which the public are substantially interested or a wholly owned subsidiary company.

- **Closely Held Company:**

  Any Company that is not one in which the public are not substantially interested is a closely held company.

9.4.1. <u>Corporate Tax</u>

Under the Constitution, Entry 85 of the Union List in the Seventh Schedule specifies Corporation tax as a tax on companies. Corporate tax refers to any tax on income, so far as that tax is payable by companies and is a tax in case the following conditions are fulfilled[50]:

(a) that it is not chargeable in respect of agricultural income;

(b) that no deduction in respect of tax paid by companies is by any enactments which may apply to the tax authorised to be made from dividends payable by the companies to individuals;

(c) that no provision exists for taking the tax so paid into account for computing for the purposes of Indian income tax, the total income of individuals receiving such dividends, or in computing the Indian income tax payable by, or refundable to, such individuals.

9.4.2. <u>Minimum Alternate Tax (Section 115JB)</u>

The Income-tax Act is comprised of a plethora of tax incentives which has the effect of eroding the tax base. The Minimum Alternate Tax (MAT) is designed to fix a cap on the eroding effect on the tax base by the Incentives. Section 115JB of the Income-tax Act provides for levy of minimum alternate tax (MAT) on the basis of book profits of a company. The levy of a minimum tax on companies was first introduced through section 80VVA by the Finance Act, 1983 w.e.f. A.Y. 1984-85. The method adopted by this section was to place a ceiling on the aggregate quantum of incentives available under various provisions of the Act. However, the unabsorbed incentives were allowed to be carried forward and set off against taxable income in future years.

The concept of a tax on the book profits was introduced by Section 115J, under the Finance Act, 1987. Section 115JA was introduced with effect from A.Y. 1997-98 and had effect up to A.Y.2000-01, that further provided for the imposition of a Minimum Alternate Tax. provides that Notwithstanding anything contained in any other provision of this Act, where in the case of an assessee, being a company, the income-tax, payable on the total income as computed under this Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 2010, is less than fifteen per cent of its

[50] Article 366(6) of the Constitution of India, See Chapter II: Block I.

book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of fifteen per cent.

As per Section 115JB(2), A company will prepare its profit and loss account for the relevant previous year in accordance with the provisions of Part II of Schedule VI of the Companies Act, 1956. However, while preparing the annual accounts including profit and loss account:

(a) The accounting policies;

(b) The accounting standards followed for preparing such accounts including profit and loss accounts; and

(c) The methods and rates adopted for calculating the depreciation, shall be the same as have been adopted for the purpose of preparing such accounts including profit and loss account and laid before the company at its annual general meeting in accordance with the provisions of Section 210 of the Companies Act, 1956.

Nothing contained in Section 115JB shall affect the determination of the amounts of unabsorbed depreciation under Section 32(2), business loss under Section 72(1), speculation loss u/s 73, Capital loss u/s 74 and loss u/s 74A in relation to the relevant previous year to be carried forward to the subsequent year or years.

The provisions of Section 115JB shall apply to the income accrued or arising on or after 1st April, 2005 from any business carried on, or services rendered, by an entrepreneur or a Developer, in a Unit or SEZ (Special Economic Zone), as the case may be and shall be effective from AY 2012-13.

- **Book Profits of a Company**

In Rashtriya Ispat Nigam Limited Case,[51] the Authority on Advance Ruling has ruled that the applicant does not have the option to reduce the current year's profits by the loss brought forward or unabsorbed depreciation for the purpose of carry forward under Section 115JB in its accounts in a manner different from the manner adopted for determination of book profits under Section 1 15JB of the Act.

- **Computation of Book Profit**

Particulars	**Amount (Rs.)**
Profit after Tax	XX
Add:	XXX

[51] [2006] 285 ITR 1

• The amount of income-tax paid or payable, and the provision there of;	XXX XXX
• The amounts carried to any reserves, by whatever name called 35[, other than a reserve specified under section 33AC];	XXX
• The amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities;	XXX
• The amount by way of provision for losses of subsidiary companies;	XXX
• The amount or amounts of dividends paid or proposed.	XXX
Less:	
• The amount withdrawn from any reserves or provision, if any such amount is credited to the Profit and Loss Account;	XXX
• The amount of any income to which any of the provisions of Sec 10 [excluding income referred to u/s 10(38)] applies if any such amount is credited to the Profit and Loss Account;	XXX XXX
• The amount of depreciation debited to the Profit and Loss Account (excluding depreciation on revaluation of assets);	XXX
• The amount withdrawn from Revaluation reserve and credited to Profit and Loss Account to the extent it does not exceed the amount of depreciation on account of revaluation of assets;	
• The amount of brought forward losses or unabsorbed depreciation whichever is less as per books of accounts;	
• The amount of profit of a Sick Industrial Company for the assessment year commencing from the assessment year in which the said company has become a sick industrial company u/s 17(1) of the Sick Industrial Companies (Special Provisions) Act' 1985 and ending with the assessment year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses	
BOOK PROFIT AS PER SECTION 115 JB	**XXX**

9.4.4. <u>Dividend Distribution of Tax (Section 115-O)</u>

A domestic company is liable to pay tax on the amounts distributed, declared or paid as dividend (whether interim or otherwise) and it shall be payable @ 15% plus surcharge @ 10% and education cess and SHEC @ 3% in addition to the income tax payable.

The amount distributed, declared or paid as dividend may be out of accumulated or current year profits and same shall not include:

(i) The amount of dividend if any received by the domestic company during the financial year, if such dividend is received from its subsidiary and;

(a) Where such subsidiary is a domestic company, the subsidiary has paid tax which is payable under this section on such dividend; or

(b) Where such subsidiary is a foreign company, the tax is payable by the domestic company under Section 115BBD on such dividend.

(ii) The amount of dividend paid to any person for, or on behalf of, the New Pension System Trust referred to in clause (44) of Section 10.

The proviso to sub-section 6 of section 115-O by which the provisions of section 115-O shall also be applicable on an enterprise or undertaking engaged in developing, operating and maintaining a SEZ. The amount of such tax shall be deposited within 14 days from the date of, earliest of the following:

(a) declaration of dividend or

(b) distribution of dividend or

(c) payment of dividend

- **Taxation of Foreign Dividends**

  As per Section 115BBD(1), Where the total income of an assessee, being an Indian company, for the previous year relevant to the assessment year beginning includes any income by way of dividends declared, distributed or paid by a specified foreign company, the income-tax payable shall be the aggregate of—

  (a) the amount of income-tax calculated on the income by way of such dividends, at the rate of fifteen per cent; and

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

9.5 ADVANCE PAYMENT OF TAX

Sections 207- 219 under Chapter XVII of the Income Tax Act deal with the computation and liability to pay Advance Tax. In advance payment of tax, the assessee has to pay tax in a financial year under estimated income which is to be taxed in the subsequent assessment year. Section 208 makes is obligatory for an assessee to pay advance tax where the advance tax payable is `10,000 or more. Any payment of advance tax payable made before March 31 shall be treated as advance tax paid during the financial year.

According to Section 234B of the Act where an assessee, who is liable to pay advance tax, under Section 208 has failed to pay such tax or where the advance tax paid under Section 210 is less than 90% of the assessed tax, he shall be liable to pay interest @ 1% for every month or part of the month.

In order to reduce the compliance burden on senior citizens exemption from payment of advance tax section 207 has been amended to provide that resident individual –

(1) not having any income chargeable under the head "Profits and gains of business or profession" and

(2) of age 60 years or more need not pay advance tax and are allowed to discharge their tax liability (other than TDS) by payment of self-assessment tax.

9.6 DOUBLE TAXATION RELIEFS

Section 90 provides that where, the Central Government enters into an agreement with the Government of any other country or specified territory outside India, for the purpose of

(a) grant of relief in respect of—

(i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or

(b) avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, or

(c) exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or investigation of cases of such evasion or avoidance, or

(d) recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory, as the case may be, and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

However the sub-clause (2A) of Section 90 provides that notwithstanding anything contained in sub-section (2), the provisions of Chapter X-A of the Act shall apply to the assessee even if such provisions are not beneficial to him.

9.7 SUMMARY

- Where at the time of making an assessment under section 143 or section 144 it is found that a change has occurred in the constitution of a firm, the assessment shall be made on the firm as constituted at the time of making the assessment.
- Where a firm carrying on a business or profession is succeeded by another firm, and the case is not one covered by section 187, separate assessments shall be made on the predecessor firm and the successor firm in accordance with the provisions of section 170.
- The term, 'Association of Persons', has not been defined under the Income Tax Act 1961. However we may distinctly say that it means an association in which two or more persons join in for a common purpose or common action to produce income, profits or gains.
- Under the Constitution, Entry 85 of the Union List in the Seventh Schedule specifies Corporation tax as a tax on companies.
- The Minimum Alternate Tax (MAT) is designed to fix a cap on the eroding effect on the tax base by the Incentives.

9.8 KEY WORDS

- Liability
- Partners
- Dissolution
- Carry forward losses
- Shares

9.9 SELF ASSESSMENT QUESTIONS

1. Explain the provisions under the Income Tax Act relating to MAT.

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2. What is the procedure of Assessment of a Partnership Firm? Does the procedure undergo any change in case of Dissolution of the Partnership Firm?

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3. Define Corporation Tax. Explain the taxation in light of the Residential Status of the Corporations.

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4. ‘The ability to determine the Share holding of the Members, affects the scheme of taxation applicable to the Association of Persons.’ Elucidate.

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UNIT – 10: COMBINATION OF COMPANIES - AMALGAMATIONS – MERGERS – DEMERGERS AND TAX CONCESSIONS

Structure:

10.0 OBJECTIVES

- To provide an insight to Corporate Restructuring
- To understand the Tax Aspects of Corporate Restructuring Activities
- To study the various Concessions Available to the Company carrying out the process of Corporate Restructuring.

10.1 INTRODUCTION

In business, **consolidation** or **amalgamation** is the merger and acquisition of many smaller companies into much larger ones. In the context of financial accounting, consolidation refers to the aggregation of financial statements of a group company as consolidated financial statements. The taxation term of consolidation refers to the treatment of a group of companies and other entities as one entity for tax purposes. Under the Halsbury's Laws of England, 'amalgamation' is defined as "a blending together of two or more undertakings into one undertaking, the shareholders of each blending company, becoming, substantially, the shareholders of the blended undertakings. There may be amalgamations, either by transfer of two or more undertakings to a new company, or to the transfer of one or more companies to an existing company".

10.2 CORPORATE RESTRUCTURING

Corporate Restructuring is a comprehensive process whereby a company, consolidates its business operations for certain strategic or financial advantages, in light of its short term and long term objectives, to strive as a competitive and successful entity. Corporate Restructuring may take place either of the following forms, viz. Amalgamation, or Merger or Demerger. The Income Tax Act provides for an exemption from the payment of capital gains tax on transfer of assets and shares pursuant to the scheme of amalgamation. The amalgamated company continues to enjoy the benefit of various deductions and allowances available to the amalgamating company, to the extent not claimed by the latter. Further, the unabsorbed depreciation of the amalgamating company can be carried forward and set-off against the business income of the amalgamated company. This acts as an incentive for healthy companies to merge sick industrial units with themselves.

10.3 MERGERS / AMALGAMATION

A merger occurs when two or more companies unite together to form a single company. A merger in India is known as amalgamation and the two terms merger and amalgamation are used interchangeably to connote the same thing. The term Amalgamation, as defined under Section 2(1B), is said to cover the process wherein there is:

- A merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company)
- in such a manner that:
    - all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation ;
    - all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation ;
    - the shareholders holding not less than 17[three-fourths] in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation.
- And such manner of Merger must be otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first-mentioned company.

Thus to be an Amalgamation, all the above three conditions are to be fulfilled.

10.3.1. <u>Carry Forward/Set off for Accumulated Losses and Unabsorbed Depreciation Allowance</u>

The term "Accumulated loss", refers to the loss of the predecessor firm or the proprietary concern or the amalgamating company or the demerged company, as the case may be, under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the reorganisation of business or amalgamation or demerger had not taken place.

The term "unabsorbed depreciation", refers to the allowance for depreciation of the predecessor firm or the proprietary concern or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganisation of business or amalgamation or demerger had not taken place.

The rule regarding set-off and carry forward of losses is that business loss incurred in one business is available to be set-off against the income from another business in the same year. If such other business income is not sufficient to absorb, then, such unabsorbed loss can be set-off against any other income from another source. If after such adjustment also, accumulated loss remains, then it is allowed to be carried forward to be set-off against income in the following years, subject to a maximum of eight years.

Normally, unabsorbed depreciation allowance and business losses can be carried forward and set-off against the business profits of subsequent years only by the person who had incurred those losses. However, the Income Tax Act carves out exceptions in case of amalgamation of companies and provides that where a company owning an industrial undertaking has amalgamated, its accumulated loss and the unabsorbed depreciation shall be deemed to be the loss, or as the case may be, the allowance for depreciation of the amalgamated company and all its provisions relating to carry forward of losses and allowance for depreciation shall apply accordingly.[52]

Section 72 A seeks to provide for a set-off for such accumulated losses and unabsorbed depreciation. However, it provides for the carry forward of such balances for set-off in, not all but, certain cases of Amalgamation alone where there has been an amalgamation of:

(a) a company owning an industrial undertaking[53] or a ship or a hotel with another company; or

(b) a banking company referred to in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949) 61a with a specified bank; or

(c) one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business, then, notwithstanding anything contained in any other provision

[52] Section 72 of the Income Tax Act 1961.
[53] Section 72(7)(aa)"industrial undertaking" means any undertaking which is engaged in—
(i) the manufacture or processing of goods; or (ii) the manufacture of computer software; or (iii) the business of generation or distribution of electricity or any other form of power; or 65[(iiia) the business of providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broadband network and internet services; or](iv) mining; or(v) the construction of ships, aircrafts or rail systems;]

of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

In case the Amalgamation is of the manner provided above, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

A. Pre-requisites for Applicability Of Section 72A

For the provisions of Section 72A to be applicable, there are certain pre-requisites that need to be meted out by the Amalgamating Company and the Amalgamated Company, as explained hereunder, respectively:

I. **Amalgamating Company:** The applicability of the Section 72A to an Amalgamating Company is pre-nuptial in nature. The conditions specified are to be fulfilled prior to the Date of Amalgamation. They are:

- For eligibility under Section 72A, it is an essential pre-condition that the Amalgamating Company has been engaged in the business, as provided, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years; and
- The Company has held at least three-fourth of the book-value of its fixed assets, two years preceding the date of amalgamation.

II. Amalgamated Company: As the Amalgamated Company comes into existence only after the process of Amalgamation; the conditions imposed are post-nuptial in nature. They are:

- The Amalgamated Company, to acquire the benefit is to hold, for at least a period of five years, three-fourths of the book-value of the fixed assets of the Amalgamating Company, as on the date of amalgamation.

- The Company is to carry on the business of the Amalgamating Company for at least a period of Five years.
- The Amalgamated Company is also to ensure compliance with Rule 9C and the Filing of Form 62 with the Returns for each of the five years.

In case of non-compliance of the conditions the the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.

10.4 DEMERGERS

Section 2(19AA) "demerger", in relation to Companies, is a process such that on its completion:

(i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;

(ii) all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;

(iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

(iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;

(v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company ;

(vi) the transfer of the undertaking is on a going concern basis;

(vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

If the above features can be identified in a Corporate Restructuring Process then such process is known as Demerger.

In the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall where such loss or unabsorbed depreciation is:

(a) **Directly Relatable** to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company;

(b **Not Directly Relatable** to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

10.5 TAX CONCESSIONS IN CASE OF CORPORATE RESTRUCTURING

- **Exemption from Capital Gains Tax [Sec. 47(vi)]:** Under section 47(vi) of the Income-tax Act, capital gain arising from the transfer of assets by the amalgamating companies to the Indian Amalgamated Company is exempt from tax as such transfer will not be regarded as a transfer for the purpose of Capital Gain.

- **Amortisation of Preliminary Expenses:**

  Under Section 35 D, when an amalgamating company merges with an amalgamated company under a scheme of amalgamation, the amount of preliminary expenses of the amalgamating company to the extend not yet written off shall be allowed as deduction to the amalgamated company in the same manner as would have been allowed to the amalgamating company.

- **Amortization of expenditure in case of Amalgamation[Section 35DD]:**

  Under Section 35DD for expenditure incurred in connection with the amalgamation the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the amalgamation takes place.

  Amortization of amalgamation expenses

- **Expenditure on Scientific Research [Section 35]:**

  Any expenditure of a capital nature incurred on scientific research relating to business of the taxpayer is allowed as a deduction under Section 35 of the Income Tax Act. If the amalgamating company transfers to the amalgamated company, any asset representing capital expenditure on scientific research, the amalgamated company is entitled to the aforesaid deduction, in the same manner as that of the amalgamating company, as if no transfer of asset had taken place.

- **Expenditure on Know How [Section 35 AB]:**

  A lump sum consideration paid by a taxpayer for acquiring any know-how for the purpose of its business is allowed as a deduction by spreading it over six years, namely, the year in which lump sum consideration is paid and five immediately succeeding years. Upon amalgamation of a company entitled to such a deduction, the amalgamated company can avail the deduction to the same extent (for the residual period) as would have been allowed to the amalgamating company, had such amalgamation not taken place.

- **Expenditure for obtaining a licence to operate telecommunication services [Sec. 35ABB(6)]:**

  Where in a scheme of amalgamation, the amalgamating company sells or otherwise transfer its licence to the amalgamated company (Being an Indian Company), the provisions of Section 35ABB which were applicable to the amalgamating company shall become applicable in the same manner to the amalgamated company, consequently.

10.6 CAPITAL GAINS TAX

A capital gain is the difference between the price at which the asset was acquired and the price at which the same asset was sold. A Capital Gain embraces the difference between cost of acquisition and the full value of consideration. Incidental expenditure and cost of improvement are allowable as deductions in the computation of capital gains.

Section 45 of the Income Tax Act provides that any profit that arises from the Transfer of Capital Assets shall be chargeable to Capital Gains Tax. The exemption created under Section 47(vi) and (vii) of the Income Tax Act 1961 provides for immunity against Capital Gains Tax for transactions between the Amalgamating Companies, arising in and out of the process Amalgamation. However, this exemption is available only if the Amalgamated Company is an Indian Company. When there is the participation of a Foreign Amalgamating Company, of a capital asset being a share or shares held in an Indian company, it is exempted from Captial Gains Tax, provided:

- at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company, and
- such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated.

10.6.1. <u>Slump Sale</u>

As per Section 2(42C), "Slump Sale" means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. Section 50 B provides that any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place, provided that any profits or gains arising from the transfer under the slump sale of any capital asset being one or more undertakings owned and held by an Assessee for not more than thirty-six months immediately preceding the date of its transfer shall be deemed to be the capital gains arising from the transfer of short-term capital assets. Capital gains arising on transfer of an undertaking are deemed to be long-term capital gains. However, if the undertaking is 'owned and held' for not more than 36 months immediately before the date of transfer, gains shall be treated as short-term capital gains.

Capital gains arising on slump sale are calculated as the difference between sale consideration and the net worth of the undertaking. Net worth is deemed to be the cost of acquisition and cost of improvement for S. 48 and S. 49 of the Act.

In the case of Industrial Machinery Associates v. CIT, [54]sale of entire business undertaking by a firm to a company as a going concern was held to be a slump sale. Slump sale may be of a single undertaking or even more than one undertaking.

The Bombay High Court, in the case of Bharat Bijlee Limited[55] upheld the decision of the Income-tax Appellate Tribunal that the transfer of a business undertaking as a going concern against bonds/ preference shares issued was not a sale, but an exchange. Therefore, section 2(42C) and section 50B of the Income-tax Act, 1961 (the Act) relating to the computation of capital gains tax was not applicable to such a transfer, as it was not a 'slump sale'.

10.7 SUMMARY

- Corporate Restructuring is a comprehensive process whereby a company, consolidates its business operations for certain strategic or financial advantages, in light of its short term and long term objectives, to strive as a competitive and successful entity.

[54]81 ITD 482 (Ahd).
[55] CIT v. Bharat Bijlee Limited [TS-270-HC-2014(BOM)]

- A merger occurs when two or more companies unite together to form a single company. A merger in India is known as amalgamation and the two terms merger and amalgamation are used interchangeably to connote the same thing.
- For the provisions of Section 72A to be applicable, there are certain pre-requisites that need to be meted out by the Amalgamating Company and the Amalgamated Company
- Any expenditure of a capital nature incurred on scientific research relating to business of the taxpayer is allowed as a deduction under Section 35 of the Income Tax Act.
- A capital gain is the difference between the price at which the asset was acquired and the price at which the same asset was sold.
- As per Section 2(42C), “Slump Sale” means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales**.**

10.8 KEY WORDS

- Merger
- Corporate Restructuring
- Taxpayer
- Capital Gains Tax
- Consolidates

10.9 SELF ASSESSMENT QUESTIONS

1. Write a note on the following:

    a. Slump Sale   b. Capital Gains Tax

2. Explain the circumstances under which an Amalgamated Company can claim for set-off against Accumulated Losses and Unabsorbed Depreciation.

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3. What are tax concessions available in case of corporate restructuring?

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4. Define the process of ‘Amalgamation’ for the purpose of Income Tax Act, 1961.

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BLOCK-III

UNIT – 11: INTRODUCTION TO INDIRECT TAXES – LIABILITY TO PAY SALES TAX – CONCEPT OF SALE - SALES TAX

Structure:

11.0 OBJECTIVES

- To introduce the concept of Indirect Taxes
- To give insight on the concept of Sales Tax
- To explain the scope and ambit of the Sales Tax
- To provide insight on the Liability to pay Sales Tax

11.1 INTRODUCTION

Government of India collects and raises revenue and funds for various purposes like defense, education, health, maintenance of public utilities etc by levying taxes from the taxpayers. These taxes are broadly classified into two major categories namely Direct Taxes and Indirect Taxes. Direct tax, as previously studied, is the tax that is levied directly from the taxpayer. Direct tax cannot be shifted to another taxpayer and can be paid only by the individual or organization on which it is imposed. Examples of Direct taxes are Income Tax, Property Tax etc.

11.2 INDIRECT TAXES

Indirect taxes are taxes imposed by the Government indirectly on the taxpayer. This tax is levied from an intermediary, such as, the restaurant owner and is paid by the taxpayer, such as, customer who visits the restaurant. Here the burden of tax can be shifted to another taxpayer, i.e., the intermediary. The customers pay for taxes inclusive in the price of the good or service when the goods are purchased or services are rendered. As mentioned earlier, incidence of tax is on the intermediary and impact of tax is on the taxpayer, thus incidence and impact are on two different persons. Some examples of Indirect taxes are Customs Duty, Excise Duty, Sales Tax, Service Tax etc. Taxes provide for the major chunk of the country's revenue out of which levy of Indirect taxes like Excise Duty and Service Tax make a significant contribution.

Some important Indirect taxes:

A. EXCISE DUTY- This is the duty on goods manufactured or produced in India. Excise Duty is levied on certain goods over the years after independence to meet the revenue requirements of the country. Central Excise Law prescribes two methods of levying duty, i.e., levy by specific duty and levy by ad valorem duty. Most goods are levied on ad valorem basis. The Central Excise Act, 1944, Central Excise Tariff Act, 1985 and rules made there under govern Central Excise Duty.

B. CUSTOMS LAW- Levy of Customs Duty dates back to the period of the British East India Company rule in India. There was uniform tariff all over India and Presidencies of Bengal, Mumbai and Chennai had their own individual customs regulations. The tariff underwent many changes and after independence, the Customs Tariff Act was effected in 1975. This is the duty imposed on goods which are imported into India. Customs Act, 1962 and Custom Tariff Act, 1975 are the two important Acts governing the law relating to Customs.

C. SERVICE TAX- Taxes imposed on the service sector. In a growing economy, the service industry provides a major part of revenue to Government by levy of Service Taxes. The Service Tax may be borne by the customer or the receiver of the service or it may be borne by the service provider who decides to charge the same value to the customer or not pass the burden of tax on to the customer. The Finance Act, 2012 provides for a negative list of taxable services wherein certain services are exempted from imposition of taxes by issue of notification.

D. SALES TAX- Both the Union and State Governments have the power to levy taxes on sale or purchase of goods. Entry 92A of the Union List, grants power to the Union Government to levy taxes on the sale or purchase of goods other than newspapers and such sale or purchase of said goods takes place in the course of inter-State trade or commerce. Entry 54 of the States List grants power to the States to levy tax on sale or purchase of goods other than newspapers subject to the provisions of Entry 92A of the Union List. Lastly Article 286(1)[56] provides that "a State cannot impose any tax on sale or purchase of goods where such sale or purchase takes place:

   (a) Outside the State;

   (b) In the course of import into or export of goods out of territory of India."

   Different state Governments have different laws relating to Sales Tax, thus Value Added Tax (VAT) has been introduced to ensure uniformity of laws pertaining to Sales Tax.

11.3 SALES TAX

Both the Union and the States have the power to levy sales-tax. Under entry 92A of the Union list, the Union Government has power to levy taxes on the sale or purchase of goods with the exception of newspapers, taking place in the course of inter-State trade or commerce.

Entry 54 of the States List gives the States the power to levy tax on sale or purchase of goods except newspapers, subject to the provisions of Entry 92A of the Union List.

Under Article 286(1) of the Constitution, a State does not have the power to impose any taxes on sale or purchase of goods occurring:

[56] Constitution of India

I. outside the State;

II. In the course of import into or export of goods out of the territory of India.

Thus, The State Governments have power to levy sales tax to sales within the State only; with separate state enactments. If a transaction is proved to be an inter-State sale it ceases to be a local sale for a particular State. All inter-State sales and the sales under the course of import and export fall under the Union's jurisdiction.

The tax laws in various states of the country are different in all respects. To bring in uniformity in the tax laws of the states, VAT has been introduced all over India. This is a major development in indirect taxes in recent times.

For the convenience of the Centre, the State sales tax authorities have been authorized to collect the central sales-tax also. We can say that, all sales tax matters, whether central or state sales tax, are administered by respective state governments including the interstate sales taxes.

11.3.1 SALE

Section 2(g) of Central Sales Tax (Amendment) Act in 1976 gives the definition of 'Sale'. Tax cannot be levied without the existence of Sale.

The four essential elements that constitute a sale are as follows.

1. Parties must be competent to contract;
2. There must be Mutual consent;
3. A thing, the absolute or general property in which is transferred from the seller to buyers and;
4. Price of money paid or promised

The definition of sale under Section 2(g) of the Central Sales Tax Act is wide enough to encompass all those transactions which the State legislatures had to specifically provide for after the 46th Amendment of the Constitution by amending the definition of sale under the State Act and there was absolutely not necessary for any amendment or incorporation of a specific provision to be made in the Central Sales Tax Act.

In accordance to Section 3 of the Central Sales Tax Act, a sale or purchase of goods shall be deemed to take place in the course of interstate trade or commerce if the sale or purchase

a) occasions the movement of goods from the state to another; or

b) If effected by a transfer of documents of title to the goods during their movement from one state to another.

11.4 LIABILITY TO PAY SALES TAX

Section 6 of the Central Sales Act, 1956 [hereinafter "the Act"] deals with the liability to tax on inter-state sales. This section imposes that the 'dealer' shall be liable to pay tax under this Act in all sales of goods other than electrical energy effected by him in the course of interstate trade. Under the Sales Tax Regime, the liability to pay the tax ensues as soon as the sale takes place, viz. on accrual basis. Liability still arises on the happening of taxable event even though total turnover is calculated annually and collection is postponed till after total turnover is calculated. The assessing authority decides the demand and tax to be levied. This section provides for taxation of 'sale' only.

Section 6A of the Act states the burden of proof in case of transfer of goods not by way of sale. Burden of proof lies on the taxing authority to show that particular sales are eligible for taxation under this Act. However this section shifts the burden of proof to the dealer to prove that the movement of goods from one State to another was by reason of transfer by him to his principal or agent or his place of business and not by reason of sale. If the dealer proves so, such transaction will not be liable to sales tax under this Act. The Assessing Officer may make an order to that effect under sub section (2) if he is satisfied with the declaration made by the dealer under sub section (1). Else if he is not satisfied with the particulars of the declaration furnished, he has the power to investigate the matter further. In B.R & Sons v. Board of Revenue[57], it was held that if the Revenue Board is not satisfied with the information provided by the assessee, they should call forth to the assessee to furnish more particulars. The court further held that the assessee had discharged the burden laid upon him.

Section 6(1A) states that a dealer is still liable to sales tax on sales of goods in the course of interstate trade even if no tax is levied under sales tax law of appropriate State when that sale has taken place in that State. This was inserted by the C.S.T Amendment Act, 1969 to nullify the Supreme Court decision in Mysore v. Yadalam Setty and Sons[58].

Sub section (2) of this section is a non obstante clause with an overriding effect which subjects the sale of goods in the course of interstate trade to following conditions:

- Must have a prior sale which either occasioned the movement of such goods from one State to another or was affected by a transfer of document of title to such goods during their movement from one State to another. Thus subsequent sale of goods to Government or Registered Dealer are applicable under this sub section.

[57] (1978) 42 S.T.C 145 (AP)
[58] (1975)16 S.T.C 231

In C.C.T v. S.T.C India Ltd[59], State Trading Corporation (STC) were a registered dealer and they purchased iron ore from mine owners in Bihar on a free on rail loading station basis to sell to Hindustan Steel Limited (HSL). STC claimed that sales by mine owners were interstate sales and Assessing Officer claimed that the sales by the mine owners was an interstate sales and sales between STC and HSL was an inter state trade Sale and therefore two distinct and separate transactions. Patna High Court held that subsequent sales between the S.T.C and HSL fell under the purview of Section 6(2) because the sale by the mines owners and the sale by the S.T.C were linked being in the course of inter-state trade and the subsequent sale was subsequent to the former within the meaning of the sub section.

- Must be sale of goods which are exempt or chargeable under the local sales tax provisions at lower rates.
- Must be exempted by notification.
- Must be sale of goods in the course of Import or Export.

If such conditions are satisfied, then sale shall not be liable to tax either under sub section (1) or under sub section (1A).

Section 8 provides for the rates of tax on sales in the course of inter state trade. Preferential concessional rate of 4 percent is given to the Government and Registered Dealer and 10 percent or State rates (whichever higher) is given to others under this section. For the purposes of levy of sales tax, the transaction of the sale of goods in the course of inter state trade has been divided into following categories:

- Sale of goods which are exempted from tax by the relevant State laws is to be exempted from tax (Section 8 (2A)).
- Sale of goods which are taxable at a lower rate under the relevant state law is to be taxed under the State rate (Section 8A).
- Sale of declared goods not made to the government or to a Registered Dealer (Section 8(1)) has to taxed at twice the rate applicable to such goods in the appropriate State (Section 8 (2) (a)).
- Sales to (i) Government when supported by 'D' form certificates or (ii) to registered dealer other than the government in whose certificate of registration the same has been specified and who furnish the prescribed form 'C' declaration are to be taxed at four percent (Section 8(1)).

[59] (1972) 30 S.T.C. 451 (Patna)

- As mentioned previously, sale of goods other than declared goods is to be taxed at rate of 10 percent or at the rate by the relevant State (whichever higher) (Section 8(2)(b)).

To decide whether Section 8(2), 8(2A), 8(5) are discriminatory of the Art. 301 and 303(1) of Constitution of India, Supreme Court held that these provisions do not offend the constitution. The court said that the Central Sales Tax Act is enacted to maintain revenue collected from sales tax and to prevent the States from making goods excessively expensive and subjecting transactions of sales and thereby obstructing the free flow of trade. It was further held by the courts that Central Sales Tax is imposed for the benefit of States though it is imposed by the Central Government. Thus by allowing the States to levy tax from sale of goods in inter state trade, no discrimination was practiced.[60]

To the question whether the eligibility certificate is effective from the date of application or date of issue, court held that the eligibility certificate for concession granting schemes is effective from the date of application for such grant or date of first sale made by the applicant and not from the date when certificate was subsequently granted and issued. Court further held that the applicant shall not be deprived of the scheme even if the notification was provided stating such certificate to be effective from the date of issue.[61]

- **DETERMINATION OF TURNOVER**

Sales price as defined under section 2(h) of the Act includes the amount of tax collected by the dealer. This amount of sales tax which has been included should be excluded while levying the tax. Thus no tax is levied on the tax element. Section 8A prescribes for the determination of turnover keeping in mind the said rule. Section 8A (1) (a) provides the deductions to be made from the aggregate of the sale prices to determine the turnover of the dealer for the purposes of the Act. Thus the dealer may keep a separate account which details the sales tax collected by him on his sales. This enables him to deduct the total amount while determining the turnover. If the dealer has not maintained such account he has to determine the turnover as per the deductions and formula mentioned under Section 8A of the Act.

Example : Suppose a dealer has inter-state sales of Rs.2,50,000 to registered dealer Rs.30,000 non-declared goods to other than registered dealers his turnover will be Rs.2,50,000 plus tax collected by him at 4 percent i.e., Rs.10,000/- totalling to Rs.2,60,000/- and Rs.30,000/- plus

[60] State of Madras v. Nataraja Mudaliar, (1968) 22 S.T.C 376 at 390 (S.C)
[61] *State of U.P.* v. *Haji .Ismail Noor Mohammad and Co.*(1988) 703 T.C 101 (S.C)

tax collected by him at 10 percent i.e., Rs.3,000/- totalling to Rs.33,000. Applying the formula he has to deduct:

a) from the sale price in respect of registered dealer:

Rate of tax (4%) x Aggregate of sales prices 2, 60,000/100 + Rate of Tax 4 OR

104000/104=10000

b) from sale price in respect of sales to other than registered dealer:

Rate of tax l0x Aggregate of Sale prices = 33000/100 + Rate of Tax 10 OR

330000/110=3000

Thus this the turnover on which the Central Sales Tax is not levied or collected.

Section 8A(2) of the Act states that the deduction can only be made from the amount provided under Section 8A(1) and no other deduction can be made from the aggregate of sale prices.

- **POWER TO LEVY**

In dealing with the power to levy the Sales Tax and penalties thereon in case of default, Section 9 to the Central Sales Act gives a two-fold approach; First: it confers rights to the Government of the State to collect the tax on the inter-state sale levied by the Government of India from which the movement of goods is commenced. Second: This part states the exceptions as to the first part; that is it specifies the appropriate States competent to levy tax, and sales affected during the inter-state movement of goods as also where such sales may be eligible to be taxed.

As per Section 6(2), the further subsequent sales may be exempted from tax. This exemption may be made only on the conditions prescribed therein. In such case that these conditions are not fulfilled, any number of subsequent sales are leviable with tax.

The proviso to 9(2) specifies which States are competent to levy tax . Both provisions to 9(1) and 9(2) are read together. Section 9(2) specifically empowers the State authorities to make assessments, to collect taxes including the penalties payable by the dealers under the Central Act on behalf of the Central Government. The State Governments are permissible to do so under the Constitution and the Central Sales Tax Act, but do not have the right to do so in respect of inter-state sales in their own discretion. They do so only on behalf of the Government of India, as their agent. The Proviso has adopted the Central Sales Tax Act machinery provisions proceedings under prescribed under the General Sales Tax law for the purpose of appointing the appropriate States for the matters specified in that subsection only.

- **LIABILITY FOR DEFAULT**

Section 10 prescribes a list of offences in relation to the levy of Sales Tax that shall lead to a criminal prosecution. They are:

i. Any person furnishes a certificate or declaration which he believes is false [Section 6(2), 6-A(1) and 8(4)]
ii. Any person fails to get himself registered under Section 7 or fails to comply with an order under Section 3-A or with the requirements of (3-C) and (3-E)
iii. any person who is a Registered Dealer Falsely purchases the goods which are not covered by the certificate of registration or
iv. any person Falsely represents himself as a registered dealer when he is not a registered dealer or
v. Any person who does not comply with the purpose specified in (b) or (c) or (d) of Section 3 without reasonable excuse.
vi. Any person or his agent or by his principal Possesses form for purposes of 8(4) and 8(8) without complying with the provisions of the Act or any rules made there under
vii. Any person Collects any amount by way of tax as against the provisions contained under Section 9-A.

Section 10 further provides the punishment for the commission of any one of the following offences as simple imprisonment up to six months or with fine or both; and when the offence is a continuing offence the punishment is a daily fee up to fifty rupees for every day during which the offence continues.

Section 10A, provides for an alternative choice for of levy of taxes. It also imposes penalty for offences under Section 10(b), 10(c), 10(d). This section imposes strict penalties on the defaulters. Prosecution under Section 10 is not allowed, when Section 10-A is applied.

- **Power to make Rules For Levy**

Under Section 13, the Rule making power given to the government by the Parliament in Section 13 has been divided between the Central and State Governments Under sub-Section (1), the Central Government may frame rules for:

i. Method by which application for Registration of rulers be made and procedure for grant, particulars, circumstances of refusal of registration.
ii. Determination of turnover and related matters and deduction made under Section 8-A(1)(c) to be allowed for ascertaining taxable turnover.
iii. Cases and circumstances leading to cancellation of registration once granted.

iv. Particulars to be contained in declarations and certificates to be given under the Act, the State of Origin and the time within which any such declaration and or certificate can be furnished or produced.

v. Enumeration of goods or classes of goods used in the manufacture or processing goods, mining, generation or distribution of electricity etc.

vi. Making necessary provisions for all or any of the matters specified in Section 9(2) to be enforced in States or parts of the States where a general Sales Tax Law is not in force, and

vii. The fees payable in respect of applications under the Act and other matters.

In exercise of the above powers under Section 13(1) the Central Government has framed the Central Sa1es Tax (Registration and Turnover) Rules, 1957 amended from time to time.

Application of the Rule of Promissory Estoppel

The Doctrine or the Rule of Promissory Estoppel under Law of Contracts states that" if a party changes his or her position substantially either by acting or forbearing from acting in reliance upon a gratuitous promise, then that party can enforce the promise although the essential elements of a contract are not present."[62]In State of Bihar v. Usha Martin Industries Ltd., the Government of Bihar issued a notification granting sales tax incentives to medium and large industries for a term of 10 years from the date from which these industries went into production. Usha Martin Industries established an industrial unit on the basis of the notification and thus went into production during the period of the grant. Later the Government reduced the number of years for which the benefits were available and thus the Supreme Court held that as the respondent initiated the industry following the announcement made by the Government, the Government had to grant the respondent the benefits for the initial said period of ten years. [63] The Government can withdraw the exemption or benefit declared by them provided it did not offend the Principle of Promissory Estoppel and deprive the industry to claim the benefit or exemption.[64]

[62] West's Encyclopedia of American Law, edition *2*. S.v. "Promissory Estoppel." Retrieved October 21 2014 from http://legal-dictionary.thefreedictionary.com/Promissory+Estoppel
[63] Poornima Oil Mills v.State of Kerala, (1987) 65 S.T.C 1 (S.C)
[64] Asst. C.C.T, Dharwar v. Dharmendra Trading Co. (1988) 70 S.T.C 59

11.5 SUMMARY

- Indirect taxes are taxes imposed by the Government indirectly on the taxpayer. This tax is levied from an intermediary, such as, the restaurant owner and is paid by the taxpayer, such as, customer who visits the restaurant.
- Both the Union and the States have the power to levy sales-tax.
- Section 2(g) of Central Sales Tax (Amendment) Act in 1976 gives the definition of 'Sale'.
- Section 6 of the Central Sales Act, 1956 [hereinafter "the Act"] deals with the liability to tax on inter-state sales.
- Sales price as defined under section 2(h) of the Act includes the amount of tax collected by the dealer.

11.6 KEY WORDS

- Estoppel
- Territory
- Central Sales Tax
- Interstate Trade
- Levy
- Liability for Default

11.7 SELF ASSESSMENT QUESTIONS

1. What are the various types of Indirect Taxes?

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2. Write a note on the liability to pay sales tax.

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3. Elucidate the Power to levy sales tax.

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UNIT-12 CUSTOMS DUTIES - ENFORCEMENT OF CUSTOMS DUTIES - EXCISE DUTY

Structure:

12.0 OBJECTIVES

- To briefly understand the concept of Customs Duty
- To understand the collection and imposition of Customs Duties
- To study the concept of Excise Duty
- To understand the Valuation and Levy of Excise Duty

12.1 INTRODUCTION

Any kind of taxes imposed on commodities that are imported is called 'Customs Duties'. The Customs Act, 1962 (hereinafter, the 'Act') levies taxes on goods imported or exported by land, sea or air. This is tax is so imposed to protect the interests of national producers. Due to this import is made costlier which induces public to resort to purchasing domestic products rather than opting for those imported. Customs are defined in Osborn's Concise Law Dictionary (7th Edition) as "the duties or to us payable upon merchandise imported into the country".

12.2 ETYMOLOGY AND HISTORY CUSTOMS DUTIES

The term customs has been derived from the French word 'contum' meaning a toll or tribune. This word further comes from the word 'coust' which means price or charge. Customs is not a newly developed concept. It has been in existence since many years in the past. One famous author V.S. Datlez said that in the past, when merchants would visit new kingdoms, they would carry gifts along with them for the king. This custom gradually developed as a law known today as 'Customs Duties'.[65]

It was believed in the past that when customs were paid, the merchants would receive protection of the king[66]. The taxes levied on the native merchants were called 'Autiqua Custum' and the taxes levied on foreign merchants, 'Nova Custuma'.

12.3 TYPES OF CUSTOMS DUTIES

Basic, Additional (CVD), Additional, Anti-dumping duty, Protective Duty, the duty on Bounty Fed articles and Safeguard Duty etc. are the various types of customs duties. They are further explained below:

I. BASIC CUSTOMS DUTY – Section 12 of the Act talks about Basic Customs Duty. It is generally levied as a percentage of Value as determined under section 14(1). The present rate is 10% but it mostly varies.

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[66] Dowell: History of Taxation and Taxes in England

II. EDUCATION CESS ON CUSTOMS DUTY – It has been imposed on goods from 9-7-2004. The cess is 2% of the aggregate of customs duty. Under sections 8B and 8C, education cess will not be payable on safeguard duty, countervailing duty under section 9, Anti Dumping Duty under section 9A of the Customs Tariff Act and education cess on imported goods. All the provisions of Customs Act, education cess on imported goods, including those relating to refund, exemption from duty and imposition of penalty shall be subject to the rules and regulations of section 94(3) of Finance (No. 2) Act, 2004.

III. SECONDARY AND HIGHER EDUCATION CESS - 1% of customs duty has been imposed from 1-3-2007.

IV. ADDITIONAL CUSTOMS DUTY (CVD) - This is also called 'Countervailing Duty' (CVD).

   i. In S K Pattnaik v. State of Orissa[67] the court observed that 'countervailing duty' is imposed when excisable articles are imported in order to counter balance the excise duty that may be levied on similar goods if manufactured within the State. Section 12 speaks of not only charging the duty under the Customs Tariff Act, 1975, but also as specified under any other law for the time being in force. Furthermore, the reference to the plural term 'duties', is wide enough to encompass within its scope the Additional Duties of Customs charged under the Customs Tariff Act.

   ii. In CC v. Indian Organic Chemicals Ltd[68], it was observed that additional duty of customs is not a duty under the Act. It arises under the peculiar circumstance of section 19 of the Act.

   iii. If a similar product is not produced or manufactured in India, the excise duty that would be leviable on that article if produced in India is the base duty otherwise it is equal to the excise duty levied on a like product produced in India. If the product is leviable with different rates, then highest rate among those rates is to be considered. The duty is leviable on Value of goods and customs duty payable including the SAD (Special Additional Duty) @ 4% is also payable.

A. CALCULATION– CVD is payable on Assessable Value plus basic customs duty chargeable under Section 12 of the Act plus any other sum chargeable on that article

[67] AIR 2000 SC 612

[68] 2000 (118) E.L.T. 3 (SC),

under any law in addition to, and in the same manner as duty of customs (e.g. NCCD of customs). Special Additional Duty payable u/s 3A of Customs Tariff Act, Safeguard duty under Sections 8B and 8C of Customs Tariff Act, Countervailing duty, if any, under Section 9 of Customs Tariff Act, Anti-dumping duty payable under Section 9A of Customs Tariff Act, and CVD itself which is payable under Section 3(1) are not to be considered while calculating CVD.

B. CVD IS NOT A CUSTOMS DUTY – CVD and Customs Duty are two independent duties under two different statues. The basic point of difference between the two is that CVD is chargeable under section 3(1) Customs Tariff Act, while customs duty is levied under Section 12 of Customs Act. However, the provisions of Customs Act under Section 3(6) of Customs Tariff Act, like recovery, payment, drawbacks, exemption, refunds, appeals etc. are applicable to Additional Customs Duty.

C. CVD PAYABLE AT EFFECTIVE RATE OF EXCISE DUTY - Additional duty (CVD) is payable at effective rate of excise duty i.e. any concession granted by a notification is to be considered.

V. ADDITIONAL DUTY UNDER SECTION 3(3) - In addition to Additional Duty under section 3(1) of Customs Tariff Act; which is chargeable on all goods, further additional duty can be imposed by Central Government to counter-balance excise duty which can be levied on raw materials etc, used for production of goods. For example, the Central Government via notifications under this section is levying additional duty on stainless steel manufactures for household use and transformer oil. Extension of CENVAT to most commodities has reduced the need of imposing additional duty under this section on inputs.

VI. PROTECTIVE DUTIES – Section 6 of the Customs Tariff Act provides that protective customs duty at the rate recommended by the Tariff Commission under Tariff Commission Act, 1951 may be imposed by the Central Government if it is satisfied that it is necessary to take immediate action to protect the interests of the Indian industry. The notification should be introduced in the Parliament in the form of a Bill, if the Bill is not passed within six months from the date of such introduction in Parliament, then the notification ceases to be in effect, however actions already taken remains valid. The protective duty can be rescinded, reduced or increased by a subsequent notification which shall be introduced in Parliament for approval in the next session.

VII. COUNTERVAILING DUTY ON SUBSIDIZED GOODS - If a country pays any subsidy, whether direct or indirect, to its exporters for exporting goods to India, the Central Government can impose a Countervailing duty up to the amount of such subsidy under section 9 of Customs Tariff Act. A provisional duty must be collected, if the amount of subsidy cannot be ascertained. After final determination, any difference may be refunded. And this imposition may be done by way of a notification.

VIII. ANTI DUMPING DUTY ON DUMPED ARTICLES – 'Dumping' is the phenomenon where the large manufactures from abroad export goods at very low prices in comparison to the prices existing in the domestic market. The reason behind this is to dispose the excess stock or intentionally cripple the domestic market. WTO permits levy on anti dumping duty. The Central Government can impose under Section 9A of the Act, anti dumping duty upto the margin of dumping on such articles, if the goods are being sold at less than its normal value; when there is a history of dumping which the importer is aware of or where serious injury is caused as a result of such dumping. Central Government can also reduce such duty and refund duty extra collected than that finally calculated. 'Margin of dumping' is the difference between normal value (i.e. the comparable price in the ordinary course of trade for consumption in the territory where such goods are exported) and export price (i.e. the price at which such goods are exported). In Volzhsky Pipe Plant v. Designated Authority[69], it was held that domestic price of foreign exporter in his country should be considered, provided it is not below per unit cost of production ,administrative selling and overheads. In case of non-market economy countries (mostly communist countries), 'normal value' can be determined on basis of price in the foreign market, price paid in India for a like product or on other reasonable basis.

IX. NCCD OF CUSTOMS – NNCD simply means 'National Calamity Contingent Duty'. This is imposed under section 129 of Finance Act, 2001. Substances such as pan masala, chewing tobacco and cigarettes fall under the ambit of NCCD. It ranges from 10% to 45%. An NCCD of customs of 1% on PFY, motor cars, multi utility vehicles and two wheelers and Rs 50 per ton is imposed on domestic crude oil; vide section 134 of Finance Act, 2003.

[69] 2001(129) ELT 408 (CEGAT)

X. EXPORT DUTY – The export duty specified in the Second Schedule to the Customs Tariff Act, 1975 was earlier only leviable on raw hide, skin and leather. But, now it also extends to varied products like steel and mineral products. The rate of duty has also been increased to 20%.

12.4 ENFORCEMENT OF AND EXEMPTION FROM CUSTOMS DUTIES

Goods become liable to import duty or export duty when there is 'import into, or export from India'.

According to section 2(28), 'export' means taking out of India to a place outside India and according to section 2(23), 'import' means bringing into India from a place outside India. In Gramophone Company of India v. Birendra Bahadur Pandey[70], it was held that 'import' included goods imported for transit across to Nepal.

India, under Section 2(27) of Customs Act, is defined as inclusive of territorial waters. Thus, 'import' is complete as soon as goods enter territorial water. In the same way, export is complete only when goods cross territorial waters. There have been conflicting judgements. Finally, in Kiran Spinning Mills v. CC [71]it was held that import is completed only when goods cross the customs barrier. The taxable event is the day when goods cross the customs barrier and not when goods land in India or enter territorial waters

In Garden Silk Mills Ltd. v. UOI, [72]the court held that import of goods commences when the goods enter the territorial waters and continues till they become part of the Indian goods. In the said case the taxable event is the time when the goods reach customs barrier and the bill of entry for home consumption is filed.

Ware housed goods continue to be in customs bond. Hence, 'import' takes place only when goods are cleared from the warehouse. Taxable event occurs on the date when goods cross customs barrier and not when they land in India or enter territorial waters.[73]

In CC v. HPCL[74] **,** it was held that the 'bulk liquid cargo' would be considered to have crossed customs barrier only when they are pumped into shore tanks which shall be considered as the taxable event. The duty will be measured by the quantity and will be payable on the basis of 'shore tank receipt' as determined by independent surveyors in the presence of custom officers; which is, the dip measurement in tanks on shore and not the usage quantity at the port of discharge on board the vessel.

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[70] AIR 1984 SC 667
[71] 2000 AIR SCW 2090
[72] AIR 2000 SC 33
[73] UOI v. Apar P Ltd. AIR 1999 SC 2515
[74] 2000 (121) ELT 109 (CEGAT)

12.5 VALUATION OF GOODS

Customs duty is payable as a percentage of value called ‘Assessable Value’ or ‘Customs Value’. The Value may be either a ‘value’ as defined in section 14(1) of the Customs Act or a Tariff value under section 14(2) of Customs Act (as amended from 10-10-2007).

The CIF value in case of imports and FOB value in case of exports is relevant.

In case of high sea sale, the price charged by importer to assessee would form the assessable value and not the invoice issued to the importer by foreign supplier.

Valuation for customs is required to be done as per provisions of Customs Valuation Rules, 2007. CIF value of goods plus 1% landing charges is the basis for deciding ‘Assessable Value’. Commission to local agents, packing cost, value of goods and tools supplied by buyer, royalty relating to imported goods are addable.

[National Wire v. CC, 2000 (122) ELT 810 (CEGAT), Godavari Fertilizers v. CC, (1996) 81 ELT 535 (CEGAT)].

According to the Rule 10 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [Rule 9 up to 10-10- 2007] the following cost and services must be added, unless they already mentioned in the invoice price:

(a) Commission and brokerage, except buying Commission

(b) Cost of container which are treated as being one with the goods for customs purposes, if not already included in the invoice price.

(c) Cost of packing whether labour or materials

(d) Materials, components, tools, dies, moulds, and consumables used in production of imported goods, supplied by buyer directly or indirectly, free of charge or at reduced cost

(e) Engineering, development, art work, design work, plans and sketches undertaken elsewhere than in India and necessary for production of imported goods, to the extent not already included in price.

(f) Royalties and license fees relating to imported goods that buyer is required to pay, directly or indirectly, as a condition of sale of goods being valued

(g) Value of proceeds of subsequent resale, disposal or use of goods that accrues directly or indirectly to seller (i.e. to foreign exporter)

(h) All other payments made as condition of sale of goods being valued made directly or to third party to satisfy obligation of seller, to the extent not included in the price

(i) Cost of transport up to place of importation

(j) Loading, unloading and handling charges associated with delivery of imported goods at place of importation

(k) Cost of insurance

Exclusions from Assessable Value - Interpretative Note to rule 3 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, provides that following charges shall be excluded:

(a) Charges for construction, erection, assembly, maintenance or technical assistance undertaken after importation of plant, machinery or equipment

(b) Cost of transport after importation

(c) Duties and taxes in India

(d) Other payments from buyer to seller that do not relate to imported goods are not part of the customs value.

Methods of Valuation

The methods following are applied in the order given below. And if one method cannot be applied the successive method must be applied.

i. Transaction Value of Imported goods
ii. Transaction Value of Identical Goods
iii. Transaction Value of Similar Goods
iv. Deductive Value which is based on identical or similar imported goods sold in India
v. Computed value which is based on cost of manufacture of goods plus profits
vi. Residual method based on reasonable means and data available

But the exception to the rule above is that the order of application of the 'computed value' method and the 'deductive value method may be interchanged if requested by the importer and permitted by the Assessing Officer. The assessing officer has the power to ask the importer for submission of further information or evidence; or he can reject the value if he reasonably doubts the given value.

Export Goods - Valuation for Assessment (section 14, customs act)

This is read along with Customs Valuation Rules, 2007. The transaction value at the time and place of exportation is generally considered as the basic criteria, when price is sole consideration and buyer and sellers are unrelated.

Valuation when buyer and seller are related – As per rule 3(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007, the transaction value will be accepted as 'value' even if buyer and seller are 'related', if the relationship has not influenced price.

Valuation if value cannot be determined on basis of transaction value –Valuation will be done by proceeding sequentially through rules 4 to 6 of the Customs Valuation (Determination of Value of Export Goods) Rules, 2007 in case it is not possible using transaction value.

These methods determine (i) export value found by the comparison of the transaction value of 'goods of like kind and quality' which are exported at or about the same time to other buyers in the same destination country (ii) computed value determined from cost of production and profit (iii) residual method determined in accordance with the principles and general provisions of rules.

12.6 EXCISE DUTY

As mentioned in the previous chapters, there are two kinds of taxes, direct taxes and indirect taxes. Indirect taxes are the taxes which are levied by the Government on the consumers and are paid by the intermediary. The burden of tax is shifted to another person. Excise duty is one such indirect tax, where the tax is levied by the Central Government on goods manufactured or produced in India. Article 246 of the Constitution of India gives power to the Central Government to levy excise duty. Entry 84 of the Union List states and empowers the Central Government to levy duty of Excise on Tobacco and other goods manufactured or produced in India excluding alcoholic liquors for human consumption, opium, Indian hemp and other narcotic drugs and narcotics but including medicinal and toilet preparations containing alcohol or opium, Indian hemp or other narcotic drugs.

Section 3 of the Central Excise Act, 1944 [hereinafter 'the Act'] prescribes the nature, creation and scope of duty, stipulated the rates at which duty can be charged, and provides the authority to collect such duty. The section provides that the goods which are manufactured or produced in India can be liable to be excised. This section does not allow goods manufactured or produced in any other place other than India and are imported in India to be liable to be excised as that shall fall under the purview of customs duty regulated by the Customs Act, 1962. The section states that the basic duty of excise called the central value added tax (CENVAT) is to be levied and collected on all excisable goods produced in India, as per the rates specified in the first schedule of Central Excise Tariff Act, 1985 [hereinafter 'CETA'], a duty of excise called special excise duty (SED) is also levied on excisable goods as per the rates specified in the Second Schedule of CETA.

12.6.1 **Concepts Of Excise Duty**

I. EXCISABLE GOODS

The term 'goods' is not defined in the Central Excise Act. However an explanation to the term 'goods' is given under Section 2(d) of the Act which states " 'goods' includes any article, material or substance which is capable of being bought and sold for a consideration and such goods shall be deemed to be marketable.' Also movable property constitutes goods. This along with a wider scope of the term can be inferred from various other definitions:

(a) Article 366(12) of the constitution of India defines', Section 2(22) of the Customs Act, 1962 and Section 2(7) of the Sale of Goods Act, 1930

Section 2(7) of the Sale of Goods Act, 1930 defines "goods" as to mean "every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale". The first part of the definition has some value to understanding the scope of the term 'goods'.

In the landmark judgment of the Supreme Court in the case of Delhi Cloth and General Mills[75] it is held that an 'an article can be called "goods" if it is known to the market and can be bought and sold in the market. The court said that actual sale of the article is not relevant but rather, it must be capable of being bought and sold. Goods from scrap waste or intermediate products for captive consumption are also held as excisable goods provided they are mentioned in CETA. Those goods already subjected to excise duty, i.e., duty paid goods ceases to be excisable goods.

The term goods can be better understood with the help of decided cases. In the state of Andhra Pradesh v. National thermal Power Corporation [76], it was held that electricity is a movable property though it is not tangible and cannot be touched or moved , electrical energy can be sold or purchased like any other moveable object, thus it was intended under the definition of 'goods'. The court held that all three stages, i.e., sale, supply and consumption of electricity take place continuously and simultaneously without any hiatus. In Associated Cement Companies Ltd. v. CC[77], drawings and designs of machinery were held as 'goods' even though the payment for such was made for information technology purposes, which is an intangible asset. If such design or idea is put on a medium like paper or diskettes, that which is supplied is considered chattel. However it was held that yeast with a short shelf life

[75] supra
[76] 127 STC 280
[77] AIR 2001 SC 862

cannot be excised to duty as there was no evidence to prove the marketability of the goods in question, although ‘yeast’ in itself are excisable goods.[78]

Section 3 of the Act provides that excise duty cannot be imposed on goods manufactured in Special Economic Zones (SEZ) as SEZ’s are considered as foreign territories. The goods manufactured in SEZ’s are not termed as ‘exempted goods’ but ‘excluded excisable goods’.

II. TAXABLE EVENT

All taxes, direct and indirect have a taxable event. Taxable event is that event or situation which creates a liability to tax on its occurrence. For example in excise duties, taxes are levied from excisable goods manufactured or produced in India, thus the taxable event will be the manufacture or production. Also since the tax cannot be paid by itself, the person who manufactures the good shall be liable to pay excise duty. In CCE v. Vazir Sultan Tobacco Co. Ltd.[79] the Supreme Court held that the levy of Central Excise will always remain upon the manufacture or production alone. The collection is shifted to the stage of removal and such removal of goods is not a taxable event.

III. MANUFACTURE

Section 2(f) of the Act provides the definition of the term ‘manufacture’. It states that

‘“manufacture” includes any process, -

I) incidental or ancillary to the completion of a manufactured product;

ii) which is specified in relation to any goods in the Section or Chapter notes of the First Schedule to the Central Excise Tariff Act, 1985 (5 of 1986) as amounting to manufacture; or

iii) which, in relation to the goods specified in the Third Schedule, involves packing or repacking of such goods in a unit container or labelling or re-labelling of containers including the declaration or alteration of retail sale price on it or adoption of any other treatment on the goods to render the product marketable to the consumer;

and the word “manufacturer” shall be construed accordingly and shall include not only a person who employs hired labour in the production or manufacture of excisable goods, but also any person who engages in their production or manufacture on his own account;’

An analysis of this section gives three parts:

A. that manufacture is a process incidental or ancillary to the completion of

[78] *CCE v. Jagjit Industries* 141 ELT 306 (SC)
[79] AIR1996 SC 3025

manufactured product

B. deemed manufacturing process as provided under Central Excise Tariff Act

C. processes specified under Third Schedule of the Act, in relation to specific goods

To explain that process which is ‘incidental or ancillary to the completion of the manufactured product’, it is essential to understand that manufacture of a product consists of a series of processes carried out in a sequence. Thus during the manufacture of a product, the product may be functional at a stage or after the completion of a particular process and may be saleable after the completion of another particular process or at a later stage. For goods to be excisable, it was held that the goods should be marketable or saleable. Therefore those processes which render the product that is functional to one which is saleable are ‘Incidental or ancillary to the completion of a manufactured product’

For example, furniture like cupboards can be functional at a particular stage but it needs to be painted to make it saleable. Thus the painting process is incidental or ancillary to completion of the manufactured product. Excise Duty is levied for the painted cupboard.

Rule 4(1) of the Central Excise Rules 2002 states that excise duty is payable by the manufacturer or producer of excisable goods.

In Flex Engineering Ltd. v. Commissioner of Central Excise,[80] the appellant was engaged in the manufacture of packaging machines, marketed as automatic form fill and seal machines called F & S machines. The technical details of the machines were made on order according to the customer’s specifications and were tested by the customer before sale. The appellant then makes entry in Daily Stock Account declaring the machine as manufactured and ready for clearance after the customer’s confirmation. This case questioned the definition of the term manufacture. An issue was brought before the court whether manufacture is complete before testing and acceptance by customer or manufacture is complete before testing itself. The court held that the process of manufacture is complete only when the goods manufactured are marketable as the machines become saleable or marketable only after they are tested and accepted by customer, no manufacture took place before testing.

Union of India v. Delhi Cloth and General Mills and others (ELT - 1977 - J. 199).

[80] U.P. 2012 (276) E.L.T. 153 (S.C.)

IV. DEEMED MANUFACTURE

Section 2(f) provides for two deeming provisions. According to CETA, the processes which are ‘amounting to manufacture’, although held by the courts as processes that do not amount to ‘manufacture’, are said to be manufactured. According to the Act, repacking, labeling or re-labeling etc all amounts to manufacture. Thus goods made by processes that are amounting to manufacture under the tariff act and processes specified in the third schedule under the Act, are excisable. This is known as deemed manufacture. The processes that are 'deemed to be manufacture' and excise duty will be levied as the process is specified in Central Excise Tariff as 'amounting to manufacture'. Examples:

A. Galvanization process of iron or steel amounts to manufacture.
B. Cutting / polishing of granites or marble slabs is held as amounting to manufacture. (note 6 of chapter 25 of CETA)
C. Labeling or relabeling of containers from bulk pack to retail packs or any other treatment of certain sugars like maltose etc, to make them marketable amounts to manufacture(chapter 17 of CETA)
D. Labeling or relabeling of containers and repacking from bulk pack to retail packs of pan masala amounts to manufacture.(chapter 21 of CETA)

The terms used in the deeming provisions are ‘repacking from bulk packs to retail packs’. Thus, mere repacking is not considered as ‘deemed manufacture’. If goods returned are re-packed, such re-packing is from one retail pack to another retail pack and that is not considered as ‘deemed manufacture’. Similarly, if goods returned for rectification are re-packed, it cannot be considered as ‘any other treatment to render the product marketable’, as the product was already marketable.

In CCE v. Osnar Chemical Pvt. Ltd.[81], Osnar Chemical Pvt. Ltd. (Osnar) was engaged in the supply of Polymer Modified Bitumen (for short “PMB”). In An agreement between Afcons Infrastructure Ltd. (Afcons) and Osnar, bitumen and certain additives were to be supplied by Afcons to Osnar directly at the site, where Osnar, in its mobile polymer modification plant, was required to heat the bitumen at a temperature of 160°C with burners. To this hot bitumen, 1% polymer and 0.2% additives were added under constant agitation, for improving its quality by increasing its softening point and penetration. The

[81] 2012 (276) E.L.T. 162 (S.C.)

process of agitation was to be continued for a period of 12 to 18 hours till the mixture becomes homogenous and the required properties were met. The said bitumen in its hot agitated condition was mixed with stone aggregates which were then used for road construction. Osnar paid duty on PMB processed at their factory in Mumbai but had not paid the same for the conversion done at their work site. Appellant contended that addition of polymer to bitumen resulted in manufacture of new marketable commodity; the court held that The process did not result in transformation of bitumen into a new product having a different identity, characteristic and use. It is well settled that 'mere improvement in quality does not amount to manufacture.'

In a different case,[82] S.C held that removal of foreign materials from iron ore and subjecting it to processes of crushing, grinding, screening and washing to remove foreign materials to concentrate such ores do not result in manufacture of different commercial commodity. Hence no Central Excise Duty is leviable.

12.6.2 <u>Types Of Excise Duty</u>

Excise duties are of the following types -

A. Duties Under Central Excise Act - Basic duty, CENVAT is levied under the Central Excise Act and at rates specified in First Schedule to Central Excise Tariff Act.
B. Education Cess and SHE Cess on Excise Duty
C. Excise Duty in case of clearances by EOU
D. National Calamity Contingent Duty
E. Duties under other Acts Duty on Medical and Toilet Preparations Additional Duty on Mineral Products

12.6.3 <u>Valuation Excise Duty</u>

Goods need to be assessed at the time of removal after duty is levied after manufacture. This assessment is made based on the CETA. There exist two rates of duty under the Act, specific rate which is unit rates on basis of quantity and ad valorem rates which are percentage rates on the basis of value of goods. Ad valorem rates are applied on most goods. There are two types of duty, specific duty and ad valorem duty, the rates and type of duty to be applied is given under the schedules to CETA. Most goods are assessed on ad valorem basis, i.e., valuation of goods take place and taking the assessable value, duty is calculated at percentage rates mentioned in CETA

[82] Commissioner v. Steel Authority of India Ltd. 2012 (283) E.L.T. A112 (S.C.)

Valuation occurs via the following methods:

(I) TARIFF VALUES (Section 3(2) notified by government)

This section authorizes the Central Government to fix tariff values for specified goods or general goods mentioned in the first and second schedule of CETA wherein value is fixed based on whole sale price or average wholesale price of goods. This value is a notional value and when this value is fixed, both transaction value and MRP based value cannot be used for such goods. It is pertinent to note that different tariff values can be fixed for different classes or description of same excisable goods and for same class or description for excisable goods which are either produced by different classes of producers or sold to different classes of buyers. Valuation through Tariff values prevent undervaluation of such goods and reduce litigation.

For example: Tariff Value is fixed for readymade garments under chapters, 61, 62 and 63 as 30% of MRP where MRP is printed. Else Transaction Value will be taken as tariff value where MRP is not printed.

Tariff values is fixed for articles of jewellery under heading 7113 excepting silver jewellery and jewellery manufactured from precious metal or old jewellery from retail customer

(II) MRP BASED VALUES (Section 4A)

Section 4A of the Act authorizes Central Government to specify goods wherein duty will be payable on retail price instead of the wholesale price. Thus the Central Government may notify goods sold in packages having MRP printed on it.

The section provides for the following- (a) The specified goods on which the retail sale price is to be declared under the provisions of the Legal Metrology Act, 2009 (1 of 2010) or the rules made there under or under any other law for the time being in force

(b) Central Government by notification can permit reasonable abatement (deductions) from the 'retail sale price'. Central Government shall take into account excise duty, sales tax and other taxes payable on the goods when permitting any abatement

(c) If more than one 'retail sale price' is printed on the same packaged good, then the maximum of such retail prices will be considered

(d) The 'retail sale price' should be the maximum price at which excisable goods in packages are sold to the ultimate customer. It includes all taxes, freight, transport charges, commission payable to dealers and all charges towards advertisement, delivery, packing, forwarding charges etc.

(e) Central Government by notification in Official Gazette has to specify the goods for which the provision is applicable and the abatements allowed.

Section 4A and Section 3(2) are mutually exclusive and section 4A overrides section 4. Thus transaction value cannot be the means of valuation for goods notified under Section 4A. MRP printed on packages is inclusive of taxes. If the goods are produced by a job worker, valuation under MRP basis is only possible when such goods are notified by the Central Government.

Sometimes, goods are cleared in bulk without putting MRP, in those cases duty is paid on basis of section 4. MRP is put either by the buyer who buys the goods or in some depot of the manufacturer, or an agent of the manufacturer. The process carried out by the buyer or by the agent or at such depot of manufacturer will be 'manufacture'. And such buyer or agent will be registered under Central Excise as 'manufacturer'. He will be levied duty on the basis of MRP.

(III) TRANSACTION VALUE (Section 4)

Transaction value will be the price actually paid as payable. Section 4 of the Act deals with assessable value, i.e., value on which excise duty is paid on percentage. When neither tariff value is fixed nor MRP is printed on excisable goods, then duty is payable on the basis of Section 4. When duty is payable on goods sold at the factory gate to an unrelated buyer keeping price as the sole consideration , the new section 4 , w.e.f 1 July , 2000 provides for valuation. If these conditions are not satisfied, valuation shall be done based on the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000. This method of valuation is based on actual sale price. In Burn Standard Co. Ltd. v. UOI [83]it was held that "free supply items" like wheel-sets etc. in the process of manufacturing are added to the full intrinsic value of the goods and hence lose their identity. The court further observed that the petitioners not being the owners of the end product as irrelevant. According to new section 4(1) (a), the following conditions need to be satisfied for excisable goods to be valued on the basis of transaction value:

A. Time and Place of removal – **T**his Section states that goods must be sold at the time and place of removal. Place of removal refers to a factory or other premises where the goods are produced from where goods are sold, A warehouse other premises where the excisable goods have been allowed to be deposited without payment of duty from where they are for sale or a depot, premises of a consignment agent from where

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[83] AIR 1991 SC 1784

excisable goods are to be sold after their clearance from factory[84]. As per section 4(3)(c) the time at which the goods are cleared from factory will be deemed to be the 'time of removal' in case of sale from depot/premises of consignment agent

B. Price must be sole consideration - Price should be the sole consideration of the sale, when excisable goods are sold from the factory at the time of removal of goods to an unrelated buyer, price is the transaction value. If there are other conditions which influence the price, assessable value is determined under Rule 6.
C. Assessee and buyer are not related- Section 3(4) (b) states the relations when assessee and buyer are related.
D. Transaction Value as Assessable Value – The section 4(3)(d) defines 'transaction value' as the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to, or on behalf of, the assessee, by reason of, or in connection with the sale, whether payable at the time of sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter; but does not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.

With reference to various circulars and law the inclusions and exclusions relevant for determination of transaction value are given:

A. Sale price is included after deducting all discounts
B. Provisions made for the buyer or charges for advertisement, marketing, selling and other expenses given under Section 4(3)(d) of the Act is included only if buyer is liable to pay to or on behalf of assessee and if it is in connection to sale.
C. Packing charges, normal or special, are included in the transaction value. This was confirmed by the Department; vide its circular No. 354/81/2000-CE dated 30-6-2000. This is further stipulated in Chapter 3 Part III Para 2.5(vi) of CBE&C's CE Manual, 2001 and CBE&C circular No. 643/34/2002-CX dated 1-7-2002. However durable and returnable packing charges are excluded.
D. Octroi, Sales tax, excise tax, other taxes payable on goods are to be excluded from the transaction value. Section 4(3)(d) of Central Excise Act states that 'transaction value'

[84] Section 4(3)(c) , Central Excise Act, 1944

does not include amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.

E. Discounts of any type and description is excluded from transaction value[85]

F. Pre-delivery inspection, dharmada expenses and royal charges are included in the assessable value

G. Interest on delayed payments and subsidies granted by the government to the manufacturer are excluded.

12.7 SUMMARY

- Any kind of taxes imposed on commodities that are imported is called 'Customs Duties'.
- CVD is payable on Assessable Value plus basic customs duty chargeable under Section 12 of the Act plus any other sum chargeable on that article under any law in addition to, and in the same manner as duty of customs.
- Additional duty (CVD) is payable at effective rate of excise duty i.e. any concession granted by a notification is to be considered.
- Customs duty is payable as a percentage of value called 'Assessable Value' or 'Customs Value'.
- Section 2(7) of the Sale of Goods Act, 1930 defines "goods" as to mean "every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale".
- Most goods are assessed on ad valorem basis, i.e., valuation of goods take place and taking the assessable value, duty is calculated at percentage rates mentioned in CETA.

12.8 KEY WORDS

- Valuation of Goods
- Excise Duty
- Transaction Value
- Assessable Value

12.9 SELF ASSESSMENT QUESTIONS

1. What are the various types of Customs Duties?

[85] CBEC Manual of Supplementary Instructions Chapter 3, Part III, Para 2.5(iv)

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2. Explain the procedure of Valuation of Goods under the Customs Regime.

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3. What are the various types of Excise Duties?

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4. Explain the procedure of Valuation under the Excise Regime.

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UNIT –13: CASCADING EFFECTS OF SALES TAXES – CST - VAT – CENVAT – TAXING OF INTER-STATE TRADE

Structure:

13.0 OBJECTIVES

- To understand the Cascading Effects of Sales Tax
- To briefly understand the Procedure of Central Sales Tax
- To study the Taxation of Inter-State Trade Activities

13.1 INTRODUCTION

The main objective of any taxation in any part of the world is obviously not to levy tax on taxes or in simple words to avoid cascading effect. Cascading effect of tax is one of the major distortions that had crept into Indian taxation. In India, taxes are multi-layered as the central Government levies taxes like excise duty, service tax and central sales tax and State governments levies taxes like VAT/sales tax, entry tax, state excise, octroi etc.

13.2 CASCADING EFFECTS OF SALES TAXES

- SALES TAX ON CENVAT

  Cenvat is a duty on the activity of manufacturing whereas sales tax is levied on transfer of property in goods. Under the present sales tax provisions which could be of either Central Sales Tax or State Value Added Tax, the sales tax shall be payable on aggregate of the sale prices received and receivable by a dealer in respect of sales made. By virtue of his, the cenvat /excise duty tax shall be included in the assessable value for charging sales tax. This in turn results in paying sales tax on cenvat levied earlier.

- SALES TAX ON CENTRAL SALES TAX (CST)

  In the present VAT system prevailing in various states of India, the dealer can claim the credit of tax paid on inputs/capital goods purchased within the State. However, credit of Central sales tax paid on inputs/capital goods purchased from other states would not be available. Even though it seems discriminatory, it has to be accepted. This in turn, leads to tax on CST.

- ENTRY TAX ON SALES TAX

  In some of the states like Karnataka, Tamil Nadu, the entry tax on goods hall be paid by the dealer causing entry of goods from one state to another. This levy has been held to be compensatory since the entry tax paid was found to be diverted to urban local bodies to provide various services and infrastructure facilities to trader community to carry on their business activities. Under these provisions, the dealer causing entry of specified goods shall be liable to pay entry tax at specified rate which generally ranges from 1 to 12.5%. The tax shall be payable on total invoice value including any taxes paid.

13.3 CENTRAL SALES TAX (CST)

The Central Sales Tax Act 1956 (CST Act) provides for levy of sales tax on Inter State sales. Whereas tax on intra-state sale is levied by the state governments, Constitution authorises Central Government to impose tax on inter-state sales. However, though it is a Central Act, the tax collected under the act in each state is assigned to that state only. CST in each state is administered by local sales tax (VAT) authorities of each state.

Relevant Constitutional Provisions

State List Entry – 54	**Union List Entry – 92A**	**Article 269**
Empowers the states to levy taxes on **Intra**-state sales/purchases of goods other than **NEWSPAPERS**	Authorizes the Central Government to levy tax on **inter-state sales / purchases** of goods other than **NEWSPAPERS**	1. Stipulates the power of Central Government levying CST 2. Provides for assignment of CST collection to **States** 3. Provides for crediting the collection in the **Union Territories** to the consolidated fund of India.

13.4 OBJECTS OF CENTRAL SALES TAX ACT

The Central Sales Tax Act has been designed :

1. To formulate principles for determining as to
   (a) Where a sale or purchase of goods takes place in the course of inter-state trade or commerce [Section 3].

(b) When a sale or purchase takes place outside a state [Section 4].

(c) When a sale or purchase takes place in the course of import into or export From India [Section 5].

2. To provide for the levy, collection and distribution of taxes on sales of goods in the course f inter-state trade or commerce
3. To declare certain goods to be of special importance in inter-state trade or commerce (called declared goods)
4. To specify the restrictions and conditions to which state laws imposing taxes on the sale or purchase of declared goods shall be subject

- **Applicability of CST Act**
  - ⇨ There should be a **Dealer (sec. 2(b))**
  - ⇨ He must be a **Registered Dealer (Sec. 7)**
  - ⇨ The Dealer must carry on **Business (sec. 2(aa))**
  - ⇨ There must be **Sale (sec. 2(g))**
  - ⇨ The sale must be of **Goods (Sec. 2(d))**
  - ⇨ The sale may be of **Declared goods or otherwise (sec. 14 & 15)**
  - ⇨ The sale must be in the course of **Inter State Trade or Commerce (sec. 3)**
  - ⇨ It should not be a **Sale Inside a State (sec. 4(2))**
  - ⇨ The Sale should not take place in the course of **Import or Export (sec. 5)**
  - ⇨ The buyer may or may not be Registered Dealer.
- **"Business" includes- [Sec. 2(aa)]**
  1. Any trade, commerce or manufacture, or any adventure or concern in the nature of trade, commerce or manufacture, whether or not such trade, commerce, manufacture, adventure or concern is carried on with a motive to make gain or profit and whether or not any gain or profit accrues from such trade, commerce, manufacture, adventure or concern ; and
  2. Any transaction in connection with, or incidental or ancillary to, such trade, commerce, manufacture, adventure or concern;
- **DEALER [Sec. 2(b)]**

  Any person who carries on (whether regularly or otherwise) the business of buying, selling, supplying or distributing goods, directly or indirectly, for cash or for deferred payment, or for commission, remuneration or other valuable consideration, and includes-

- a local authority, a body corporate, a company, any co-operative society or other society, club, firm, Hindu undivided family or other association of persons which carries on such business ;
- a factor, broker, commission agent or any other mercantile agent, by whatever name called, who carries on the business of buying, selling, supplying or distributing goods belonging to any principal whether disclosed or not; and
- an auctioneer who carries on the business of selling or auctioning goods belonging to any principal, whether disclosed or not and whether the offer of the intending purchaser is accepted by him or by the principal or a nominee of the principal.

- **GOODS. [Sec. 2(d)]**

  CST is levied on sale of "goods" . The definition of ''goods'' in the act Includes

  - All materials
  - Articles and Commodities
  - All kinds of Movable Property

  Does not Include

  - Newspapers.
  - Actionable claims.
  - Stocks and Shares.

This definition has to be taken note of as No sales tax under this act shall be leviable on items not included in definition of goods. In an interesting case, one News paper publisher sold bundles of old news paper as waste paper and claimed that no CST is leviable in the case. It has been held that this was not the sale of news paper as such, and hence not exempt. (Andhra Prabha Pvt. Ltd.) As per above definition, electrical energy is treated as goods but sec. 6(1) of C.S.T. Act exempts sale of electrical energy from the levy of C.S.T. Standing Tress are not goods for the purpose of C.S.T. Packaged Software's are considered goods as per court's decisions.

- **SALE [Sec. 2(g)]**

"Sale" with its grammatical variations and cognate expressions, means

1. any transfer of property in goods
2. by one person to another
3. for cash or deferred payment or for any other valuable consideration,
4. and includes,

- a transfer than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;
- a transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;
- a delivery of goods on hire-purchase or any system of payment by instalments;
- a transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;
- a supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;
- a supply of goods, by way of or as part of any service or in any other manner what so ever , 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.

5. But does not include a mortgage or hypothecation of or a charge or pledge on goods.

- **SALE OR PURCHASE IN THE COURSE OF INTER-STATE TRADE: Sec. 3**

The liability to Central Sales Tax arises only if the sale takes place in the course of interstate trade or commerce. Section 3 states that a sale or purchase of goods shall be deemed to take place in the course of inter-state trade or commerce in the following two circumstances:

1. If the sale or purchase occasions the movement of goods from one state to another (also called Direct interstate sale), or
2. If the sale or purchase is effected by a transfer of documents of title to the goods during their movement from one state to another.

- **SALE OR PURCHASE TAKNIG PLACE OUTSIDE A STATE OR INSIDE A STATE: Sec. 4**

Apart from providing for levy of CST on interstate sales, CST Act also lays down rules for determining as to in which state a “non interstate sales” shall be deemed to have taken place. This determination is necessary in order to find out which state shall levy local sales tax. For this purpose, goods have been divided into two groups (i) Specific or ascertained and (ii) Unascertained or Future goods.

1. In the case of specific or ascertained goods, the sale or purchase shall be deemed to have taken place inside a state if the goods were within that state at the time the contract of sale was made.

2. As regards the unascertained goods or future goods, their sales or purchase of goods shall be deemed to take place inside a state if the goods are within the state at the time of their appropriation to the contract of sale either by the seller or by the buyer. It is immaterial whether the other party to the contract gives his assent to the appropriation prior or subsequent to such appropriation.
3. In the case of both the above groups of goods, it may so happen that there is a single contract of sale or purchase of goods situated at more places than one. In such a case it shall be deemed that there are separate contracts in respect of the goods at different places.

Above provisions are subject to provisions of Sec. 3 meaning thereby that these provisions shall be applicable only when the sale is "not an interstate sale".

- **Stock Transfer/ Branch Transfer (Sec. 6A)**

One of the basic and obvious conditions of inter-state sale is that there should be a 'sale'. If a manufacturer sends goods to his branch in other state, it is not a ‘sale’ as one cannot sell to oneself. Similarly, if a dealer sends goods to his agent in other state who stocks goods on behalf of the dealer, it is not a sale. Such agent is usually called ‘consignment agent’. Goods are dispatched to another state on consignment basis and the person dispatching goods retains ownership of goods. Since no sale is involved, there is no ‘interstate sale’ and consequently there is no CST liability. This is called ‘stock transfer’ or ‘branch transfer’. Here, movement of goods takes place from one state to another, but it is not an interstate sales.

As per Sec. 6A, where any dealer claims that an interstate movement of goods is due to stock transfer and not due to sale, the burden of proving this is on that dealer. For this purpose he should furnish to the assessing authority, a **declaration in Form F**, duly filled and signed by the principal officer of the branch or agent to whom goods have been transferred, along with the evidence of dispatch of such goods.

If the assessing authority is satisfied, after making necessary inquiry, that the particulars contained in form F are true, he may, at the time of assessment or before the assessment of the tax payable by the dealer, make an order to that effect. There upon the movement of goods to which the declaration related, shall be deemed to have been occasioned otherwise than as a result of sale.

- **DECLARED GOODS**: **(Sec. 14)**

“Declared goods” are given a separate treatment in the CST Act. These are the goods which are treated of special importance in inter-state trade. CST Act provides a list of such goods and further specifies various restrictions to which any state law imposing local sales tax on these goods shall be subject to.

The following goods have been declared as of special importance in inter-state trade and commerce and constitute ‘‘declared goods’’:

1. Cereals (paddy, rice, wheat, jowar, bazra etc.)
2. Coal, including coke in all its forms, but excluding charcoal.
3. Cotton, (indigenous or imported) in its unmanufactured state, where ginned or baled, pressed or otherwise, but not including cotton waste.
4. Cotton fabrics.
5. Cotton yarn, but not including cotton yarn waste.
6. Liquefied petroleum gas for domestic use(LPG)
7. Crude oil.
8. Hides and skins, whether in a raw or dressed state.
9. Iron and steel.
10. Jute.
11. Oilseeds.
12. Pulses.
13. Man-made fabrics.
14. Sugar.
15. Woven fabrics of wool.

- **Restrictions and conditions in regard to tax on sale or purchase of declared goods within a State. (Sec. 15)**

Act provides that in respect of declared goods, following restrictions and conditions shall be applicable on state sales tax law:-

1. The rate of tax in respect of any sale or purchase of declared goods inside the State cannot exceed 5%.
2. Where a tax has been levied under state law on the sale or purchase inside the State of any declared goods and such goods are sold in the course of inter-State trade or commerce, and tax has been paid under CST Act in respect of the interstate sale of such goods, the tax levied under state law shall be reimbursed to the person making such sale in the course of inter-State trade or commerce.

13.5 VALUE ADDED TAX (VAT)

- **Registration** is based on following criteria

  1. Turnover.

- Turnover exceeds ₹ 5 lakhs / ₹10 lakhs.
- The registration to be made within 30 days of crossing the limit.

2. Transaction.

- Dealers purchasing goods from other states.
- Dealers selling goods to other states.
- Dealers exporting and importing goods from a country outside India.
- Dealer is liable to pay tax @ 20% on goods {petrol, diesel etc.}.

- **Cancellation of Registration**

1. Dealer transfer his business to a new location.
2. Annual turnover falls below the specified amount.
3. Discontinue of business.
4. Dealer has become insolvent.
5. Change of business.

- **Variants of VAT**

1. Gross Product Variant
2. Income Variant
3. Consumption Variant

1. Gross Product Variant.

- Tax is levied on all sales.
- Deduction is allowed on all purchases of raw materials.
- No deduction is allowed on capital goods.
- The seller can take credit of tax paid only on the raw materials purchased by him and set off such credit against the tax payable on his products.
- VAT to be remitted = VAT payable on sales - VAT credit allowed on raw material.

2. Income Variant.

- Deduction is allowed on all purchases of raw materials as well as depreciation on capital goods.
- There are different methods of depreciation to arrive the depreciation amount and the life of all capital goods is not the same.
- Credit can be availed on a pro-rata basis as and when depreciation is charged on the capital goods.

- VAT to be remitted = VAT payable on sales (-) VAT credit allowed on input goods (+) proportionate VAT credit allowed on depreciation on capital goods.

3. Consumption Variant

- Tax is levied on all sales.
- Deduction is allowed on all purchases of raw materials as well as Capital Goods.
- No need to examine whether the goods are capital goods or not.
- No need to calculate depreciation on capital.
- VAT to be remitted = VAT payable on sales (-) VAT credit allowed on input plus capital goods.

4. Composition scheme.

- Dealers who are liable to pay VAT but whose gross turnover does not exceed Rs. 50 lakhs, are eligible for composition scheme.
- Under the composition scheme, tax shall be payable as a small percentage of the gross turn-over.
- Under the composition scheme Input tax credit cannot be availed.

Composition scheme not eligible for:

- Dealer who sells goods to other states.
- Dealer who is involved in import or export.
- Dealer who transfers goods outside the state otherwise than by way of sale for the execution of a work contract.
- Dealer who purchases goods from other states.
- Manufacture / dealer who want to issue VAT invoice.

13.6 CENTRAL VALUE ADDED TAX (CENVAT)

Taxation of inputs, like raw materials, components and other intermediaries had a number of limitations. In production process, raw material passes through various processes or stages till a final product is achieved. Thus, output of the first manufacturer becomes input for second manufacturer and so on. When the inputs are used in the manufacture of product, the cost of the final product increases not only on account of the cost of the inputs, but also on account of the duty paid on such inputs. As the duty on the final product is on ad valorem basis and the final cost of product includes the cost of inputs, inclusive of the duty paid, duty charged on product meant doubly taxing raw materials. In other words, the tax burden goes on increasing as raw material and final product passes from one stage to other because, each subsequent purchaser has to pay tax again and again on the material which has already suffered tax. This is called cascading effect or double taxation.

This led to evolution of a new scheme, `MODVAT' (Modified Value Added Tax). MODVAT Scheme which essentially follows VAT Scheme of taxation. i.e. if a manufacturer X purchases certain components(raw materials) from another manufacturer Y for use in its product. Y would have paid excise duty on components manufactured by it and would have recovered that excise duty in its sales price from X. Now, X has to pay excise duty on product manufactured by it as well as bear the excise duty paid by the supplier of raw material Y. Under the MODVAT scheme, a manufacturer can take credit of excise duty paid on raw materials and components used by him in his manufacture. It amounts to excise duty only on additions in value by each manufacturer at each stage.

The Modvat scheme is regulated by Rules 57A to 57U of the Central Excise Rules and the notifications issued there under (**The Central Excise Rules, 2002 (Section 143 of the Finance Act, 2002**). Modvat Scheme ensures the revenue of the same order and at same time the price of the final product could be lower. Apart from reducing the costs through elimination of cascade effect, and bringing in greater rationalization in tax structure and also bringing in certainty in the amount of tax leviable on the final product, this scheme will help the consumer to understand precisely the impact of taxation on the cost of any product and will, therefore, enable consumer resistance to unethical attempts on the part of manufacturers to raise prices of final products, attributing the same to higher taxes.

Subsequently, MODVAT scheme was restructured into CENVAT(Central Value Added Tax) scheme. A new set of rules 57AA to 57AK , under **The Cenvat Credit Rules, 2004**, were framed and whatever restrictions were there in MODVAT Scheme were removed and a free hand was given to the assessee. Under the Cenvat Scheme, a manufacturer of final product or provider of taxable service shall be allowed to take credit of duty of excise as well as of service tax paid on any input received in the factory or any input service received by manufacturer of final product.

The term "Input" means: -

- All goods, except light diesel oil, high speed diesel oil and motor spirit, commonly known as petrol, used in or in relation to the manufacture of final products whether directly or indirectly and whether contained in the final product or not and includes lubricating oils, greases, cutting oils, coolants, accessories of the final products cleared along with the final product, goods used as paint, or as packing material, or as fuel, or for generation of electricity or steam used in or in relation to manufacture of final products or for any other purpose, within the factory of production.

- All goods, except light diesel oil, high speed diesel oil, motor spirit, commonly known as petrol and motor vehicles, used for providing any output service;

The term "Input service" means any service: **-**

- Used by a provider of taxable service for providing an output service; or
- Used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products from the place of removal,

And includes services used in relation to setting up, modernization, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage upto the place of removal, procurement of inputs, activities relating to business, such as accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry and security, inward transportation of inputs or capital goods and outward transportation upto the place of removal;"

Manufacturer and service providers can avail Cenvat credit of capital goods used by them. The plant and machinery and allied items are purchased by a manufacturer. Such goods known as capital goods may be duty paid. The capital goods shall be used in manufacture of final products or for providing output service. The CENVAT credit in respect of duty paid on capital goods shall be taken only for an amount not exceeding fifty percent of the duty paid in the same financial year and the credit of balance amount can be take in any financial year subsequent to the financial year in which the capital goods were received.

13.6.1. Duty Paying Documents against which CENVAT credit can be availed are:-

- Invoice issued by
    - A manufacture of capital goods.
    - An importer
    - Provided the depot/ premises is registered with central excise
    - A first/second stage dealer.
- A supplementary invoice
- A bill of entry.
- A certificate issued by customs appraiser.
- An invoice/bill/challan issued by providers of input service.

- A challan evidencing payment of service tax.

Credit of duty is allowed only if all the conditions given below are met:-

- The basic criteria for availing of credit of duty paid on inputs or capital goods are that the goods shall be used in manufacture of final products.
- The goods shall be accompanied with prescribed documents.

The final products shall not be exempt from whole of duty or chargeable to nil duty.

13.7 SUMMARY

- The main objective of any taxation in any part of the world is obviously not to levy tax on taxes or in simple words to avoid cascading effect.
- Cenvat is a duty on the activity of manufacturing whereas sales tax is levied on transfer of property in goods.
- In the present VAT system prevailing in various states of India, the dealer can claim the credit of tax paid on inputs/capital goods purchased within the State.
- This definition has to be taken note of as No sales tax under this act shall be leviable on items not included in definition of goods.
- Under the MODVAT scheme, a manufacturer can take credit of excise duty paid on raw materials and components used by him in his manufacture. It amounts to excise duty only on additions in value by each manufacturer at each stage.

13.8 KEY WORDS

- Credit
- Excise duty
- Cenvat credit
- Invoice
- Challan
- Input service

13.9 SELF ASSESSMENT QUESTIONS

1. Explain the salient features of the Central Sales Tax Act.

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2. Explain the Procedure of Registration under the VAT Regime.

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3. What are the variants under the VAT Regime? Explain them in brief.

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4. Write Short Notes on the following:

a. "Sale" under the CST b. "Declared Goods" under the CST

13.10 REFERENCES

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UNIT – 14: SERVICE TAX – TAXATION OF INTELLECTUAL PROPERTY – NEGATIVE LIST OF SERVICE TAXES

Structure:

14.0 OBJECTIVES

- To Study the Concept of Service Tax
- To determine the liability of Intellectual Property under the Service Tax Regime
- To briefly deal with the Negative List of Service Taxes

14.1 INTRODUCTION

Service tax is a tax levied on services rendered by a person and the duty to make payment of the tax is cast upon the service provider. It is an indirect tax as it can be recovered from the recipient of service by the Service Provider in the course of business transactions.

Service tax was introduced on the recommendation of Dr. Raja Chelliah Committee on tax reforms in 1994 under Chapter V of the Finance Act, 1994. It was imposed on a initial set of three services in 1994 and the scope of the service tax has since been expanded continuously by subsequent Finance Acts.

14.2 SERVICE TAX

The law relating top Service Tax is chiefly governed by Chapter V of the Finance Act 1994(as amended from time to time); The Service Tax Rules 1994; The Point of Taxation Rules, 2011; Service Tax (Determination of Value) Rules, 2006.

The Finance Act 2012 has defined the term "Service" for the first time by the insertion of Clause (44) of Section 65B, wherein the term Service has been defined as here under: "Service" means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include–

(a) an activity which constitutes merely,–

(i) a transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or

(ii) such transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of clause (29A) of Article 366 of the Constitution; or

(iii) a transaction in money or actionable claim;

(b) a provision of service by an employee to the employer in the course of or in relation to his employment;

(c) fees taken in any Court or tribunal established under any law for the time being in force.

14.3 LEVY OF SERVICE TAX

The levy of service tax, by the centre is facilitated through the insertion of article 268A to the Constitution vide the 88th Amendment Act, 2003. In addition to article 268A, entry 92C has been inserted in the union list to make the enactment relating to service tax a subject matter of union list. The Service Tax Rules, 1994 provide for the rules as to the levy of service tax.

With effect from 01st July 2011, the liability to pay the service tax is on accrual basis and thus there is a rift from the erstwhile liability based on receipt basis.

The imposition of Service Tax was challenged in All India Federation of Tax Practitioners v. Union of India[86], where, the Hon'ble Supreme Court observed that, "Service tax is an indirect tax levied on certain services provided by certain categories of persons including companies, association, firms, body of individuals etc. Service sector contributes about 64% to the GDP. Services constitute heterogeneous spectrum of economic activities. Today services cover wide range of activities such as management, banking, insurance, hospitality, consultancy, communication, administration, entertainment, research and development activities forming part of retailing sector. Service sector is today occupying the centre stage of the Indian economy. It has become an Industry by itself. In the contemporary world, development of service sector has become synonymous with the advancement of the economy. Economics hold the view that there is no distinction between the consumption of goods and consumption of services as both satisfy the human needs.

The Finance Act, 2012 has made remarkable changes in service tax legislation whereby the concept of Positive list of Taxable services has been replaced with a negative list. Thereby all services except as notified in Negative list or exemption list are subject to applicability of service tax. Section 66B provides that there shall be levied a tax (hereinafter referred to as the service tax) at the rate of twelve per cent on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed. The liability to pay the Service tax, arises on the following counts:

- Charge on all services [defined u/s 6B(44)], other than Negative list,
- Service provided or agreed to be provided,
- Service should be in the taxable territory (as determined under The Place of Provision of Service Rules, 2012)
- Service by one person to another

[86]2007 (7) S.T.R. 625 (S.C.)

14.4 TAXATION OF INTELLECTUAL PROPERTY RIGHTS

- **Intellectual Property Rights: Goods or Service?**

  The Finance Act 2004 explicitly defined 'Intellectual Property Right' to mean "any right to intangible property, namely, trademarks, designs, patents or any other similar intangible property, under any law for the time being in force, but does not include copyright. Although in common parlance, Intellectual Property is inclusive of Copyrights, they are specifically sought to be excluded from the ambit of taxation under this law.

It becomes imperative that for the applicability of Service tax, the subject matter of taxation is essentially a service and not the sale of goods. In Tata Consultancy Services v. State of Andhra Pradesh[87], the Supreme Court observed in relation to a 'software' being whether or not a good; "A software programme may consist of various commands which enable the computer to perform a designated task. The copyright in that programme may remain with the originator of the programme. But the moment copies are made and marketed, it becomes goods. There is no difference between a sale of a software programme on a CD/floppy disc from a sale of music on a cassette/CD or a sale of a film on a video cassette/CD. In all such cases, the intellectual property has been incorporated on a media for purposes of transfer. Sale is not just of the media which by itself has very little value. The software and the media cannot be split up. What the buyer purchases and pays for is not the disc or the CD.IPRs are goods only if they are expressed on a media."

IPR when treated as a 'Sale of Goods' cannot be made liable to the Service Tax. As the definition of 'service' under Section 65B(44) of the Finance Act, 1994specifically excludes the 'sale of goods'.

Section 66E(c)of the Finance Act, 1994 provides that the following amounts to an "IPR Service", viz. the temporary transfer; or permitting the use or enjoyment of any intellectual property right. In case of a permanent transfer of intellectual property right does not amount to rendering of service. On such transfer, the person selling these rights no longer remains a 'holder of intellectual property right' so as to come under the purview of taxable service. Thus, there would not be any service tax on permanent transfer of IPRs.

There may arise circumstances wherein, the transaction involved may be of a composite nature, thereby leading to the dilemma as to the transaction being either a 'sale' or 'service'. In such cases the Dominant Nature Test is to be applied.

[87] 2004 (178) ELT 22 (SC)

The Supreme Court observed in Bharat Sanchar Nigam Ltd. v. Union OfIndia[88], that to determine taxability of composite transaction, the following principles are to be considered while rendering the dercision:

- The nature of a composite transaction, except in case of two exceptions carved out by the Constitution, would be determined by the element which determines the 'dominant nature' of the transaction.
- If the dominant nature of such a transaction is sale of goods or immovable property, then such transaction would be treated as such.
- If the dominant nature of such a transaction is provision of a service, then such transaction would be treated as a service and taxed as such, even if the transaction involves an element of sale of goods.
- If the transaction represents two distinct and separate contracts and is discernible as such then contract of service in such transaction would be segregated and chargeable to service tax if other elements of taxability are present. This would apply even if a single invoice is issued.

14.5 NEGATIVE LIST OF SERVICE TAX

According to Section 66B of the Finance Act, 1994, service tax is to be levied on all services provided in the taxable territory by a person to another for a consideration other than the services specified in the negative list. The services specified in the negative list therefore go out of the ambit of chargeability of service tax. The negative list of service is specified in the Act under Section66 D.

In toto, there are seventeen heads of services that have been specified in the negative list. Thereby all the seventeen list of services have been excluded from the ambit of Service tax.

14.5.1. <u>Services by Government or a local authority excluding the following services to the extent they are not covered elsewhere—</u>

(i) services by the Department of Posts by way of speed post, express parcel post, life insurance and agency services provided to a person other than Government;

(ii) services in relation to an aircraft or a vessel, inside or outside the precincts of a port or an airport;

(iii) transport of goods or passengers; or

[88] 2006(2) STR 161

(iv) support services, other than services covered under clauses (i) to (iii) above**,** provided to business entities: The term ‘Support services’ has been defined in section 65B of the Act as ‘infrastructural, operational, administrative, logistic marketing or any other support of any kind comprising functions that entities carry out in ordinary course of operations themselves but may obtain as services by outsourcing from others for any reason whatsoever and shall include advertisement and promotion, construction or works contract, renting of movable or immovable property, security, testing and analysis.

14.5.2. <u>Services provided by Reserve Bank of India</u>

This item covers only those services that are provided by the Reserve Bank of India. The Education Guide provides that the clause does not cover Services provided to the Reserve Bank of India are not in the negative list and they would be taxable unless otherwise covered in any other entry in the negative list. Similarly, Services provided by banks to RBI would be taxable as these are neither in the negative list nor covered in any of the exemptions.

14.5.3.<u>Services by a foreign diplomatic mission located in India</u>

Any service that is provided by a diplomatic mission of any country located in India is in the negative list. This entry does not cover services, if any, provided by any office or establishment of an international organization.

14.5.4. <u>Services relating to agriculture or agricultural produce.</u>

The services relating to agriculture or agricultural produce that are specified in the negative list are services relating to –

- agricultural operations directly related to production of any agricultural produce including cultivation, harvesting, threshing, plant protection or seed testing;
- supply of farm labour;
- processes carried out at the agricultural farm including tending, pruning, cutting, harvesting, drying cleaning, trimming, sun drying, fumigating, curing, sorting, grading, cooling or bulk packaging and such like operations which do not alter essential characteristics of agricultural produce but makes it only marketable for the primary market;
- renting of agro machinery or vacant land with or without a structure incidental to its use;
- loading, unloading, packing, storage and warehousing of agricultural produce;
- agricultural extension services;

- services provided by any Agricultural Produce Marketing Committee or Board or services provided by commission agent for sale or purchase of agricultural produce;

Agricultural produce has been defined under Section 65B of the Act which means any produce of agriculture on which either no processing is done or such processing is done as is usually done by a cultivator or producer which does not alter its essential characteristics but makes it marketable for primary market. It also includes specified processes in the definition like tending, pruning, grading, sorting etc. which may be carried out at the farm or elsewhere as long as they do not alter the essential characteristics.

The Education Guide to Service Tax provides the rationale for insertion of these provisions by stating that, the marketing committees or boards have been set up in most of the States and provide a variety of support services for facilitating the marketing of agricultural produce by provision of facilities and amenities like, sheds, water, light, electricity, grading facilities etc. They also take measures for prevention of sale or purchase of agricultural produce below the minimum support price. APMCs collect market fees, license fees, rents etc. Services provided by such Agricultural Produce Marketing Committee or Board are covered in the negative list. However any service provided by such bodies which is not directly related to agriculture or agricultural produce will be liable to tax e.g. renting of shops or other property.

14.5.5. <u>Trading of goods</u>

Trade involves the transfer of the ownership of goods or services from one person or entity to another in exchange for other goods or services or for money. Possible synonyms of "trade" include "commerce" and "financial transaction". Types of trade include barter. A network that allows trade is called a market. The original form of trade, barter, saw the direct exchange of goods and services for other goods and services. Later one side of the barter started to involve precious metals, which gained symbolic as well as practical importance. Modern traders generally negotiate through a medium of exchange, such as money. As a result, **buying** can be separated from **selling**, or earning. The invention (and later credit, paper money and non-physical money) greatly simplified and promoted trade. Trade between two traders is called bilateral trade, while trade between more than two traders is called multilateral trade.

Trade exists due to the specialization and division of labor, in which most people concentrate on a small aspect of production, trading for other products. Trade exists between regions because different regions may have a comparative advantage(perceived or real) in the production of some trade-able commodity, or because different regions' size may encourage mass production. As such, trade at market prices between locations can benefit both locations. Retail trade consists of the sale of goods or merchandise from a very fixed location, such as a department store, boutique or kiosk, online or by mail, in small or individual lots for direct consumption or use by the purchaser. Wholesale trade is defined as the sale of goods that are sold as merchandise to retailers, and/or industrial, commercial, institutional, or other professional business users, or to other wholesalers and related subordinated services. Trading is a value-added function: it is the economic process by which a product finds its end user, in which specific risks are borne by the trader. Trading can also refer to the action performed by traders and other market agents in the financial markets

14.5.6. <u>Processes amounting to manufacture or production of goods</u>

Section 65B of the Act defines the phrase 'processes amounting to manufacture or production of goods' as a process on which duties of excise are leviable under section 3ofthe Central Excise Act, 1944 (1 of 1944) or any process amounting to manufacture of alcoholic liquors for human consumption, opium, Indian hemp and other narcotic drugs and narcotics on which duties of excise are leviable under any State Act. This entry, therefore, covers manufacturing activity carried out on contract or job work basis, which does not involve transfer of title in goods, provided duties of excise are leviable on such processes under the Central Excise Act, 1944 or any of the State Acts.

14.5.7. <u>Selling of space or time slots for advertisements other than advertisements broadcast by radio or television</u>

The term 'Advertisement' has been defined under section 65 B of the Act as "any form of presentation for promotion of, or bringing awareness about, any event, idea, immovable property, person, service, goods or actionable claim through newspaper, television, radio or any other means but does not include any presentation made in person."

14.4.8. <u>Access to a road or a bridge on payment of toll charges</u>

Toll roads in some form have existed since antiquity, collecting their fees from passing travelers on foot, wagon or horseback; but their prominence increased with the rise of the automobile, and many modern tollways charge fees for motor vehicles exclusively. The amount of the toll usually varies by vehicle type, weight, or number of axles, with freight trucks often charged higher rates than cars.

Tolls are collected at points known as toll booths, toll houses, plazas, stations, bars, or gates. Some toll collection points are unmanned and the user deposits money in a machine which opens the gate once the correct toll has been paid. To cut costs and minimize time delay many tolls today are collected by some form of automatic or electronic toll collection equipment which communicates electronically with a toll payer's transponder. Toll booths are usually still required for the occasional users who do not have a transponder. The tolls are often prepaid or collected "automatically" from an affiliated credit card service. Some toll roads have "automated" toll enforcement systems that take photos of drivers who do not pay the tolls and their license plates. They typically get the toll bill along with a fine.

Criticisms of toll roads include the time taken to stop and pay the toll, and the cost of the toll booth operators—up to about one third of revenue in some cases. Automated toll paying systems help minimize both these. Others object to paying "twice" for the same road: in fuel taxes and with tolls. In addition to toll roads, toll bridges and toll tunnels are also used by public authorities to generate funds to repay the cost of building the structures. Some tolls are set aside to pay for future maintenance or enhancement of infrastructure, or are applied as a general fund by local governments, not being earmarked for transport facilities. This is sometimes limited or prohibited by central government legislation. Also road congestion pricing schemes have been implemented in a limited number of urban areas as a transportation demand management tool to try to reduce traffic congestion and air pollution.

14.4.9. Betting, gambling or lottery

“Betting or gambling’ has been defined in section 65B of the Act as ‘putting on stake something of value, particularly money, with consciousness of risk and hope of gain on the outcome of a game or a contest, whose result may be determined by chance or accident, or on the likelihood of anything occurring or not occurring’.

14.5.10. Entry to Entertainment Events and Access to Amusement Facilities

‘Entertainment event’ has been defined in section 65B of the Act ‘as an event or a performance which is intended to provide recreation, pastime, fun or enjoyment, such as exhibition of cinematographic films, circus, concerts, sporting events, fairs, pageants, award functions, dance performances, musical performances, theatrical performances including cultural programs, drama, ballets or any such event or programme’.

‘Amusement facility’ has been defined in the Act as ‘a facility where fun or recreation is provided by means of rides, gaming devices or bowling alleys in amusement parks, amusement arcades, water parks, theme parks or such other places but does not include a place within such facility where other services are provided’.

14.5.11. Transmission or distribution of electricity

An ‘electricity transmission or distribution utility’ has also been defined in section 65B of the Act. It includes the following –

• the Central Electricity Authority

• a State Electricity Board

• the Central Transmission Utility (CTU)

• a State Transmission Utility (STU) notified under the Electricity Act, 2003 (36 of 2003)

• a distribution or transmission licensee licensed under the said Act

• any other entity entrusted with such function by the Central or State Government

14.5.12. <u>Specified services relating to education</u>

Few of the services that are in relation to the field of education are included in the Negative List, viz.:

- pre-school education and education up to higher secondary school or equivalent
- education as a part of a prescribed curriculum for obtaining a qualification recognized by law for the time being in force;
- education as a part of an approved vocational education course

Under this entry the conduct of degree courses by colleges, universities or institutions which lead grant of qualifications recognized by law would be covered. Training given by private coaching institutes would not be covered as such training does not lead to grant of a recognized qualification.

However this entry does not cover 'Auxiliary educational services'. Auxiliary Educational Services are defined in the mega notification. In terms of the definition, the following activities are auxiliary educational services:

- any services relating to imparting any skill, knowledge or education, or
- development of course content, or
- any other knowledge – enhancement activity, whether for the students or the faculty, or
- any other services which educational institutions ordinarily carry out themselves but
- may obtain as outsourced services from any other person, including following services relating to:
  - admission to such institution
  - conduct of examination
  - catering for the students under any mid-day meals scheme sponsored by Government
  - transportation of students, faculty or staff of such institution.

14.5.13. Services by way of renting of residential dwelling for use as residence

Renting' has been defined in section 65B as ''allowing, permitting or granting access, entry, occupation, usage or any such facility, wholly or partly, in an immovable property, with or without the transfer of possession or control of the said immovable property and includes letting, leasing, licensing or other similar arrangements in respect of immovable property'. However the term 'Residential Dwelling' has not been defined under the Act, as such it has to be interpreted in terms of the normal trade parlance as per which it is any residential accommodation, but does not include hotel, motel, inn, guest house, camp–site, lodge, houseboat, or like places meant for temporary stay.

14.5.14. Financial sector

The following are included in the Negative List, services by way of—

(i) extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount;

(ii) inter se sale or purchase of foreign currency amongst banks or authorised dealers of foreign exchange or amongst banks and such dealers;

14.5.15. Services relating to transportation of passengers

Services in relation to transportation of passengers, with or without accompanied belongings, by the following are included in the Negative List:

- a stage carriage;
- railways in a class other than (i) first class; or (ii) an AC coach;
- metro, monorail or tramway;
- inland waterways;
- public transport, other than predominantly for tourism purpose, in a vessel, between
- places located in India; and
- metered cabs, radio taxis or auto rickshaws.

14.5.16. Service relating to transportation of goods

The following services provided in relation to transportation of goods are specified in the negative list of services:-

- by road except the services of (i) a goods transportation agency; or (ii) a courier agency
- by aircraft or vessel from a place outside India up to the customs station of clearance in India; or

- by inland waterways.

14.5.17 <u>Funeral, burial, crematorium or mortuary services includingtransportation of the deceased</u>.

14.6 SUMMARY

- Service tax is a tax levied on services rendered by a person and the duty to make payment of the tax is cast upon the service provider.
- The levy of service tax, by the centre is facilitated through the insertion of article 268A to the Constitution vide the 88th Amendment Act, 2003.
- The Finance Act 2004 explicitly defined 'Intellectual Property Right' to mean "any right to intangible property, namely, trademarks, designs, patents or any other similar intangible property, under any law for the time being in force, but does not include copyright.
- According to Section 66B of the Finance Act, 1994, service tax is to be levied on all services provided in the taxable territory by a person to another for a consideration other than the services specified in the negative list.

14.7 KEY WORDS

- Finance Act
- Negative list
- Intangible property
- Service provider

14.8 SELF ASSESSMENT QUESTIONS

1. Write a note on 'Service Tax'.

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2. Explain the levy of Service Tax.

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3. State in brief 'Taxation of IPR'.

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4. Write about the Negative List under the Service tax regime.

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UNIT – 15: TRANSFER PRICING – METHOD OF COMPUTING TRANSFER PRICE - SAAR – GAAR – TDS AND TCS

Structure:

15.0 OBJECTIVES

- To Study the Concept of Transfer Pricing
- To understand the concept of GAAR and SAAR
- To study the various methods of Computation of Transfer Pricing
- To provide insight to the concept of TDS and TCS

15.1 INTRODUCTION

The law relating to transfer pricing in India is still in its infancy. Some decisions recently from the Judiciary have clarified some issues. The operation of the business in the globalised world has led to the integration of the world economy. Therefore the realm of related persons has also increased multi fold due to the concepts of Subsidiaries, Mergers and Acquisitions.

15.2 TRANSFER PRICING

The Finance Act, 2001 introduced law of transfer pricing in India through Sections 92 to 92F of the Income Tax Act, 1961 that guides computation of the transfer price and provides detailed documentation procedures. The introduction of these provisions caused a change in transfer pricing regulations in India whereby government extended the applicability of transfer pricing regulations to specified domestic transactions which are enumerated in Section 92BA. These provisions help in curbing the practice of transferring profit from a taxable domestic zone to tax free domestic zone.

The mechanism of accounting the pricing for Related Party Transactions is called Transfer Pricing. Related Party transaction means the transaction between/among the parties which are associated by reason of common control, common ownership or other common interest. Transfer Price refers to the price of goods/services used in relation to the transfer of goods or services from one unit to another or from one company to another associated company. Transfer price has the potential to affect the revenue of transferring division and the cost of receiving division. Thereby, the levy of tax from the Transferrring Unit and the Deductions that can be claimed from the Transferred Unit is affected. Hence its study becomes imperative.

Section 92A of the Act, provides aid in identifying Related Party transactions. It provides for the definition of "associated enterprise", in relation to another enterprise, as an enterprise–

(a) Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

(b) In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

From the definition, we decipher that the basic ingredient for identification of an Associated Group is the participation in management, control or capital (ownership) of one enterprise by another enterprise whereby the participation or control, may be direct or indirect or through one or more intermediaries.

Section 92(2) contains a list of enterprises that are deemed to be Associated Enterprises. The list enumerates as follows, in relation to the previous year:

(a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or

(b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises; or

(c) a loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise; or

(d) one enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise; or

(e) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or

(f) more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; or

(g) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or

(h) ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or

(i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or

(j) where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or

(k) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family or by a relative of a member of such Hindu undivided family or jointly by such member and his relative; or

(l) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals; or

(m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

The applicability of these provisions depends on the nature of Transaction at hand.

- **International Transactions/Deemed International Transactions**

Section 92B provides that “International Transaction” means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

As per Section 92B(2) of Income Tax Act, A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise. It further provides that the term ‘International Transaction’ shall include:

(a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;

(b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;

(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;

(d) Provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;

(e) A transaction of business restructuring or reorganization, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date.

- **"Specified domestic transaction"**

In case of an assessee means any of the following transactions, not being an international transaction, namely:–

(i) Any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;

(ii) Any transaction referred to in section 80A;

(iii) Any transfer of goods or services referred to in sub-section (8) of section 80-IA;

(iv) Any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;

(v) Any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or

(vi) Any other transaction as may be prescribed, and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees.'

The Section aims at covering only a portion of the domestic transactions, and not all. It covers only those transactions that is covered by criteria as given therein and the aggregate value of such transactions exceeds 5 crore Rupees in a year.

15.3 GENERAL ANTI-AVOIDANCE RULES (GAAR)

The GAAR is an anti-avoidance measure that empowers the tax authorities to call a business arrangement or a transaction an 'impermissible avoidance arrangement' and thereby deny tax benefits to the parties involved in the transaction.

Tax Avoidance is legal phenomenon that allows investors to legally reduce their tax liability. The GAAR is a concept that empowers the Revenue Authorities in a country to disallow/deny the tax benefits of transactions that do not have any commercial purpose other than achieving the tax benefit.

A GAAR typically comprises a set of broad rules based on general principles to counter potential avoidance of the tax in general, in a form which cannot be predicted and provided for at the time when the law is introduced. If enacted, this will be a new concept in Indian law.

For the applicability of GAAR, the following ingredients are to be fulfilled:

- There must be a transaction that has no commercial purpose.
- The object of such transaction must be solely to avoid taxes
- And It:
    i. creates rights or obligations, which would not be created if the transaction was implemented at arm's length; or
    ii. results, directly or indirectly, in the misuse of the provisions of the Code; or
    iii. lacks commercial substance in whole or in part; or
    iv. is entered into or carried out by means, or manner which would not be normally adopted for bonafide purposes.

The Supreme Court of India in its ruling in the case of Vodafone International Holdings BV[89] has unequivocally reiterated the age old principle that all tax planning cannot be said to be illegal / illegitimate or impermissible. Genuine strategic tax planning is permissible. This is one of the chieftain criticism raised against the GAAR concept.

The Expert-Committee has deferred the implementation of GAAR Principles to the Financial Year 2016-2017, on grounds of Administrative incapacity and lack of intensive training.

15.4 SPECIFIC ANTI-AVOIDANCE RULE (SAAR)

The Indian tax law has several anti-avoidance provisions, introduced over the years. These are, however, specific rules to cover specific transactions. The major provisions of

[89]SLP (C) No. 26529 of 2010, Judgement dated 20 January 2012

SAAR are contained under Chapter X to the Income Tax Act 1961. There are few other provisions that are scattered in the Income Tax Act 1961 that deal with SAAR.

15.5 ARM'S LENGTH PRICE

The Arm's Length Price refers to the fair price of goods transferred or services rendered. The calculation of Arm's length price is very crucial for a company. In case the transfer price is not at arm's length, it may ensue the following events:

- Wrong Performance Evaluation
- Wrong Pricing of finished goods/services
- Non compliances of Laws, thereby applicability of penalty and punishment

Section 92C of Income Tax Act defines the methods which are to be used in determination of Arm's Length prices for International Transaction and specified domestic transaction. The arm's length price in relation to an international transaction/specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely :-

(A) Comparable Uncontrolled Price Method (CUP)

(B) Resale Price Method (RPM)

(C) Cost Plus Method (CPM)

(D) Profit Split Method (PSM)

(E) Transactional Net Margin Method (TNMM)

(F) Such other method as may be prescribed by the Board.

Rule 10C of the Indian Income Tax Rules, 1962 provides that in selecting a most appropriate method, the following factors shall be taken into account namely,

(a) The nature and class of the international transaction.

(b) The class or classes of Associated Enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises.

(c) The availability, coverage and reliability of data necessary for application of the method.

(d) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions.

(e) The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions.

(f) The nature, extent and reliability of assumptions required to be made in the application of a method.

15.5.1. <u>Comparable Uncontrolled Price Method (CUP)</u>

Comparable Uncontrolled Price ("CUP") is a method that compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances. This is the most direct method for the computing the Arms' length price. If the uncontrolled price, the price agreed between the unrelated parties for the transfer of goods or services, is comparable with the price charged for transfer of goods or services between the Associated Enterprises, then such a price is the Comparable Uncontrolled Price (CUP).

- **Internal CUP Method**

  The Internal CUP is considered a good estimate as it takes into consideration the processes involved, risks undertaken and assets employed. This method is available where the the tax payer enters into a similar transaction with unrelated parties, as is done with a related party.

- **External CUP Method**

  This Method is looked into where the transaction between two independent enterprises takes place under comparable conditions involving comparable goods or services.

15.5.2. <u>Resale Price Method (RPM)</u>

Rule 10B (1) (b) of Income Tax Rules, 1962 prescribes Resale Price method by which,

I. The price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise is identified;

II. Such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;

III. The price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;

IV. The price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions which could materially affect the amount of gross profit margin in the open market;

V. The adjusted price arrived at under sub-clause (iv) is taken to be an arms length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.

15.5.3. <u>Cost plus Method</u>

This method is provided under Rule 10B (1) (c) of Income tax Rules, 1962. It is a method by which,

(i) The direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;

(ii) The amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;

(iii) The normal gross profit mark-up so determined is adjusted to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;

(iv) The costs referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under sub clause (iii);

(v) The sum so arrived at is taken to be an arm’s length price in relation to the supply of the property or provision of services by the enterprise.

In accordance to the Cost Plus Method, an arm’s-length price equals the controlled party’s cost of producing the tangible property plus an appropriate gross profit mark-up, defined as the ratio of gross profit to cost of goods sold, after deducting the expanses, for a comparable uncontrolled transaction.

15.5.4. <u>Profit Split Method</u>

This method is used chiefly in International Transactions. This method is provided under Rule 10B (1) (d) of Income tax Rules, 1962 that provides where international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which:

(i) The combined net profit of the associated enterprises arising from the international transaction in which they are engaged, is determined;

(ii) The relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;

(iii) The combined net profit is then split amongst the enterprises in proportion to their relative contributions, as computed above;

(iv) The profit thus apportioned to the assessee is taken into account to arrive at an arm’s length price in relation to the international transaction.

There are two steps that are involved in the Profit Split Method, viz.

- Firstly, It involves the Determination of the sum of profit gained by the associate parties from a controlled transaction.
- Secondly, the allocation of profit among the associate parties based on the comparative price of their assistance to the non-arm's length dealings, allowing for the properties used and the risks undertaken by each non-arm's length associate parties, in connection to what arm's length parties would have taken.

15.5.5. <u>Transactional Net Margin Method</u>

This method is advocated under Rule 10B (1) (e) of Income Tax Rules, 1962. It is a method by which:

(i) The net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(ii) The net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(iii) The net profit margin referred to in (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;

(iv) the net profit margin realized by the enterprise and referred to in (i) is established to be the same as the net profit margin referred to in (iii);

(v) The net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.

15.6 TAX DEDUCTED AT SOURCE (TDS)

Chapter X of the Income Tax Act, 1961 provides for the Payment of Tax by means of Deduction or Collection at Source or by means of Advance Payment. This mechanism is an effective and inexpensive way by means of which taxes can be collected. Further it assists compliance, avoids the problems of the tax payers inability to pay, reduce the number of tax payments to be processed, puts the revenue into the Treasury faster, identifies tax payers and makes taxes psychologically easier to bear.[90]

Sections 192 to 195 and 206C of the Income-Tax Act, govern procedure in T.D.S Under Section 192(1), persons responsible for disbursement of salaries shall, at the time of disbursement deduct income tax computed on the basis of rates in force, vide part III of the First Schedule in the Finance Act passed by the parliament. Similar procedure is followed in T.D.S. on dividend, income, interest on securities, lottery and race horses winnings, payment to contractors, and sub-contractors (194-C), income by way of trading in alcoholic liquors, forest produce etc.

The punishment for not deduction tax at source regarding the types of income referred to above is:

1. Payment of amount of tax due.
2. Liable in penal interest (15 percent annually)
3. Penalty u/s 221, and
4. Liable for prosecution and fine u/s 286-b.

The income from the following sources is subjected to tax deduction at source:

- Salary and all other positive incomes under any head on income(Section 192)
- Interest on securities (Section 193)
- Interest other than interest on securities(Section 194A)

[90] Leon Yudkin: "A Lega Structure for Effective Income Tax Administration", 1971, page- 32

- Payments to contractors and sub-contractors(Section 194C)
- Winnings from Lottery or crossword puzzles(Section 194B)
- Winnings from horse races(Section 194BB)
- Insurance Commission covering all payments for procuring Insurance business(Section 194D)
- Any interest other than interest on securities payable to non-residents not being a company or to a foreign company (Section 195)
- Payment to non-resident sportsman including athlete or sports association/institution. In case of non-resident sportsman, payments in respect of advertisements as well as articles on any game/sports in India in newspapers, magazines, etc. is included(Section 194E)
- Payment in respect of deposits under NSS[National Savings Scheme](Section 194EE)
- Payment on account of repurchase of Units by Mutual Fund or UTI(Section 194F)
- Payment for Commission or brokerage(Section 194H)
- Payment of rent(Section 194I)
- Payment of fees for professional or technical services(Section 194J)
- Commission to Stockist, distributors, buyers and sellers of Lottery tickets including remuneration or prize on such tickets(Section 194G)
- Income from Units purchased in foreign currency or long-term capital gain arising from the transfer of such Units purchased in foreign currency (Section196B)
- Payment of any income to non-residents in respect of interest or dividend on bonds and shares (Section 196C) etc.

15.7 TAX COLLECTION AT SOURCE (TCS)

Tax collection at source arises on the part of the seller of goods. In these cases the tax is collected at the source of income. It is to be collected at the source from the buyer, by the seller at the point of sale. Such tax collection is to be made by the seller at the time of debiting the amount payable to the buyer to the account of the buyer or at the time of receipt of such amount from the buyer, whichever is earlier. A person collecting tax shall furnish a certificate specifying whether tax has been collected or not, what sum has been collected, the rate of tax applied on it and other such particulars as may be prescribed.

The Seller is under a duty to collect taxes at source from the purchaser/buyer of the following items:

- Alcoholic liquor for human consumption

- Tendu leaves
- Timber obtained under a forest lease
- Timber obtained by any mode other than under a forest lease
- Any other forest produce not being timber or tendu leaves
- Scrap
- Parking lot
- Toll plaza
- Mining and quarrying

15.8 SUMMARY

- The operation of the business in the globalised world has led to the integration of the world economy.
- The Finance Act, 2001 introduced law of transfer pricing in India through Sections 92 to 92F of the Income Tax Act, 1961 that guides computation of the transfer price and provides detailed documentation procedures.
- The GAAR is an anti-avoidance measure that empowers the tax authorities to call a business arrangement or a transaction an ‘impermissible avoidance arrangement’ and thereby deny tax benefits to the parties involved in the transaction.
- The major provisions of SAAR are contained under Chapter X to the Income Tax Act 1961.
- The Arm’s Length Price refers to the fair price of goods transferred or services rendered**.**

15.9 KEY WORDS

- Business arrangement
- Transaction
- World economy
- Anti-avoidance measure

15.10 SELF ASSESSMENT QUESTIONS

1. What is Transfer Pricing?

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2. Explain the different modes of Valuation of Arms’ Length Price.

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3. Write a note on Tax Deducted at Source.

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4. Write a note on GAAR.

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BLOCK-IV

UNIT – 16: INTERNATIONAL TAXATION – DOUBLE TAXATION – UNILATERAL AND BILATERAL RELIEF- PERMANENT ESTABLISHMENT - DTAA – NON-DISCRIMINATION IN TAX TREATIES

Structure:

16.0 OBJECTIVES

- An Assessment of nature Scope and significance of International taxation
- An examination about the concept of double taxation and unilateral and bilateral reliefs
- A overview on DTAA Double Taxation Avoidance Agreements DTAA Non discrimination in tax treaties

16.1 INTRODUCTION

In the current era of cross -border transactions across the world, due to unique growth in international trade and commerce and increasing interaction among the nations, residents of one country extend their sphere of business operations to other countries where income is earned. One of the most significant results of globalization is the noticeable impact of one country's domestic tax policies on the economy of another country. This has led to the need for incessantly assessing the tax regimes of various countries and bringing about indispensable reforms.

Therefore, the consequence of taxation is one of the important considerations for any trade and investment decision in any other countries. Fiscal jurisdiction is often the most aggressively protected jurisdiction in India. Consequently, even in times when economies are going global & borders vanishing, leading to liquid movement of goods, services and capital, double taxation is still one of the major obstacles to the development of inter-country economic relations. India are often forced to negotiate and accommodate the claims of other nations within their heavily defended fiscal jurisdiction by the means of double taxation avoidance agreements, in order to bring down the barriers to global trade.

16.2 INTERNATIONAL TAXATION

International taxation[91] issues revolve around two main concepts that are also fundamental reasons/causes of international juridical double taxation. These two concepts are known as the concept of source and the concept of residence. Both concepts arise from domestic tax law provisions, which distinguish between two types of taxpayers – non-residents and residents.

The first category of taxpayers would generally have limited nexus (connection) with the country in question, however the income received by these taxpayers will have an economic link – will originate in the particular country. This country wishes to levy tax on this taxpayer, however only in respect of the income originated therein (having source in this

[91] International taxation available at http://icai.org.resource_file

country) –referred to as source taxation and sometimes known also as limited tax liability. The second category of taxpayers – residents – would have a close personal and economic connection (nexus) with the country in question and the country chooses to tax this taxpayer on his/her worldwide income – referred to as worldwide taxation and sometimes known also as unlimited tax liability.

Where a taxpayer is resident in one country but has a source of income situated in another country, it gives rise to possible double taxation. This arises from two basic rules that enable the country of residence as well as the country where the source of income exists to impose tax, namely, (i) source rule and (ii) theresidence rule. The source rule holds that income is to be taxed in the country in which it originates irrespective of whether the income accrues to a resident or a nonresident whereas the residence rule stipulates that the power to tax should rest with the country in which the taxpayer resides. If both rules apply simultaneously to a business entity and it were to suffer tax at both ends, the cost of operating in an international scale would become prohibitive and deter the process of globalization. It is from this point of view that Double taxation avoidance Agreements (DTAA) become very significant.

16.3 DOUBLE TAXATION

Double taxation is the enforced duty of two or more taxes on the same, property or monetary transactions. Double taxation may occur when the legal authority associations, used by different nations, overlap or it may occur when the taxpayer has links with more than one country. Double taxation can take different forms and occur in different situations. Sometimes double taxation is being distinguished based on the number of taxpayers involved. Cases where the same income is being taxed twice in the hands of the same taxpayer are being referred to as juridicaldouble taxation. For example, the dividend is being taxed in the country of source by a way of withholding tax and then one more time in the country of residence of the shareholder by a way of tax assessment. Cases where the same income is being taxed twice in the hands of two different taxpayers are being referred to as economic double taxation.

Double taxation may occur for any of the following reasons:

(a) **Residence – Residence Conflict**[92]: Two States may tax a person (individual or company) on his world-wide income or capital because they have inconsistent

[92]Committee of Experts on International Cooperation in Tax Matters Seventh session

definitions for determining residence. For example, a corporation may be treated by State A as its resident because it is incorporated therein, whereas State B may treat that corporation as its resident because it is managed therein. As another example, State A may treat an individual as its resident for a taxable year under its domestic tax rules because that individual was present in the State for 183 days during that year. That same individual may be treated as a resident of State B under its domestic laws because the individual has lived in that State for many years and maintains close financial and social ties to that State. Residence-residence conflicts can occur rather frequently with respect to corporations, unless a corporation has intentionally made itself a dual resident to obtain the benefit of a loss in more than one State. This type of double taxation can be eliminated on the basis of tax treaties using the tie-breaker rules contained in Article 4 paragraphs 2-3 of the tax treaties, which determine the states, which would qualify as the only country of residence of the person in question.

(b) **Source – Residence Conflict:**

One State may tax income derived by a person by application of the residence or nationality principle, whereas another State may tax that same income by application of the source principle. For example, Company A, a resident of State A, may earn income in State B from extensive activities therein. StateA would tax Company A on its worldwide income, which would include the income earned in State B. State B would tax the income arising from the activities conducted within its territorial boundaries.

A major objective of bilateral tax treaties is to provide for relief from such source-residence double taxation, typically by requiring the residence State either to give up its claim to tax or to make its claim subordinate to the claim of the source State. This type of double taxation can be eliminated by the tax treaties, either on the basis of the exclusive taxing right – where the treaty permits only one country to tax the income, or on the basis of the methods for double taxation relief, where the country of residence will have the obligation to provide the relief (exemption or credit) in the way prescribed by the treaty to eliminate double taxation.

(c) **Source-Source Conflict:** Two States may invoke the source principle to tax the same item of income, due to conflicts in the way the source of income is determined under their domestic legislation. For example, the domestic tax laws of State A may provide that sales income of a non-resident corporation is taxable in that State if the sale was made through an office located in that State. In contrast, the tax laws of State B may tax income derived from sales by a non-resident corporation if the transfer of possession of the goods sold takes place within that State. Given this conflict in the tax rules of State A and State B, income derived from a sale made through an office located in State A for delivery in State B would be taxed in both States. Tax treatiesmay eliminate some of these situations, by providing sourcing rules, which will help to determine only one country of source.

(d) **Triangular Cases**: In some cases, a State may have a source-residence conflict with one State and a source-source conflict with another State. For example, assume that Company A is a corporation resident in State A. It has an office in State B and makes sales from that office into State C. Under their domestic laws, State A taxes income from those sales under the residence principle and State B and State C both tax that income under the source principle. A bilateral tax treaty between State A and State B is likely to solve the residence-source conflict but probably would not solve the source conflict. If State B and State C also have a bilateral tax treaty, however, the source-source conflict may also be solved.

16.**4** RELIEF AGAINST DOUBLE TAXATION

Relief from double taxation can be provided mainly in two ways

A) Bilateral relief

B) Unilateral relief.

BILATERAL RELIEF:

Under this method, the Governments of two countries can enter into an agreement to provide relief against double taxation by mutually working out the basis on which relief is to be granted. Bilateral relief may be granted in either one of the following methods:

(i) Exemption method:

By which a particular income is taxed in only one of the two countries Tax relief methods under which, an income is taxable in both countries in accordance with Under the exemption method, a State exempts from taxation certain items of income derived by its residents in another State. It may do so in accordance with its domestic legislation or by treaty. Domestic legislation typically would grant the exemption without reference to the State where the income is generated, whereas an exemption granted by treaty would be limited to treaty States. The typical effect of the exemption method is that the State where an item of income is generated, that is, the source State, has the exclusive right to tax that item of income. As a rule, exemptions granted to residents for foreign-source income are confined by statute or treaty to profits derived through foreign permanent establishments and income from real property situated abroad or wages earned abroad. The policy goal of this limitation is to confine the exemption to income that the source State would have jurisdiction to tax, although the source State may choose to exempt the income as an investment incentive[93].

(ii) **Credit Method**

The essential feature of the credit method, whether granted unilaterally or by bilateral tax treaty, is that the residence State treats a foreign income tax paid to the source State by its residents, within certain statutory limitations, as if it were an income tax paid to itself. When the foreign tax rate is lower than the domestic rate, only the excess of the domestic tax over the foreign tax is payable to the residence State. When the foreign tax is the higher one, the residence State does not collect any tax. The effective overall tax burden is the higher of the domestic tax or the foreign tax.

(iii)Tax sparing method

Tax-sparing credit is the practice of a residence State using the credit method of adjusting the taxation of its residents to permit those residents to receive the full benefits of tax concessions provided to them by a source State. It often takes the form of a credit (notional credit) for taxes that would have been paid but for a tax incentive. For example, assume that Company A, a corporation resident in State A, is investing and earning income in State B. State A and State B have entered into a tax-sharing agreement. Company A earns 100 in State B. Under their normal rules, State A and State B imposes taxes at a rate of 35 per cent. Thus, Company A normally would owe taxes of35 to State B. State B, however, has provided Company A with a tax holiday that reduces its taxes to zero. In the absence of the tax-sharing agreement, State A would impose a tax of 35 on Company A, thereby wiping out the benefit to Company A of the tax holiday. Under the tax-sparing agreement, State A may grant Company A a credit for the taxes that would have been paid (that have been spared) but for the tax holiday. In that way, Company A receives the intended benefits of the tax holiday[94].

[93]OECD, Harmful Tax Competition: An Emerging Global Issue (1998). OECD, Tax Sparing: A

Reconsideration (1998).

[94] OECD, Harmful Tax Competition: An Emerging Global Issue (1998). OECD, Tax Sparing: A

Reconsideration (1998).

UNILATERAL RELIEF

This method provides for relief of some kind by the home country where no mutual agreement has been entered into between the countries.

16.5. DOUBLE TAXATION AVOIDANCE AGREEMENTS: NON DISCRIMINATION IN TAX TREATIES

Double taxation is the systematic imposition of two or more taxes on the same income (in the case of income taxes), asset (in the case of capital taxes), or financial transaction (in the case of sales taxes). It refers to taxation by two or more countries of the same income, asset or transaction, for example, income paid by an entity of one country to a resident of a different country. The double liability is often mitigated by tax treaties between countries. Therefore, double taxation can be defined as the levy of taxes on income / capital in the hands of the same tax payer in more than one country in respect of the same income or capital for the same period. The problem gets complicated since taxation schemes of different countries contain divergent notions regarding definition of income as source

To avoid such a hardship to individuals and also with a view to seeing that national economic growth does not suffer, Double Taxation Avoidance Agreements (D.T.A.A.)[95] is entered into with other countries. Such tax treaties, therefore, serve the purpose of providing full protection to tax payers against double taxation and thus prevent the discouragement which double taxation may provide in the free flow of international trade and international investment. Besides, such treaties generally contain provisions for mutual exchange of information and for reducing litigation.

Therefore, the need for Agreement for Double Tax Avoidance arises because of conflicting rules in two different countries regarding chargeability of income based on receipt and accrual, residential status etc. As there is no clear definition of income and taxability thereof, which is accepted internationally, an income may become liable to tax in two countries. In such a case, the two countries have an Agreement for Double Tax Avoidance, in which case the possibilities are:

1. The income is taxed only in one country.
2. The income is exempt in both countries.
3. The income is taxed in both countries, but credit for tax paid in one country is given against tax payable in the other country.

[95] RajkumarAdukia "Double Taxation Avoidance Agreement and Taxation"

OBJECTIVES OF DTAA:

1. Protection against double taxation: These Tax Treaties serve the purpose of providing protection to tax-payers against double taxation and thus preventing any discouragement which the double taxation may otherwise promote in the free flow of international trade, international investment and international transfer of technology;
2. Prevention of discrimination at international context: These treaties aim at Preventing discrimination between the taxpayers in the international field and providing a reasonable element of legal and fiscal certainty within a legal framework;
3. Mutual exchange of information: In addition, such treaties contain provisions for mutual exchange of information and for reducing litigation by providing for mutual assistance procedure;
4. Legal and fiscal certainty: They provide a reasonable element of legal and fiscal certainty within a legal framework.

16.6. DOUBLE TAXATION AVOIDANCE AGREEMENT (DTAA) IN INDIA

The Indian Income Tax Act, 1961 administrate the taxation of income accrued in India. As per Section 5 of the Income Tax Act, 1961 residents of India are liable to tax on their global income and non-residents are taxed only on income that has its source in India.[96] India: (a) has a network of 77 comprehensive DTAAs, the oldest, with Greece, signed in 1965; (b) is also reported to be in the process of negotiating another 12 treaties with autonomous territories; and (c) is also signatory to the 2005 multilateral SAARC avoidance of double tax convention and some other bilateral treaties which, however, are not comprehensive.

A typical DTA Agreement[97] between India and another country usually covers persons, who are residents of India or the other contracting country, which has entered into the agreement with India. A person, who is not resident either of Indicator of the other contracting country, would not be entitled to benefits under DTA Agreements. International double taxation has adverse effects on the trade and services and on movement of capital and people. Taxation of the same income by two or more countries would constitute a prohibitive burden on the tax-payer. The domestic laws of most countries, including India, mitigate this difficulty by affording unilateral relief in respect of such doubly taxed income (Section 91 of the Income Tax Act). But as this is not a satisfactory solution in view of the divergence in the

[96]D.P.MittalI"IndianDoubl Taxation and Agreements and Tax Laws" p. 453
[97]VinodSinghania and Monica Singhania "Corporate Tax Planning and Business Tax Procedure" 205(Taxman 11thEdition 2010)

rules for determining sources of income in various countries, the tax treaties try to remove tax obstacles that inhibit trade and services and movement of capital and persons between the countries concerned. It helps in improving the general investment climate.

The need for Agreement for Double Tax Avoidance arises because of conflicting rules in two different countries regarding chargeability of income based on receipt and accrual, residential status etc. As there is no clear definition of income and taxability thereof, which is accepted internationally, an income may become liable to tax in two countries. Double taxation occurs when an individual is required to pay two or more taxes for the same income, asset, or financial transaction indifferent countries. Double taxation occurs mainly due to overlapping tax laws and regulations of the countries where an individual operates his business.

In India, Under Section 90 and 91 of the Income Tax Act, relief against double taxation is provided in two ways:

1) UNILATERAL RELIEF

Under Section 91, an individual can be relieved from double taxation by Indian Government irrespective of whether there is a DTAA between India and the other country concerned. Unilateral relief to a tax payer may be offered if:

- The person or company has been a resident of India in the previous year.
- In India and in another country with which there is no tax treaty, the income should have been taxed. The tax has been paid by the person or company under the laws of the foreign country in question.

2) BILATERAL RELIEF

Under Section 90, the Indian government offers protection against double taxation by entering into a DTAA with another

Country, based on mutually acceptable terms. Such relief may be asked under two methods

a) EXEMPTION METHOD: This ensures complete avoidance of tax overlapping.

b) TAX CREDIT METHOD This provides relief by giving the tax payer a deduction from the tax payable in India.

16.7 SUMMARY

- Double Taxation Avoidance Agreements are evidently an interaction of two tax systems each belonging to different country, which aim to mitigate the effect of double taxation.

- Double taxation is still one of the major obstacles to the development of inter-country economic relations.
- Every country seeks to tax the income generated within its territory on the basis of one or more connecting factors.
- By means of Double Taxation Avoidance Agreements, each country accommodates the claims of other nations within their fiscal arena to develop international trade and investments with minimal barriers.

16.8 KEY WORDS

- Double Taxation
- Legal and fiscal certainty
- Exemption

16.9 SELF ASSESSMENT QUESTIONS

1. What is Double Taxation? Why does it occur?

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2. What are the Reliefs against Double Taxation?

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3. Write a note on Double Taxation Avoidance Agreements in India.

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4. Write a note on Non-Discrimination in Tax Treaties.

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UNIT – 17: TAX TREATIES – E-COMMERCE TAXATION IN TAX TREATIES – TREATY SHOPPING – MISUSE OF DTAAS IN TAX HEAVENS – TYPES OF TAX HAVEN COUNTRIES

Structure:

17.0 OBJECTIVES

- To introduce the concept of Tax Treaties
- To deal with the International Measures taken in respect of Taxing of E-Commerce
- To provide insight into the concept of Tax Havens and the misuse of DTAA in Tax Havens
- To understand the aspect of Treaty Shopping

17.1 INTRODUCTION

Tax treaties are a species of an international treaty and as such, governed by the principles of international law of treaties. Treaties enable subjects of international law to supplement the rudimentary rules of international customary law and the general principles of law recognized by civilized nations "by more precise and concrete optional principles and standards"[98] Treaties, like contracts, create rights and obligations between the Contracting States. It should be pointed out that treaties only apply to the States that are party to them. In other words, treaties cannot create rights or obligations for a third party without its consent.

17.2 TAX TREATIES

Tax treaties are international agreements which attempt to harmonize the conflicts arising from the assertion of overlapping tax jurisdiction by more than one State.[99] Tax treaties are not conflict rules as understood in private international law in that they do not lay down norms for choosing between domestic and foreign law. Rather, they provide an independent mechanism for the avoidance of double taxation by coordinating the Contracting States' claims to a tax base; in other words, they lay down the boundaries of domestic taxation, without creating new taxing rights for governments.[100]

The status of tax treaties in various countries again differs. In some countries, treaties are of equal status with any other law. This is usually the case with countries in which treaties need to be formally incorporated. After such incorporation, tax treaties attain equal status with other law and can be overridden by subsequent law. In other countries, treaties may be given special status and therefore cannot be overridden by domestic legislation.

- **E-Commerce Taxation**

Tax systems, and particularly international taxation arrangements, can struggle to keep pace with globalization and market liberalization. Most of today's tax arrangements were

[98] Schwarzenberger, Georg, International law (London: Stevens & Sons Limited, 1957,3 `d edn.), p-422-423.
[99] Seligman, Edwin R. A., Double Taxation and International Fiscal Cooperation (NY: The Macmillan Company, 1929), p-2-3.
[100] Christiana Hjipanayi, 'Double Taxation, Tax Treaties, Treaty-Shopping And The European Community', Thesis submitted to the Department of Law, London School of Economics, UK, August 2006

developed in an era when tax authorities could rely upon Exchange controls, highly regulated capital markets and technological constraints to protect them from the negative fiscal effects of global activities. These barriers to cross-border activities protected tax authorities from the full implications of the interaction between national tax systems. While corporations globalized, tax authorities remained constrained by national frontiers.[101]

The OECD has established 5 Technical Assistance Groups (TAGs) to analyse the problems and propose technological and legal solutions. The work carried out has focused upon three major areas:

- International direct tax issues
- Consumption Taxes
- Tax administration issues

The Technical Advisory Group on Treaty Characterization Issues was set up by the OECD Committee on Fiscal Affairs in January 1999, with the general mandate to "to examine the characterization of various types of electronic commerce payments under tax conventions with a view to provide the necessary clarifications in the commentary".

Under the rules of tax treaties, liability to a country’s tax first depends on whether or not the taxpayer that derives the relevant income is a resident of that country. Any resident taxpayer may be taxed on its business profits wherever arising (subject to the requirement that the residence country eliminate residence-source double taxation) whilst, as a general rule, non-resident taxpayers may only be taxed on their business profits to the extent that these are attributable to a permanent establishment situated in the country.

The OECD Treaty provides for taxation on the basis of the test of Residence and That of the Source of Income, with the provision that the onus to r

17.3 TAX HAVENS

With the rising influence of the Globalisation and the ratification of Trade-Related Treaties such as those of the World Trade Organisation, there has been a rise in issues such as those of Transfer Pricing, Tax Havens, Double Taxation, etc. It has become imperative that these issues are to be dealt with in brevity while discussing the taxation aspects.

The OECD defines the term “tax haven” as a jurisdiction without: taxes, transparency in relation to tax information, the exchange of tax-related information and “real business activity.” The concept of Tax Havens has emerged in the global scenario as a result of the competition among various governments of the world to lure more investments from abroad. A Tax Haven is a place wherein there are no taxes collected in respect of income, or that the

[101] Jeffrey Owens: “Taxation in a global environment”, March 2002. The OECD Observer.

taxes are collected at a low or nominal rate. Individuals or corporate entities try to move to such jurisdictions so as to reduce their overall tax liability in respect of income and other transactions. Several countries have adopted diverse tax structures for its various customers. This concept adversely affects the revenue of the country from wherein the Corporations transfer their operations to the Tax Haven places.

A Tax Haven may, in general, have the following specific features or characteristics[102]:

i. Nil or Nominal Rate of Taxes
ii. Minimal or No Regulatory supervision of financial transactions by the Government
iii. The Role of the Government facilitates the Corporations to carry out operations without strict compliance of rules and procedures.
iv. Lack of Transparency in respect to the Tax Regime.

17.3.1. <u>Types Of Tax Havens</u>

- **No-Tax Havens**

  These kind of Tax Havens do not tax either of the sources of income, viz. Salary, Capital Gains, Dividends, Profits and Gains and Income from Other Sources. The governments if these countries do earn some revenue from the corporations; "no-tax" means that what you pay is independent of the income derived trough a company. These states may impose small fees on documents of incorporation, a small charge on the value of corporate shares, annual registration fees, etc. Primary examples of a No-Tax Haven are Bermuda, Bahamas, and Cayman Islands.

- **No-Tax-on-Foreign-Income Havens**

  This type of Tax Havens imposes income taxes, both on individuals and corporations, but only on locally derived income. They exempt from taxes any such income that is earned from foreign sources that does not involve local business activities apart from simple "housekeeping" matters. For example, in such a haven there is often no tax on income derived from export or local manufactured goods.

  These type of tax havens are of two kinds, viz. those that allow a corporation to do business both internally and externally, taxing only the income coming from internal sources, and those that require a company to decide at the time of incorporation whether it will be one allowed to do local business, with the consequent tax liabilities, or one permitted to do only foreign business and thus be exempt from taxation.

[102] Organization for Economic Development and Cooperation, Harmful Tax Competition: An Emerging Global Issue, 1998, p. 23.

Primary examples in these two sub-categories are Panama, Jersey, Guernsey, Isle of Man and Gibraltar.

- **Low-Tax Havens**

  This type of Tax Havens, impose minimal or Nominal taxes on all corporate income, wherever earned. However, most have double-taxation agreements many the high-tax countries that may reduce the withholding tax imposed on income derived from the high-tax countries by local corporations. Cyprus is a primary example. The British Virgin Islands is another, but no longer has a tax treaty with the U.S.

- **Special Tax Havens**

  This type of Tax Haven impose all or most of the usual taxes, but allow for special concessions or deduction to special types of companies (such as a total exemption from tax on shipping companies, or movie production companies) or allow very special flexible corporate arrangements, such as those offered by Liechtenstein.

17.3.2. <u>Misuse Of DTAA By Tax Havens</u>

The evolution of tax treaties was guided by the self interest of nations to promote free trade. In the matter of fiscal laws every country guided by its own interest, economic programmes and policies, there being no governing rule in international law to affect fiscal laws which are essentially within the sovereignty of each nation.

The International community has attempted to develop uniform principles of international taxation of which the Double Tax Avoidance Agreements are at the pedestal. However, the good intentions of nations to promote freer flow of international trade through DTA Agreements were being exploited by transnational corporations to further their own economic ends. The Double Tax Avoidance initiatives of countries were not meant to forego taxation by giving up the revenue jurisdiction, but only to avoid excessive taxation and mitigate the rigours of double taxation. This good intention has often been exploited by MNCs to practice a scheme which lead to avoidance of taxation, aided and abated by tax haven countries who in violation of fiscal norms apply unduly low taxes to attract flow of capital, thus permitting or encouraging tax avoided in other countries. Most Developing countries are caught in a clench, on the one hand, they are forced to lower corporate tax rates to attract investment and on the other, despite giving up revenue, the MNCs are resorting to tax schemes to avoid even these lower rates of tax by exploiting the DTA treaties between countries. India has suffered this kind of abuse first hand, especially in the case of the "Mauritius Route".

Most companies by establishing subsidiaries in the territory of a party to the DTA Agreement try to exploit the favourable tax treatment under the DTA Agreement to channel investments into the other party to the same DTA Agreement. Thus a Company which is not entitled to the favourable treatment of the" DTA Agreement seeks to exploit loopholes under the DTA Agreement regime of a country to save tax.

Double Tax Avoidance Agreements provide for reduction in the ,overall taxation by avoiding taxation twice on the same income, these agreements are handy for MNCs to route their profits through low tax jurisdictions which have signed DTA Agreements with high tax jurisdictions. There are two such methods - Profit Diversion and Profit Extraction.

- **Profit Diversion**

  Under this method the Profits of a company are diverted away from high tax jurisdictions into the tax haven, thereby taxed at very low rates by means of exploiting the DTA Treaty arrangements. Then later, the profits that are diverted are later brought into the home country as means of "Capital Investment", a non-taxable item; which in reality was the income earned by way of profit. Thus avoiding taxes.

- **Profit Extraction**

  A tax haven company renders services to a company in a high tax jurisdiction and "extract money from that subsidiary in terms of management consultancy fees, fee for licensing technology or royalties, all being grossly inflated so that effectively money is brought into the tax haven while the high tax jurisdiction subsidiary claims these fees as deductible expenses. If a DTA treaty is already in place it acts as a further bonus for the tax haven company.

It has therefore become imperative to take measures to combat tax avoidance through abuse of DTA treaties. Since Tax avoidance is ever on the increase, developing countries which are newly liberalising have to be careful about the effect of DTA treaties on their fiscal jurisdictions. The methods to prevent abuse of DTA treaties acquire added significance in the light of the Indian experience in the case of the Indo-Mauritius Double Tax Avoidance Treaty.

17.3.3. <u>Combat Of The Misuse Of DTAA</u>

The following modes are used in order to avoid the misuse of DTA Treaty provisions:

i. **Judicial Principles Of Anti-Tax Avoidance**

The decision rendered by Lord Templeman in Gaven v. White[103], a case decided by the House of Lords, the then Highest Court of England, is the best summarization of the judicial evolution of anti-tax avoidance principles. It provides for the following Principles/Rules:

1. Anti-tax avoidance principles apply where the tax payer plans an artificial scheme by combining a taxable transaction with a tax avoidance transaction whose sole purpose is avoidance of the assessment.

2. Further, four essential conditions have to be fulfilled where the tax avoidance transaction precedes taxable transaction:

   a. Tax payer must decide to carry out a scheme to avoid assessment of tax on an intended taxable transaction by combining with a prior tax avoidance transaction.

   b. Tax avoidance transaction must have no business purpose apart from the avoidance of the tax on the intended taxable transaction.

   c. After tax avoidance transaction has taken place, the tax payer must retain the power to carry out his part of the intended taxable transaction.

   d. The intended taxable transaction must take place.

ii. Statutorily Enacted Principles

Another effective method to combat misuse of DTA 'treaties would be to enact legislation which specifically' provide for anti- Tax avoidance Principles.

iii. Executive Review of DTA Treaties

It is submitted that only through continuous review by the Executive of DTA treaties in force can loopholes in and misuse of such treaties be detected in time. A continuous review, and renegotiation of treaties are very important if the Tax Department has to prevent abuse of Indian DTA Treaties.

iv. Interpretative Principles

Certain interpretative principles have to be evolved in order to prevent misutilisation of DTA treaties. Prominent among these are the 'Substance over Form' rule of interpretation. In essence, this rule is a method of anti-tax avoidance akin to the corporate law principle of lifting the Corporate veil. Here, while interpreting the treaty to decide, whether a particular corporation is eligible to claim benefits under the treaty, the fiscal implication of the transaction must be given more weightage over the legal form to prevent misuse of the DTA treaties.

[103] 1990 183 ITR 216 (H.L.)

17.4 TREATY SHOPPING

The expression treaty shopping is of American origin and it is closely related to the term forum shopping, a term used in U.S. civil procedure. Forum shopping describes a behaviour by which a party in a court case tries to “shop” into a jurisdiction or circuit where he expects a more favourable decision to be given. Treaty shopping is a typical example of tax avoidance or tax planning, it is a way of structuring commercial transactions in a manner designed to minimize the tax burden. However, a tax planning technique, for example treaty shopping, could be illegal anyway because the tax legislation in a country involved in the transaction does not allow the suggested transaction.

Treaty shopping is sometimes seen as abusive. This is made quite clear through the numerous legislative and political ways of hindering treaty abuse. Limits may be reached where transactions are entered, in other countries, solely for the purpose of enjoying the benefit of particular treaty rules existing between the Country involved and a third Country which otherwise would not be applicable, e.g. because the person claiming the benefit is not a resident of one of the contracting states.[104]

According to the OECD-written International Avoidance and Evasion, treaty shopping is defined as a procedure that leads to tax benefits in the source state. The tax benefits mainly consists of a reduction of the overall taxation effect achieved through a reduced tax rate regulated in the taxation treaties when it comes to payments of dividends, interests and royalties.[105] Treaty shopping is a way of using another state’s internal taxation system and/or their taxation treaties with a third state, in which an investment or business is to be made, in a way which leads to an advantageous taxation effect (compared with the effect not using the procedure).[106]

17.4.1. Modes of Treaty Shopping

Treaty shopping can be done in various ways. The most typical structure for a multinational group includes an intermediate holding company, acting as a link between the parent company located in a given country and the controlled companies operating in other countries. Often, an intermediate holding company is the body through which treaty shopping

[104] Nyberg, ‘Treaty shopping’, Master Thesis, Faculty Of Law, University of Lund, 2001
[105] Issues in International Taxation, No 1, International Tax Avoidance and Evasion, Four Related Studies, 1987.
[106] Sundgren, P.,”Treaty shopping”, (1992) Skattenytt 370 at 370.

is done and generally applicable in two forms, through Direct Conduit and Stepping Stone Conduit.[107]

- **Direct Conduit**

The direct conduit companies technique is used when two companies, in two different countries, intends to transfer income to each other, and there is an absence of a, for the purpose, "good" double taxation treaty between the states.[108]

This mode can be explained with the following example[109]:

A company has its residence in Country A (the residence Country). The company has developed a patent and wants to license it to a separate company situated in Country X (the source Country). Country A does not have a double taxation treaty with Country X. When the company in Country A receives payment for the royalty, a taxation effect occurs. Let us assume that the tax rates for received income on royalties are 30% - that is Country X taxes the company in Country A with a source tax of 30%.

To avoid this taxation at the source, the company in Country A transfers the patent to a wholly-owned company in Country B. This company license the patent to the company situated in country X. Country B has a double taxation convention with country X, where it states that royalty payments to companies in Country B are not taxed. The money can be transferred as dividends between Country B and Country A. It is of importance to see to that this procedure is tax free.

Through this direct conduit arrangement, money can be transferred almost tax-free to the company in Country A, instead of an executed source tax of 30%.

- **Stepping Stone Conduit**

In this situation Country B (the base/conduit/holding company Country) is a high tax country. The company in Country A (the residence Country) wants to give a loan to a company in Country X (the source Country). The source tax on interest to the lender situated in Country A is 30% in country X. Therefore the loan is mediated to Country B and from there lent to the company in Country X. This manner of transaction helps the Unit to actually avoid taxes on the rationale that the rate of taxes on loans is lesser than those by other means.

The essential difference between the direct conduit method and the stepping stone method is that the direct conduit method makes use of an exemption from tax in the

[107] Scarlata, G.F., Global Tax Planning and Offshore Opportunities, (Helsingborg, Comtax Publishing AB, 1995) at 90
[108] Ibid. 90
[109] Sundgren, P.,"Treaty shopping", (1992) Skattenytt at 371.

intermediary country, while the stepping stone method reduces a tax liability in that country by a counterbalancing expense.[110]

17.4.2. <u>Prevention of Treaty Shopping</u>

It is a well-established rule of conduct in tax law that taxpayers are free to arrange their economic affairs in the manner they deem to be the most beneficial for them. The fact a particular action has been taken for tax purposes cannot prevent the taxpayer in question of tax benefits to which they are otherwise entitled under the law.[111]

The ways to hinder treaty shopping are many. It could be done through legislative or political matters. One way is to bring into conformity different countries double taxation conventions, thereby trying to plug the loophole that arises when countries have different tax legislation. The OECD is one important forum where tax matters, such as harmful tax competition, are discussed.

- **The Need to prevent Treaty Shopping:**

Treaty shopping is, as tax planning in general, permitted in principle. However, as with all types of tax planning, there are borders which when crossed lead to transactions that are no longer acceptable.[112] Governments dislike treaty shopping for various reasons, some of them listed below:

i. Double taxation treaties are normally designed to relieve double taxation that would otherwise be suffered by residents of the contracting states. They are not intended to be used by residents of a third country. More exact, the source tax country loses tax because its rate of withholding tax is limited by operation of this treaty with the third country. The result is not intended, since the double taxation treaty should be used by the contracting countries.

ii. Treaty shopping encourages the use of transactions that have little or no economic substance. This can diminish taxpayers respect for the tax system.

iii. The possibility of treaty shopping makes the source country "worse off" when negotiating for tax benefits for its own residents from a foreign country. If treaty shopping is available, the other country may not be worried by high taxes imposed by

[110] Department of International Economic and Social Affairs, Contributions to international co-operation in tax matters (New York, United Nations, 1988) at 4.
[111] See, Vodafone International Holdings B.V. v. Union of India & Anr. [S.L.P. (C) No. 26529 of 2010]
[112] Vogel, K., Klaus Vogel on Double Taxation Conventions, 3 ed., (London, Kluwer Law International Ltd., 1997) at 119.

the first country. Therefore, the principle of reciprocity is breached and the balance of sacrifices is altered.[113]

- **The OECD and its model convention**

The Organisation for European Economic Co-operation (OECD) is an international organisation consisting of 30 member states. In 1956 the OECD started to work on a model convention in the double taxation area. This resulted in a ready convention 1963, and later, in 1977 and 1992, two updated editions with minor differences were published. The main purpose with the Model Convention is to create unitary tax legislation. Unitary tax legislation tends to plug unwanted loopholes, loopholes that one looks for when it comes to, for example, treaty shopping. The model convention is, as apparent from the name, non-binding; in other words it only constitutes a recommendation. [114] These suggestions were subsequently incorporated in the 1992 Commentary to Article 1 and updated in the 2003 Commentary following the 2002 OECD Report on Restricting the Entitlement to Treaty Benefits. The Model Treaty sets out the solutions, as suggested benchmarks that treaty negotiators might consider when searching for a solution to specific cases. These are THE BENEFICIAL OWNERSHIP APPROACH,[115] THE LOOK-THROUGH APPROACH,[116] THE CHANNEL APPROACH,[117] THE LIMITATION ON RESIDENCE APPROACH,[118] THE EXCLUSION APPROACH[119] AND THE SUBJECT-TO-TAX APPROACH.[120]

[113] Sundgren, P.,"Treaty shopping", (1992) Skattenytt at p- 374
[114] Pelin, L., International skatterätt ur ett svenskt perspektiv, 2nd ed. (Lund, Studentlitteratur, 2000), at 159
[115] The beneficial ownership provision which is found in Articles 10 to 12 of the OECD Model, precludes the extension of specific treaty benefits to entities which are not *beneficial owners* of the particular income, even if they are formal recipients of it. Neither the OECD Model nor its Commentary give a definition of the term 'beneficial owner'. However, a substance over form approach is preferred.
[116] "A company that is a resident of a Contracting State shall not be entitled to relief from taxation under this Convention with respect to any item of income, gains or profits if it is owned or controlled directly or through one or more companies, wherever resident, by persons who are not residents of a Contracting State."
[117] The channel approach, also called base erosion, seeks to catch intermediary entities whose tax base is eroded in favour of third country residents (usually controlling shareholders or associated persons) through the payment of interest or royalties or by the discharge of obligations. The typical wording of a channel clause reads as follows:
"Where income arising in a Contracting State is received by a company resident of the other Contracting State and one or more persons not resident in that other Contracting State:
(1) have directly or indirectly or through one or more companies, wherever resident, a substantial interest in such company, in the form of a participation or otherwise, and
(2) exercise directly or indirectly, alone or together, the management or control of such company, any provision of this Convention conferring an exemption from, or a reduction of, tax shall not apply if more than 50 per cent of such income is used to satisfy claims by such persons (including interest, royalties, development, advertising, initial and travel expenses, depreciation of any kind of business assets including those on immaterial goods, processes etc)."
[118] The limitation on residence features in Article 4 of the OECD Model. The Article reads as follows:
"[…] the term 'resident of a Contracting State' means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not

It is recommended in the OECD Commentary that all of the above approaches be accompanied by "specific provisions to ensure that treaty benefits will be granted in bona fide cases".

17.5 SUMMARY

- Tax treaties are a species of an international treaty and as such, governed by the principles of international law of treaties.
- The OECD has established 5 Technical Assistance Groups (TAGs) to analyse the problems and propose technological and legal solutions.
- Under the rules of tax treaties, liability to a country's tax first depends on whether or not the taxpayer that derives the relevant income is a resident of that country.
- The OECD defines the term "tax haven" as a jurisdiction without: taxes, transparency in relation to tax information, the exchange of tax-related information and "real business activity."
- The International community has attempted to develop uniform principles of international taxation of which the Double Tax Avoidance Agreements are at the pedestal. However, the good intentions of nations to promote freer flow of international trade through DTA Agreements were being exploited by transnational corporations to further their own economic ends.
- The expression treaty shopping is of American origin and it is closely related to the term forum shopping, a term used in U.S. civil procedure.
- Treaty shopping can be done in various ways.

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include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein."

[119] The exclusion approach denies treaty benefits to companies that are tax-exempt or nearly tax exempt. A typical clause would read as follows:
"No provision of the Convention conferring an exemption from, or reduction of, tax shall apply to income received or paid by a company as defined under section […] of […] the Act, or under any similar provision enacted by […] after signature of the Convention".

[120] General subject-to-tax provisions provide that source country treaty benefits are granted only if the respective income is subject to tax in the country of residence. The subject-to-tax approach, although similar to the exclusion approach, is not confined to tax-exemptions or reductions in the country of residence. The OECD Model suggests a more restrictive clause incorporating a safeguarding provision such as the following.
"Where income arising in a Contracting State is received by a company resident of the other Contracting State and one or more persons not resident in that other Contracting State:
(a) have directly or indirectly or through one or more companies, wherever resident, a substantial interest in such company, in the form of participation or otherwise, or
(b) exercise directly or indirectly, alone or together, the management or control of such company, any provision of this Convention conferring an exemption from, or a reduction of, tax shall apply only to income which is subject to tax in the last-mentioned State under the ordinary rules of its tax law". OECD Commentary, paragraph 15.

17.6 KEY WORDS

- Tax haven
- Treaty shopping
- Economic ends
- International trade
- Real Business Activity

17.7 SELF ASSESSMENT QUESTIONS

1. Write a note on Tax Havens. Are there different types of Tax Havens?

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2. Describe E-Commerce Taxation under Tax Treaties.

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3. What are the measures to combat misuse of Double Taxation Avoidance Agreement?

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4. Explain the various modes of Treaty Shopping.

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UNIT – 18: OECD AND UN MODELS OF TAX TREATIES – OECD GUIDELINES FOR CROSS-BORDER TAX DISPUTES – MUTUAL AGREEMENT PROCEDURE FOR RESOLVING TAX DISPUTES

Structure:

18.0 OBJECTIVES

- To study the OECD and UN Models of Tax Treaties
- To provides insight to the OECD Guidelines in Resolution of Cross Border Tax Disputes
- To study the characteristics of MAP

18.1 INTRODUCTION

International juridical double taxation – generally defined as the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods – has harmful effects on the international exchange of goods and services and cross-border movements of capital, technology and persons. In recognition of the need to remove this obstacle to the development of economic relations between countries, as well as of the importance of clarifying and standardising the fiscal situation of taxpayers who are engaged in activities in other countries, the OECD Model Tax Convention on Income and on Capital provides a means to settle on a uniform basis the most common problems that arise in the field of international juridical double taxation. The OECD Model requires constant review to address the new tax issues that arise in connection with the evolution of the global economy. Working Party No. 1 of the OECD's Committee on Fiscal Affairs meets this need and its work results in regular changes to the Model. Updates were published in 1994, 1995, 1997, 2000, 2003, 2005, 2008, 2010 and 2014.

Beginning with the 1997 update, the Model was presented in two volumes. Volume I includes the Introduction and the text of the Articles of the Model and their Commentaries. Volume II includes a section on the positions of non-member countries, reprints of previous reports dealing with tax conventions that the Committee on Fiscal Affairs has adopted since 1977, the list of tax conventions concluded between member countries and the text of the Council Recommendation on the Model Tax Convention. A condensed version of the Model, which includes only the Introduction, the text of the Articles of the Model, their Commentaries and the positions of non-member countries is also available.

18.2 ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT

The Organisation for European Economic Cooperation (OEEC) was established in 1948 to run the US-financed Marshall Plan for reconstruction of a continent ravaged by war. By making individual governments recognise the interdependence of their economies, it paved the way for a new era of cooperation that was to change the face of Europe. Encouraged by its success and the prospect of carrying its work forward on a global stage, Canada and the US joined OEEC members in signing the new OECD Convention on 14

December 1960. The Organisation for Economic Co-operation and Development (OECD) was officially born on 30 September 1961, when the Convention entered into force. Today, 34 OECD member countries worldwide regularly turn to one another to identify problems, discuss and analyse them, and promote policies to solve them.

18.3 UNITED NATIONS

The United Nations [UN] is an international organization founded in 1945 after the Second World War by 51 countries committed to maintaining international peace and security, developing friendly relations among nations and promoting social progress, better living standards and human rights. The UN has 4 main purposes:

- To keep peace throughout the world;
- To develop friendly relations among nations;
- To help nations work together to improve the lives of poor people, to conquer hunger, disease and illiteracy, and to encourage respect for each other's rights and freedoms;
- To be a centre for harmonizing the actions of nations to achieve these goals.

18.4 UN AND OECD MODELS OF DOUBLE TAX AVOIDANCE AGREEMENTS

Both the U.N, model and the OECD model drafts on the double tax avoidance agreements came out within a span of three years. It is mainly due to such concurrent efforts that the drafts are similar in many respects. An examination of both the drafts would lead one to conclude that in certain respects the U.N, model is an improvement over the OECD draft as it was of later origin. Most of the agreements for double tax avoidances concluded by India are based on the U.N, model. This is especially so regarding the agreements entered into in the 1980s. [Treaties entered into with Netherland (1989) U.K. (1981) Korea (1986) and Romania (1988) are some examples).

The basic approach of these models was to work out a draft with maximum flexibility and whenever uniformity was not possible, to leave scope for a different set of arrangements to be adopted by the concerned countries while actual negotiations for individual treaties are in progress. The double tax avoidance agreements normally apply to the residents of one or both of the contracting States. Where provisions of non discrimination are concerned as regards taxation the provisions of the agreement not only apply to persons to either or both of the contracting States but also to persons who are not residents of one or both the contracting States [Article 24(1) of the U.N. Convention and the OECD Convention). Let us now examine the concept of resident under the model drafts.

- **Concept of "Resident"**

The concept of resident is a wider than the traditional concept of citizen. Article 4 of both the UN and the OECD model takes into account the varying concepts of "residence" contained in the domestic laws of contracting States. A resident of a contracting State is a person who is liable to tax not only by reason of his residence but also on account of his domicile, place of management of a company or other similar criterion which cover individuals and companies in various forms of personal attachment to a State as per the scheme of their domestic laws. However confusion may arise when persons are equally attached with more than one State by either of the criterion. This happens not only in business and professions but also in case of trans-border movements. In such cases it may become difficult to determine taxability on the basis of residence and it becomes essential to avoid the confusion of double taxability.

The Model Conventions have accordingly determined criteria for both individual and other legal entities. [Article 4(2) & (3) of the U.N, and OECD Models] In the case of individuals the criteria are (i) permanent home (ii) centre of vital interest (iii) habitual abode and (iv) nationality in decreasing order of relevance. For corporations, it is the place of effective management which determines the residential status.

- **Permanent Establishment**

All tax treaties provide that an enterprise of one State is taxable in the other State only if it maintains a permanent establishment in the other state and only to the extent that the profits named by the enterprise in that State or attributable to the permanent establishment. This principle frees casual or stray business transactions from taxation in the source country.[121]

The OECD model made an improvement on these models and introduced the concept of "fixed base" used in case of professional services or other activities of an independent character. The permanent establishment is established at a distinct place with a certain degree of permanence. The important point to note is that the establishment must have a productive character, i.e., contribute to the profits of the Corporation. A permanent establishment begins to exit as soon as the enterprise commences to carry on its business through a fixed base. The period of time during which the fixed base of business is being set up by the enterprise should not be counted, provided that this activity differs substantially from the activity for which the place of business is to serve permanently.

There are some differences between the U.N, and the OECD models regarding the concept of permanent establishment. In fact, the UN model is an improvement on the concept

[121] Srinivasan K.. Guide to Double Taxation Avoidance (1993), p-181.

of permanent establishment as mentioned in the OECD model. The U.N, model therefore encompasses a wider area, e.g, merchandising on behalf of the enterprise is also covered. [Article 5(5)(a)(b) of the UN model]

Similarly in the UN model, any person working as a broker general commission agent or any other agent of independent status and devoting himself wholly or almost wholly on behalf of the enterprise is considered as working as a permanent Establishment for such foreign enterprise provided that he meets an other' criteria stipulated in Article 5 of the UN model. It was also stated in the UN model that in order to constitute a permanent establishment the agent working wholly or almost wholly must have been so working by virtue of an agreement. However it has been clarified that a subsidiary company of a foreign company does not constitute a permanent establishment of a foreign parent company. [Article 5(8) of the U.N. model]

- **Profit From Business**

The most relevant question in intentional tax practice concerning business profit relates to the fact that what makes an enterprise liable to taxation on its profits in a foreign country. The UN model draft has followed the so called "arms length" rule stipulated in Article 7 of the OECD model, according to which profits attributable to a permanent establishment are those which could be earned by the establishment if it were a wholly independent entity.

The U.N, model goes further regarding the business profits of a Permanent Establishment. Due to persistent insistence by developing nations for a force of attraction rule the UN model makes a limited extension. The principle adopted in the UN models was, if an enterprise has a permanent establishment (P.E) in the other country (contracting State) for the purpose of selling goods or merchandise, sales of the same or similar kind may be taxed in that State even if they are not conducted through the permanent establishment. A similar rule will apply if the P.E, is used for other business activities and the same or similar activities are performed without any connection with the P.E. [Article 7 of the U.N model].

18.5 OECD GUIDELINES FOR CROSS-BORDER TAX DISPUTES

International tax disputes arise in two general contexts. The first is probably the most common dispute and involves a taxpayer or taxpayers on one side and the government or governments on the other side. In these disputes, the government typically claims taxes are owed and the taxpayer resists the imposition of taxes. The second type of dispute involves two or more government arguing over the allocation of tax revenues derived from trade and investment transactions between their territories.

An arbitration provision with a broader scope now is included in Article 25 of the 2008 OECD Model Income Tax Convention. Under Article 25(5), if the competent authorities fail to resolve a controversy submitted to them within two years, any unresolved issues must be submitted to arbitration if the taxpayers request it. Recent amendments to bilateral tax treaties also contain arbitration provisions for resolving tax disputes. Many of these various arbitration regimes are discussed in greater detail in the next part of this paper.

18.5.1. Mutual Agreement Procedure For Resolving Tax Disputes

The 2008 OECD Model Income Tax Convention is the latest version of the OECD models. Paragraphs 1 through 4 of Article 25 of that model contain the traditional MAP as discussed above. Article 25, Paragraph 5 added arbitration as a new element to the MAP in the 2008 Model. Under Article 25(5), if the competent authorities are unable to reach an agreement to resolve the complaint within two years after it is submitted to them, any unresolved issues are to be submitted to arbitration if the complainant so requests. The complainant requesting the arbitration can make written submissions during the arbitration process and, with the assent of the arbitrators, present his case orally during the arbitration proceedings.[122] The arbitration decision is binding on the competent authorities, although the complainant can refuse to accept the decision and litigate the issue on local courts. The arbitrators are treated as the authorized representatives of the competent authorities and are subject to the same strict confidentiality requirements as the competent authorities.[123] The arbitration decision may be published, but only with the consent of both competent authorities and the complainant. Even then, only the basic elements of the decision should be published and the name of the complainant should not be disclosed.[124]

Among the key features of the arbitration provisions in the 2008 OECD Model Income Tax Convention are the following:

- As under the traditional MAP, the competent authorities are only obligated to accept a complaint if they determine that the complaint is "well founded".[125] It has been suggested that in some jurisdictions the decision of the competent authority to accept or reject a complaint may be subject to judicial review, with the standard of review similar to that applied to administrative decisions generally.[126]

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[122]OECD, The 2008 Update to the OECD Model Convention at p. 99.
[123]OECD, The 2008 Update to the OECD Model Convention at p. 99Update at p. 105.
[124] Update at p. 108-9.
[125]Id Article 6(2).
[126] Y. Hadari, Compulsory Arbitration in International Transfer Pricing and Other Double Taxation Disputes, at http://ssrn.com/abstract=1483621 (visited 27 October, 2009).Compulsory Arbitration in International Transfer

- MAP Arbitration is generally available for any tax disputes that involve the underlying tax treaty; it is not limited to the resolution of transfer pricing disputes as under the EU Arbitration Convention.
- The complainant requesting the arbitration can make written submissions during the arbitration process and, with the assent of the arbitrators, present his case orally during the arbitration proceedings.[127]
- The arbitration process is an integral part of the MAP. As a result, arbitration only is available when the competent authorities have left unresolved issues. If the competent authorities have agreed on all of the issues, arbitration is not allowed even if taxpayer disagrees with the decision.[128]
- The OECD Model arbitration agreement takes as the starting point the independent opinion approach to deciding a case. The OECD recognizes, however, that use of other methods, such as the last best offer method, may be suitable in some circumstances.[129]
- The arbitration decision is binding on the competent authorities, but apparently not on the taxpayer who can decline to accept the arbitration decision and pursue the dispute in domestic courts.[130]
- The costs of the arbitration process are borne by the competent authorities, although any expenses incurred by the complainant in making written submissions or oral presentations should be borne by the complainant.
- Although an arbitration decisions under Article 25(5) is not intended to serve as formal precedent, the OECD has recognized that having the decision available to the public would make the process more transparent and it might influence the course of subsequent disputes and it could contribute to greater uniformity of tax law administration. As a consequence, arbitration decisions under Article 25(5) may be published, but only if the complainant agrees. In addition, if the decision is published, it should be done in such a fashion as to maintain the confidentiality of the complainant.

Pricing and Other Double Taxation Disputes, at http://ssrn.com/abstract=1483621 (visited 27 October, 2009) at p. 7.

[127]OECD, The 2008 Update to the OECD Model Convention atOECD, The 2008 Update to the OECD Model Tax Convention, at p. 99, available at http://www.oecd.org/dataoecd/20/34/41032078.pdf (last visited Oct. 20, 2011) p. 99.

[128] Commentary to the 2008 OECD Model Income Tax Treaty at p. 373.

[129] at p. 102.

[130] Article 25(5 of the 2008 OECD Model Income Tax Treaty.

18.6 SUMMARY

- The Organisation for Economic Co-operation and Development (OECD) was officially born on 30 September 1961, when the Convention entered into force.
- The United Nations[UN] is an international organization founded in 1945 after the Second World War by 51 countries committed to maintaining international peace and security, developing friendly relations among nations and promoting social progress, better living standards and human rights.
- The basic approach of these models was to work out a draft with maximum flexibility and whenever uniformity was not possible, to leave scope for a different set of arrangements to be adopted by the concerned countries while actual negotiations for individual treaties are in progress.
- International tax disputes arise in two general contexts.
- An arbitration provision with a broader scope now is included in Article 25 of the 2008 OECD Model Income Tax Convention.
- Under Article 25(5), if the competent authorities are unable to reach an agreement to resolve the complaint within two years after it is submitted to them, any unresolved issues are to be submitted to arbitration if the complainant so requests.

18.7 KEY WORDS

- Agreement
- Arbitration
- International tax
- Organisation
- Convention

18.8 SELF ASSESSMENT QUESTIONS

1. Write a note on the UN and OECD Model Tax Treaty.

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2. What are the salient features of MAP under the OECD Guidelines?

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UNIT – 19: TAX PLANNING AND MANAGEMENT – TYPES OF TAX PLANNING – FACTORS TO BE CONSIDERED FOR TAX PLANNING - SETTING NEW BUSINESS- BUSINESS TAX HOLIDAYS

Structure:

19.0 OBJECTIVES

- To introduce the Concept of Tax Planning and distinguishing from Tax Avoidance and Tax Evasion
- To understand the factors that affect Tax Planning
- To deal with the Taxation Aspects of Setting up of New Business

19.1 INTRODUCTION

Tax management is a complex and risky undertaking at the best of times, but these days businesses also have to contend with economic uncertainty and ever-growing regulatory oversight. Making sure that you have the right people in place—and are employing the efficient processes and up-to-date technologies—to effectively manage you tax obligations is not easy, especially is tax management is not core business for your company. But which systems and procedures should you employ to deal effectively and efficiently with your company's tax commitments? Where do you begin? Most would say tax reduction. But, while tax reduction is a hot-button issue these days, boards are increasingly aware that it is an area with its own unique demands and risks. What's more, tax reduction means different things to different people—depending upon their responsibilities within a company; but one thing is certain—done correctly it can relieve the (sometimes) onerous financial burdens that can stymie a company's development. However, if you do business in Europe, you also have to adjust to the changes arising from changes in EU law. And these days it seems that a lot of people other than management—shareholders, business analysts, audit committees and other stakeholders—have some sort of stake in EU law-related risks and opportunities, e.g., "Did the company file claims based upon EU law?" "Did it meet all the statutory limitations for filing these?" "Should the company file its tax returns based upon EU law arguments?" Fortunately, at PricewaterhouseCoopers we can help you answer these (and a wide range of other tax-related) questions.

19.2 TAX PLANNING

Tax planning is an exercise undertaken to minimize the tax liability of persons liable to pay taxes, through the utilisation of all the available deductions, allowances, exclusions and rebates. The Supreme Court has observed in McDowell & Co. v. CTO[131] that observed that "tax planning may be legitimate provided it is within the framework of the law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by resorting to dubious methods"

[131] (1985) 154 ITR 148

Tax planning is not to be undertaken with intent to defraud the revenue. It may so happen that although the transactions entered into by an assessee could be legal, yet on the whole these transactions may be devised to defraud the revenue. All such devices where statute is followed in strict words but actually spirit behind the statute is marred would be termed as colourable devices and they do not form part of tax planning. All transactions in respect of tax planning must to be in accordance with the true spirit of statute and should be correct in form and substance.

The form and substance of a transaction is real test of any tax-planning mechanism. The form of transaction refers to the transaction, as it appears superficially and the real intention behind such transaction may remain concealed. Substance of a transaction refers to lifting the veil of legal documents and ascertaining the true intention of parties behind the transaction.

19.2.1. <u>Tax Evasion And Tax Avoidance: Distinguished</u>

Tax Evasion refers to a situation where a person tries to reduce his tax liability by deliberately suppressing the receipt of income or by inflating the expenditures so incurred by him, thereby showing the income earned to be lower than the actual income and resorting to various types of deliberate manipulations. Tax Evasion is per se illegal and is punishable under the relevant laws. It is a dubious way of attempting to receive tax gains and benefits, when not entitled to claim the benefit by bonafide means. A tax evader has to pay not only penalty but he also incurs the risk of being prosecuted. Tax evasion can never be construed as tax planning because it amounts to breaking of law whereas tax planning is devised within the legal framework by availing of what the legislature provides. Tax planning ensures not only accrual of tax benefits within the legal framework and at the same time, it ensures that tax obligations are properly discharged so as to prevent prosecution and penalty.

According to G.S.A. Wheat Craft, "tax avoidance is the act of dodging tax without actually breaking the law". The line of demarcation between tax planning and tax avoidance is very thin and blurred. There could be elements of malafide motive involved in tax avoidance also. It is usually done by adjusting the affairs in such a manner that there is no infringement of taxation laws and by taking full advantage of the loopholes therein so as to attract the least incidence of tax. Earlier tax avoidance was considered completely legitimate, but at present it may be illegitimate in certain situations. In the judgement of the Supreme Court in McDowell's case[132], tax avoidance has been considered as heinous as tax evasion

[132] 1985 (154 ITR 148) SC

and a crime against society. The categories of situations that fall under 'Tax avoidance' are those wherein the tax payer has apparently circumvented the law, without committing an offence, by the use of a scheme, so devised or arranged in a complex form, whose chief or sole purpose is to defer, reduce or completely avoid the tax payable under the law. In certain cases, the Tax Avoidance is done by means of shifting the liability to a person, who is not subject to the laws of taxation.[133]

Tax planning can neither be equated to tax evasion nor to tax avoidance with reference to a person, it is the scientific planning of the person's operations in such a way so as to attract minimum liability to tax or postponement or for that matter deferment of the tax liability for the subsequent period by availing various incentives, concessions, allowances, rebates and relief's provided for in the tax laws. They are meant to be availed of and they have certain clear objectives to achieve.

19.2.2. <u>Objectives of Tax Planning</u>

The key objectives of Tax Planning are to ensure the following:

i. **Reduction of tax liability**

   Tax Planning aims chiefly at the reduction of tax liability of the individual or the person carrying out such exercise. In this process, the tax payer makes use of those provisions of law that avail him of such benefit to reduce the liability towards taxes. For instance the use of the provisions under Chapter VI A to the Income Tax Act 1961, which contains the sums that can be deducted from the Taxable Income, subject to an overall limit of the total tax due by the person.

ii. **Minimisation of litigation**

   It may so happen that in a bid to reduce or refrain from payment of taxes the person so liable to taxes may resort to Tax Evasion or Tax Avoidance, thereby giving rise to the chances of litigation or prosecution against him. Tax Planning, when implemented soundly, provides for a way to reduce the chances of such litigation and prosecution as the process is legitimate and legal.

iii. **Productive investment**

   The process of Tax Planning involves the Tax payer in channelising the investment in such a manner that it reduces the tax liability. Such channelization of investment usually has twin objectives, viz.:

   - to harness the resources for socially productive projects, and,

[133] See Block IV: Unit II; Section 2.1. Tax Havens.

- to relieve the tax payer not only from the initial brunt of taxation, but also to convert the earnings so made into means of further earnings.

iv. Healthy growth of economy

A sound tax planning policy would not only benefit the person, as an individual, albeit, would contribute to the growth of the economy as a whole. As, the growth of the Economy is also concerned with the development and growth of the individuals comprised in it.

v. Economic stability

A sound Tax Planning, enables to avail avenues for productive investments by the tax payers and further allows for the harness of resources for national projects aimed at general prosperity of the national economy and reaping of benefits even by those not liable to pay tax on their incomes.[134]

19.2.3. Essential Characteristics Of Tax Planning

The following features are necessary for the formation of an effective Tax Planning Scheme:

i. **No Time lag between the Scheme and the Laws:**

A Tax Planning scheme must be based on the Relevant Laws, as revised from time to time. The Assesee must keep track of the circulars, notifications, clarifications and Administrative instructions issued by the CBDT from time to time. Further, the decisions of appropriate Tribunals must also be kept track of by the assessee.

ii. Transparency and Timely Disclosure

A Tax Planning Scheme and its necessary components have to be disclosed to the Income Tax Department. The law on disclosure contained under Section 271 of the Income tax Act, for instance, provides for a duty of disclosure, when breached or not performed, provides for the levy of penalty ranging from 100 to 300% of the amount of tax sought to be evaded.

iii. Consistency with Laws

The Tax Planning Scheme must not involve a transaction that is sought to be avoided by the law. For instance, sham transactions or colourable devices, which are entered into just with a view to circumvent the legal provisions, must be avoided. A genuine

[134] See, *M.V.Valliapan* v. *ITO,* (1988) 170 ITR 238 (Mad.).

tax-planning device, aimed at carrying out the rules of law and Court's decisions and to overcome heavy burden of taxation, is fully valid.[135]

iv. Foresight

A Tax Planning Strategy like all other concepts of Corporate Planning must have foresight and be amenable to its possible future changes.

19.2.4. Types of Tax Planning

i. Short-range planning & Long-range planning

Short-range planning refers to year to year planning to achieve some specific or limited objective. Whereas, Long-range tax planning, on the other hand, involves entering into activities, which may not pay-off immediately, but rather, give a pay out in the long run.

ii. Permissive tax planning

Permissive tax planning is tax planning under the express provisions of tax laws. Tax laws of our country offer many exemptions and incentives.

iii. Purposive tax planning

Purposive tax planning is based on the measures which circumvent the law. The permissive tax planning has the express sanction of the Statute while the purposive tax planning does not carry such sanction.

19.3 SETTING UP OF NEW BUSINESS

Setting up a business within the scope of the Income Tax Act has a correlation to the purpose of a Tax Planning strategy. The company incurs certain expenditure of revenue nature during the intervening period after setting up and before the commencement of business. It is a general rule under the tax laws that the general expenses prior to the date of setting up are inadmissible but those incurred from the date of setting up and before the commencement of the business may be allowed as deduction for tax purposes provided they are of revenue nature and are incurred wholly and exclusively for the purpose of business.

The Supreme Court in CIT v. Ramaraju Surgical Cotton Mills Ltd.[136] observed that, it is a settled principle that a business is set up as soon as it is ready to commence production and it is not necessary that the actual production should be so commenced.

In case of New Business Entities, it is advisable to maintain a separate Book of Account. In CIT v. Dunlop Rubber Co. (I) Ltd[137], the Supreme Court observed, where the Assessee had

[135] See, Vodafone International Holdings B.V. v. Union of India & Anr. [S.L.P. (C) No. 26529 of 2010, dated 20 January 2012]

[136] (1967) 63 ITR 478

not maintained a separate book of Accounts in respect of the new business, and claimed for deductions in respect of the incurred expenditure, that "it was the duty of the I.T.O. under Sections 143 to 145 of the Act, to determine the total income of the assessee and determine the tax payable, even if the income could not be derived from the books of the assessee. So, Income-tax Officer cannot deny the relief. Difficulty in computing the relief cannot be a ground for rejecting the claim. A rule of apportionment consistent with commercial accounting must be evolved in computing the income. If the assessee already followed certain system, which is in vogue in general, from a commercial accounting angle, and if the Income-tax Officer disputes such system he should correct it and cannot reject it as whole-sum. In this case it was held that the Income-tax Officer could not refuse the claim for exemption."

Similarly, in Textile Machinery Corporation Ltd. v. Commissioner of Income-tax[138], the Supreme Court observed that, although there are no separate book of accounts or that there was a common management in respect of two business entities would not lead to the conclusion that they are not Separate Undertakings. It further stated that the test is whether it is a new and identifiable undertaking separate and distinct from the existing business. It is sufficient if the new undertaking is an integrated unit by itself wherein articles are produced and a minimum of 10 persons are employed.

19.4 BUSINESS TAX HOLIDAYS

Tax incentives may be defined as any incentives that reduce the tax burden of enterprises in order to induce them to invest in particular projects or sectors. They are exceptions to the general tax regime. Tax incentives would include, for example, reduced tax rates on profits, tax holidays, accounting rules that allow accelerated depreciation and loss carry forwards for tax purposes, and reduced tariffs on imported equipment, components, and raw materials, or increased tariffs to protect the domestic market for import substituting investment projects.

Tax holidays are a common form of tax incentives used by developing countries and by countries with economies in transition so as to attract Foreign Direct Investment. The provisions may exempt firms from other tax liabilities as well. Tax holidays eliminate tax on net revenues from investment projects over the holiday period, which, depending on the case considered, tends to encourage investment. At the same time, tax holidays deny firms certain

[137] (1977) 107 ITR 182
[138] (1977) 108 ITR 195

tax deductions over the holiday period or indefinitely (e.g. depreciation costs and interest expense), tending to offset at least in part any stimulative effect.[139]

19.5 SUMMARY

- Tax planning is an exercise undertaken to minimize the tax liability of persons liable to pay taxes, through the utilisation of all the available deductions, allowances, exclusions and rebates.
- Tax Evasion is per se illegal and is punishable under the relevant laws.
- According to G.S.A. Wheat Craft, “tax avoidance is the act of dodging tax without actually breaking the law”.

19.6 SELF ASSESSMENT QUESTIONS

1. Write a note on Tax Planning.

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2. What are the objectives of Tax Planning?

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3. Distinguish Tax Planning from Tax Avoidance and Tax Evasion.

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4. What are the characteristics of Tax Planning?

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19.7 KEY WORDS

- Tax Planning
- Tax Evasion
- Tax Avoidance
- Dodging of tax

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UNIT – 20: TAX PLANNING IN RESPECT OF AMALGAMATION, MERGER, DEMERGER AND ACQUISITIONS – TAX PLANNING RELATING TO EMPLOYEE REMUNERATION

Structure:

20.0 OBJECTIVES

- To Study the Tax Concessions Available in Case of Corporate Restructuring Activities
- To provide insight to carrying out Tax Planning in Corporate Restructuring Activities
- To study manner of Tax Planning in case of Employee Remuneration

20.1 INTRODUCTION

Corporate restructuring is the process of redesigning one or more aspects of a company. The process of reorganizing a company may be implemented due to a number of different factors, such as positioning the company to be more competitive, survive a currently adverse economic climate, or poise the corporation to move in an entirely new direction. Here are some examples of why restructuring may take place and what it can mean for the company.

Restructuring a corporate entity is often a necessity when the company has grown to the point that the original structure can no longer efficiently manage the output and general interests of the company. For example, a corporate restructuring may call for spinning off some departments into subsidiaries as a means of creating a more effective management model as well as taking advantage of tax breaks that would allow the corporation to divert more revenue to the production process. In this scenario, the restructuring is seen as a positive sign of growth of the company and is often welcome by those who wish to see the corporation gain a larger market share.

20.2 CORPORATE RESTRUCTURING PROCESS

Companies often undertake Corporate Restructuring Activities to get the benefit of carry forward and set off of operating losses or tax credit. The condition insisted upon is that the acquirer should continue to operate the preacquisition business of the company. This will hold good even in respect of cross border amalgamation.

When the asset is acquired on amalgamation, the cost taken will have to be as that of the amalgamating company, as provided under Section 49(i) (iii) of the IT Tax Act. Whether the tax incentives that encourage merger activity are desirable or not, it is important to know what their impact is. The tax impact of properly structuring the disposition and acquisition of a company can have a very material impact on the economics of the transaction to both parties. , there are numerous tax planning opportunities that allow each party to obtain its specific tax and economic objectives without harming the other party. This part deals with the implications of tax on shareholders of amalgamating company, implications on amalgamating and amalgamated companies.[140]

- **Tax Concessions in case of Amalgamation[141]**

  The following tax concessions are available if an amalgamation satisfies the conditions of Section 2(1B) and the amalgamated company is an Indian company:

  1. Non-chargeability of capital gain on the transfer of a capital asset including shares held by a shareholder at the time of amalgamation[142]
  2. Eligibility of amalgamated company for the deduction in respect of any asset representing expenditure of a capital nature on scientific research,[143]
  3. Eligibility of the amalgamated company for the deduction in respect of acquisitions of patent rights or copy rights[144]
  4. Similar deduction in respect of expenditure on knowhow as provided in[145]
  5. Amortization of expenditure for obtaining telecom licence fees[146]
  6. Amortization of certain preliminary expenses[147]
  7. Amortization of expenditure on amalgamation.[148]
  8. Amortization of expenditure on prospecting etc. for certain minerals.[149]
  9. Writing off bad debts.[150]
  10. Deduction in respect of any expenditure for the purposes of promoting family planning[151]
  11. Computation of written down value of the transferred fixed assets in the case of amalgamated company.[152]
  12. Continuance of deduction available.[153]
  13. Benefit of carry forward and setoff of accumulated losses and unabsorbed depreciation[154]

[140] Kusum, Tax Implications On Mergers And Acquisitions Process, (JBM&SSR) Volume 3, No.5, May 2014,p 6274.
[141] See Block II; Unit V.
[142] Section 47(vi) and (vii) .
[143] Section 35(5).
[144] Section 35A(6).
[145] Section 35AB(3)
[146] Section 35ABB(6).
[147] Section 35D(5) read with rule 6AB
[148] Section 35DD
[149] Section 35E(7) read with Rule 6AB
[150] Section 36(1)(vii)
[151] Section 36(1)(ix).
[152] Explanation 2(b) to Section 43(6)
[153] Section 80IA and 80IB

Depending upon the business strategy, an entity may acquire

(a) The entire business, done by way of: Merger/Amalgamation or Share buyout

(b) A part of the business, being a unit or an undertaking, by way of Acquisition through a Demerger or Slump sale

The Act seeks to extend tax neutral treatment to transactions of mergers and demergers. The tax neutrality is subject to fulfillment of prescribed conditions under the Act. All Mergers are not treated as amalgamation as per Income tax Act. In order to be so, the:

(a) merger should be pursuant to a scheme of amalgamation.

(b) All the assets and liabilities of the amalgamating company should be included in the scheme of amalgamation.

In Central India Industries Limited v. CIT[155], it was laid down that amalgamation is an arrangement whereby the assets of two companies become vested in or, under the control of one company (which may or may not be any one of the original two companies), which has as its shareholders all, or substantially, all the shareholders of the two companies.

The tax impact of properly structuring the disposition and acquisition of a company can have a very material impact on the economics of the transaction to both parties. , there are numerous tax planning opportunities that allow each party to obtain its specific tax and economic objectives without harming the other party.

A Corporate Restructuring transaction presents a unique opportunity to implement tax planning and create substantial synergies which are unlikely to have been taken into account when evaluating the merger. These opportunities are therefore all upside. Similarly, if not planned and implemented properly, a merger can create huge costs which were also not planned.

Prior to formal deals, letters of intent or commencement of due diligence, corporate should have developed a tax strategy that meets deal objectives. This strategy should include an identification of alternative structures and a high level understanding of potential tax issues and opportunities. The Indian corporate sector has also accelerated the trend of M&A for repositioning to seize the opportunities and meet the challenges in the emerging scenario. The underlying object of corporate restructuring is efficient and competitive business operations by increasing the market share, brand power and operational synergy. Indian companies are gearing up for global size operations.‘ `Size of a company‘has acquired central

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[154] Section 72A

[155] (1975) 99 ITR 211

place as a strategy of survival and growth in the competitive economy. There is no reason why the company and I-T laws should not be harmonized. M&A will be easier if the time-consuming processes under company law, like approaching the Company Law Board and the High Courts for approval, are either eliminated or made less cumbersome than at present. The direct tax code (DTC) seeks to simplify and rationalize the scheme of taxation with respect to amalgamations, demergers and other forms of business reorganizations as also the sale of businesses.[156]

20.2.1. <u>Tax Concession to The Amalgamated Company</u>

If the amalgamating company has incurred any expenditure eligible for deduction under sections 35(5), 35A(6),35AB(3), 35ABB, 35D, 35DD, 35DDA, 35E and/or 36(1)(ix), prior to its amalgamation with the amalgamated company as per section 2(1B) of the Act and if the amalgamated company is an Indian company, then the benefit of the aforesaid sections shall be available to the amalgamated company, in the manner it would be available to the amalgamating company had there been no amalgamation. Also under section 72A of the Act, the amalgamated company is entitled to carry forward the unabsorbed depreciation and unabsorbed accumulated business losses of the amalgamating company provided certain conditions are fulfilled.[157]

20.2.2. <u>Tax Concessions To The Amalgamating Company</u>

Any transfer of capital assets, in the scheme of amalgamation, by an amalgamating company to an Indian amalgamated company is not treated as transfer under section 47(vi) of the Act and so no capital gain tax is attracted in the hands of the amalgamating company.

20.2.3. <u>Tax Concessions To The Shareholders Of An Amalgamating Company</u>

When the shareholder of an amalgamating company transfers shares held by him in the amalgamating company in consideration of allotment of shares in amalgamated company in the scheme of amalgamation, then such transfer of shares in not considered as transfer under section 47(vii) of the Act and consequently no capital gain is attracted in the hands of the shareholder of amalgamating company. The above are only few out of the various tax concessions available to the aforementioned categories of the assesses due to M&A transactions.[158]

[156] Kusum, Tax Implications On Mergers And Acquisitions Process, (JBM&SSR) Volume 3, No.5, May 2014,p 6274.

[157] Kusum, Tax Implications On Mergers And Acquisitions Process, (JBM&SSR) Volume 3, No.5, May 2014,p 6274.

[158] Ibid.

20.3 TAX PLANNING RELATING TO CORPORATE RESTRUCTURING

The following suggestions could be useful for tax planning in respect of amalgamation, merger, demerger etc: [159]

I. Planning for carry forward and set off of unabsorbed losses and unabsorbed depreciation:

Since the unabsorbed losses and unabsorbed depreciation cannot be allowed to be carried forward and set off in the hands of the amalgamated company, except in the cases prescribed under Section 72A of the Act, it is proposed:

(a)that the scheme of the amalgamation can be put off till such time the full benefit of set off is availed of by the amalgamating company; and (b) that the loss carrying company should absorb or take over the business of profit making company.

In other words, the profit making company should merge itself with the loss incurring company. This would help in carrying to carry forward the benefits of all unabsorbed losses and depreciation to be set off against the profits derived from the business of the profit making company.

II. **Allowability of bad debts in amalgamation scenario**

To save from disallowance of the debts of the amalgamating company which subsequently become bad in the hands of the amalgamated company, the amalgamated company should plan to make suitable provision for the expected losses on account of bad debts at the time of fixing the consideration while taking over the business of the amalgamated company. However, in view of the Court judgement of CIT v. T. Veerabhadra Rao[160], the bad debts are not allowed to an assessee by way of personal relief but to a business. So, it is possible for the amalgamated company to claim bad debts even in respect of debts taken over from the amalgamating company.

III. **Amalgamation of a unlisted company with a listed company:**

A company whose shares are not quoted on a recognised stock exchange may avail the benefit of amalgamation by amalgamating itself with another company whose shares are quoted on a recognised stock exchange. This would help its shareholders to take the advantage of the quoted price of their shares in the stock exchange while determining their liability for wealth tax purposes.

IV. **Amalgamation of a company holding immovable properties with an Industrial company:**

[159] Advanced Tax Laws And Practice, ICSI: Professional Programme, 187-188.

[160] (1985) 22 Taxman 45

A company holding investments in immovable properties may avail the benefit of non applicability of the provisions of the Urban Land Ceiling Act by amalgamating itself with an Industrial company.

V. **Amalgamation of loss incurring company and profit making company to reduce tax incidence**

A loss incurring company and a profit making company may merge in order to reduce the overall incidence of liabilities to tax under the Income-tax Act, 1961.

VI. **Reverse merger**

In case the conditions provided under Section 2(1B) and 72A of the Act are not satisfied, it may be suggested that the profit making company should merge itself with the loss making company, so that the loss making company does not lose its existence and also enjoys all other benefits.

VII. **Reduction of dissenting shareholders to complete amalgamation**

Under Section 2(1B) of the Act, it is provided that for availing the benefits of amalgamation, atleast 75% of the shareholders of the amalgamating company should become shareholders of the amalgamated company. In case more than 25% of the shareholders are not willing to become shareholders of the amalgamated company, it is proposed that the amalgamating company may persuade the other shareholders who may be willing, to purchase the shares in the amalgamated company to acquire the shares of the remaining shareholders so that the percentage of dissenting shareholders does not exceed 25%. Alternatively, the amalgamated company prior to amalgamation may purchase shares from such dissenting shareholders so as to make such dissenting shareholders to go below the specified percentage of 25%.

20.4 TAX PLANNING RELATING TO EMPLOYEE REMUNERATION[161]

The employees should keep the following aspects in view while planning their salary package:

(a) Division of salary into basic pay and allowances: The employee should opt for division of salary into basic pay and allowances and should not opt for the consolidated salary as some allowances are exempt to the extent provided under section 10 of the Act e.g. House rent allowance, Transport allowance, Uniform allowances, Children education allowance.

(b) Dearness allowance should be forming part of salary: Under the terms of employment, dearness allowance should form part of the retirement benefits. This will not only

[161] Advanced Tax Laws And Practice, ICSI: Professional Programme, p- 194-196.

increase the employees retirement benefits but also reduce his tax incidence in respect of HRA, gratuity, commuted pension, employer's contribution to RPF, etc.

(c) Commission to be based on turnover: Any commission payable as per the terms of employment should be based on turnover so as to form part of salary. This will also reduce the tax incidence in respect of HRA, commuted pension, interest credited to RPF.

(d) Cubic capacity of more than one car for private use not to exceed 1.6 Litre: If the employee is allowed the use of more than one car for his private purposes, the horse power of any such car should not exceed 1.6 litre cubic capacity as otherwise he shall be deemed to have been provided with one car of 1.6 cubic litre capacity which would lead to higher valuation of such perquisite.

(e) Employer's contribution to RPF exempt upto 12% of salary: The employer's contribution to RPF should be 12% of salary as it is exempt upto this limit.

(f) Medical facility instead of medical allowance: The employee should opt for reimbursement of expenses on medical treatment (or free medical facility) in place of medical allowance because such allowance is fully taxable whereas the reimbursement is not taxable upto the extent of `15,000.

(g) Perquisites in preference to taxable allowances: Perquisites should be preferred to taxable allowances. This shall help not only in lower valuation of a perquisite like rent free house but the employee will also be free from falling into the category of specified employees.

(h) Use of furniture not taxable in case of non specified employee: It may be noted that if furniture is provided without rent free accommodation, it will not be taxable in the hands of non specified employees.

(i) RPF maintained in the enterprise of subsequent employers: An employee who resigns before completing five years of continuous service in an organisation, should ensure that the new organisation he joins maintains RPF so that the accumulated balance of the provident fund could be transferred to the new organisation to claim exemption thereon.

(j) Preference should be for commuted pension on retirement: On retirement, the employee should opt for commuted pension to the maximum permissible limit as it is exempt from tax within certain limits.

(k) Leave encashment should be received on retirement: Leave encashment should preferably be done on termination of employment by superannuation or otherwise as it will then be exempt from tax within certain limits.

(l) Avail permissible deductions under Chapter VIA: The employee should also plan for taking full advantage of the relevant provisions under Section 80C to 80U of the Act.

- **Tax Planning:**

  (a) Entertainment Allowance:

  - Expenditure incurred by an employee in entertaining company's customers or for official purposes should be reimbursed to him to avoid his tax liability.

  (b) Education Allowance: Instead of education allowance, education facility should be provided. Education facility is not taxable in the hands of an employee who is non-specified. For a specified employee, the company is suggested to evolve a scheme of scholarship based on merit. It is not an Income of Employee. Employer may claim deduction u/s 37(1). Also, employee is entitled to claim exemption upto `100 per month per child.

  (c) Medical Expenses: Instead of medical allowance, reimbursement for medical expenses should be provided as medical allowance is fully taxable while medical reimbursement is exempt upto ` 15,000.

  (d) Establishment and Upkeep Allowance: This allowance can be given under the name of House Rent allowance to an employee so as to enable him to claim exemption under Section 10(13A) read with Rule 2A. Employer is entitled to claim deduction under Section 37(1).

  (e) Leave Travel Concession: The company is advised to grant leave travel concession or reimbursement to enable the employees to seek exemption under Section 10(5) instead of Leave Travel allowance which is fully taxable.

  (f) Retirement Benefit Scheme: The Company is advised to introduce retirement benefit scheme, i.e., Introduction of Recognized Provident Fund (RPF). Employer's contribution is deductible u/s 36 read with Section 43B. Employee gets deduction u/s 80C. Repayment at retirement is exempt if employee has served 5 years or more.

20.5 SUMMARY

- Companies often undertake Corporate Restructuring Activities to get the benefit of carry forward and set off of operating losses or tax credit.
- If the amalgamating company has incurred any expenditure eligible for deduction under sections 35(5), 35A(6),35AB(3), 35ABB, 35D, 35DD, 35DDA, 35E and/or 36(1)(ix), prior to its amalgamation with the amalgamated company as per section 2(1B) of the Act and if the amalgamated company is an Indian company, then the benefit of the aforesaid sections shall be available to the amalgamated company, in

the manner it would be available to the amalgamating company had there been no amalgamation.

- When the shareholder of an amalgamating company transfers shares held by him in the amalgamating company in consideration of allotment of shares in amalgamated company in the scheme of amalgamation, then such transfer of shares in not considered as transfer under section 47(vii) of the Act and consequently no capital gain is attracted in the hands of the shareholder of amalgamating company.
- Under Section 2(1B) of the Act, it is provided that for availing the benefits of amalgamation, at least 75% of the shareholders of the amalgamating company should become shareholders of the amalgamated company.

20.6 KEY WORDS

- Amalgamating
- Shareholder
- Company
- Corporate Restructuring

20.7 SELF ASSESSMENT QUESTIONS

1. Write about Tax Planning Relating To Corporate Restructuring.

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2. What are the Concessions available to the Amalgamating and Amalgamated Company?

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3. Write a note on Tax Planning in respect of Employee Remuneration.

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