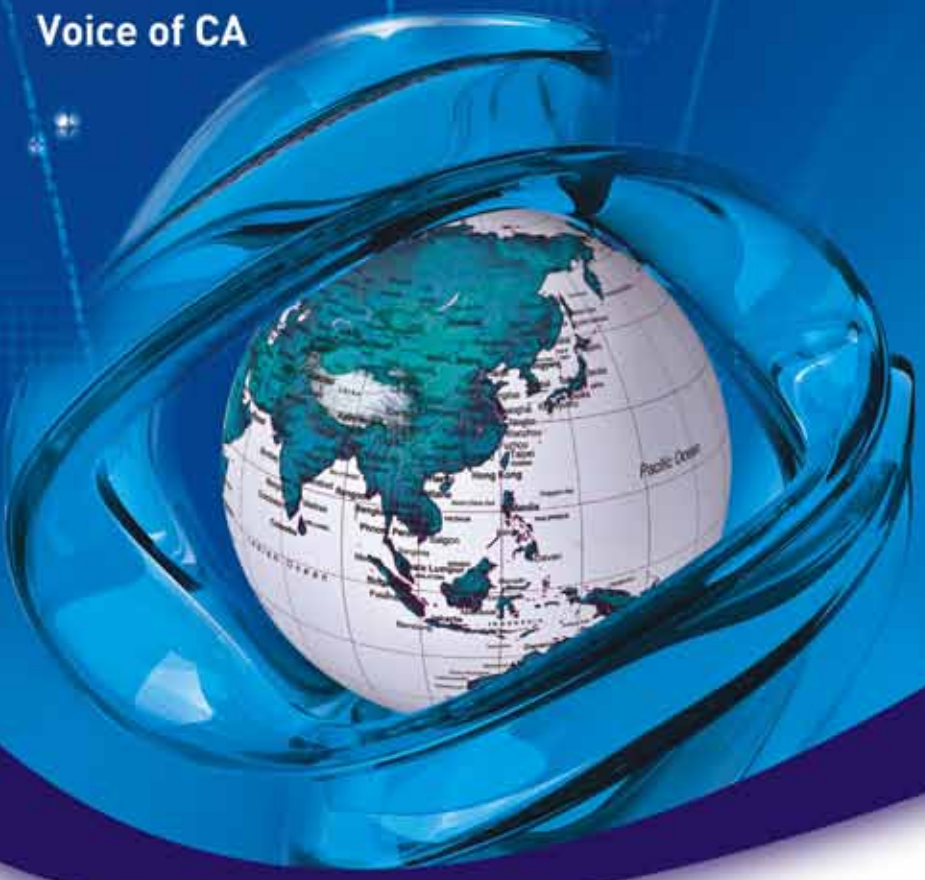
Voice of CA

3rd September, 2012



Background Material on

DIRECT AND INDIRECT TAXES

Covering Various Practical Aspects on Complex Topics

TDS • HUF • Charitable Trust • Deemed Dividend u/s 2(22)(e) • Section 14A • Capital Gain • Overview of Wealth Tax • Service Tax

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- TDS
- HUF
- Taxation of Charitable Trust
- Taxation of Deemed Dividend u/s 2(22)(e)
- Analysis of Section 14A
- Capital Gain
- Overview of Wealth Tax
- Service Tax (Amended upto 31st August, 2012)

PRINT-WAYS Publishing House

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AN INITIATIVE OF
'VOICE OF CA'

Voice of CA is a registered NGO formally incorporated on 05/03/2009, working with the objective of professional development of members of the "Institute of Chartered Accountants of India". In all spheres of professional, Social & Political exposure, Voice of CA attempted to share thoughts, news and views concerning CA's (after collecting data from various reliable sources, deep scrutiny and vision) through email from the forum of www.voiceofca.in. Besides this, issues related to the profession are also brought to the notice of members. More than 30000 members come in to its horizon.

Till date over 1000 mails updating members on recent case laws have been sent, more than 4000 queries have been answered and presentation have been circulated covering various aspects of Income Tax such as Penalty, Search & Seizure, Issues on TDS, Charitable Trust, Assessment & Reassessment, Cash Credits, Deemed Dividend, Representation Before Income Tax Appellate Tribunal & CIT(A), Important aspects of Section 14A, Hindu Undivided Family under the Hindu Law & Income Tax Act, 1961, Amendments in Income Tax. Presentation on topics of Service Tax and Excise Duty, other relevant areas such as An Article on Letter of Credit, Foreign Contribution (Regulation) Act, 2010, FEMA - Rules & Procedures, GST Presentation: Compilation of all the updates of GST since July, 2010, article on Haryana VAT and various other topics, Information on relevant tenders daily news is also circulated through Voice of CA.

The main aims and objectives of this NGO are as follows:

a. Enabling members to serve their employers, clients and the nation as a whole in a better manner.

b. To protest the rights of the members against any discrimination and ill recognition.

c. Represent members in front of regulators and legislators, below mentioned are some of the instances where Voice of CA represented for the benefit of its members:

   1. Representation has been made against RBI proposed decision about limiting the coverage of audit of bank branches.
   2. Representation before the Commissioner of Service Tax- New Delhi, against additional requirement for registration under Service Tax.
   3. Voice has been raised against dilution of identity with "Cost Accountants".
   4. Representation has been made in respect of an article in Money Market & Business Standard regarding "Banks don't want CA's to appear before DRT".
   5. Representation has been made before Central Board of Direct Taxes for delaying the application of new provisions of Rule 30,31,31A, 31AA as brought by Notification no. 31/2009, dated March 25, 2009 along with Circular no. 02/2009, in consequence of which CBDT delayed the applicability of the same for indefinite period vide PRESS RELEASE, New Delhi dated 30th June, 2009.
   6. Representation has been made before Hon'ble Union Minister of India, Corporate Affairs, Government of India challenging the Notification no. G.S.R. 888(E) dated 24/12/2008, requiring the same should operate in exception to Form No. 5 as fresh filling of this form involves high financial burden.
   7. Representation has been made before various internal authorities such as The President, ICAI,

for the benefit of students to remove the infirmities and provide better educational and examination facilities.

8. Representation has been made to ICAI on issues related to:
    - Limit of Tax Audit.
    - Cap on Concurrent Audit.
    - Live Telecast of Council proceedings.
    - Publication of Council decisions.
    - Increase in Fees of CAG audits.
    - Panels for IRDA audits.

d. Creating better infrastructure facilities like improved libraries, shared workstations etc. for members.

e. Reduction in steep hike in fees for members for various courses as well as membership fee.

f. Timely & relevant academic updates is the need of the time & are quite valuable for the members & therefore a strong step need to be taken in this direction so that the same can be made available to the members as per their work requirements.

g. Post qualification courses which are under-promoted, need to be popularized & equipped with better faculties & facilities with assurance of high professional benefits.

h. To formulate a comprehensive roadmap to avoid recurrence of any fraud like Satyam Scam.

i. If a CA in his audit report gives any material qualification regarding financial statements which can have adverse effect on a going concern assumption, such CA's should not be removed unless & until a clean report is received. Also some Alternate Dispute Resolution Mechanism should be included.

j. Role of independent director will be reviewed and there should be atleast one CA in Board of Directors of every company as an independent director by way of amendment in relevant laws.

k. Distinguish between statutory & tax audit in reference to the responsibility of CA towards stake holders, by advertising in the media and to the public at large, so that members are not straight away held guilty by the Press/Media without facing a fair trial from members

l. Promoting dual audit criteria rather than Peer review for better Corporate Governance.

m. Steps for allotting audits of Listed Companies & all those concerns where public money is at stake, to a CA Firm out of a panel maintained by ICAI, RBI etc. on rotational basis.

n. Promotion of Micro, Small & Medium CA. firms.

o. To make the networking more meaningful & having recognition in public sector work.

p. Conduct research in various fields to develop business modules to help members opting to go in business field.

q. To identify members in various organizations working on top positions as business ICONs & to bring back them with honour to help younger generations. Create an environment and a platform for interaction with persons of their own fraternity.

r. To promote quality service and excellence in the profession of Chartered Accountancy and to press members to be proactive to changes and ensures that members are in pace with the changes.

s. Conduct seminars to enlighten the CAs and CA students about the recent developments and practical aspects of prevailing law. For example, a Mock Search was performed by creating an identical environment of real Search & Seizure conducted under Income Tax Act.

t. To publish articles, books and compilations on various topics to enlighten the members about various practical aspects and the latest amendments of law.

Voice of CA wishes to bring together all the members, so that we know each other better and join hands and to take tprofession to greater heights.

Contents

INDIRECT TAXES

VOICE OF CA

Part-I

Tax Deducted at Source Under the Income Tax Act, 1961

(As Amended By Finance Act, 2012)

Chapter -I

AMENDMENTS BROUGHT IN "TDS PROVISIONS VIDE FINANCE ACT 2012"

A. Threshold for TDS on payment of interest on debentures - Amendment to Clause (v) of proviso of section 193 [w.e.f. 1st July, 2012]

"any interest payable to an individual or a Hindu undivided family, who is resident in India, on any debenture issued by a company in which the public are substantially interested, if—

(a) the amount of interest or, as the case may be, the aggregate amount of such interest paid or likely to be paid on such debenture during the financial year by the company to such individual or Hindu undivided family does not exceed five thousand rupees; and

(b) such interest is paid by the company by an account payee cheque."

Brief of Amendment

The present limit of Rs. 2500 has been announced to Rs. 5000 and this limit is also applied to the unlisted debentures. Provided the interest should be paid by Account payee cheque. The new provisions are also makes eligible HUF beside individuals.

B. Taxation of a non-resident entertainer, sports person etc by amending provision of Section 115BBA, and consequent change made to 194E.- [w.e.f. 1st July, 2012]

"Where any income referred to in section 115BBA is payable to a non-resident sportsman (including an athlete) or an entertainer who is not a citizen of India or a non-resident sports association or institution, the person responsible for making the payment shall, at the time of credit of such income to the account

of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of twenty per cent."

Brief of Amendment

Consequential amendment is proposed in section 194E to provide for withholding of tax at the rate of 20% from income payable to non-resident, non-citizen, entertainer, or sportsmen or sports association or institution.

C. Amendment brought u/s 194J vide Finance Act 2012 - Section 194J (1) (ba) - [Newly Inserted w.e.f. 1st July, 2012]

"(ba) any remuneration or fees or commission by whatever name called, other than those on which tax is deductible under section 192, to a director of a company; or

Brief of Amendment - *Deduction of tax at source @ 10% by a company in respect of remuneration or fees or commission by whatever name called, paid to a director which is not in the nature of salary and it will be considered as fees for professional or technical services.*

D. Threshold for TDS on compensation or consideration for compulsory acquisition increased by amending provisio of Section 194LA - w.e.f. 1st July, 2012]

Provided that no deduction shall be made under this section where the amount of such payment or, as the case may be, the aggregate amount of such payments to a resident during the financial year does not exceed **two hundred thousand rupees.**

Brief of Amendment

The limit raised to Rs. 2,00,000/- from Rs. 1,00,000 for non deduction of tax u/s 194LA.

E. SECTION 194LC - INCOME BY WAY OF INTEREST FROM INDIAN COMPANY. [NEWLY INSERTED, W.E.F. 1ST JULY, 2012]

"(1) Where any income by way of interest referred to in sub-section (2) is payable to a non-resident, not being a company or to a foreign company by a specified company, the person responsible for making the payment, shall at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct the income-tax thereon at the rate of five per cent.

(2) The interest referred to in sub-section (1) shall be the income by way of interest payable by the specified company,—

(i) in respect of monies borrowed by it at any time on or after the 1st day of July, 2012 but before the 1st day of July, 2015 in foreign currency, from a source outside India,—

(a) under a loan agreement; or

(b) by way of issue of long-term infrastructure bonds, as approved by the Central Government in this behalf; and

(ii) to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf, having regard to the terms of the loan or the bond and its repayment.

Explanation.—For the purpose of this section—

(a) "foreign currency" shall have the meaning assigned to it in clause (m) of section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999);

(b) "specified company" means an Indian company.'

Brief of Amendment

- If specified company raises a loan in foreign currency from abroad, which is approved by central Government, the interest paid by specified company to non-resident is chargeable to 5% on interest paid and accordingly new section 194LC inserted which provides TDS is deducted at 5% plus surcharge and cess on such amount paid.

- The interest payable to a non resident by an Indian company engaged in certain specified business relating to generation or distribution of power, operation of aircraft, manufacture or production of fertilizer, construction of road, toll road, bridge, port, inland port, shipyard, ship or dam shall be subjected to withholding tax @ 5% at the time of payment or accrual whichever is earlier.

- Long-term low cost funds from abroad- the benefit of lower rate of withholding tax i.e. 5% shall also extend to all businesses. This lower rate of tax would also be available for funds raised through long term infrastructure bonds in addition to borrowing under a loan agreement. Thus interest paid between 1/07/12 and 1/07/15, under an agreement, (including rate of the interest payable), approved by the Central Government, shall be taxable @ of 5% (plus applicable surcharge and cess).

F. Amendment in section 197A (1C) [Amended w.e.f. 1st July, 2012]

"Notwithstanding anything contained in section 193 or section 194 or section 194A or section 194EE or section 194K or sub-section (1B) of this section, no deduction of tax shall be made in the case of an individual resident in India, who is of the age of ***sixty years*** *or more at any time during the previous year, if such individual furnishes to the person responsible for paying any income of the nature referred to in section 193 or section 194 or section 194A or section 194EE or section 194K, as the case may be, a declaration in writing in duplicate in the prescribed form and verified in the prescribed manner to the effect that the tax on his estimated total income of the previous year in which such income is to be included in computing his total income will be nil."*

Brief of Amendment

The age of Senior Citizen is specified in section 197A is reduced to 60 years in place of 65 years.

G. Amendment to sub-section (1) of Section 201

Section201(1) - Before the Proviso to sub–section (1) of Section 201 following proviso is newly inserted.[w.e.f. 1st July, 2012]

"Provided that any person, including the principal officer of a company, who fails to deduct the whole or any part of the tax in accordance with the provisions of this Chapter on the sum paid to a resident or on the sum credited to the account of a resident shall not be deemed to be an assessee in default in respect of such tax if such resident—-

- ***i. has furnished his return of income under section 139;***
- ***ii has taken into account such sum for computing income in such return of income; and***
- ***iii. has paid the tax due on the income declared by him in such return of income, and the person furnishes a certificate to this effect from an accountant in such form as may be prescribed."***

H. Amendment to Proviso to sub-section (1) of section 201 [w.e.f. 1st July, 2012]

Provided further ***that no penalty shall be charged under section 221 from such person, unless the Assessing Officer is satisfied that such person, without good and sufficient reasons, has failed to deduct and pay such tax.***

I. A proviso after sub-section (1A) of Section 201 is newly inserted. [w.e.f. 1st July, 2012]

"Provided that in case any person, including the principal officer of a company fails to deduct the whole or any part of the tax in accordance with the provisions of this Chapter on the sum paid to a resident or on the sum credited to the account of a resident but is not deemed to be an assessee in default under the first proviso of sub-section (1), the interest under clause (i) shall be payable from the date on which such tax was deductible to the date of furnishing of return of income by such resident."

J. Amendment to Clause (ii) sub-section (3) of Section 201. [w.e.f. 1st April, 2010]

Six years ***from the end of the financial year in which payment is made or credit is given, in any other case***

K. Explanation after sub-section (4) of section 201 shall be inserted. [w.e.f. 1st July, 2012]

Explanation.—For the purposes of this section, the expression "accountant" shall have the meaning assigned to it in the Explanation to sub-section (2) of section 288

L. Clause (iv) of Section 204. [Newly Inserted, w.e.f. 1st July, 2012]

"In the case of credit, or as the case may be, payment of any sum chargeable under the provisions of this Act made by or on behalf of the Central Government or the Government of a State, the drawing and disbursing officer or any other person, by whatever name called, responsible for crediting, or as the case may be, paying such sum."

Chapter-II

TDS FROM SALARY

192. (1) Any person responsible for paying any income chargeable under the head "Salaries" shall, at the time of payment, deduct income-tax on the amount payable at the average rate of income-tax computed on the basis of the [rates in force] for the financial year in which the payment is made, on the estimated income of the assessee under this head for that financial year.

[(1A) Without prejudice to the provisions contained in sub-section (1), the person responsible for paying any income in the nature of a perquisite which is not provided for by way of monetary payment, referred to in clause (*2*) of section 17, may pay, at his option, tax on the whole or part of such income without making any deduction there from at the time when such tax was otherwise deductible under the provisions of sub-section (1).

(1B) For the purpose of paying tax under sub-section (1A), tax shall be determined at the average of income-tax computed on the basis of the rates in force for the financial year, on the income chargeable under the head "Salaries" including the income referred to in sub-section (1A), and the tax so payable shall be construed as if it were, a tax deductible at source, from the income under the head "Salaries" as per the provisions of sub-section (1), and shall be subject to the provisions of this Chapter.]

[(2) Where, during the financial year, an assessee is employed simultaneously under more than one employer, or where he has held successively employment under more than one employer, he may furnish to the person responsible for making the payment referred to in sub-section (1) (being one of the said employers as the assessee may, having regard to the circumstances of his case, choose), such details of the income under the head "Salaries" due or received by him from the other employer or employers, the tax deducted at source therefrom and such other particulars, in such form and verified in such manner as may be prescribed, and thereupon the person

responsible for making the payment referred to above shall take into account the details so furnished for the purposes of making the deduction under sub-section (1).]

[(2A) Where the assessee, being a Government servant or an employee in a [company, co-operative society, local authority, university, institution, association or body] is entitled to the relief under sub-section (1) of section 89, he may furnish to the person responsible for making the payment referred to in sub-section (1), such particulars, in such form and verified in such manner as may be prescribed, and thereupon the person responsible as aforesaid shall compute the relief on the basis of such particulars and take it into account in making the deduction under sub-section (1).]

[*Explanation*.—For the purposes of this sub-section, "University" means a University established or incorporated by or under a Central, State or Provincial Act, and includes an institution declared under section 3 of the University Grants Commission Act, 1956 (3 of 1956), to be a University for the purposes of that Act.]

[(2B) Where an assessee who receives any income chargeable under the head "Salaries" has, in addition, any income chargeable under any other head of income (not being a loss under any such head other than the loss under the head "Income from house property") for the same financial year, he may send to the person responsible for making the payment referred to in sub-section (1) the particulars of—

(*a*) such other income and of any tax deducted thereon under any other provision of this Chapter;

(*b*) the loss, if any, under the head "Income from house property",

in such form and verified in such manner as may be prescribed, and thereupon the person responsible as aforesaid shall take—

(*i*) such other income and tax, if any, deducted thereon; and

(*ii*) the loss, if any, under the head "Income from house property",

also into account for the purposes of making the deduction under sub-section (1) :

Provided that this sub-section shall not in any case have the effect of reducing the tax deductible except where the loss under the head "Income from house property" has been taken into account, from income under the head "Salaries" below the amount that would be so deductible if the other income and the tax deducted thereon had not been taken into account.]

[(2C) A person responsible for paying any income chargeable under the head

"Salaries" shall furnish to the person to whom such payment is made a statement giving correct and complete particulars of perquisites or profits in lieu of salary provided to him and the value thereof in such form and manner as may be prescribed.]

(3) The person responsible for making the payment referred to in sub-section (1) [or sub-section (1A)] [or sub-section (2) or sub-section (2A) or sub-section (2B)] may, at the time of making any deduction, increase or reduce the amount to be deducted under this section for the purpose of adjusting any excess or deficiency arising out of any previous deduction or failure to deduct during the financial year.

(4) The trustees of a recognised provident fund, or any person authorised by the regulations of the fund to make payment of accumulated balances due to employees, shall, in cases where sub-rule (1) of rule 9 of Part A of the Fourth Schedule applies, at the time an accumulated balance due to an employee is paid, make therefrom the deduction provided in rule 10 of Part A of the Fourth Schedule.

(5) Where any contribution made by an employer, including interest on such contributions, if any, in an approved superannuation fund is paid to the employee, [tax] on the amount so paid shall be deducted by the trustees of the fund to the extent provided in rule 6 of Part B of the Fourth Schedule.

(6) For the purposes of deduction of tax on salary payable in foreign currency, the value in rupees of such salary shall be calculated at the prescribed rate of exchange.

Questions and Answers on Section 192

Q.1. Who is responsible to deduct tax on Salary?

A.1. All persons paying salary are responsible to deduct TDS on income chargeable under the head "Salary". In other words none of the payer of Salary is excluded; Individual, HUF, Partnership firms, companies, cooperative societies, Trust and other artificial judicial persons have to deduct TDS on Salary.

Q.2. Who is the payee?

A.2. Any employee having taxable income under the head "Salary" shall be treated as payee for TDS u/s 192. For application of S. 192, there must exist employer employee relationship between payer and payee. For eg. Director of company is not employee and as such no TDS u/s 192 on any amount paid to director, visiting professors are not employees and therefore no TDS u/s 192 on the amount paid by the institutions to the visiting faculty.

Q.3. Application of TDS on Non resident Employees?

A.3. Yes, TDS to be deducted by employers on payments made to non resident employee u/s 192.

Q.4. When does the liability to deduct tax at source shall arise u/s 192?

A.4. Liability to deduct tax at source shall arise at the time of actual payment of salary and not at the time of accrual.

Q.5. At what amount tax has to be deducted u/s 192?

A.5. TDS u/s 192 has to be deducted on estimated income of the employee under the head "Salaries" for that Financial Year. No tax will however be required to be deducted at source for financial year 2012-2013 in any case unless the estimated salary income including the value of perquisites, exceeds –

S.No.	*Amount*	*Particulars*
1.	Rs. 250000	For an individual resident in India of the age of 60 years and above but less than 80 years.
2.	Rs. 500000	For an individual resident in India of the age of 80 years of more.
3.	Rs.200000	Any other individual.

Q.6. At which rate TDS has to be deducted u/s 192?

A.6. TDS U/s 192 has to be deducted at the average of income tax computed on the basis of rates in force during the financial year. The total tax to be deducted on the estimated income of the employee for the relevant financial year is divided the number of months of his employment. The amount so arrived is the monthly deduction of tax at source.

However, if the employee does not have PAN No., TDS shall be deducted 20% without including Education Cess & SHEC, if the normal tax rate in this case is less than 20%. **(Please refer section 206AA and Circular No.8 dated 13.12.2010).**

Q.7 Whether employer is also liable to deduct tax on non monitory perquisites?

A.7. Section 192 (1)(A) provides an option to employer to pay tax on behalf of employee on non monitory perquisites however it is not mandatory. For the purpose of paying tax by employer u/s 1(a) tax shall be determined at the average rate of income tax of tax in force on the income chargeable under the head salaries including the value of non monitory perquisites.

Q.8 How to compute TDS on Salary in case of simultaneous employment? What are relevant Forms and Rules?

A.8. Situation1: In case where change of employment made during the year– Where the employee was employed some other person before joining the present employer during the financial year, tax will be deducted by the present employer by taking into account the salary received from the TDS employer, tax deducted at source etc. for this purpose the employee has to submit in writing the full particulars regarding salary received.

Situation 2: Where employee is simultaneously working under more than one employer. In this case tax will be deducted by the employer, the concerned employee so chooses. The employee shall submit the details of salaries due or received by him from other employer(s) the tds there from and such other particulars as may be prescribed in Form No.12B.

The relevant judicial pronouncements:

1. Employer not liable to deduct tax, if employee not intimate his earning from other employer, it was so held in **CIT V/s Marubeni India Pvt. Ltd. (2007) 294 ITR 157 (Del).**

2. The assessee is not liable to deduct tax at source on payments received by its employee from any other employer. **CIT v/s Woodward Governor India Pvt. Ltd. 295 ITR 1 Del) (See also Kinetics Technology (India) Ltd. v/s Jt. CIT (2006) 94 ITD 63 (Del)**

Q.9. What are the provisions of section 192[3] of the Act? Can an employer increase or decrease the amount of monthly TDS on Salary?

A.9. Yes, the employer is authorized to adjust such excess/deficit in the subsequent months. However the same is permissible in case of same employee. **[Please refer CIT v/s Enron Expat Services Inc (2010) 45 DTR 154: 194 Taxman 70 (Uttarakhand)] [See also Commissioner of Income-tax v. Delhi Public School (2012) 247 CTR 317 (Del)].**

The relevant judicial pronouncements:

1. Interest u/s 201(1A) is not applicable if the exact amount of TDS is not deducted in each month. **ITO V/ Asia Hotels Ltd. (1991) 41 TTJ (Del) 28.**

2. No interest u/s 201(1A) for non deduction in initial months on grant of ex gratia, increments and DA since there was no default in terms of section 192(3).**{Executive Engineer, T.L.C. Division, A.P. State Electricity Board v. ITO (1987) 20 ITD 318 (Hyd)].**

3. In correct estimate of salary cannot inevitably lead to inference that estimation is not honest and fair. **[Lintas Indi Ltd. v. Asst. CIT (206)5 SOT 310 (Mum) ; Gwalior Rayon Silk Co. Ltd. V. CIT (1983) 140 ITR 832 (MP) and Nishith M. Desai v. ITO (206) 9 sot 42 (Mum)] ; CIT v ONGC Ltd. (2002) 254 ITR 121, 124 (Guj).**

4. The adjustment either of increasing or decreasing the tax deduction at source is to be made with reference to the estimated income of "the assessee" i.e. an employee and not all of them taken together deducting from some and refunding to others. **(Shriram Pistons & Rings Ltd. v. ITO (2000) 16 DTC 331(Del-Trib) (2000) 73 ITD 30 (Del-Trib)].**

Q.10. Can the person, responsible for any deduction of tax at source, adjust the excess tax deducted and deposited against the subsequent tax to be deducted in respect of payment to any other person?

A.10. No. In this case the employee, whose tax has been deducted in excess than required, shall be allowed to take back the refund after filing return of income.

Q.11. What are the provision for deduction of tax at source on accumulated balance of recognized provident fund?

A.11. Section 192(4) states that the trustees of a recognized provident fund, or any other person, authorized by the regulation of the fund to make payment of accumulated balances due to employees shall deduct tax at the time when such accumulated balance due to the employee is paid, where such payment from recognized provident fund is taxable.

Q.12. Whether benefit of lower deduction or no deduction of TDS is available u/s 192?

A.12. Yes. However assessee to whom the salary is payable may make an application in Form No.13 to the Assessing Officer and if the Assessing Officer is satisfied that the total income of the recipient justifies the deduction of income tax at any lower rate or no deduction of income-tax, he my given such certificate as may be appropriate.

W.E.F. 1-4-2010, as per section 206AA(4), no certificate under section 197 shall be granted unless the application made in Form No.13 under that section contains the Permanent Account Number of the applicant.

Q.13. What the provisions of TDS on salary in case where employer undertakes to pay tax free salary?

A.13. Where an employer undertakes to pay tax free income to an employee, what he undertakes to pay is an agreed sum of money plus the tax payable for that amount. Therefore, at the time of making the estimate of salary income for the purpose of making deduction under section 192(1), the employer is under an obligation to take into consideration not only the actual amount that has been paid to the employee but also the tax payable on the salary income . **[British Airways v. CIT (1992) 193 ITR 439 (Cal)].**

Q.14. Whether the employer is liable to deduct tax at source on amount paid as compensation to employee upon settlement on termination of employment?

A.14. No. **please refer Mahindra Singh Dharwal v. Hindustan Motors Ltd. (1985) 152 ITR 68 (SC)], All India Reporter Ltd. v. Ramachandra D. Datar (1961) 41 ITR 446 (SC)].,**

Q.15. How the tax to be deducted at source shall be calculated in case employee is earning income, which is taxable under other heads?

A.15. where an employee also has any income (not being a loss other than a loss under the head house property) for the same financial year, chargeable under any other head, he may furnish the statement of such other income and any tax deducted thereon to his employer to take them into consideration while deducting tax from his salary. However the resultant tax deductible u/s 192 cannot be less than the amounts that would have been deductible if such other income and tax deducted there on would not have been taken in to account.

However, any loss incurred under the head "Income from house property" can be taken in to account while determining TDS u/s 192.

Q.16. Whether private arrangement for making tax – free payments can discharge obligation to deduct tax at source?

A.16. No, Whatever the private arrangements between the payor and payee may be, the payer's liability under the statute is clear. **Please refer John Patterson & Co. (India) Ltd. V. ITO (1959) 36 ITR 449 (Cal.)**

Q.17. Whether employer should rely upon employees assurance about making of savings by him while determining TDS u/s 192. ?

A.17. No**.** On mere assurance of petitioner that he will make saving of particular amount without any documentary proof, it is not justifiable to reduce the TDS

from salary proportionately. **Please refer Major General, Vinay Kumar Singh v. UOI (2000) 18 DTC 19 (MP – HC) see also Koti Enterprises Pvt. Ltd. v. ITO (2000) 74 ITD 437 (Cal.) (SMC).**

Q.18. Whether provisions of S. 192 shall also apply to any remuneration in addition to 'Salary'?

A.18. Yes Remuneration in addition to salary received by employee for work done is chargeable as ' Salary Income', therefore the same is liable for tax deduction at source. **Please refer CIT v. V.R. Chaphekar (1977) 107 ITR 49 (Bom.) also refer American Express Bank Ltd V ITO (2002) 74 TTJ (Del – Trib) 599.**

Q.19. Whether transport facility given to employees from their residence to office and vice versa is a perquisite to attract TDS u/s 192?

A.19. **Please refer Transworks information services Ltd. V ITO (2009) 29 SOT 543 (Mum).**

Q.20. Whether the employee is liable to once again pay tax where employer duly deducted Tax u/s 192 but not had issued TDS certificate?

A.20. once an employer has deducted tax at source employee assessee cannot be held responsible for payment once again. **Please refer Pranab Kumar Chakraborty V DCIT (2008) 115 ITD 113 (Mum), see also J.G. Joseph v JCIT (2008) 303 ITR (AT) 395 (Mum).**

Q.21. Whether provisions of s. 192 shall also apply to salary paid by non resident employer to a non resident employee for services rendered in India?

A.21. Yes, Provisions of S. 192 shall apply if the salary was paid for services rendered in India even though the employers as well as employee were nonresident and the payment is made outside India. **Please refer Bobcock Power (Overseas Projects) Ltd. v. ACIT (2002) 81 ITD 29 (Del).**

Q.22. When nonresident employer is deducting tax, whether the resident employer is also liable to deduct tax at source u/s 192 to whom the services of the employee have been made available?

A.22. No, Please refer Cholamandalam MS General Insurance Co. Ltd., In re (2009) 309 ITR 356 (AAR) (Del).

Q.23. Whether the home salary payment made to expatriated employees by the foreign company in foreign currency abroad can be held to be 'deemed to accrue or arise in India', consequently whether tax u/s 192 shall be deductible thereon?

A.23. Whether the home salary payment made to expatriated employees by the foreign company in foreign currency abroad can be held to be 'deemed to accrue or arise in India' would depend upon the in-depth examination of the facts in each case. If the home salary/special allowance payment made by the foreign company abroad is for rendition of services in India and if no work is found to have been performed for foreign company, then such payment would certainly come under section 192 (1), read with section 9(1)(ii). **Please refer CIT v Eli Lilly & Co. (India) (P.) Ltd.*[2009] 312 ITR 225 (SC).**

Q. 24 Whether fees paid to consultant doctor are covered by S. 192?

A.24. Fees paid to consultant doctors by assessee-hospital under a contract (FGC) are covered by section 194J and not section 192**. ITO v. Apollo Hospitals International Ltd.[2011] 9 taxmann.com 95 (AHD. - ITAT)**

However where there is a employer-employee relationship between assessee and consultant doctors and, consequently, remuneration paid to them was chargeable to tax under head 'Salaries' and payments in question were subject to deduction of tax as per provisions of section 192 and not section 194J**. St. Stephen's Hospital v. Dy. CIT, [2006] 6 SOT 60 (Delhi)**

Q.25. Whether the provision of S. 40(a)(iii) shall attract, where deduction of Salary claimed being due but TDS not deducted since the same is not actually paid?

A.25. Where assessee claimed deduction of salary payable to its employee outside India on accrual basis and deducted tax at source under section 192, at time of payment or remittance of salary, assessee's claim would not be hit by provisions of section 40(a)(iii). **Please refer Citigroup Global Markets India (P.) Ltd.* v Dy. CIT [2009] 29 SOT 326 (MUM.)**

Q.26. whether shares and stock option plan offered at concessional rate will be treated as perquisite for the purpose of deduction u/s 192?

A.26. No. payer is not liable to deduct TDS under section 192 in respect of issue of its shares under stock option plan to its employees at a concessional rate as it could not be treated as a perquisite (salary). **Please refer CIT v Wipro Ltd. [2009] 319 ITR 289 (KAR.)**

Q.27. Whether employer responsible for deducting TDS in case of misuse of meal coupons by employee?

A.27. No. where employer had distributed free food/meal coupons to its employees for purchase of meals only at specified eating points; such coupons were not transferable; and value of each coupon did not exceed monetary limit provided by rule 3(7)(iii), merely because some of employees had misused said facility

by using coupons for other purposes, employer could not be treated to be in default for non-compliance with requirement of deducting tax at source under section 192, **Please refer CIT(TDS) v. Reliance Industries Ltd. [2009] 308 ITR 82 (GUJ.)**

Q.28. Whether reimbursement of expenses to parent company on account of expenses of globol manager shall attract TDS u/s 192?

A.28. No, Amount paid by assessee-company to its parent company on account of reimbursement of expenditure incurred in respect of global accounts manager, could not be treated as payment of salary, so as to attract deduction of tax at source. **Please refer Expeditors International (India) (P.) Ltd v. ACIT [2008] 118 TTJ 652(Delhi).**

However Salaries paid overseas to managing director for services rendered by him in India would fall under head 'salaries' as income earned in India and chargeable to tax and, consequently, section 192 would apply. **Kinetic Technology (India) Ltd. v. ITO, [2005] 96 ITD 441 (Delhi)**

Q.29. Whether tips paid by customers to employees working in a restaurant can be considered as part of their salary liable for deduction of tax at source?

A.29. No, **please refer Nehru Place Hotels Ltd. v. ITO [2008] 173 Taxman 88.**

Q.30. Whether foreign employer is liable to deduct tax at source on salary paid to expatriate technicians, account of remuneration for services rendered by them in India, irrespective of their residential status.?

A.30. Yes, Payment made to expatriate technicians by foreign employer, having permanent establishment in India, on account of remuneration for services rendered by them in India, is liable to tax in India irrespective of their stay in India. Therefore, foreign employer is liable to deduct tax at source U/s 192 while making such payments to expatriates. **Please refer Pride Foramer S.A. v. ACIT, [2005] 97 ITD 86 (Delhi).**

Q.31. Where director of a company is receiving commission in addition to Salary, whether TDS will be deducted upon actual payment.?

A.31. No, commission shall become taxable on due basis. **Please refer Sanjib Kumar Agarwal V CIT (2009) 310 ITR 295 (Cal).**

Q.32. Whether honorarium to part time teacher shall attract deduction u/s 192.?

A.32. Honorarium to part time teacher held as salary, if the employee is under the control of the employer, **please refer Max Mueller Bhavan, In re (2004) 268 ITR 31, 32, 35 – 36 (AAR).**

Q33. Whether salary paid to MP, MLA. Ministers & Chief Ministers shall attract TDS u/s 192?

A33. MP and MLA are not employed by any body, rather they are elected by the public, their remuneration cannot be said to be salary within the meaning of section 15, such income shall be taxable under the head income from other sources as consequent to election they acquire constitutional position and discharge functions and obligations **[CIT v Shiv Charan Mathur (2008) 306 ITR 126 (Raj)]**

However pay and allowances received by the Chief Minister of State or a minister is salary. It cannot be taxed under the head income from other source **(Please refer Lalu Prasad v CIT (2009) 316 ITR 186 (Patna).**

Article 125 & 221 of the constitution deals with the salaries of Supreme Court and High Court Judges respectively and expressly state that what the judges receive are salaries. **[Justice Deoki Nandan Agarwala v. Union of India (1999) 237 ITR 872 (SC).**

IMPORTANT CIRCULARS

1. **Circular: No. 707, dated 11/07/1995 -** Where non-residents are deputed to work in India and taxes are borne by employers, in certain cases if an employee to whom refunds are due has already left India and has no bank account here by the time assessment orders are passed, refund can be issued to employer as tax has been borne by it.

2. **Circular : No. 761, dated 13-1-1998.-** Banks has been advised that as per section 17(1)(ii) of the Income-tax Act, 1961, the term 'salary' includes pension, once tax has been deducted under section 192 of the Income-tax Act, 1961, the tax-deductor is bound by section 203 to issue the certificate of tax deducted in Form 16. No employee-employer relationship is necessary for this purpose the certificate in Form No. 16 cannot be denied on the ground that the tax deductor is unaware of the payees' other income.

3. **Circular: No. 285 [F. No. 275/77/79-IT(B)], dated 21-10-1980-** Where the tax is deducted at source and paid by the branch office of the assessee and the quarterly statement/annual return (in case of salaries) of tax deduction at source is filed by the branch, such branch office would be treated as a separate unit independent of the head office. After meeting any existing tax liability of such a branch, which would normally be in relation to the deduction of tax at source, the balance amount may be refunded to the said branch office. The Income-tax Officer, who will refund the amount, would be the one who receives the quarterly statement/ annual return (in case of salaries) of tax deduction at source from that branch office and keeps record of the payments of tax deduction at source made by that branch.

Chapter –III

TDS FROM PAYMENTS TO CONTRACTORS

194C. (1) Any person responsible for paying any sum to any resident (hereafter in this section referred to as the contractor) for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor and a specified person shall, at the time of credit of such sum to the account of the contractor or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to—

(*i*) one per cent where the payment is being made or credit is being given to an individual or a Hindu undivided family;

(*ii*) two per cent where the payment is being made or credit is being given to a person other than an individual or a Hindu undivided family,

of such sum as income-tax on income comprised therein.

(2) Where any sum referred to in sub-section (1) is credited to any account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

(3) Where any sum is paid or credited for carrying out any work mentioned in sub-clause (e) of clause (*iv*) of the *Explanation,* tax shall be deducted at source—

(*i*) on the invoice value excluding the value of material, if such value is mentioned separately in the invoice; or

(*ii*) on the whole of the invoice value, if the value of material is not mentioned separately in the invoice.

(4) No individual or Hindu undivided family shall be liable to deduct income-tax on the sum credited or paid to the account of the contractor where such sum is credited or paid exclusively for personal purposes of such individual or any member of Hindu undivided family.

(5) No deduction shall be made from the amount of any sum credited or paid or likely to be credited or paid to the account of, or to, the contractor, if such sum does not exceed [thirty] thousand rupees :

Provided that where the aggregate of the amounts of such sums credited or paid or likely to be credited or paid during the financial year exceeds [seventy-five] thousand rupees, the person responsible for paying such sums referred to in sub-section (1) shall be liable to deduct income-tax under this section.

(6) No deduction shall be made from any sum credited or paid or likely to be credited or paid during the previous year to the account of a contractor during the course of business of plying, hiring or leasing goods carriages, on furnishing of his Permanent Account Number, to the person paying or crediting such sum.

(7) The person responsible for paying or crediting any sum to the person referred to in sub-section (6) shall furnish, to the prescribed income-tax authority or the person authorised by it, such particulars, in such form and within such time as may be prescribed.

Explanation.—For the purposes of this section,—

(*i*) "specified person" shall mean,—

(*a*) the Central Government or any State Government; or

(*b*) any local authority; or

(*c*) any corporation established by or under a Central, State or Provincial Act; or

(*d*) any company; or

(*e*) any co-operative society; or

(*f*) any authority, constituted in India by or under any law, engaged either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both; or

(*g*) any society registered under the Societies Registration Act, 1860 (21 of 1860) or under any law corresponding to that Act in force in any part of India; or

(*h*) any trust; or(*i*) any university established or incorporated by or under a Central, State or Provincial Act and an institution declared to be a university under section 3 of the University Grants Commission Act, 1956 (3 of 1956); or

(*j*) any Government of a foreign State or a foreign enterprise or any association or body established outside India; or

(*k*) any firm; or

(*l*) any person, being an individual or a Hindu undivided family or an association of persons or a body of individuals, if such person,—

(A) does not fall under any of the preceding sub-clauses; and

(B) is liable to audit of accounts under clause (*a*) or clause (*b*) of section 44AB during the financial year immediately preceding the financial year in which such sum is credited or paid to the account of the contractor;

(*ii*) "goods carriage" shall have the meaning assigned to it in the *Explanation* to sub-section (*7*) of section 44AE;

(*iii*) "contract" shall include sub-contract;

(*iv*) "work" shall include—

(*a*) advertising;

(*b*) broadcasting and telecasting including production of programmes for such broadcasting or telecasting;

(c) carriage of goods or passengers by any mode of transport other than by railways;

(*d*) catering;

(e) manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer,

but does not include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from a person, other than such customer.]

QUESTIONS AND ANSWERS ON SECTION 194C

Q.1 Who is responsible to deduct tax u/s 194C?

A.1. Any person responsible for paying any sum to any resident contractor for carrying out any work (including supply of labour for carrying out any work) under a contract in pursuance of a contract between contractor and person specified, shall deduct in context at the time of such payment thereof in cash of by issue of a cheque or draft or by any other mode or its credit to contractor's account or any other account, by whatever name called, whichever happens earlier. Specified person are referred in explanation to section 194C, as under:-

(a) the Central or State Government; or

(b) any local authority; or

(c) any corporation established by or under a Central, State or Provisional Act; or

(d) any company; or

(e) any co-operative society; or

(f) any authority constituted in India by or under any law, engaged either for the purpose of dealing with the satisfying the needs for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages or for both (e.g. CIDCO, HUDCO, etc.] ; or

(g) any society registered under the Societies Registration Act, 1860 or under any such corresponding law; or

(h) any trust; or

(i) any university or deemed university; or

(j) any government of a foreign state or foreign enterprise or any association or body established outside India; or

(k) any firm;

(l) any person, being an individual or a Hindu undivided family or an association of persons or a body of individuals, whether incorporated or not other than those falling under any of the preceding clauses, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (a) or

clause (b) of section 44AB during the financial year immediately preceding the financial year in which such sum is credited or paid to the account of the contractor.

W.e.f. 1-10-2009 as per newly inserted section 194C(6), no deduction shall be made from any sum credited or paid or likely to be credited or paid during the previous year to the account of a contractor during the course of business of plying, hiring or leasing goods carriages, on furnishing of his Permanent Account Number, to the person paying or crediting such sum.

Q.2. At what rate TDS has to be deducted u/s 194C ?

A.2 (a) 1% where the payment is being made or credit is given to an individual or a HUF.

(b) 2% where the payment is being made or credit is to be given to any other entity.

W.e.f. 1-10-2009, the nil rate will be applicable if the transporter quotes his PAN. The rate of TDS will be 20% in all the above cases, if PAN is not quoted by the deductee on or after 1-4-2010.

No surcharge, education cess and SHEC shall be added. Hence, TDS shall be deductible at basic rates.

Q.3. What is the meaning of work for the purpose of section 194C?

A.3. Meaning of work for the purpose of section is contained in clause (iv) of Exoplanation (iv) to section 194C(7) "Work" shall include-

(a) Advertising;

(b) Broadcasting and telecasting including production of programmes for such broadcasting or telecasting;

(c) carriage of goods or passengers by any mode of transport other than by railways;

(d) catering;

(e) manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer,

but does not include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from a person, other than such customer.

Q.4. Whether contract for Sale shall also be covered by TDS u/s 194C?

A.4. No, the provisions of S. 194C shall not apply to contract for sale, it has been provided that "work" shall not include manufacturing or supply a product according to the requirement or specification of a customer by using raw material purchased from a person other than such customer as such a contract is a contract for `sale', **please refer Circular : No. 681, dated 8-3-1994.**

Purchase of advertisement material from a person without supplying any material used in preparation of said material shall be a contract for sale. **Please refer Dy. CIT v. Eastern Medikit Ltd.* [2012] 135 ITD 461 (ITAT-Delhi)**

Q.5. Whether Individuals and HUF are liable to deduct tax if the payment made to a contractor is for personal use?

A.5. Section 194C(4) provides that no individual or a Hindu undivided family shall be liable to deduct income-tax on the sum credited or paid to the account of the contractor where such sum is credited or paid exclusively for personal purposes of such individual or any member of Hindu undivided family.

Q.6. Under what circumstances TDS u/s 194C is not deductible?

A.6. (i) Where single payment does not exceed Rs.30000/-

(ii) Where the aggregate payment does not exceed Rs.75000/-

(iii) In case of transporter TDS u/s 194C is not deductible if the transporter provides its PAN

(iv) In case, where payee applied in form 13 to AO for non deduction, being his taxable income including rent below taxable limit, and has obtained certificate thereof.

Q.7. Are Individuals and HUF also covered by the provisions of section 194C for deduction of tax on payments to contractors?

A.7. As per proviso to section 194C(2) individuals and HUF whose total sales/ turnover/receipts from the business/profession carried on by him in the immediately preceding financial year exceeded the monetary limit specified under section 44AB(a) or (b) (i.e. it exceed Rs.6,00,000 / 15,00,000, as the case may be), are also required to deduct tax at source.

Q.8. Whether provision of S. 194C shall also apply to hiring or renting of equipment?

A.8. The provisions of section 194C would not apply in relation to payments made for hiring or renting of equipments, etc. Hiring of an assets does not amount to

a contract to carrying out any work. **Please refer CIT v. Poompuhar Shipping Corporation Ltd. (2006) 282 ITR 3 (Mad). See also Roy Mitra Enterprise v. ACIT [2012] 20 taxmann.com 86 (ITAT-Kol.), Jaiprakash Enterprises Ltd. v. ACIT [2012] 49 SOT 1 (ITAT-Luck.)**

Q.9. Whether supply of out sources, manufactured goods under contract will be treated as a works contract u/s 194C.?

A.9. It was held that the supply of outsourced manufactured goods by the contract manufacturer constituted an outright sale and could not be treated as a works contract within the scope of section 194C. Consequently, the assessee was not liable to deduct tax at source from the purchase price of the goods paid by it to the contract manufacturer or the supplier. **[Tuareg Marketing (P) Ltd. v. ACIT (2009) 28 SOT 1 (Del); Novartis Healthcare (P) Ltd. v. ITO, TDS (Mum). See also CIT v. Nova Nordisk Pharma India Ltd. [2012] 341 ITR 451 (Kar.), CIT v. Glenmark Pharmaceuticals Ltd. (2010) 324 ITR 199 (Bom), Dy CIT v. Reebok India Co. (2006) 10 TTJ 976 (Del). Also see Whirlpool of India Ltd. v. Jt. CIT (2007) 16 SOT 435 (Del)].**

Q.10. Whether Service contract covered by S. 194C?

A.10. Yes, **Circular :** *No. 681, dated 8-3-1994*

Q.11. Whether provisions of section 194C shall apply in respect of all contracts?

A.11. Before a person can be called a contractor his status must have nexus in its characteristics as carrying out work for another person as a contractor in the ordinary sense and not merely carrying on activities of his own business or profession in the ordinary course by charging fees or remuneration. **[All Gujarat Federation of Tax Consultants v CBDT (1995) 214 ITR 276 (Guj)].**

Q.12. Is there any circular that may help in differentiating between works contract and any other contract?

A.12. Yes, Circular No.681, dated 8-3-1994 issued by CBDT elaborates upon various kinds of contracts that may fall within the definition of works contract and also specifies the nature of contract that shall fall out of the preview of section 194C.

Q.13. Whether the provisions of section 194C are also applicable to non resident?

A.13. No, the payments made to non resident contractor would come within the preview of section 195.

Q.14. Whether provisions of section 194C shall apply to franchise agreements?

A.14. No, the provisions of section 194C shall not apply to franchise agreement as under the franchise arrangement, their consist mutual obligations and rights. **Please refer CIT v. Career Launcher India Ltd. (2012) 250 CTR 240 (Del)].**

Q.15. Where the assessee entered into contract with transporter for transporting goods from plant to various destination, whether such contract shall attract TDS u/s 194C or 194I?

A.15. (i) That to decide whether a contract is one for "transportation" or for "hiring", the crucial thing is to see who is doing the transportation work. If the assessee takes the trucks and does the work of transportation himself, it would amount to hiring. However, if the services of the carrier were used and the payment was for actual transportation work, the contract is for transportation of goods and not an arrangement for hiring of vehicles, and as such provisions of section 194C shall apply. **Please refer ITO v. Indian Oil Corporation (Del) (Trib).www. itatonline.org], see also CIT (TDS) v. Swayam Shipping Services P. Ltd. (2011) 339 ITK 647 (Guj)].**

(ii) Payments made by assessee to transporters providing vehicles and driver to pick and drop employees is liable to TDS under section 194C and not section 194-I. **Bharat Electronics Ltd. v. Dy. CIT (TDS), [2012] 50 SOT 172 (ITAT-Delhi)**

However in case of payments made by transport contractor for hiring tankers to use them in transport contract business is not liable to TDS under section 194C, in such case S. 194I shall apply. **Bhail Bulk Carriers v. ITO [2012] 50 SOT 622 (ITAT-Mum.)**

Q.16. Whether provisions of S. 194C shall apply to subcontracting?

A.16. Yes, where assessee contractor got work done through another party under his supervision and control, there existed relationship of 'contractor' and 'sub-contractor' requiring assessee to deduct tax at source under section 194C. **Ratan J Batliboi v. ACIT [2012] 24 taxmann.com 96 (ITAT-Mum.)**

Q.17. Whether, having a contract is a primary requirement for deduction of tax u/s 194C?

A.17. Yes, In absence of any contract between assessee-contractor and sub-contractor, assessee was not liable to deduct TDS under section 194C on payments made to them. **Ratnakar Sawant, Dinesh N. Shah & Co. v. ITO, [2012] 22 taxmann. com 218 (ITAT-Mum.)**

Q.18. Whether the provisions of Section 194C shall also apply in a situation when assessee entered in to a separate contract for supply of goods and erection work?

A.18. In a case where three separate agreements were entered into : one for supply of goods, second for erection works and third for civil engineering work, section 194C cannot be pressed into service to deduct tax at source on payment for supply of material merely because said agreement is a part of composite transaction. **CIT v. Karnataka Power Transmission Corporation Ltd. [2012] 21 taxmann.com 473 (Kar.)**

Q.19. Whether TDS u/s 194C deductible on erection and commissioning of plan even in case of composite contract?

A.19. In case of common purchase order for supply of plant and for erection and commissioning of plant, the pre dominant object of the contract is the purchase of the plant and the erection and commissioning is only incidental. However in the cases where two contracts are separable contracts TDS shall be deductible on the amount attributable to the erection and commissioning and not on the gross sum paid by the assessee. **Please refer Senior Accounts Officer (O & M), Haryana Power Generation Corpn. Ltd. v. ITO (2006) 103 TTJ 584 (Del).**

Q.20. Whether Contract for carrying goods and passengers by trailer, utility vans, water tanker, sumos, etc., is covered by section 194C or by section 194-I?

A.20. Contract for carrying goods and passengers by trailer, utility vans, water tanker, sumos, etc., is covered by section 194C and not by section 194-I. **CIT (TDS) v. Reliance Engineering Associates (P.) Ltd. [2012] 21 taxmann.com 539 (Guj.)**

Q.21. Whether Production of motion films or cinematographic films would fall within meaning of expression 'work' as contemplated under section 194C?

A.21. Yes, production of motion films or cinematographic films would fall within meaning of expression 'work' as contemplated under section 194C. **Nitin M. Panchamiya v. ACIT*[2012] 50 SOT 468 (ITAT- Mum.)**

Q.22. Whether contract for supply of labour shall attract TDS u/s 194C?

A.22. Yes, payment made to Calcutta Dock Labour Board for supply of labor for assessee's business, attracted TDS provisions of section 194C **Dy. CIT v. Kamal Mukherjee & Co. (Shipping) (P.) Ltd.* [2012] 51 SOT 73 (ITAT- Kol.), see also Associated Cement Co. Ltd. v. CIT (1979) 120 ITR 444 (Pat).**

Q.23. Whether sponsorship money paid shall attract TDS u/s 194C?

A.23. Where assessee-management consultant was organizing conferences and sponsorship money was paid to it after conceptualization of conferences, it could not be said that assessee had undertaken to organize said conference at instance of sponsors and, hence, provisions of section 194C (2) could not be invoked. Dr**. Raju L Bhatia v. JCIT* [2012] 134 ITD 615 (ITAT-Mum.)**, however **Circular: No. 715, dated 8-8-1995**, provides for TDS u/s 194C on sponsorship.

Q.24. Whether payments made to finance companies in consideration of providing access to their customer database shall attract TDS u/s 194C?

A.24. Where assessee entered into agreements with finance companies to provide access to their customer database, it was not a contract for service and, thus, assessee was not required to deduct tax at source while making payments to finance companies. **Dy. CIT v. Armour Consultants (P.) Ltd.* [2012] 50 SOT 140 (ITAT-Chennai)**

Q.25. Whether provisions of section 194C shall apply to payment made to Security Guard?

A.25. Yes, please refer **Glaxo Smith Kline Pharmaceuticals Ltd. v. ITO (TDS) (2011) 48 SOT 643 (Pune)(Trib).**

Q.26. Whether payment made to daily wager shall attract TDS u/s 194C?

A.26. No, please refer **CIT v. DewanChand (2009) 17 DTR 337 (Del)**.

Q.27. Whether the provision of section 194C shall also apply to the collections made by contractor?

A.27. Tax u/s 194C has to be deducted from the payments made to a contractor at the time of such payment to the account of the contractor or at the time of payment thereof in cash or by issue of a cheque or draft or any other more and therefore no tax deductible on the amount collected by contractor on behalf of municipal committee. **{S.S. and Co. Octroi Contractors v. State of Punjab and Others (204) 268 ITR 398 (P&H)].**

Q.28. What is the criteria to distinguish between works contract and contract for sale of goods?

A.28. The question whether a particular contract is a contract for sale or works contract shall depend upon the facts and circumstances of each case. **Please refer State of Gujarat v Variety Body Builders 38 STC 176 (SC) and Anamolu Seshagiri Rao & Co. v. State of Andhra Pradesh (1973) 32 STC 51 (AP), P.S.&**

Company v. State of Andhra Pradesh 56 STC 283, Sentinel Rolling Shutters & Engineering Co. (P) Ltd. v. CST (1978) 42 STC 409 (SC).

Q.29. Whether a contract to improve customers goods will amount to works contract?

A.29. Yes, please refer **Shankar Vittal Motor Co. v. State of Mysore (1964) 15 STC 771 (Mys).**

Q.30. Whether provisions of section 194C shall apply to bottling contracts ?

A.30. yes, please refer **United Exercise v. CST 28 STC 16.**

Q.31. Whether provisions of section 194C shall apply to periodic repairing?

A.31. yes, please refer **Eastern Typewriter Service v. State of Andhra Pradesh (1978) 42 STC 18 (AP), also refer Circular: No. 715, dated 8-8-1995.**

Q.32. Whether provisions of section 194C shall apply on supply of packing material?

A.32. Where assessee-company purchased printed cartons with its own specifications from different suppliers for packing plastic containers in which rolls films were packed, payment for said purchases was not contractual payment requiring deduction of tax under section 194C. Please refer **Jindal Photo Films Ltd. v. ITO [2006] 5 SOT 272 (Delhi), see also Wadilal Dairy International Ltd. v. Asssitant CIT (2001) 70 TTJ (Pune-Trib) 77. Also see Balsara Home Products Ltd. v. ITO (2005) 94 TTJ (Ahd.) 970. See also ITO v. Dr.Willmar Schwabe India Pvgt. Ltd. (205) 3 SOT 71 (Del).**

Q.33 Whether provision of section 194C shall apply on supply of printed labels by printer to assessee?

A.33. The supply of printed labels by the printer to the assessee amounted to sale and not a works contract and that the provisions of S. 194C were not attracted. **Please refer CIT v. Dabur India Ltd. (2005) 198 CTR (Del) 375. BDA Ltd. v. ITO, (TDS)(2006) 281 ITR 999 (BOM), CIT v. Dabur India Ltd. (2006) 283 ITR 197 (Del) also refer Circular: No. 715, dated 8-8-1995.**

Q.34. Whether provisions of section 194C shall apply to clearing and forwarding agent?

A.34. Payment made to clearing and forwarding agent is of the nature of payment made for carrying out any work. **Please refer National Panasonic India Pvt. Ltd. v. DCIT (TDS) (205) 3 SOT 16 (Del). See also Glaxo Smith Kline Consumer Healthcare Ltd. v. ITO (2007) 12 sot 221 (Del Trib).**

Q.35. What would be the scope of an advertising contract for the purpose of section 194C of the Act?

A.35. The term 'advertising' has not been defined in the Act. During the course of the consideration of the Finance Bill, 1995, the Finance Minister clarified on the Floor of the House that the amended provisions of tax deduction at source would apply when a client makes payment to an advertising agency and not when advertising agency makes payment to the media, which includes both print and electronic media. The deduction is required to be made at the rate of 1 per cent. It was further clarified that when an advertising agency makes payments to their models, artists, photographers, etc., the tax shall be deducted at the rate of 5 per cent as applicable to fees for professional and technical services under section 194J of the Act. **Circular: No. 715, dated 8-8-1995.**

Q.36. At what rate is tax to be deducted if the advertising agencies give a consolidated bill including charges for art work and other related jobs as well as payments made by them to media?

A.36. The deduction will have to be made under section 194C at the rate of 1 per cent. The advertising agencies shall have to deduct tax at source at the rate of 5 per cent under section 194J while making payments to artists, actors, models, etc. If payments are made for production of programmes for the purpose of broadcasting and telecasting, these payments will be subjected to TDS @ 2 per cent. Even if the production of such programmes is for the purpose of preparing advertisement material, not for immediate advertising, the payment will be subject to TDS at the rate of 2 per cent. **Circular: No. 715, dated 8-8-1995.**

Q.37 Where the tax is required to be deducted at source on payments made directly to the print media/Doordarshan for release of advertisements?

A.37. The payments made directly to print and electronic media would be covered under section 194C as these are in the nature of payments for purposes of advertising. Deduction will have to be made at the rate of 1 per cent. It may, however, be clarified that the payments made directly to Doordarshan may not be subjected to TDS as Doordarshan, being a Government agency, is not liable to income-tax. **Circular: No. 715, dated 8-8-1995.**

Q.38. Whether a contract for putting up a hoarding would be covered under section 194C or 194-I of the Act?

A.38. The contract for putting up a hoarding is in the nature of advertising contract and provisions of section 194C would be applicable. It may, however, be clarified that if a person has taken a particular space on rent and thereafter sub lets the same fully or in part for putting up a hoarding, he would be liable to

TDS under section 194-I and not under section 194C of the Act. **Circular: No. 715, dated 8-8-1995.**

Q.39. Whether payment under a contract for carriage of goods or passengers by any mode of transport would include payment made to a travel agent for purchase of a ticket or payment made to a clearing and forwarding agent for carriage of goods?

A.39. The payments made to a travel agent or an airline for purchase of a ticket for travel would not be subjected to tax deduction at source as the privity of the contract is between the individual passenger and the airline/travel agent, notwithstanding the fact that the payment is made by an entity mentioned in section 194C(1). The provision of section 194C shall, however, apply when a plane or a bus or any other mode of transport is chartered by one of the entities mentioned in section 194C of the Act. As regards payments made to clearing and forwarding agent for carriage of goods, the same shall be subjected to tax deduction at source under section 194C of the Act. **Circular: No. 715, dated 8-8-1995.**

Q.40. Whether a travel agent/clearing and forwarding agent would be required to deduct tax at source from the sum payable by the agent to an airline or other carrier of goods or passengers?

A.40. The travel agent, issuing tickets on behalf of the airlines for travel of individual passengers, would not be required to deduct tax at source as he acts on behalf of the airlines. The position of clearing and forwarding agents is different. They act as independent contractors. Any payment made to them would, hence, be liable for deduction of tax at source. They would also be liable to deduct tax at source while making payments to a carrier of goods, **Please refer CIT v Cargo Linkers (2008) 218 CTR 695 (Del), ACIT v Grandprix Fab.(P) Ltd. (2010) 34 DTR 248 (Del – Trib). Circular: No. 715, dated 8-8-1995.**

Q.41. Whether section 194C would be attracted in respect of payments made to couriers for carrying documents, letters, etc.?

A.41. The carriage of documents, letters, etc., is in the nature of carriage of goods and, therefore, provisions of section 194C would be attracted in respect of payments made to the couriers. **Circular: No. 715, dated 8-8-1995.**

Q.42. In case of payments to transporters, can each GR be said to be a separate contract, even though payments for several GRs are made under one bill?

A.42. Normally, each GR can be said to be a separate contract, if the goods are transported at one time. But if the goods are transported continuously in pursuance of a contract for a specific period or quantity, each GR will not

be a separate contract and all GRs relating to that period or quantity will be aggregated for the purpose of the TDS. **Circular: No. 715, dated 8-8-1995.**

Q.43. Whether there is any obligation to deduct tax at source out of payment of freight when the goods are received on "freight to pay" basis?

A.43. Yes. The provisions of tax deduction at source are applicable irrespective of the actual payment. **Circular: No. 715, dated 8-8-1995.**

Q.44. Whether a contract for catering would include serving food in a restaurant/ sale of eatables?

A.44. TDS is not required to be made when payment is made for serving food in a restaurant in the normal course of running of the restaurant/cafe. **Circular: No. 715, dated 8-8-1995.**

Q.45. Whether payment to a recruitment agency can be covered by section 194C?

A.45. Provisions of section 194C apply to a contract for carrying out any work including supply of labour for carrying out any work. Payments to recruitment agencies are in the nature of payments for services rendered. Accordingly, provisions of section 194C shall not apply. The payment will, however, be subject to TDS under section 194J of the Act. **Circular: No. 715, dated 8-8-1995.**

Q.46. Whether section 194C would cover payments made by a company to a share registrar ?

A.46. In view of answer to the earlier question, such payments will not be liable for tax deduction at source under section 194C. But these will be liable to tax deduction at source under section 194J. **Circular: No. 715, dated 8-8-1995.**

Q.47. Whether FD commission and brokerage can be covered under section 194C?

A47. No **Circular: No. 715, dated 8-8-1995.**

Q.48. Whether tax is required to be deducted at source under section 194C or 194J on payment of commission to external parties for procuring orders for the company's product?

A.48. Rendering of services for procurement of orders is not covered under the provisions of section 194C. However, rendering of such services may involve

payment of fees for professional or technical services, in which case tax may be deductible under the provisions of section 194J. **Circular: No. 715, dated 8-8-1995.**

Q.49. Whether advertisement contracts are covered under section 194C only to the extent of payment of commission to the person who arranges release of advertisement, etc., or whether deduction is to be made on the gross amount including bill of media?

A.49. Tax is to be deducted at the rate of 1 per cent of the gross amount of the bill. **Circular: No. 715, dated 8-8-1995.**

Q.50. Whether deduction of tax is required to be made under section 194C for sponsorship of debates, seminars and other functions held in colleges, schools and associations with a view to earn publicity through display of banners, etc., put up by the organisers?

A.50. The agreement of sponsorship is, in essence, an agreement for carrying out a work of advertisement. Therefore, provisions of section 194C shall apply. **Circular: No. 715, dated 8-8-1995.**

Q.51. Whether deduction of tax is required to be made on payments for cost of advertisement issued in the souvenirs brought out by various organisations?

A.51. Yes. **Circular: No. 715, dated 8-8-1995.**

Q.52. Whether a maintenance contract including supply of spares would be covered under section 194C or 194J of the Act?

A.52. Routine, normal maintenance contracts which includes supply of spares will be covered under section 194C. However, where technical services are rendered, the provision of section 194J will apply in regard to tax deduction at source. **Circular: No. 715, dated 8-8-1995.**

Q.53. Whether the deduction of tax at source under sections 194C and 194J has to be made out of the gross amount of the bill including reimbursements or excluding reimbursement for actual expenses ?

A.53. Sections 194C and 194J refer to any sum paid. Obviously, reimbursements cannot be deducted out of the bill amount for the purpose of tax deduction at source. **Circular: No. 715, dated 8-8-1995.**

Q.54 Whether provisions of S. 194C shall apply to cooling charges paid to cold storage owners?

A.54 Yes, the arrangement between the customer and cold storage owners are basically contractual in nature and hence the provisions of section 194C

(instead of section 194-I) will be applicable to the amount paid as cooling charges by the customers of the cold storage. **[Circular No. 1/2008, dated 10/01/2008].**

Q.55 Whether provisions of S. 194C shall also apply to banks in relation to services rendered by it?

A.55 The provisions of section 194C would not apply in relation to payments made to banks for discounting bills, collecting/receiving payments through cheques/ drafts, opening and negotiating Letters of Credit and transactions in negotiable instruments. **Circular : No. 681, dated 8-3-1994**

Chapter-IV

TDS FROM COMMISSION AND BROKERAGE

194H. Any person, not being an individual or a Hindu undivided family, who is responsible for paying, on or after the 1st day of June, 2001, to a resident, any income by way of commission (not being insurance commission referred to in section 194D) or brokerage, shall, at the time of credit of such income to the account of the payee or at the time of payment of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of [ten] per cent :

Provided that no deduction shall be made under this section in a case where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year to the account of, or to, the payee, does not exceed [five thousand rupees] :

[**Provided further** that an individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (*a*) or clause (*b*) of section 44AB during the financial year immediately preceding the financial year in which such commission or brokerage is credited or paid, shall be liable to deduct income-tax under this section:]

[**Provided also** that no deduction shall be made under this section on any commission or brokerage payable by Bharat Sanchar Nigam Limited or Mahanagar Telephone Nigam Limited to their public call office franchisees.]

Explanation.—For the purposes of this section,—

(*i*) "commission or brokerage" includes any payment received or receivable, directly or indirectly, by a person acting on behalf of another person for services rendered (not being professional services) or for any services in the course of buying or selling of goods or in relation to any transaction relating to any asset, valuable

article or thing, not being securities;

(*ii*) the expression "professional services" means services rendered by a person in the course of carrying on a legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or such other profession as is notified by the Board for the purposes of section 44AA;

(*iii*) the expression "securities" shall have the meaning assigned to it in clause (*h*) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956)[83] ;

(*iv*) where any income is credited to any account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.]

QUESTIONS AND ANSWERS ON S. 194H

Q.1 who is responsible to deduct tax u/s 194H?

Ans. Any person, (other than individual or a Hindu undivided family) who is responsible for paying, to a resident, any income by way of commission (not being insurance commission referred to in section 194D) or brokerage, shall, deduct income-tax thereon.

However, individuals and HUF who were covered under section 44AB(a) and (b) in the preceding previous year i.e. whose gross turnover/receipts of the business/profession in the immediately preceding financial year exceeded business/profession in the immediately preceding financial year exceed ` 60,00,000 / 15,00,000, as the case may be, are also required to deduct tax at source.

Q.2 What is the point of deduction of TDS u/s 194H?

Ans. It will be deducted at the time of credit of such income to the account of the payee or to any account, whether called suspense account or by any other name or at the time of payment, of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

Q.3. At what rate TDS has to be deducted u/s 194H ?

Ans. The rate of TDS shall be 10%.

Notes:

1. No surcharge, education cess or SHEC shall be added to the above rates. Hence, tax will be deducted at source at the basic rate.

2. The rate of TDS will be 20% in all cases, if PAN is not quoted by the deductee on or after 1-4-2010.

Q.4. Under what circumstances TDS u/s 194H is not deductible?

Ans. **(1)** No deduction shall be made under this section in a case where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year to the account of, or to the payee, does not exceed ₹ 5,000 (₹ 2,500 upto 30.06.2010)

(2) No tax shall be deducted on any commission or brokerage payable by Bharat Sanchar Nigam Ltd. or Mahanagar Telephone Nigam Ltd. to their public call office franchises (Third proviso to section 194H inserted w.e.f. 1-6-2007)

Q5. What is the meaning of words "Commission or brokerage" for the purpose of section 194H?

Ans. Commission or brokerage includes any payment received or receivable, directly or indirectly, by a person acting on behalf of another person:

(a) for services rendered (not being professional services), or

(b) for any services in the course of buying or selling of goods, or

(c) in relation to any transaction relating to any asset, valuable article or thing, not being securities.

Q.6. Whether having Principal-agent relationship is a sine qua non for invoking provisions of section 194H?

Ans. Principal-agent relationship is a sine qua non for invoking provisions of section 194H. When bank issues bank guarantee on behalf of assessee, there is no principal-agent relationship between bank and assessee and, therefore, assessee is not required to deduct tax at source under section 194H from payment of bank guarantee commission made to bank. ***Kotak Securities Ltd. v. Dy. CIT [2012] 18 taxmann.com 48 (Mum.) see also Jagran Prakashan Ltd.v. Dy. CIT (TDS)* [2012] 21 taxmann.com 489 (All.), ACIT v. Pearl Bottling (P.) Ltd.* [2011] 10 taxmann.com47.(Visakhapatnam.), Ajmer Zila Dngh Utpadaicsang Ltd. V ITO (2009)30 DTR 418 (JP)(Trib)]***

Q.7. Whether TDS u/s 194H is deductible on commission paid by Mother dairies to concessionaires?

Ans. Commission paid by Mother Dairy to concessionaires who sell milk of assessee from booths owned by assessee not liable to TDS under section 194H as

principle-agent relationship is missing. ***CIT v. Mother Dairy India Ltd.* [2012] 18 taxmann.com 49 (Delhi), Delhi Milk Scheme v. ITO [2006] 8 SOT 344 (Delhi), Government Milk Scheme V ACIT (2006) 98 ITD 306 (Pune).***

Q.8. **Whether Provisions of section 194H applicable on discounts offered by laboratories rendering testing facility to collection centers/franchisees?**

Ans. Where assessee laboratory was rendering services of testing samples to collection centres/franchisees, TDS under section 194H not required in respect of discount offered by assessee to said collection centres/franchisees. ***SRL Ranbaxy Ltd. v. ACIT[2011] 16 taxmann.com 343 (Delhi).***

Q.9. Whether Provisions of section 194H applicable on discounts offered by Mobile companies to retailers of rechargeable coupons and starter packs?

Ans. Such starter packs/rechargeable coupons were sold by distributors to retailers at rate stipulated by assessee which was less than MRP on Sim cards - After selling all Sim cards and pre-paid coupons to retailers, franchisees were to make payment of sale proceeds to assessee after deducting a discount . Since there was principal-agent relationship between assessee and franchisees and, therefore, receipt of discount by franchisee was, in real sense, commission paid to franchisees and same would attract provisions of section 194H. Please refer ***Bharti Cellular Ltd. v. ACIT, . [2011] 12 taxmann.com 30 (Cal.) see also Vodafone Essar Cellular Ltd. v. ACIT*[2010] 194 Taxman 518 (KER.), however contrary decision given by the Hyderabad tribunal in ACIT v Idea Cellular Ltd. (2009) 29 DTR 237 (Hyd)***

Q.10. Whether deduction of TDS u/s 194H permissible, in case agreement between payer and payee is on principal to principal basis?

Ans. Assessee-company, engaged in business of manufacture and sale of soft drinks, had appointed a C&F-cum-distributor for purpose of distribution and sale of its products vide an agreement - Assessing Officer held that payments made by assessee to distributor would constitute commission under section 194H and assessee was liable to deduct tax at source on such payments. Since agreement between assessee and distributor was clearly stipulated to be an agreement on principal-to-principal basis, payments made by assessee to distributor were as incentives and discounts and not commission liable for deduction of tax at source under section 194H. Please refer ***CIT v. Jai Drinks (P.) Ltd.* 2011] 198 Taxman 271 (Delhi)***

Q.11. Whether TDS u/s 194H applicable to tickets issued by airlines to its travel agents at a concessional price?

Ans. Assessee-airlines issued tickets to its travel agents at a concessional price, transaction between assessee and travel agents was that of principal-to-principal and difference in price was discount and therefore, such transaction would not fall with ambit of section 194H. ***CIT v. Singapore Airlines Ltd.* [2009] 180 Taxman 128 (Delhi).***

Q.12. Whether Provisions of section 194H applicable to trade incentive to dealers?

Ans. Where assessee, a manufacturer of bicycles, was giving trade incentive to dealers, Tribunal was justified in holding that if dealers were selling goods at price for which they were purchasing from company, such trade incentive would amount to commission for purpose of section 194H. ***Please refer Tube Investments of India Ltd. v. ACIT[2009] 223 CTR 99 (MAD.)***

Q.13 Whether Provisions of section 194H applicable on Discount granted to licensed stamp vendors on sale of stamp paper?

Ans. Discount granted to licensed stamp vendors on sale of stamp paper, by treasury cannot be termed as `commission or brokerage' to attract TDS under section 194H. ***Please refer Kerela State Stamp Vendors Association v. Office of the Accountant General [2006] 150 Taxman 30/282 ITR 7/200 CTR 658 (Ker)***

Q.14 Whether Provisions of section 194H applicable on payments made by news channel to advertising agencies?

Ans. Where assessee, a unit of Prasar Bharati, was paying certain amount at the rate of 15 per cent to the advertising agencies, since there was no relationship of principal and agent between assessee and advertising agency, aforesaid amount deducted by the advertising agency out of gross payment received by agency from advertiser could not be treated to be payment of commission by assessee to agency so as to attract deduction of tax at source under section 194H on payment received by agency. Please refer ***All India Radio Commercial Broadcasting Service / Prasar Bharati Broadcasting Corpn. of India v. ITO [2006] 8 SOT 513 (Delhi)***

Q.15. Whether consigner is liable to deposit TDS u/s 194H to the credit of Central Government where consignee retained its commission out of sale proceeds of goods?

Ans. Where commission or brokerage is retained by the consignee/agent and not remitted to the consignor/principal while remitting the sale consideration. It may be clarified that since the retention of commission by the consignee/

agent amounts to constructive payment of the same to him by the consignor/ principal, deduction of tax at source is required to be made from the amount of commission. Therefore, the consignor/principal will have to deposit the tax deductible on the amount of commission income to the credit of the Central Government, within the prescribed time***. Please refer Circular: No. 619, dated 4-12-1991.***

Q.16. Whether provisions of S. 194H shall apply to free issue of goods under trade scheme?

Ans. Free issue of goods under trade scheme and free gift on sponsorship and promotions and early payment discount given to distributors do not constitute commission as the distributor works on principal to principal basis and not on principal agent relation. ***[Foster's India (P) Ltd. v ITO (2009) 29 SOT 32 (Pune) (URO).]***

Q.17. Whether TDS u/s 194H deductible on turnover commission payable by RBI to Agency Banks?

Ans. Tax deduction at source under section 194H should not be applicable in respect of Turnover Commission payable by the Reserve Bank of India to the Agency Banks (Banks authorized for conducting Government business) for performing the general banking business of the Central and State Governments on behalf of RBI. ***Circular: No. 6/2003, dated 3-9-2003.***

Chapter -V

TDS ON RENT

194-I. Any person, not being an individual or a Hindu undivided family, who is responsible for paying to [a resident] any income by way of rent, shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, [deduct income-tax thereon at the rate of—

[(*a*) two per cent for the use of any machinery or plant or equipment; and

(*b*) ten per cent for the use of any land or building (including factory building) or land appurtenant to a building (including factory building) or furniture or fittings:]]

Provided that no deduction shall be made under this section where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year by the aforesaid person to the account of, or to, the payee, does not exceed [one hundred and eighty thousand rupees] :

[Provided further that an individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (*a*) or clause (*b*) of section 44AB during the financial year immediately preceding the financial year in which such income by way of rent is credited or paid, shall be liable to deduct income-tax under this section.]

Explanation.—For the purposes of this section,—

[(*i*) "rent" means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any,—

(*a*) land; or

(*b*) building (including factory building); or

(*c*) land appurtenant to a building (including factory building); or

(*d*) machinery; or

(e) plant; or

(*f*) equipment; or

(*g*) furniture; or

(*h*) fittings,

whether or not any or all of the above are owned by the payee;]

(*ii*) where any income is credited to any account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.]

QUESTION AND ANSWERS ON S. 194I

Q.1. who is liable to deduct TDS on Rent?

A.1. Any person, other than an individual or a HUF, is responsible for paying to resident in India, any income by way of the rent, amounting in aggregate to more than Rs. 180000 in a financial year. However w.e.f. 01/06/2002, individuals and HUF who were covered under section 44AB (a) and (b) in the preceding previous year, are also required to deduct tax at source.

Q.2. What is the point of deduction of TDS u/s 194I?

A.2. Tax should be deducted either at the time of actual payment of rent or at the time of its credit to the account of the payee whichever is earlier.

Q.3. What is the meaning of Rent?

A.3. Clause (c.)of Explanation to section 194I specifies the meaning of "Rent" means any payment, by whatever name called, under any lease, sub lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any, -

(a) Land; or

(b) Building (including factory building); or

(c.) land appurtenant to a building (including factory building); or

(d) Machinery; or

(e) Plant; or

(f) Equipment; or

(g) Furniture; or

(h) Fittings,

Whether or not any or all of the above are owned by the payee.

Q.4. At what rate tax to be deducted u/s 194I?

A.4. The rates of TDS in case of rent shall be as under:

Nature of payment – Rent (194I)		
(a)	Rent of Plant Machinery or equipment	2%
(b)	Rent of Land, Building or furniture to an individual and Hindu undivided family.	10%
(c)	Rent of land, Building or furniture to a person other than an individual or Hindu Undivided Family.	10%

Q.5. Under what circumstances there is no need to deduct TDS u/s 194I?

A.5. There is no need to deduct TDS u/s 194I under below mentioned circumstances:

(i) Where aggregate amount of rent does not exceed Rs. 180000/-

(ii) In case, where rent paid to Government and Certain entities.

(iii) Entities whose income is unconditionally exempt u/s 10. (Refer circular no. 4/2002, dated 10/07/2002 also refer circular No. 12/2002, dated 22/11/2002, circular no. 735, dated 30.01.1996].

(iv) In case, where payee applied in Form 13 to AO for non deduction, being his taxable income including rent below taxable limit, and has obtained certificate thereof.

Q.6. Whether a contract for putting up a hoarding would be covered under section 194C or 194-I of the Act?

A.6. The contract for putting up a hoarding is in the nature of advertising contract and provisions of section 194C would be applicable. It may, however, be clarified that if a person has taken a particular space on rent and thereafter sub

lets the same fully or in part for putting up a hoarding, he would be liable to TDS under section 194-I and not under section 194C of the Act. **Circular : No. 715, dated 8-8-1995. See also ITO v Roshan Publicity Pvt. Ltd. (2005) 4 SOT 105 (Mum).**

Q.7. Whether payments made to a hotel for rooms hired during the year would be of the nature of rent?

A.7. Payments made by persons, other individuals and HUFs for hotel accommodation taken on regular basis will be in the nature of rent subject to TDS under section 194-I. **Circular : No. 715, dated 8-8-1995.**

Q.8. Whether the rent paid should be enhanced for notional income in respect of deposit given to the landlord?

A.8. The tax is to be deducted from actual payment and there is no need of computing notional income in respect of a deposit given to the landlord. If the deposit is adjustable against future rent, the deposit is in the nature of advance rent subject to TDS. **Circular: No. 715, dated 8-8-1995.**

Q.9. Whether payments made by company taking premises on rent but styling the agreement as a business centre agreement would attract the provisions of section 194-I?

A.9. The tax is to be deducted from rent paid, by whatever name called, for hire of a property. The incidence of deduction of tax at source does not depend upon the nomenclature, but on the content of the agreement as mentioned in clause (*i*) of *Explanation* to section 194-I. **Circular: No. 715, dated 8-8-1995.**

Q.10. Whether in a case of a composite arrangement for user of premises and provision of manpower for which consideration is paid as a specified percentage of turnover, section 194-I of the Act would be attracted?

A.10. If the composite arrangement is in essence the agreement for taking premises on rent, the tax will be deducted under section 194-I from payments thereof. **Circular: No. 715, dated 8-8-1995.**

Q.11. Whether tax is required to be deducted at source where a non-refundable deposit has been made by the tenant?

A.11. In cases where the tenant makes a non-refundable deposit tax would have to be deducted at source as such deposit represents the consideration for the use of the land or the building, etc., and, therefore, partakes of the nature of rent as defined in section 194-I. If, however, the deposit is refundable, no tax would be deductible at source. It is further clarified that if the deposit carries interest, the

tax to be deducted on the amount of interest will be governed by section 194A of the Income-tax Act. **Circular: No. 718, dated 22-8-1995**

Q.12. Whether the tax is to be deducted at source from warehousing charges?

A.12. The term 'rent' as defined in *Explanation* (*i*) below section 194-I means any payment by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of any building or land. Therefore, the warehousing charges will be subject to deduction of tax under section 194-I. **Circular: No. 718, dated 22-8-1995**

Q.13. On what amount the tax is to be deducted at source if the rentals include municipal tax, ground rent, etc.?

A.13. The basis of tax deduction at source under section 194-I is "income by way of rent". Rent has been defined, in the *Explanation* (*i*) of section 194-I, to mean any payment under any lease, tenancy, agreement, etc., for the use of any land or building. Thus, if the municipal taxes, ground rent, etc., are borne by the tenant, no tax will be deducted on such sum. **Circular: No. 718, dated 22-8-1995**

Q.14. Whether section 194-I is applicable to rent paid for the use of only a part or a portion of any land or building?

A.14. Yes, the definition of the term "any land" or "any building" would include a part or a portion of such land or building. **Circular: No. 718, dated 22-8-1995**

Q.15. Where accommodation in hotel rooms taken on regular basis whether tax is deductible u/s 194C or 194I?

A.15. Where earmarked rooms are let out for a specified rate and specified period, they would be construed to be accommodation made available on 'regular bases. Similar would be the case, where a room or set of rooms are not earmarked, but the hotel has a legal obligation to provide such types of rooms during the currency of the agreement. However, where an agreement is merely in the nature of a rate contract, it cannot be said to be accommodation 'taken on regular basis', as there is no obligation on the part of the hotel to provide a room or specified set of rooms. The occupancy in such cases would be occasional or casual. In other words, a rate-contract is different for this reason from other agreements, where rooms are taken on regular basis. Consequently, the provisions of section 194-I while applying to hotel accommodation taken on regular basis would not apply to rate contract agreements. **Please refer Circular: No. 5/2002, dated 30-7-2002.**

Q.16. How he can take credit of TDS deducted on advance rent?

A.16. Where advance rent is spread over more than one financial year and tax is deducted thereon, credit shall be allowed in the same proportion in which such income is offered for taxation for different assessment years. However where rent agreement gets terminated/cancelled resulting into refund of balance amount of advance rent to the tenant. Or the rented property is transferred, credit for the entire balance of tax deducted at source, which has not been given credit so far, shall be allowed in the assessment year relevant to the financial year during which the rent agreement gets terminated/cancelled or rented property is transferred and balance of advance rent is refunded to the transferee or the tenant, as the case may be. **Please refer Circular : No. 5/2001, dated 2-3-2001.**

Q.17. Whether provisions of S. 194I shall apply in a situation where payment is made for hotel accommodation by an employee or an individual representing a company?

A.17. Where an employee or an individual representing a company (like a consultant, auditor, etc.) makes a payment for hotel accommodation directly to the hotel as and when he stays there, the question of tax deduction at source would not normally arise (except where he is covered under section 44AB as mentioned above) since it is the employee or such individual who makes the payment and the company merely reimburses the expenditure. **Circular: No. 5/2002, dated 30-7-2002.**

Q.18. Whether provisions of S. 194 I shall apply to proceeds of film exhibition?

A.18. Provisions of section 194-I are not attracted to proceeds of film exhibition, since :

(i) The exhibitor does not let out the cinema hall to the distributor;

(ii) Generally, the share of the exhibitor is on account of composite services; and

(iii) The distributor does not take cinema building on lease or sub-lease or tenancy or under any agreement of similar nature.

Please refer - **Circular : No. 736, dated 13-2-1996.**

Q.19. Whether TDS u/s 194 I deductible on gross amount inclusive of service tax?

A.19. Service tax paid by the tenant doesn't partake the nature of "income" of the landlord. The landlord only acts as a collecting agency for Government for

collection of service tax. Therefore it has been decided that tax deduction at source (TDS) under sections 194-I of Income-tax Act would be required to be made on the amount of rent paid/payable without including the service tax. Please refer **CIRCULAR NO. 4/2008, DATED 28-4-2008**

Q.20. Whether holding company is liable to deduct TDS on rent in respect of premises shared with its subsidiary?

A.20. Where holding company of assessee took a premise on rent and allowed assessee to use a part of it, and there was no relationship of lessor and lessee between them, assessee had no TDS obligation under section 194-I while reimbursing a part of rent to holding company. **Please refer ACIT *v.* Result Services (P.) Ltd. [2012] 23 taxmann.com 93 (Delhi)**

Q.21. Whether TDS u/s 194 I on payments in respect of entitlement rights of assured supply of railway rakes?

A.21. Seconding entitlement rights of assured supply of railway rakes and receiving charges for same is not rent as defined in section 194-I and, therefore, there would be no TDS obligation. **Bonai Industrial Co. Ltd. v. Dy.CIT, [2012] 24 taxmann.com 158 (Cuttack - Trib.)**

Q.22. Where there are several co – owners whether threshold limit of Rs. 180000/- shall be taken in to consideration in respect of each co-owner separately?

A.22. Where property in question leased out to a bank was owned by various co-owners and each owner was having a definite and ascertainable share in property, threshold limit for purpose of deduction of tax at source under section 194-I would apply to each of co-owners separately. **CIT v. Senior Manager, SBI*[2012] 20 taxmann.com 40 (All.) see also CIT v. Manager, State Bank of India[2009] 226 CTR 310 (RAJ.), Amalendu Sahoo V ITO (2003) 264 ITR 16 (Cal), Orient Bank of Commerce V TDS / TRO (2006) 99 TTJ 1235 (Chd).**

Q.23. Whether the tenant / assessee can be held as assessee in default, where the landlord duly paid the short deduction of TDS along with interest?

A.23. Once landlord paid amount of short deduction of TDS with interest on amount of rent, tenant/assessee could not be construed as an assessee-in-default. **CIT v. Sony India (P.) Ltd.* [2012] 17 taxmann.com 126 (Kar.)**

Q.24. Whether TDS on Landing and parking charges is deductible u/s 194C or 194I?

A.24. Landing and parking charges paid by assessee-airlines to Airport Authority of India were 'rent' within meaning of provisions of section 194-I as those were

payments made for use of land of airport. **CIT v. Japan Airlines Co. Ltd. [2010] 325 ITR 298 (Delhi) see also CIT v Asiana Airlines (2008) 175 Taxman 177 (Del, United Airlines V CIT (2006) 287 ITR 281 (Del), however Chennai high court has given an adverse opinion in Singapore Airlines Ltd. V ITO (2006) 7 SOT 84 (Chennai).**

Q.25. Whether provisions of S. 194I shall apply to non refundable security deposit?

A.25. Amount paid as security deposit under terms of lease agreement which was not refundable at the time of termination of lease. It could be said that said amount was in fact advance rent and as such, assessee was required to deduct tax at source from payment of such advance rent under section 194-I. **Please refer CIT* v. Reebok India Co. [2007] 291 ITR 455 (Delhi)**

Q.26. Where only land and warehouse are used and no other ser-vices are provided – Whether tax deductible u/s 194C or 194I?

A.26. Where only land and warehouse are used and no other ser-vices are provided, payment made is rent subject to deduction of tax at source under section 194-I of IT Act. **Hindustan Coca-Cola Bev. (P.) Ltd. v. CIT [2004] 141 Taxman 60 (Delhi)**

Q.27. Whether TDS u/s 194I is deductible on upfront fee?

A.27. Where the lessee paid an upfront fee against license fee for a lease covering a period of 30 years, tax is deductible at source even on such upfront fee as rent under section 194I. **Please refer TRO v Bharat Hotels Ltd. (2009) 318 ITR (AT) 244(Bom)].**

Q.28. Whether fee for infrastructure partakes the character of Rent for the purpose of deduction of tax u/s 194I?

A.28. where fees collected from students were shared by assessee and it franchisees and the assessee for the purpose of its convenience, had categorized said fees shared as marketing claim and infrastructure claim. No tax is deductible on infrastructure claim u/s 194I. **Please refer [CIT v NIIT Ltd. (2009) 184 Taxman 472 (Del) see also ACIT v Nib Ltd. (2008) SOT 44 (Del) (URO).**

Q.29. Where rent paid to Co - owners separately will partake the character of rent paid to AOP?

A.29. No, **please refer [CIT v Lally Motors (2009) 311 ITR 29 (P&H)].**

Q.30. Whether TDS u/s 194I applies to premium payable for lease?

A.30. The definition of rent includes any payment by whatever name called **[(CIT v Panbari Tea Co. Ltd. (1965) 57 ITR 422 (SC)]**

Q.31. Whether hiring of storage tanks qualified either as land and building or hire charges?

A.31. The storage tanks in question did not qualify either as land or as building within the meaning of section 194I, what is attached to the land belongs to the land is a principle not applicable to India. Therefore, the structure though erected on land, could not be regarded as part of the land. **Please refer [Gulf Oil India Ltd. V ITO (2000) 75 ITD 172 (Mum)].**

Q.32. Whether provision of S. 194I shall attract where C&F agent provides other services in addition to storage?

A.32. Where the terms & conditions of the agreement are such that, to reveal that the agent not only stored the goods but also rendered certain other professional services like inventory management, packing, follow up, collection, maintaining banks account of the sale proceeds, under these circumstances it could not be said that the payment made by the assessee to them was in the nature of rent. **Please refer [Eli Lilly & Co. (India) (P) Ltd. V DCIT (2006) 99 TTJ 461 (Del)]**.

Chapter -VI

TDS ON FEES FOR PROFESSIONAL OR TECHNICAL SERVICES

194J. (1) Any person, not being an individual or a Hindu undivided family, who is responsible for paying to a resident any sum by way of—

(*a*) fees for professional services, or

(*b*) fees for technical services, [or]

[(ba) *any remuneration or fees or commission by whatever name called, other than those on which tax is deductible under section 192, to a director of a company; or***]**

[(*c*) royalty, or

(*d*) any sum referred to in clause (*va*) of section 28,]

shall, at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to [ten] per cent of such sum as income-tax on income comprised therein :

Provided that no deduction shall be made under this section—

(*A*) from any sums as aforesaid credited or paid before the 1st day of July, 1995; or

(*B*) where the amount of such sum or, as the case may be, the aggregate of the amounts of such sums credited or paid or likely to be credited or paid during the financial year by the aforesaid person to the account of, or to, the payee, does not exceed—

(*i*) [thirty thousand rupees], in the case of fees for professional services referred to in clause (*a*), or

(*ii*) [thirty thousand rupees], in the case of fees for technical services referred to in [clause (*b*), or]

(*iii*) [thirty thousand rupees], in the case of royalty referred to in clause (*c*), or

(*iv*) [thirty thousand rupees], in the case of sum referred to in clause (*d*) :]

[Provided further that an individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (*a*) or clause (*b*) of section 44AB during the financial year immediately preceding the financial year in which such sum by way of fees for professional services or technical services is credited or paid, shall be liable to deduct income-tax under this section :]

[Provided also that no individual or a Hindu undivided family referred to in the second proviso shall be liable to deduct income-tax on the sum by way of fees for professional services in case such sum is credited or paid exclusively for personal purposes of such individual or any member of Hindu undivided family.]

Explanation.—For the purposes of this section,—

(*a*) "professional services" means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or advertising or such other profession as is notified by the Board for the purposes of section 44AA or of this section;

(*b*) "fees for technical services" shall have the same meaning as in *Explanation 2* to clause (*vii*) of sub-section (1) of section 9;

[(*ba*) "royalty" shall have the same meaning as in *Explanation 2* to clause (*vi*) of sub-section (1) of section 9;]

(*c*) where any sum referred to in sub-section (1) is credited to any account, whether called "suspense account" or by any other name, in the books of account of the person liable to pay such sum, such crediting shall be deemed to be credit of such sum to the account of the payee and the provisions of this section shall apply accordingly.

Note in respect of Amendment brought u/s 194J vide Finance Act 2012 - Section 194J (1)(ba) - [Newly Inserted w.e.f. 1st July, 2012]

"any remuneration or fees or commission by whatever name called, other than those on which tax is deductible under section 192, to a director of a company; or

Notes to clause:

The existing provisions in sub-section (1) of the aforesaid section 194J provide that a person, not being a individual or a HUF, who is responsible for paying to a resident any sum by way of fees for professional services, fees for technical services royalty or sums referred to in clause (va) of section 28 shall deduct an amount equal to 10% of such sum as income tax. It is proposed to amend the aforesaid sub-section (1) to insert a new clause (ba) so as to provide that the person referred to in sub-section (1) of the aforesaid section who is responsible for paying to a director of a company any sum by way of any remuneration or fees or commission, by whatever name called (other than those on which tax is deductible under section 192), shall deduct an amount equal to 10% in accordance with the provisions of the aforesaid section.

Memorandum Explaining Finance Bill 2012

Under the existing provisions of the Income-tax Act, a company, being an employer, is required to deduct tax at the time of payment of salary to its employees including Managing director/whole time director. However, there is no specific provision for deduction of tax on the remuneration paid to a director which is not in the nature of salary.

It is proposed to amend section 194J to provide that tax is required to be deducted on the remuneration paid to a director, which is not in the nature of salary, at the rate of 10% of such remuneration.

Brief of Amendment

The amendment is proposed to provide for deduction of tax at source @ 10% by a company in respect of remuneration or fees or commission by whatever name called, paid to a director which is not in the nature of salary and it will be considered as fees for professional or technical services.

Q.1. <u>Who is liable to deduct TDS u/s 194J</u>?

A.1. Any person, other than in individual or a HUF, who is responsible for paying to a resident any sum by way of:-

i. Fees for professional services,

ii. Fees for technical services,

iii. Any remuneration or fee or commission by whatever name called paid to a director, which is not in the nature of salary (w.e.f. 1.7.2012)

iv. Royalty,

v. Any sum referred to in clause (va) of section 28 which relates to non-complete payment, or

vi. Shall deduct income tax on income comprised therein.

vii. However, an individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or professional carried on by him exceed the monetary limits specified under clause (a) or clause(b) of section 44AB during the financial year immediately preceding the financial year in which such sum by way of fees for professional services or technical services is credited or paid, shall also be liable to deduct income-tax under this section. [Proviso 2 to section 194J(1)].

Q.2. What is the point of deduction of TDS u/s 194J?

A.2. Tax is to be deducted either at the time of actual payment of such fees or its credit to the account of the payee whichever is earlier.

Q.3. At what rate tax to be deducted u/s 194J?

A.3. 10% on such income.

Notes:

i. No surcharge, education cess or SHEC shall be added to the above rates. Hence, tax will be deducted at source at the basic rate.

ii. The rate of TDS will be 20% in all cases, if PAN is not quoted by the deductee on or after 1-4-2010.

Q.4. Under what circumstances there is no need to deduct TDS u/s 194J?

A.4. There is no need to deduct TDS u/s 194J where the amount of such sum or, as the case may be, the aggregate of the amounts of such sums credited or paid or likely to be credited or paid during the financial year by the aforesaid person to the account of, or to, the payee, does not exceed-

(i) Rs. 30,000 in the case of fees for professional services referred to above.

(ii) Rs. 30,000 in the case of fees for technical services referred to above.

(iii) Rs. 30,000 in the case of royalty referred to above.

(iv) Rs. 30,000 in the case of non-complete fee referred to above.

Q.5. What is the meaning of professional Services in reference to S. 194J?

A.5. Explanation (a) to Section194J provides that 'Professional Services' means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or advertising or such other profession as is notified by the Board for the purposes of section 44AA or of this section.

Q.6. What is the meaning of Expression "fees for technical services" in reference to section 194J?

A.6. Explanation (b) to Section194J provides that "fees for technical services" shall have the same meaning as in *Explanation 2* to clause (*vii*) of sub-section (1) of section 9, which provides "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries".

Q.7. What is the meaning of "Royalty" in reference to S. 194J?

A.7. Explanation (ba) to Section194J provides that "royalty" shall have the same meaning as in *Explanation 2* to clause (*vi*) of sub-section (1) of section 9, which provides that "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—

(*i*) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(*ii*) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(*iii*) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;

(*iv*) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;

(*iva*) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB

(*v*) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films ; or

(*vi*) the rendering of any services in connection with the activities referred to in sub-clauses (*i*) to (*iv*), (*iva*) and] (*v*).

To further clarify meaning of royalty explanation 4, 5 and 6 inserted to *Explanation 2* to clause (*vi*) of sub-section (1) of section 9, vide Finance Act, 2012, which are as under:

"Explanation 4.—For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a license) irrespective of the medium through which such right is transferred.

Explanation 5.—For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—

(a) the possession or control of such right, property or information is with the payer;(b) such right, property or information is used directly by the payer;

(c) the location of such right, property or information is in India.

Explanation 6.—For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fiber or by any other similar technology, whether or not such process is secret;"

Q.8. Whether provisions of S. 194J are applicable to Transaction charges paid by assessee-stock broker to Stock Exchange?

A.8. Transaction charges paid by assessee-stock broker to BSE in respect of transactions carried out through BOLT system constituted fees for technical services under section 194J read with Explanation 2 to section 9(1)(vii) and, hence, assessee was liable to deduct tax at source before crediting transaction charges to account of stock exchange. **CIT v. Kotak Securities Ltd.* [2011] 15**

taxmann.com 77 (Bom.)also refer DCIT v Angel Broking Ltd (2010)35 SOT 457(Mum).

Q.9. Whether provisions of S. 194J are applicable to payments made for rendering services in course of carrying on medical profession?

A.9. Payment is made to a recipient for rendering services in course of carrying on medical profession or other professions as stipulated in section 194J, deduction of tax at source has to be made and it is immaterial whether recipient is an individual, firm or an artificial person. **Vipul Medcorp TPA (P.) Ltd. v. Central Board of Direct Taxes [2011] 14 taxmann.com 13 (Delhi)**

Q.10. Whether provisions of S. 194J are applicable to service provided by MTNL/ BSNL for services of interconnect/port/access/toll?

A.10. The expression 'fees for technical services' as appearing in section 194J would have reference to only technical service rendered by a human; it would not include any service provided by machines or robots. Therefore service provided by MTNL/BSNL for services of interconnect/port/access/toll would not fall within the purview of payments as provided for under section 194J, so as to be liable for tax deduction at source. **CIT v. Bharti Cellular Ltd.[2008] 175 TAXMAN 573 (DELHI)** However, the Apex Court remitted the matter to the Assessing Officer, directing him to examine the case with the help of a technical expert to study whether any human intervention is involved. **[CIT v Bharti Cellular Ltd. & Hutchison Essar Telecome Ltd. (2011) 330 ITR 239 (SC)] see also HFCL Infotel Ltd. v. ITO [2006] 99 TTJ (Chd.) 440**

Q.11. Whether tax deductible u/s 194J on payments made to person engaged in business of providing cellular mobile telephone facility?

A.11. Payments made to person engaged in business of providing cellular mobile telephone facility by subscribers, being firms and companies, are not covered by definition of 'fees for technical services' in section 194J, read with Explanation 2 to section 9(1)(vii) and as such no tax is required to be deducted at source on such payments by subscribers. **Please refer Skycell Communications Ltd. v. Dy.CIT [2001] 119 TAXMAN 496 (MAD.)**

Q.12. Whether tax deductible u/s 194J on payment made to a stockist appointed for sale on commission basis?

A.12. Section 194J is not applicable to a stockist appointed by drug manufacturer for sale of drugs on commission basis. **Please refer Piramal Healthcare Ltd. v. ACIT(TDS) [2012] 21 taxmann.com 225 (Mum.)**

Q.13. Whether TDS u/s 194J deductible on various services provided during the course of carrying of Medical profession?

A.13. Maintaining operation theatre and surgical equipments, RO system, CT scan machine, MRI machine, medical equipments and providing service of lift sterlisation and anti-termite treatment in a hospital, would amount to rendering technical and professional services. Please refer **ITO (TDS) v. Accounts Officer, Govt. Medical College, Jammu*[2012] 22 taxmann.com 149 (Asr.)**

Q.14. Whether the services rendered by news agencies to newspaper Company shall attract TDS u/s 194J?

A.14. Payments made by newspaper Company to news agencies is liable for deduction of tax at source under section 194J. **Please refer ACIT v. Ushodaya Enterprises (P.) Ltd.* [2012] 23 taxmann.com 258 (Hyd.)**

Q.15. Whether payments made to hospital for medical services provided by it shall attract TDS u/s 194J?

A.15. Where 'assessee-trust acted as a nodal agency for State of Andhra Pradesh to provide health care coverage to individuals, payments made to hospitals by assessee for medical services received by hospitals were liable to TDS u/s 194J'. **Please refer Arogya Sri Health Care Trust v. ITO [2012] 20 taxmann.com 539 (Hyd.) (see also Medi Assist India TPA (P) Ltd. v DCIT (TDS) (2009) 184 Taxman 359 (Kar)**

Q.16. Whether payment made directly to any actor on account of composite agreement entered into for financing film project shall attract TDS u/s 194J?

A.16. Contractors/sub-contractors payment to' and further having regard to fact that even if assessee had made payment directly to any actor or any person connected with film making then it was only out of composite agreement entered into for financing film project, it could not be concluded that payment made directly by assessee attracted provisions of section 194J, **Please refer Entertainment One India Ltd. * v. ITO (TDS) [2010] 126 ITD 491 (MUM.)**

Q.17. Whether non resident not having PE in India, making payments to CA, Lawyer, advocate or solicitor are required to deduct TDS u/s 194J?

A.17. Any fees paid through regular banking channel to any Resident - CA, Lawyer, advocate or solicitor by a Non Resident who do not have any agent of business connection or permanent establishment in India, may not be subject to the provisions of tax deduction at source u/s 194J. However Foreign Companies & and accounting firms are required to sent quarterly statement stating names and address of the person to whom the payments are made to the Deputy Secretary,

Foreign tax Division, CBDT, Department of Revenue, Ministry of Finance, New Delhi. **Please refer Circular No. 726, dated 18/10/1995.**

Q.18. Whether TDS u/s 194J is also deductible on reimbursements?

A.18. TDS u/s 194C & 194J refer to any sum paid i.e including reimbursements – applicable only in cases where bills are raised for the gross amount inclusive of professional fees as well as reimbursement of actual expenses.**Circular No. 715 dated 08/08/1995. Further Circular No. 720 dated 30/8/1995** provides that the provision of sec 194 C &194J is not applicable – where bills were raised separately by the consultants for reimbursements of actual expenses incurred by them. **ITO vs. Dr. Willmar Schwabe India (P) Ltd (2005) 95 TTJ (Del.)53.**

Q.19. Whether charges paid to International Airport Authority of India for navigational facilities, shall attract TDS u/s 194J?

A.19. Where assessee-airlines paid charges to International Airport Authority of India for navigational facilities, such payments attracted section 194J. **Singapore Airlines Ltd. v. ITO [2006] 7 SOT 84 (Chennai)**

Q.20. Where assessee, a non-resident company, set up a liaison office in India in and appointed consultants – whether tax deductible u/s 192 or 194J?

A.20. Where assessee, a non-resident company, set up a liaison office in India in and appointed six persons as consultants pursuant to agreements, as there was no employer-employee relationship between assessee-company and consultants, case was governed by section 194J and not section 192. **Please refer Dy CIT v. Coastal Power Co. [2006] 9 SOT 89 (Delhi)**

Q.21. At what rate TDS deductible u/s 194J by an advertising agency making payments for professional services to a film artist?

A.21. Where an advertising agency makes payments for professional services to a film artist such as an actor, a Cameraman, a director etc, tax will be deducted at the rate of 5%. **Please refer Circular No. 714, dated 03/08/1995.**

Q.22. Whether the services of a regular electrician on contract basis will fall in the ambit of technical services to attract the provisions of section 194J of the Act? In case the services of the electrician are provided by a contractor, whether the provisions of section 194C or 194J would be applicable?

A.22. The payments made to an electrician or to a contractor who provides the service of an electrician will be in the nature of payment made in pursuance of a contract for carrying out any work. Accordingly, provisions of section 194C will apply in such cases**. Please refer Circular No. 715, dated 08/08/1995.**

Q23. Whether a maintenance contract including supply of spares would be covered under section 194C or 194J of the Act?

A.23. Routine, normal maintenance contracts which includes supply of spares will be covered under section 194C. However, where technical services are rendered, the provision of section 194J will apply in regard to tax deduction at source. **Please refer Circular No. 715, dated 08/08/1995.**

Q.24. Whether the deduction of tax at source under sections 194C and 194J has to be made out of the gross amount of the bill including reimbursements or excluding reimbursement for actual expenses?

A.24. Sections 194C and 194J refer to any sum paid. Obviously, reimbursements cannot be deducted out of the bill amount for the purpose of tax deduction at source. **Please refer Circular No. 715, dated 08/08/1995.**

Q.25. Whether TDS u/s 194J deductible on payment made for purchase of course or study material?

A.25. NO, **Please refer ACIT v Frontline Software Services (P) Ltd. (2009) 24 DTR 232 (Ind-Trib)**

Q.26. Whether the provision of TDS u/s 194J applicable to payments made for facilities of bandwidth and internet?

A.26. Since bandwidth and net working operating facilities for VSNL/MTNL were standard facilities and were not in the nature of technical services with the meaning of section 194J the assessee would not be liable to deduct tax at source under section 194J. **Please refer – Pacific Internet (India) (P) Ltd. v. ITO TDS Mumbai (2009) 27 SOT 523 (Mum)]**

Chapter - VII

MISCELLANEOUS ISSUES (SECTION 193, 194, 194A, 194B, 194BB, 194D, 194E, 194EE, 194G, 194LA, 194LB, 194LC)

Q.1. Whether assessee liable to deduct TDS u/s 193 on provision of interest in case payee is not identified.

Ans. Explanation to section 193 cannot be invoked in a case where person who is to receive interest cannot be identified at stage at which provision for 'interest accrued but not due' is made and therefore there was no obligation upon assessee to deduct tax at source, there could not be any question of levy of penalty and interest under section 201 upon assessee. ***Industrial Development Bank of India v. ITO [2007] 107 ITD 45 (ITAT- MUM.).***

Q.2. Whether TDS u/s 193 deductible on Interest on own debentures?

Ans. No**, please refer *CIT V Nattarasankottai Electric Supply Corporation (1947) 15 ITR 495 (Mad).***

Q.3. Whether TDS u/s 193 deductible on Interest on debentures issued by cooperative bank?

Ans. No**. please refer *CIT v. Lakshmi Vilas Bank Ltd. (1997) 228 ITR 697 (Mad).***

Q.4. Whether TDS u/s 194 applicable to both types of dividends, i.e., normal dividend as well as deemed dividend?

Ans. Section 194 requires TDS only when payment is made to a shareholder. Payments to shareholders will cover both types of dividends, i.e., normal dividend as well as deemed dividend. Otherwise also, deemed dividend will be taxed in the hands of the shareholder and not in the hands of non-shareholder

payee. Therefore, section 194 does not require TDS when payment is made to a non-shareholder. Please refer ***NZ Reality (P.) Ltd. v. ITO, [2009] 29 SOT 61 (ITAT- JP.)(URO).***

Q.5. Whether TDS u/s 194 is deductible at the time of preparation of Warrant or at the time of dispatch of warrants?

Ans. When company declaring dividend is liable to deduct tax from dividends when warrants are sent out to shareholders and not on date on which dividends warrants are prepared. ***CIT v. Hindustan General Industries Ltd. 2000] 113 TAXMAN 506 (DELHI)***

Q.6. Whether credit of TDS can be denied on the footing that TDS certificate does not show the actual date of payment of tax to Government treasury.

Ans. Assessing Officer could not deny credit of TDS from dividend on ground that TDS certificate filed in Form No. 19 did not show actual date of payment of tax to Government treasury and that it did not contain seal of company. ***M.M. PUBLICATIONS LTD. V. ACIT [1997] 92 TAXMAN 51 (ITAT-COCH.) (MAG.)***

Q.7 Whether TDS u/s 194A deductible on interest on delayed payment of purchase bills?

Ans. Payment which has direct link and immediate nexus with trading liability will not fall within category of interest; while paying interest on delayed payment of purchase bills, no TDS obligation arises. ***Sri Venkatesh Paper Agencies (Hyd.) (P.) Ltd. v. Dy. CIT [2012] 24 taxmann.com 52 (Hyd.)***

Q.8. Whether TDS u/s 194A deductible on reimbursement of Interest?

Ans. Reimbursement of interest by subsidiary to parent company which, in turn, had repaid it to lender bank, did not involve any element of income and, thus, no TDS liability would arise under section 194A on reimbursement. ***Onward e-Services Ltd. v. ACIT* [2012] 22 taxmann.com 60 (ITAT-Mum.)***

Q.9. Whether TDS u/s 194A deductible on delayed receipt of compensation on land acquisition?

Ans. Interest received as a payment for delayed receipt of compensation on land acquisition is a revenue receipt liable to TDS under section 194A. ***Rameshwar v. Ujjain Development Authority [2012] 23 taxmann.com 6 (MP)***

Q.10. Whether TDS u/s 194A deductible on interest paid to RRRDA?

Ans. Where Rajasthan Rural Road Development agency (RRRDA) kept funds released by Ministry of Rural Development in a separate account opened with assessee-bank to be utilized for purpose of approved work under Pradhan Mantri Gram

Sadak Yojna (PMGSY), interest paid by assessee to RRRDA would not be liable to tax deduction at source under section 194A. ***ITO v. Branch Manager, State Bank of Bikaner & Jaipur* [2012] 19 taxmann.com 221 (ITAT-JP.)***

Q.11. Whether TDS u/s 194A deductible on interest neither credited nor paid during relevant period?

Ans. Where assessee has not credited interest in its books of account and such interest has not been paid in relevant year, mandate of section 194A cannot be attracted to further invoke disallowance under section 40(a)(ia). ***Pranik Shipping & Services Ltd. v. ACIT*[2012] 19 taxmann.com 107 (ITAT-Mum.)***

Q.12. Whether credit of TDS and assessment of income permissible in two different years?

Ans. Credit of tax based on TDS certificates be allowed in respect of interest income in the year in which subject-matter of deduction of tax is assessed. ***CIT v. H. Krishna Vijoy Arora* [2012] 20 taxmann.com 655 (Ker.)***

Q.13. Whether TDS u/s 194A deductible on interest credited but not paid due to loss?

Ans. Tax was to be deducted at source under section 194A where due to losses no interest was paid by assessee to its creditor but credit entry was made as if interest was paid to creditors. ***Solar Automobiles India (P.) Ltd. v. Dy.CIT (TDS), [2012] 17 taxmann.com 260 (Kar.).***

Q14. Whether interest u/s 194A deductible on interest income of trust where beneficiaries are individuals?

Ans. No, Please refer ***ML family trust v State of Gujrat (1995) 213 ITR 152 (Guj), see also Food Corporation of India v ITO (2007) 18 SOT 289 (Del), ITO v Arihant Trust (1995) 214 ITR 306 (Mad).***

Q.14. Who is responsible to deduct tax u/s 194B.

Ans. A person, who conducts any scheme in name of lottery or drawing by lot by giving a person a chance to win by participating in scheme, is responsible to deduct tax at source on value of goods given to winner. ***Hind Motors India Ltd.* v. ITO 2006] 9 SOT 556 (ITAT-CHD.)***

Q.15. Whether provisions of S. 194B applicable where participants identified on the basis of their skill or knowledge?

Ans. In 'World Cup Football Forecast' or 'Lok Sabha Election Forecast' contests were held by assessee-company and no price was paid for participation, but

only skill or knowledge was criterion and prize winners were selected by lot, said contests did not amount to lottery and, therefore, assessee was not liable to deduct tax at source before distribution of prize money of said contests as contemplated under section 194B. ***ITO v. Malayala Manorama Co. Ltd. [2005] 94 ITD 195 (ITAT-COCHIN)***

Q.16. Whether provisions of S. 194B applicable on amount of refund of prize money from unsold tickets of lotteries and unclaimed prizes?

Ans. Refund by Directorate of State Lotteries to organising agent of prize money from unsold tickets of lotteries and unclaimed prizes would not attract provisions of section 194B ***ACIT v. Director of State Lotteries . [2002] 123 TAXMAN 405 (GAU.) see also Commercial Corporation of India V ITO (1993) 201 ITR 348 (Bom).***

Q.17. Whether provisions of S. 194B applicable on monthly prize scheme?

Ans. Assessee was carrying as a prized scheme, in which 250 members were enrolled - Members were required to subscribe Rs. 300 every month for a period of 52 months - Every month there was a lucky draw and once a subscriber was declared a winner in any such draw, he need not make any payment thereafter - All others, who were not successful in previous draw had to go on paying every month till completion of Scheme - After completion of scheme all subscribers who were not successful in monthly draws would get back their contributions without interest - Whether scheme in question could be treated as `lottery' scheme and assessee was liable to deduct tax at source under section 194B - Held, yes. ***Lakshmi Gnaneswara Enterprises & Financiers v. ITO [2000] 72 ITD 295 (ITAT-HYD.)see also CIT v Sanjiv Kumar (1980)123 ITR 187 (P&H).***

Q.18. Whether deduction of floor limit of Rs. 2,500 is to be allowed from each winning from horse race?

Ans. Yes. Please refer ***Delhi Race Club (1940) Ltd. V. Dy.CIT [2007] 17 SOT 39 (Delhi)(URO)***

Q.19. Whether tax u/s 194BB is deductible only from net income?

Ans. Tax is required to be deducted only from net income arising out of horse race to punter from any particular race after deducting investment made by him in purchasing all tickets relating to such horse race. ***Royal Calcutta Turf Club v. Dy. CIT [2001] 76 ITD 237 (ITAT-CAL.)***

Q.20. Whether TDS u/s 194D is deductible on commission paid on reinsurance accepted by assessee?

Ans. No. *Please refer* ***General Insurance Corpn. of India v. Asstt. CIT [2009] 28 SOT 453 (Mum.), Tata AIG General Insurance Co. Ltd. * v. ITO [2011] 43 SOT 215 (ITAT- Mum)***

Q.21. Whether TDS u/s 194E deductible on payments to non-resident sportsman or sports association for participation in match in India ?

Ans. Amount paid to foreign team for participation in match in India in any shape, either as prize money or as administrative expenses, is income deemed to have accrued in India and is taxable under section 115BBA and, thus, section 194E is attracted. ***INDCOM* v. CIT [2011] 11 taxmann.com 109 (Cal.)***

Q.*22*. Whether obligation to deduction under section 194E is not affected by DTAA ?

Ans. Obligation to deduction under section 194E is not affected by the DTAA, since such a deduction is not the final payment of tax nor can it be said to be an assessment of tax. The deduction has to be made and after it is done, the assessee concerned gets the credit of the same and once it is found later on, that income from which the deduction is made is not exigible to tax, then on application being made refund with interest is always allowed. Fundamental distinction between the deduction at source by the payer is one thing and obligation to pay tax is another thing. Advantage of the DTAA can be pleaded and taken by the real assessee on whose account the deduction is made and not by the payer. Therefore, irrespective of the existence of the DTAA, the obligation under section 194E has to be discharged once the income accrues under section 115BBA. ***Pilcom* v. CIT [2011] 198 Taxman 555 (Cal.)***

Q. *23*. Whether TDS u/s 194E deductible on guarantee fee paid by assessee to overseas cricket boards?

Ans. The guarantee fee paid by the assessee was to the cricket bodies of the countries with which India had entered into tax treaties. It is settled legal position that in view of the provisions of section 90(2), the provisions of the tax treaty prevail over that of the domestic law unless the domestic law is more beneficial to the assessee. Therefore, in case it was concluded that the payment in question was not taxable in terms of the provisions of the applicable tax treaty, there was no need to address to the scope of provisions of the domestic law. Unless it is of the income nature, there is no question of taxability thereof. ***ITO v. Board for Cricket Control in India [2007] 14 SOT 287 (ITAT-MUM.)***

Q.24. Whether TDS u/s 194G is applicable where petitioner purchased lottery tickets at discount from State Government?

Ans. Section 194G envisages deduction of tax at source only if any commission, remuneration or prize is paid. Here in present case petitioner, who was authorized lottery ticket agent, purchased lottery tickets in bulk at a discount from State Government. Whether since tickets were given to agents on a discount and there was no payment of commission to agent at time of purchase of ticket, section became automatically inapplicable. ***M.S. Hameed v. Director of State Lotteries[2001] 114 TAXMAN 394 (KER.)***

Q.25. **Whether question of deducting tax at source arises at time of making payment and it has nothing to do with date of award of compensation?**

Ans. Section 194LA was not on the statute book on the date of the award, *i*.e., 30-5-1995 and that the said section was inserted, subsequently, by the Finance Act, 2004 with effect from 1-10-2004. *Compensation was paid on 28-4-2010 and on that day, section 194LA was on the statute book and, therefore, tax had to be deducted while making the payment of compensation.* ***Leela Bhagwansing Advani v. Union of India*[2012] 21 taxmann.com 124 (Bom.)***

Q.26. **Whether TDS u/s 194LA deducted on compensation paid for acquiring agriculture land?**

Ans. "194LA. Any person responsible for paying to a resident any sum, being in the nature of compensation or the enhanced compensation or the consideration or the enhanced consideration on account of compulsory acquisition, under any law for the time being in force, of any immovable property **(other than agricultural land),** shall, at the time of payment of such sum in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to ten per cent, of such sum as income-tax thereon: There is no jurisdiction to make deduction from compensation for agricultural land. ***Risal Singh v. Union of India2010] 321 ITR 251 (PUNJ. & HAR.)***

Q.27. **Whether definition of 'agricultural land' contained in section 2(14)(iii)(a) & (b) cannot be borrowed to influence definition of 'agricultural land' contained in Explanation to section 194LA?**

Ans. There are two definitions of the agricultural land in the Act. One is provided in section 2(14) and the other in section 194LA. The question now arises which definition is to be used for deciding the issue, whether land acquired by the LAO is agricultural land or not or what is acquired is part and parcel of or inclusive of agricultural land. For deciding the issue one has to see the purpose and object for which the two definitions have been enacted. Since in section 2(14)(iii)(a) &

(b) definition of agricultural land is given in the context of deciding what should be the capital asset then this definition can be used only for that purpose. The definition in section 2(14)(iii) is linked with section 45 where chargeability of capital gains is provided on transfer of capital asset. Therefore, the definition of agricultural land as capital asset in section 2(14), read with section 45, cannot be imported to influence the concept of agricultural land as specifically provided for in section 194LA.

The definition of immovable property given in section 194LA, and the definition of agricultural land given therein are specific to the activity of deduction of tax. Specific enactment for specific purpose should alone be invoked. ***Special Land Acquisition Officer * v. ITO[2010] 42 SOT 9 (ITAT-AHD.)***

Q.28. **Whether interest on delayed payment of enhanced compensation in respect of acquisition of immovable property is revenue receipt eligible to tax u/s 4 and, therefore, is liable to TDS u/s 194A?**

Ans. It has been concluded by the Supreme Court in various cases that interest on delayed payment on the acquisition of immovable property would be revenue receipt and would, thus, be exigible to tax.

Once interest is regarded as revenue receipt, then it would fall within the mischief of section 4, which is a charging section. Therefore, TDS under section 194A was to be paid by the petitioner in respect of the interest income on the delayed payment***. Karnail Singh v. State of Haryana*[2010] 326 ITR 501(PUNJ. & HAR.)***

Q.29. **Whether claimant is not liable to pay income-tax or if he is entitled to pay tax at lower rates, he will have to obtain necessary tax deduction certificate from Land Acquisition Officer and claim such benefit before competent authority under Act?**

Ans. It is a well settled position of law that whenever any authority deducts income-tax at source, he is bound to issue a tax deduction certificate to the claimant. So, the claimant is entitled to get a certificate of tax deducted at source or tax paid under sub-section (1A) of section 192 by the Land Acquisition Officer. Under rule 31(1) a certificate shall be issued within the time fixed under the rules and in the form prescribed. If the compensation and interest due under a decree is to be divided among a number of claimants, income-tax has to be deducted from the share found due to each claimant and separate tax deduction certificates issued to each of them. ***State of Kerala* v. Mariyamma[2006] 280 ITR 225 (KER.)***

Chapter – VIII

FAQ ON E-FILLING OF TDS RETURNS

1. What is annual e-TDS/TCS Return?

Annual e-TDS/TCS return is the TDS return under section 206 of the Income Tax Act (prepared in Form Nos. 24, 26 or 27) or TCS return under section 206C of the Income Tax Act (prepared in Form No. 27E), which is prepared in electronic media as per prescribed data structure. Such returns furnished in a CD/Pen Drive should be accompanied by a signed verification in Form No. 27A in case of Annual TDS returns or Form No. 27B in case of Annual TCS return

2. What is quarterly e-TDS/TCS statement?

TDS/TCS returns filed in electronic form as per section 200(3)/206C, as amended by Finance Act, 2005, are quarterly TDS/TCS statements. As per the Income Tax Act, these quarterly statements are required to be furnished from FY 2005-06 onwards. The forms used for quarterly e-TDS statements are Form Nos. 24Q, 26Q and 27Q and for quarterly e-TCS statement is Form No. 27EQ. These statements filed in CD/Pen Drive should be accompanied by a signed verification in Form No. 27A in case of both e-TDS/TCS statements.

3. Who is required to file e-TDS/TCS return?

As per Income Tax Act, 1961, all corporate and government deductors/collectors are compulsorily required to file their TDS/TCS returns on electronic media (i.e. e-TDS/TCS returns). However, deductors/collectors other than corporate/ government can file either in physical or in electronic form.

4. e-TDS/TCS returns have been made mandatory for Government deductors. How do I know whether I am a Government deductor or not?

All Drawing and Disbursing Officers of Central and State Governments come under the category of Government deductors.

5. Under what provision should e-TDS/TCS returns be filed?

An e-TDS return should be filed under Section 206 of the Income Tax Act in accordance with the scheme dated August 26, 2003 for electronic filing of TDS return notified by the Central Board of Direct Taxes (CBDT) for this purpose. CBDT Circular No. 8 dated September 19, 2003 may also be referred.

An e-TCS return should be filed under Section 206C of the Income Tax Act in accordance with the scheme dated March 30, 2005 for electronic filing of TCS return notified by the CBDT for this purpose.

As per section 200(3)/206C, as amended by Finance Act 2005, deductors/ collectors are required to file quarterly TDS/TCS statements from FY 2005-06 onwards.

6. Who is the e-Filing Administrator?

CBDT has appointed the Director General of Income Tax (Systems) as e-Filing Administrator for the purpose of electronic filing of TDS/TCS returns.

7. Who is an e-TDS/TCS Intermediary?

BDT has appointed National Securities Depository Limited, (NSDL), Mumbai, as e-TDS/TCS Intermediary. NSDL has established TIN Facilitation Centres (TIN-FCs) across the country to facilitate deductors/collectors file their e-TDS/TCS returns.

8. How should the e-TDS/TCS return be prepared?

e-TDS/TCS return has to be prepared in the data format issued by e-Filing Administrator. This is available on the Income Tax Department website (www. incometaxindia.gov.in) and NSDL-TIN website (www.tin-nsdl.com). There is a validation software (File Validation Utility) available along with the data structure which should be used to validate the data structure of the e-TDS/TCS return prepared. The e-TDS/TCS return should have following features:

- Each e-TDS/TCS return file should be in a separate CD/Pen Drive.
- Each e-TDS/TCS return file should be accompanied by a duly filled and signed (by an authorised signatory) Form No. 27A in physical form.

- Each e-TDS/TCS return file should be in one CD/Pen Drive. It should not span across multiple floppies.
- If an e-TDS return file is required to be compressed, it should be compressed using Winzip 8.1 or ZipItFast 3.0 compression utility (or higher version thereof) to ensure quick and smooth acceptance of the file.
- Label should be affixed on each CD/Pen Drive mentioning name of the deductor, his TAN, Form no. (i.e. 24, 26 or 27) and period to which the return pertains.
- There should not be any overwriting/striking on Form No. 27A. If there is any, then the same should be ratified by an authorised signatory.
- No bank challan or copy of TDS/TCS certificate should be filed alongwith e-TDS/TCS return file.
- In case of Form Nos. 26 & 27, deductor need not file physical copies of certificates of no deduction or lower deduction of TDS received from deductees.
- In case of Form 24, deductor should file physical copies of certificates of no deduction or deduction of TDS at lower rate, if any, received from deductees. However, there is no such requirement in case of Form 24Q.
- e-TDS/TCS return file should contain TAN of the deductor/collector without which, the return will not be accepted.
- CD/Pen Drive should be virus-free.
- In case any of these requirements are not met, the e-TDS/TCS return will not be accepted at TIN-FCs.

9. Is there any software available for preparation of e-TDS/TCS return?

NSDL has made available a freely downloadable return preparation utility for preparation of e-TDS/TCS returns. Additionally, you can develop your own software for this purpose or you may acquire software from various third party vendors. A list of vendors, who have informed NSDL that they have developed software for preparing e-TDS/TCS returns, is available on the NSDL-TIN website.

10. Are the forms used for e-TDS/TCS return same as for physical returns?

Forms for filing TDS/TCS returns were notified by CBDT. These forms are same for electronic and physical returns. However, e-TDS/TCS return is to be prepared as a clean text ASCII file in accordance with the specified data structure (file format) prescribed by ITD.

11. What are the forms to be used for filing annual/quarterly TDS/TCS returns?

Following are the forms for TDS/TCS returns and their periodicity:

Form No.	Particulars	
Form No. 24	Annual return of 'Salaries' under Section 206 of Income Tax Act, 1961	Annual
Form No. 26	Annual return of deduction of tax under section 206 of Income Tax Act, 1961 in respect of all payments other than 'Salaries'	Annual
Form No. 27	Statement of deduction of tax from interest, dividend or any other sum payable to certain persons	Quarterly
Form No. 27E	Annual return of collection of tax under section 206C of Income Tax Act, 1961	Annual
Form No. 24Q	Quarterly statement for tax deducted at source from 'Salaries'	Quarterly
Form No. 26Q	Quarterly statement of tax deducted at source in respect of all payments other than 'Salaries'	Quarterly
Form No. 27Q	Quarterly statement of deduction of tax from interest, dividend or any other sum payable to non-residents	Quarterly
Form No. 27EQ	Quarterly statement of collection of tax at source	Quarterly

12. What is Form No. 27A?

Form No. 27A is a control chart of quarterly e-TDS/TCS statements to be filed in paper form by deductors/collectors alongwith quarterly statements. It is a summary of e-TDS/TCS returns which contains control totals of 'amount paid' and 'income tax deducted at source'. The control totals of 'amount paid' and 'income tax deducted at source' mentioned on Form No. 27A should match with the corresponding control totals in e-TDS/TCS return. A separate Form No. 27A is to be filed for each e-TDS/TCS return.

In case of Annual Returns the relevant control charts are Form 27A for e-TDS and Form 27B for e-TCS.

13. What are the precautions to be taken while submitting Form No. 27A/B?

While submitting Form No. 27A/B, one should ensure that:

1. There is no overwriting/striking on Form No. 27A/B. If there is any, then the same should be ratified (signed) by the authorised signatory.
2. Name and TAN of deductor and control totals of 'amount paid' and 'income tax deducted at source' mentioned on Form No. 27A/B should match with the respective totals in the e-TDS/TCS return.
3. All the fields of Form No. 27A/B are duly filled.

14. What is the data structure (file format) for preparing e-TDS/TCS return?

e-TDS/TCS return should be prepared in accordance with the data structure (File Format) prescribed by the e-filing administrator. Separate data structure has been prescribed for each type of form whether it is annual return (up to FY 2004-05) or Quarterly return (FY 2005-06 onwards).

15. What is Challan Serial Number given by the Bank?

Bank Challan Number is a receipt number given by the bank branch where TDS is deposited. A separate receipt number is given for each challan deposited. You are required to mention this challan number in the e-TDS/TCS return and not the preprinted numbers on the bank challan form i.e. ITNS 269 or ITNS 271.

16. What is 'Bank Branch Code'? Where do I get it from?

Reserve Bank of India has allotted a unique seven-digit code to each bank branch. You are required to mention the code of the bank branch where TDS is deposited in the e-TDS/TCS return. You can get this code from the bank branch where TDS amount is deposited.

17. Is it mandatory to mention Tax Deduction Account Number (TAN) in e-TDS/ TCS return?

Yes, it is mandatory to mention the 10 digit reformatted (new) TAN in your e-TDS/ TCS return.

18. Can I file Form No. 26Q separately for contractors, professionals, interest etc.?

No. A single Form No. 26Q with separate annexures corresponding to each challan payment for each type of payment has to be filed for all payments made to residents.

19. I do not know the Bank Branch Code of the branch in which I deposited tax. Can I leave this field blank?

Bank Branch code or BSR code is a 7-digit code allotted to banks by RBI. This is different from the branch code, which is used for bank drafts etc. This number is given in the OLTAS challan or can be obtained from the bank branch or from the search facility at NSDL-TIN website. It is mandatory to quote BSR code both in challan details and deductee details. Hence, this field cannot be left blank. Government deductors transfer tax by book entry, in which case the BSR code can be left blank.

20. What should I mention in the field 'paid by book entry or otherwise' in deduction details?

If payment to the parties (on which TDS has been deducted) has been made actually i.e. by cash, cheque, demand draft or any other acceptable mode, then 'otherwise' has to be mentioned in the specified field. But if payment has not been actually made and merely a provision has been made on the last date of the accounting year, then the option 'Paid by Book Entry' has to be selected.

21. By whom should the control chart Form 27A be signed?

Form 27A is the summary of the TDS/TCS statement. It has to be signed by the same person who is authorized to sign the TDS/TCS statement in paper format.

22. What if e-TDS/TCS return does not contain PANs of all deductees?

In case PANs of some of the deductees are not mentioned in the e-TDS/TCS return, the Provisional Receipt will mention the count of missing PANs in the e-TDS/TCS return. The details of missing PANs (to the extent it can be collected from the deductees) may be filed within seven days of the date of Provisional Receipt to TIN-FC. e-TDS/TCS return will be accepted even with missing PANs. However, if PAN of deductees is not given in the TDS return, tax deducted from payment made to him cannot be posted to the statement of TDS to be issued to him u/s 203AA.

23. Is the Challan Identification Number compulsory?

Yes. Challan Identification Number is necessary for all non-Government deductors.

24. Is PAN mandatory for deductors and employees/deductees?

PAN of the deductors has to be given by non-Government deductors. It is essential to quote PAN of all deductees failing which credit of tax deducted will not be given.

25. I am a deductor having more than one office/branch, do I file separate e-TDS/TCS returns for each office/branch or can I file a consolidated return for all offices/branches? Can I quote the same TAN for filing e-TDS/TCS returns for each branch?

If you have more than one office/branch you can file a consolidated e-TDS/TCS return for all offices/branches. In this case you should quote the same TAN. You can also file e-TDS/TCS returns office/branch-wise individually. In such cases you

need to have separate TAN for every branch. In case you do not have separate TAN for each branch then you should apply for TAN for each of the branches filing separate e-TDS/TCS return.

26. Should I file copies of certificate for no deduction or concessional deduction of tax along with the e-TDS/TCS return?

In case of salary e-TDS/TCS return (Form No. 24), you have to file certificate for no deduction or concessional deduction of TDS alongwith the e-TDS/TCS return. In case of non-salary (Form No. 26/27) you need not file certificates for no deduction or concessional deduction of TDS alongwith the e-TDS/TCS return. This is not required in case of any quarterly statements

27. How do I file my quarterly e-TDS/TCS return, if I don't have PANs of all deductees?

You can file your e-TDS/TCS return for the deductees who have valid PANs and subsequently file correction return for remaining deductees whose PANs were not available with you while furnishing regular return.

28. How do I include deductees whose details were not provided earlier due to unavailability of PAN?

You are required to file a correction return in a prescribed file format available at **www.tin-nsdl.com**

29. What amount should be mentioned in the challan details in case a regular return is filed only for those deductees whose PAN is present and subsequently a correction is filed with the remaining deductees?

The amount deposited vide that particular challan should be mentioned in the original as well as correction return. Refer below example:

- Suppose a challan payment of Rs.1,00,000/- has been made for non-salary TDS against 100 deductees each with TDS of Rs.1,000/-. Under the existing procedure the deductor will have to quote at least 85 PAN failing which his return will be rejected.
- If there are only 50 deductees whose PAN is available and the deductor attempts to file a return with details of 100 deductees with PAN of only 50 deductees, the return will automatically be rejected at present.
- However, if he files a return with challan amount of Rs. 1,00,000/- and with details of 50 deductees with PAN, with deductee total of Rs.50,000/-, the return will be accepted. It means the deductor can furnish the details relating to such

deductees whose PANs are available.

- The deductor can later file correction returns with other details of remaining deductees with the same challan details, i.e., the challan amount should be the amount deposited (in this case Rs. 1,00,000/-).
- The return will be accepted so long as the TDS total of incremental deductees is less than or equal to the balance of Rs.50,000/-.

30. After I prepare my e-TDS/TCS return, is there any way I can check/verify whether it conforms to the prescribed data structure (file format)?

Yes, after you have prepared your e-TDS/TCS return you can check/verify the same by using the File Validation Utility (FVU). This utility is freely downloadable from the NSDL-TIN website.

31. What is File Validation Utility (FVU)?

FVU is a program developed by NSDL, which is used to ascertain whether the e-TDS/TCS return file contains any format level error(s). When you pass e-TDS/TCS return through FVU, it generates an 'error/response file'. If there are no errors in the e-TDS/TCS return file, error/response file will display the control totals. If there are errors, the error/response file will display the error location and error code along with the error code description. In case you find any error, you can rectify the error and pass the e-TDS/TCS return file again through the FVU till you get an error-free file.

32. What is the 'Upload File' in the new File Validation Utility?

Earlier the e-TDS/TCS return file after validating using File Validation Utility (FVU) had to be filed with TIN-FC. Now 'Upload File' that is generated by the FVU when the return is validated using the FVU has to be filed with TIN-FC. This 'upload file' is a file with the same filename as the 'input file' but with extension .fvu. Example 'input file' name is 27EQGov.txt, the upload file generated will be 27EQGov.fvu.

33. What are the platforms for execution of FVU?

For Annual Returns, FVU can be executed on any of the Windows platforms mentioned below: Win 95/Win 98/Win 2K Professional/Win 2K Server/Win NT 4.0 Server/Win XP Professional.

For Quarterly Returns, Java has to be installed to run FVU. Details are given in FVU section of NSDL-TIN website.

34. What are the Control Totals appearing in the Error/Response File generated by validating the text file through File Validation Utility (FVU) of NSDL?

The Control Totals in Error/Response File are generated only when a valid file is generated. Otherwise, the Error/Response File shows the nature of error. The control totals are as under:

- **Number of deductee/party records:** In case of Form 24/24Q, it is equal to the number of employees for which TDS return is being prepared. In case of Form 26/27/26Q/27Q, it is equal to the total number of records of tax deduction. 10 payments to 1 party would mean 10 deductee records.
- **Amount Paid:** This is the Total Amount of all payments made on which tax was deducted. In case of Form 24/24Q, it is equal to the Total Taxable Income of all the employees. In case of Form 26/27/26Q/27Q, this is equal to the total of all the amounts on which tax has been deducted at source.
- Tax Deducted: This is the Total Amount of tax actually deducted at source for all payments.
- Tax Deposited: This is the total of all the deposit challans. This is normally the same as Tax Deducted but at times may be different due to interest or other amount.

35. Are the control totals appearing in Form 27A same as that of Error/ Response File?

Yes, the control totals in Form 27A and in Error/Response File are same.

36. WHAT IF ANY OF THE CONTROL TOTALS MENTIONED IN FORM NO. 27A DO NOT MATCH WITH THAT IN E-TDS/TCS RETURN?

In such a case the e-TDS/TCS return will not be accepted by the TIN-FC. You should ensure that the control totals generated by FVU and that mentioned on Form No. 27A match. In case of any difficulties/queries, you should contact the TIN-FC or TIN Call Centre at NSDL.

37. Where can I file my TDS/TCS return?

You can file your TDS/TCS return at any of the TIN-FCs managed by NSDL. TIN-FCs are set-up at specified locations across the country. Details are given in the NSDL-TIN website. These can also be furnished directly at NSDL-TIN web-site.

38. Will annual returns/quarterly statements furnished by entities who are eligible to file the same in physical form be accepted by the Income Tax Department?

No. Physical TDS/TCS returns/statements will be received at TIN-FCs.

39. What are the basic details that should be included in the of e-TDS/TCS return?

Following information must be included in the e-TDS/TCS return for successful acceptance. If any of these essential details is missing, the returns will not be accepted at the TIN-FCs:

- Correct Tax-deduction/collection Account Number (TAN) of the deductor/ collector should be clearly mentioned in Form No. 27A as also in the e-TDS/ TCS return, as required by sub-section (2) of section 203A of the Income-tax Act.
- The particulars relating to deposit of tax deducted at source in the bank should be correctly and properly filled.
- The data structure of the e-TDS/TCS return should be as per the structure prescribed by the e-Filing Administrator.
- The Control Chart in Form No. 27A (enclosed in paper form with the e-TDS/ TCS return on CD/Pen Drive) should be duly filled and signed.

40. What are the charges for filing e-TDS/TCS return with TIN-FCs?

You have to pay charges as mentioned below:

No. of deductee records in e-TDS/TCS return	Upload charges (inclusive of service tax)
Returns having up to 100 records	₹31
Returns having 101 to 1000 records	₹185
Returns having more than 1000 records	₹618

41. What are the due dates for filing quarterly TDS Returns?

The due dates for filing quarterly TDS returns, both electronic and paper are as under:

Quarter	Due Date for Form Nos. 24Q & 26Q	Due Date for Form No. 27Q	Due Date for Form No. 27EQ
April to June	15 July	15 July	15 July
July to September	15 October	15 October	15 October
October to December	15 January	15 January	15 January
January to March	15 May	15 May	15 May

42. Is the procedure for filing of e-TCS different from that of filing e-TDS return?

The procedure for filing of e-TCS return is the same as those of e-TDS return except the forms to be used are different. The relevant forms for filing the e-TCS return are:

a) **Annual return:** Form No. 27E, 27B (Control Chart)

b) **Quarterly statement:** Form No 27EQ, 27A (Control Chart).

The e-TCS returns are also to be filed with NSDL at the various TIN-FCs

43. Should I file TDS certificates and bank challans along with the e-TDS/TCS return?

No, you need not file TDS certificates and bank challans for tax deposited along with the e-TDS/TCS return.

44. Can more than one e-TDS/TCS return be filed in a single computer media (CD/Pen Drive)?

Yes, More than one e-TDS/TCS statements can be furnished in same computer media.

45. Can a single e-TDS/TCS return be filed in two or more CD / Pen Drive?

No, one return cannot be furnished in two computer media.

46. Can e-TDS/TCS return be filed in compressed form?

Yes, if e-TDS/TCS return file is filed in compressed form, it should be compressed using Winzip 8.1 or ZipItFast 3.0 (or higher version compression utility only), so as to ensure quick and smooth acceptance of the file.

47. Do I have to affix a label on the e-TDS/TCS return CD/Pen Drive? What do I mention on the label affixed on the e-TDS/TCS return CD/Pen Drive?

No, there is no need to affix a label on computer media.

48. What if e-TDS/TCS return does not contain PANs of all deductees?

In case PANs of some of the deductees are not mentioned in your e-TDS/TCS return, the Provisional Receipt will contain the count of missing PANs in the e-TDS/TCS return. You may file the details of missing PANs within seven days of the date of Provisional Receipt to TIN-FC as a corrected e-TDS/TCS return.

49. If a deductor faces any difficulty in filing of e-TDS return where can it approach for help?

The details regarding the help required for filing of e-TDS are available on the Income-Tax Department website and the NSDL-TIN website. The TIN-FCs are also available for all related help in the e-filing of TDS returns.

50. Will computer media be returned by TIN-FC after acceptance of e-TDS/ TCS statement?

Yes, computer media will be returned to deductor after acceptance of the e-TDS/ TCS statements.

51. Whether the particulars of the whole year or of the relevant quarter are to be filled in Annexures I, II and III of Form No. 24Q?

(i) In Annexure I, only the actual figures for the relevant quarter are to be reported.

(ii) In Annexures II & III, estimated/actual particulars for the whole financial year are to be given. However, Annexures II & III are optional in the return for the 1st, 2nd and 3rd quarters but in the quarterly statement for the last quarter, it is mandatory to file Annexures II & III giving actual particulars for the whole financial year.

52. In Form No. 24Q, should the particulars of even those employees be given whose income is below the threshold limit or in whose case, the income after giving deductions for savings etc. is below the threshold limit?

(i) Particulars of only those employees are to be reported from the 1st quarter onwards in Form No. 24Q in whose case the estimated income for the whole year is above the threshold limit.

(ii) In case the estimated income for the whole year of an employee after allowing deduction for various savings like PPF, GPF, NSC etc. comes below the taxable limit, his particulars need not be included in Form No. 24Q.

(iii) In case, due to some reason, estimated annual income of an employee exceeds the exemption limit during the course of the year, tax should be deducted in that quarter and his particulars reported in Form No. 24Q from that quarter onwards.

53. How are the particulars of those employees who are with the employer for a part of the year to be shown in Form No. 24Q?

(i) Where an employee has worked with a deductor for part of the financial year only, the deductor should deduct tax at source from his salary and report the same in the quarterly Form No. 24Q of the respective quarter(s) up to the date of employment with him. Further, while submitting Form No. 24Q for the last quarter, the deductor should include particulars of that employee in Annexures II & III irrespective of the fact that the employee was not under his employment on the last day of the year.

(ii) Similarly, where an employee joins employment with the deductor during the course of the financial year, his TDS particulars should be reported by the current deductor in Form No. 24Q of the relevant quarter. Further, while submitting Form No. 24Q for the last quarter, the deductor should include particulars of TDS of such employee for the actual period of employment under him in Annexures II & III.

54. The manner of computing total income has been changed in the budget for the current year by allowing deduction under section 80C. However, the present Form No. 24Q shows a column for rebate under section 88, 88B, 88C and 88D. How should Form No. 24Q be filled up in absence of a column for section 80C?

While filling up Form No. 24Q, the columns pertaining to sections 88, 88B, 88C and 88D may be left blank. As regards deduction under section 80C, the same can be shown in the column 342 pertaining to 'Amount deductible under any other provision of Chapter VI-A'.

55. Form No. 24Q shows a column which requires explanation for lower deduction of tax. How can a DDO assess it? Please clarify.

Certificate for lower deduction or no deduction of tax from salary is given by the Assessing Officer on the basis of an application made by the deductee. In cases where the Assessing Officer has issued such a certificate to an employee, deductor has to only mention whether no tax has been deducted or tax has been deducted at lower rate on the basis of such a certificate.

56. From which financial year will the Annual Statement under Sec. 203AA (Form No. 26AS) be issued?

The annual statement (Form No. 26AS) will be issued for all tax deducted and tax collected at source from FY 2005-06 onwards after the expiry of the financial year.

57. How will the PAN-wise ledger account be created by NSDL in respect of payment of TDS made by deductors in banks?

The PAN-wise ledger account will be created after matching the information in the TDS/TCS statements filed by the deductor/collector and the details of tax deposited in banks coming through On Line Tax Account System (OLTAS).

58. What essential information should be given in the quarterly statements to enable accurate generation of PAN-wise ledger account?

The accuracy of PAN-wise ledger account will depend on:

- Correct quoting of TAN by the deductor.
- Correct quoting of PAN of deductor.
- Correct and complete quoting of PAN of deductee.

Correct quoting of CIN (Challan Identification Number) wherever payment is made by challan.

59. Will a deductee be able to view his ledger account on NSDL-TIN website?

Yes. The scheme for such views is expected to be notified by ITD soon.

60. Can the e-TDS/TCS return be filed online?

Yes e-TDS/TCS return can be filed online under digital signature.

61. What are the different views available for Tax Payers?

On the NSDL-TIN website, three types of views are available for a tax payer:

a) Access without authentication.

b) Access with Digital Signature Certificate (DSC).

c) Access through TIN-FC.

62. What is access without authentication?

On providing the TAN and provisional receipt number / Token Number, the deductor can view the following details:

- Whether quarterly statements have been uploaded to TIN central system by TIN-FC.
- Whether quarterly statements have been accepted by TIN central system.

- Whether challans in statements have been matched with challans uploaded by banks.
- Number of deductees whose PAN accounts have been booked.
- Line no. of deductees in statements whose PAN accounts could not be booked.
- Confirm whether a specific PAN account has been booked.

63. What is access with authentication?

To access this view, the tax payer should have a Digital Signature Certificate (DSC) which has to be registered with NSDL in advance. (Details of the same are available at Online Uploads section of the NSDL-TIN website.) The tax payer has to authenticate its identity using the DSC. All the views mentioned above will be available with financial details.

64. What is access through TIN-FC?

Deductors can access details of their statements through the TIN-FC who has uploaded their statements.

65. Will the Paper TDS data be available online on TIN?

Yes, the Paper TDS data will also be available in TIN database after the digitalization of the Paper TDS return by the e-intermediary.

66. Will the TIN-FC give any acknowledgment/receipt after acceptance of e-TDS/TCS return?

If the e-TDS/TCS return file is complete in all aspects, TIN-FC will issue a provisional receipt to you. The provisional receipt issued by TIN-FC is deemed to be the proof of e-TDS/TCS return filed by you.

67. What if my e-TDS/TCS return is not accepted by TIN-FC, how will I know the reason for rejection?

In case of non-acceptance of your e-TDS/TCS return file, TIN-FC will issue a Non-Acceptance Memo which will state reason for rejection.

68. What is course of action in case a regular statement is rejected

Please refer to Course of action - regular rejection for the common causes for rejection of a regular statement and corresponding course of action for a deductor.

69. What is course of action in case a correction statement is rejected?

Please refer to Course of action - correction rejection for the common causes for rejection of a correction statement and corresponding course of action for a deductor.

70. What is a correction TDS/TCS statement?

Deductor/collector is required to furnish one regular TDS/TCS statement for a particular TAN, Form, Financial year and quarter. In case there are any additions/ updations to be made to the details of the regular statement accepted at the TIN central system, the same should be done by furnishing a correction statement.

71. Why should I furnish a correction statement?

The payment information provided in the regular TDS/TCS statement, is verified with the corresponding details provided by the bank where tax was deposited. On successful verification credit of tax deducted/collected by you is reflected in the annual tax statement (Form 26AS) of the deductees/transacting parties where PAN of deductee / transacting party is present.

In case of deficiencies in the accepted regular TDS/TCS statement such as incorrect challan details or PAN not provided or provided incorrectly, the tax credit will not reflect in the Form 26AS of the deductees in your statement.

To facilitate correct credit in Form 26AS of the deductees you are required to remove deficiencies, if any, in the accepted regular TDS/TCS statement by filing a correction statement.

72. What are the different types of corrections that I can make?

The following are the various types of corrections that you can make to an accepted regular TDS/TCS statement:

- Update deductor details such as Name, Address of Deductor. This type of correction is known as C1
- Update challan details such as challan serial no., BSR code, challan tender date, challan amounts etc. This type of correction is known as C2.
- Update/delete /add deductee details. This type of correction is known as C3.
- Add / delete salary detail records. This type of correction is known as C4.
- Update PAN of the deductee or employee in deductee/salary details. This type of correction is known as C5.

- Add a new challan and underlying deductees. This type of correction is known as C9.
- Cancel accepted statement. This type of correction is known as Y. Regular TDS /TCS statement can be cancelled only if the TAN of the deductor is to be corrected. After the regular statement with incorrect TAN is cancelled a regular TDS / TCS statement with the correct TAN should be filed.

73. Can I update / add deductee and challan details in the same correction statement? Do I need to file separate correction statements for updating a PAN as well as adding a challan and its underlying deductees?

Yes. There is no need to file separate statements for different types of corrections. In case you need to update or add different deductees / challans in the same statement, it can be done in a single correction file.

Depending on the type of correction a single correction file may contain multiple correction statements. A correction file containing more than one correction statement is called "multiple batch correction statement".

74. Can I file the correction e-TDS/TCS statement with any TIN-FC?

You can file the corrected e-TDS/TCS return at any TIN-FC.

75. Do I have to pay upload fee for filing correction e-TDS/TCS return?

Yes. Upload fee is payable for each and every e-TDS/TCS return accepted by the TIN-FC, irrespective of whether it is a correction e-TDS/TCS statement or an original e-TDS/TCS statement. Upload fees applicable for correction statement is as per table below:

No. of deductee records in e-TDS/TCS return	Upload charges (inclusive of service tax)
Returns having up to 100 records	Rs.30
Returns having 101 to 1000 records	Rs.182
Returns having more than 1000 records	Rs.606

76. Do I have to pay upload fee for filing correction e-TDS/TCS return?

Yes. Upload fees are applicable for cancellation (Y) statements. Charges would be as per regular statement being cancelled.

77. Will the TIN-FC give any acknowledgment/receipt after acceptance of corrected e-TDS/TCS return?

Yes, TIN-FC will issue a Provisional Receipt in case corrected e-TDS/TCS return file is valid and accepted by the TIN-FC. The Provisional Receipt issued by TIN-FC is deemed to be the proof of corrected e-TDS/TCS return filed by you.

78. What are the prerequisites for furnishing a correction TDS/TCS statement?

The following are the prerequisites for furnishing a correction TDS/TCS statement:

- check the status of the regular statement on the TIN website by entering the TAN and PRN at **https://onlineservices.tin.nsdl.com/TIN/JSP/tds/linktoUnAuthorizedInput.jsp**
- Correction statement should be prepared only if the corresponding regular statement has been accepted at the TIN central system.
- .fvu file of the corresponding accepted regular statement should be available for preparing a correction statement
- Provisional receipt of the corresponding accepted regular statement should be available.

79. How can I check the status of the TDS/TCS statement submitted by me?

You can check the status of the statement submitted by you at **https://onlineservices.tin.nsdl.com/TIN/JSP/tds/linktoUnAuthorizedInput.jsp**

You need to mention the TAN and PRN in the field provided. Details of the statement along with status whether accepted (displayed as Received by TIN) or rejected (along with reason for rejection) will be displayed to you.

In case statement is accepted, you can further check the status of challans and deductee PANs in the statement.

80. What are the different statuses of a challan in the TDS/TCS statement?

The following are the various statuses of challans in a TDS/TCS statement:

- **Booked:** Challan / transfer voucher detail in the statement matches with corresponding details received from banks / PAO.
- **Match Pending:** Corresponding challan details not received from the bank.
- **Match Failed (Challan):** TAN and/or amount relating to a challan in the statement do not match with the corresponding details received from banks.
- **Match Failed (Transfer Voucher):** Amount relating to a transfer voucher does not match with corresponding details received from PAO.
- **Provisionally Booked:** In case of Government deductors where TDS/TCS statement is received by TIN and mode of payment of TDS/TCS is through book entry (transfer voucher) and e-TBAF details from PAO is not received by TIN.

81. What is the significance if the status of challan is 'Booked'?

If the challan is in Booked status, credit of tax deducted will be reflected in the annual tax statement (Form 26AS) of all the underlying deductees with a valid PAN.

Correction in challan details is not allowed once a challan is booked. Correction can be made on underlying deductee records of a booked challan.

82. What should I do if the status of challan is Match pending?

A challan is in Match pending status as the CIN is not present in the payment information provided by the Bank. As a result the credit of tax deducted will not be reflected in the Form 26AS of corresponding deductees with valid PAN.

The possible cause could be due to error in quoting CIN details (Challan serial no., BSR code and challan tender date) either in the TDS statement or in the details provided by the Bank. Error in TDS statement can be rectified by filing a correction statement, where as error.

83. What should I do if the status of challan is in status 'Match failed'?

A challan is in Match failed status as the TAN/challan amount in the statement does not match the details provided by the Bank. As a result the credit of tax deducted will not be reflected in Form 26AS of corresponding deductees with valid PAN.

The possible cause could be error in quoting challan amount. The same can be rectified by filing a correction statement.

84. How do I prepare the first correction on a regular TDS/TCS statement?

Correction statement should be prepared as per data structure prescribed by Income Tax Department which is different from the data structure of a regular TDS/TCS statement. Data structure of correction statement is available on the NSDL TIN website at **http://www.tin-nsdl.com/Downloadsquarreturns_correct.asp**

Correction in challan details is not allowed once a challan is booked. Correction can be made on underlying deductee records of a booked challan.

85. Is any utility/software available for preparing correction TDS/TCS statement?

There are many software providers who have developed softwares for preparation of TDS/TCS statements. List of software providers along with their website details

are available on the TIN website at **http://www.tin-nsdl.com/eTDSswProviders.asp**

Alternatively, freely downloadable return preparation utility (RPU) developed by NSDL is available on the TIN website at **http://www.tin-nsdl.com/Downloadsquarreturns_correct.asp.**

86. What are the steps involved in preparing a statement using NSDL RPU?

NSDL RPU can be used to prepare correction statements being filed the first time on an accepted regular statement. The steps to be followed for making a correction statement using NSDL RPU are as under:

1. You should have the .FVU file of the accepted regular statement on which corrections need to be made.
2. After downloading the NSDL RPU, you have to execute the same (double click the exe).
3. You have to select the option "Correction" for preparation of correction statement and import the .FVU file of the regular TDS/TCS statement into the RPU.
4. You will have to provide the provisional receipt number / Token Number of the regular statement to be corrected.

Details of the regular statement will be displayed to you in the utility. You can make the required corrections by selecting the option Add/Update/Delete in the utility.

After making the corrections, you need to click on "Create file" and the correction statement will be created.

87. Can I update a challan?

Yes. You can update a challan.

88. How can I update a challan?

You can update any of the details provided in the challan viz; CIN details, amounts etc.

Points to be kept in mind while updating challan:

- identify the challan to be updated by
- its sequence no as per regular statement

- CIN, deposit amount as per regular statement
- Update the challan detail as required.
- Along with the updated values, the correction statement should contain value of the CIN and deposit amount as per regular statement as well.

Example: In order to correct challan serial number from 013 to 014 in the sixth challan of the regular statement filed by you, the steps as under need to be followed

1. Identify the challan by the sequence number as well as the CIN and deposit amount as per regular statement.
2. Update the value in the field challan serial number to 014.
3. Ensure that the value in the field Last Bank challan no is 013, i.e. as per regular statement.

89. Can I add a challan?

Yes. You can add a challan.

90. How can I add a challan?

You can add a new challan as well as the underlying deductee records. The procedure for adding a challan is as under:

1. Maintain the sequence of the new challan record in continuation to the sequence number of the last challan as per regular statement and add details of challan in this record.
2. Add the underlying deductee records and associate the same with the sequence number of the newly added challan.

Example: If a regular statement filed by you has six challans and you wish to add one more challan and underlying five deductees, the steps as under need to be followed:

1. Sequence of new challan being added should be 7.
2. Add underlying five deductees in the deductee annexure and associate them with new challan having sequence no. 7.

91. Can I delete a challan?

No. You cannot delete a challan.

92. Can I update a deductee record?

Yes. You can update a deductee record.

93. How can I update a deductee record?

You can update deductee details viz; PAN of deductee, name, amount etc. Steps to update a deductee record are as under:

- Identify the challan corresponding the deductee record to be updated by
  - its sequence no as per regular statement
  - CIN, deposit amount as per regular statement
- Identify the underlying deductee record to be updated by
  - its sequence number as per regular statement under the challan identified as above.
  - PAN of deductee, total tax deducted and total tax deposited as per regular statement.
- Update the deductee details as required.
- Along with the updated values, the correction statement should contain CIN, deposit amount in challan details, PAN of deductee, total tax deducted and total tax deposited in deductee details as per regular statement as well.

Example: In order to correct deductee PAN from PANINVALID to AAAPI0147G in the sixth deductee record of the fourth challan of the regular statement filed by you, the steps as under need to be followed:

1. Identify challan no. 4 and corresponding deductee record having sequence no. 6 as per regular statement
2. Update the value in the field deductee PAN to AAAPI0147G.
3. Ensure that the value in the field Last deductee PAN is PANINVALID, i.e. as per regular statement.

94. Can I add a deductee?

Yes. You can add a deductee record.

95. How do I add a deductee record?

You can add a new deductee records under an existing challan. The procedure for adding deductee records is as under:

- identify the challan corresponding the deductee record to be updated by
  - its sequence no as per regular statement
  - CIN, deposit amount as per regular statement
- Add the new deductee record
- Maintain sequence of the new deductee record in continuation to the sequence number of the last deductee record under the said challan as per regular statement add details of deductee in this record.
- Along with newly added deductee record, correction statement should contain value of CIN and deposit amount as per regular statement as well.

Example: If a regular statement filed by you has six challans and you wish to add five more deductees to challan 4 which has 4 deductees as per regular statement, the steps as under need to be followed:

1. Identify challan having sequence no. 4
2. Sequence of new deductee being added to 5 in the challan details section
3. Add underlying five deductees in the deductee annexure and associate them with challan having sequence no. 4.

96. Can I delete a deductee record?

Yes. You can delete a deductee record.

97. How can I delete a deductee record?

Steps to delete a deductee record are as under:

- identify the challan corresponding the deductee record to be updated by
  - its sequence no as per regular statement
  - CIN, deposit amount as per regular statement
- Identify the deductee record to be updated by
  - its sequence number as per regular statement under the challan identified as above.

- PAN of deductee, total tax deducted and total tax deposited as per regular statement.

- Flag the deductee details to be deleted
- Along with the flag for deletion, the correction statement should contain CIN, deposit amount in challan details, PAN of deductee, total tax deducted and total tax deposited in deductee details as per regular statement as well.

98. Can I update a salary detail?

Yes. You can update a salary detail record.

99. How can I update a salary record?

You can update salary details viz; Name and PAN of employee, salary amount, deductions etc. Steps for updating salary record are as under:

- Identify the salary detail record by
  - its sequence number as per regular statement
  - Value in the field 'Gross total Income' as per regular statement.
- Update the salary details as required
  - Along with updated values, Gross Total Income as per regular statement should also be provided in the correction statement.

100. Can I add a salary record?

Yes. You can add a salary record.

101. How can I add a salary record?

You can add a new salary records as per following procedure.

1. Maintain the sequence of the new challan record in continuation to the sequence number of the last challan as per regular statement and add details of challan in this record..

Example Regular statement filed by you has three salary records and you wish to add one more salary record

1. Sequence of new record being added should be 4 in the Annexure II.
2. Add new salary record.

102. Can I delete a salary record?

Yes. You can delete a salary record.

- **How can I delete a salary record?**

  Steps for deleting a salary record are as under:

  - Identify the salary record to be deleted by
    - its sequence number as per regular statement
    - Gross total income as per regular statement
  - Flag the salary detail record to be deleted.
  - Along with flag for deletion, correction statement should also contain value of the field Gross total Income as per regular statement.

103. Can I update the Assessment Year of a regular TDS/TCS statement by filing a correction statement?

No, the fields TAN, Form no., quarter, FY and A.Y quoted in a regular statement cannot be updated by furnishing a correction statement

104. What is the significance of a identifying a record while updating/ deleting the same?

While preparing a correction statement, the record to be updated/deleted is required to be identified by its sequence number as well as values of certain fields as per regular statement. List of fields used for identifying a record are as under:

1. Challan detail – CIN details and deposit amount
2. Deductee detail – PAN of the deductee, total tax deducted and total tax deposited
3. Salary details – Gross total income.

The correction statement should contain values of the fields referred to above as per regular statement along with the corrections made. Once the correction statement is received at TIN central system, the values of the identification fields are verified with the corresponding values as per TIN central system.

If the values match, the correction statement will get accepted. If the values do not match, the correction statement will get rejected at the TIN central system.

Example: If the value in the field Last Bank challan no. (i.e. challan no. as per regular statement) in the correction statement does not match the corresponding details as per the regular statement in the TIN central system, the correction statement will get rejected for the reason **"Last Bank challan serial number of the correction statement is not matching with corresponding statement details available at TIN Central system".**

105. Can I rectify the details of a challan if the status of the same on the NSDL website is displayed as 'Booked'?

Once the challan is updated with status 'Booked' modifications or rectifications to the details of the said challan are not allowed. As a result any correction TDS/TCS statement with modifications/rectifications on a booked challan will get rejected at the TIN central system.

106. How many times can I furnish a correction TDS/TCS statement?

A correction TDS/TCS statement can be furnished multiple times to incorporate changes in the regular TDS/TCS statement whereas a regular TDS/TCS statement will be accepted at the TIN central system only once.

107. What are the important points to be kept in mind while preparing correction statement more than once on the same regular statement?

You have to kept in mind, the following points while preparing correction statement more than once on the same regular statement:

1. The TDS/TCS statement on which correction is to be prepared should be updated with details as per all previous corrections.
2. Modifications/addition/deletion in correction statements accepted at the TIN central system only should be considered.

108. The first correction filed by me contains three types of correction (three PRNs / Token Number) and one of the types of correction has got rejected at the TIN central system. What should I do?

The steps as under should be followed:

1. You have to update modifications as per the accepted corrections in the TDS statement.
2. Identify the record for which correction was rejected earlier by its sequence no. and fields for identification

3. Correct the said record.

4. Correction statement should contain updated values as well as value of identification field as per regular statement.

109. Which Provisional Receipt Number / Token Number should I quote while preparing correction statement more than once on the same regular statement?

There are two fields for Provisional Receipt Number (PRN) / Token Number in a correction statement as under:

a. Original Provisional Receipt Number / Token Number - PRN of the regular statement should be mentioned in this field.

b. Previous Provisional Receipt Number / Token Number - PRN of the last accepted correction statement should be mentioned in this field. In case the value in this field is incorrectly mentioned, the statement will get rejected at TIN central system for the reason: **"Either Previous Provisional Receipt No. provided is incorrect or combination of Original Provisional Receipt Number / Token Number and Previous Provisional Receipt Number / Token Number is not in sequence"**

Example:

Single batch correction statement - Only one type of correction in the file

a. You have filed a regular statement having PRN / Token Number 010010200083255 and subsequently filed a single batch correction statement having PRN / Token Number 010010300074112. While preparing correction statement, you have to mention PRN / Token Number 010010200083255 in the field original PRN and the PRN / Token Number 010010300074112 in the field Previous PRN.

Multiple batch correction statement - different types of correction in a single file

b. You have filed a regular statement having PRN / Token Number 010010200083255 and subsequently filed a multi batch correction statement having three batches and corresponding PRNs / Token Numbers as 010010300074112, 010010300074123 and 010010300074134. While preparing the correction statement, you have to mention PRN / Token Number 010010200083255 in the field original PRN and check the status of all the three PRNs of correction statement.

- If all the three PRNs / Token Numbers are accepted at the TIN central system, you may mention any of the three PRNs / Token Numbers in the field previous PRN.
- If any of the three PRNs / Token Numbers is rejected, then you should mention the PRN / Token Number which has been accepted at the TIN central system in the field Previous PRN.
- If all the three PRNs / Token Numbers are rejected, then you must mention the PRN / Token Number of the regular statement, i.e. 010010200083255 in the field Previous PRN.

110. How many times can I update PAN of a deductee/transacting party?

Structurally valid PAN of a deductee in the regular statement can be updated to another structurally valid PAN only once.

111. When does a statement get 'Partially Accepted'?

A correction statement containing updates in PAN of deductee/employee may get Partially Accepted. This is possible when the PAN in the any of the records being updated by you in the correction statement is invalid, i.e. PAN not present in PAN Master Database. In such a scenario, the said record gets rejected resulting in partial acceptance of the statement.

112. What should I do if the status of correction statement filed by me is 'Partially accepted'?

In case correction statement is in status 'Partially accepted', you have follow steps as under:

1. You have to update modifications as per the accepted records in the TDS statement.
2. Identify the deductee/salary record which has got rejected due to invalid PAN.
3. Rectify the incorrect PAN
4. Correction statement should contain value of identification keys as per regular statement along with the updated values.

113. What could be the cause of rejection of TDS/TCS statement for the reason "Total Deposit amount of deductees is more than Challan amount actually deposited in bank"?

The total tax deposited amount as per challan should be greater than or equal to the total tax deposited amount as per deductee details, else a regular TDS/TCS statement will not get validated through FVU.

If you file a correction statement for adding deductee records under a particular challan, the total tax deposited as per challan in regular statement should be greater than or equal to the total tax deposited in deductee details as per regular as well as correction statement.

Note: Amount in the fields Interest and others in the challan is not considered in the total tax deposited as per

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Part-II

HINDU UNDIVIDED FAMILY
Under the Hindu Law & Income Tax Act, 1961

(As Amended By Finance Act, 2012 &
Hindu Succession (Amendment) Act, 2005)

Chapter-I

CONCEPT OF HINDU UNDIVIDED FAMILY

I. MEANING OF HUF

Income Tax Act provides a special status to HUF under the Act and covers it in the definition of person u/s 2(31) of the Act. The Hindu Undivided Family (HUF) has not been defined under Income Tax Act, 1961, however, as per Hindu Law

A Hindu Undivided Family (HUF) is ordinarily joint not only in estate but in food and worship. The members of a Hindu Family live in a state of union, unless the contrary is established. HUF is a creation of law and cannot be created by the act of parties, except in the case of adoption by member of HUF. HUF is a separate legal entity as per section 2(31) of the Income Tax Act and therefore, as long as the HUF is in existence, no individual member can be separately assessed in respect of its income. **[*ITO vs. BachuLalKapoor (1966) 60 ITR 74 (SC)*].** Even if the family is reduced to sole - surviving coparcener (male or female) with other family members, income tax is leviable on the joint family and not on male members as individual.

Concept of Coparcener

A HUF, as such, can consist of a very large number of members including female members (w.e.f. 9th September, 2005, whether married or unmarried) as well as distant blood relatives in the male line. However, out of this, coparceners are only those males who are within 4 degrees in lineal descendent from the common male ancestor and including the common ancestor and the daughter of the common ancestor.

The relevance of concept of coparcener is that only coparceners can ask for partition. The other male family members; i.e, other than coparceners in a HUF, have

no direct claim over HUF property, but can claim only through the coparceners. The coparcener must be a member of the family but a member of the family need not be a coparcener.

HUF may be composed of

- Large or
- Small or
- Nuclear Joint Families

HUF is a Joint Hindu Family consisting of:-

Male members lineally descended from a common male ancestor, together with their-

- Mothers.
- Wives.
- Unmarried daughters and
- The Hindu coparcenary *

[CGT v. B.K. Sampangiram (1986) 160 ITR 188 (Karn.)]

Note: STRANGER can be introduced in HUF only by adoption ***[CIT vs. M.M. Khanna (1963) 49 ITR 232 (Bom)].***

Distinction – Co-parcener and a member

A HUF, as such, can consist of a very large number of members including female members as well as distant blood relatives in the male line.

However, out of this, coparceners are only those males & females who are within 4 degrees in lineal descendent from the common male ancestor. The relevance of concept of coparcener is that **only coparceners can ask for partition**. The other family members; i.e., other than coparceners in a HUF, have no direct claim over HUF property, but can claim only through the coparceners.

School of Thoughts under Hindu Law

There are two principle school of thoughts under Hindu Law, namely Mitakshara and Dayabhaga.

1. Mitakshara Scool:

- The Mitakshara School exists throughout India except in the State of Bengal and Assam. The Inheritance is based on the principle or propinquity i.e. the nearest in blood relationship will get the property.
- Sapinda relationship is of blood. The right to Hindu joint family property is by birth. So, a son immediately after birth gets a right to the property.
- The system of devolution of property is by survivorship. The share of co-parcener in the joint family property is not definite or ascertainable, as their shares are fluctuating with births and deaths of the coparceners. The coparcener has no absolute right to transfer his share in the joint family property, as his share is not definite or ascertainable.
- A woman could never become a coparcener. But, the amendment to Hindu Sucession Act of 2005 empowered the women to become a coparcener like a male in ancestral property. A major change enacted due to western influence.
- The widow of a deceased coparcener cannot enforce partition of her husband's share against his brothers.
- There are four Sub-Schools under the Mitakshara School:
  - Dravidian School of thought (Madras school)
  - Maharashtra school (Bombay school of thought)
  - Banaras school of thought:
  - Mithila school of thought:

2. Dayabhaga school:

- It exists in Bengal and Assam only. It has no sub-school. It differs from Mistakshara School in many respects.
- Inheritance is based on the principle of spiritual benefit. It arises by pinda offering i.e. rice ball offering to deceased ancestors.
- Sapinda relation is by pinda offerings.
- The right to Hindu joint family property is not by birth but only on the death of the father.
- The system of devolution of property is by inheritance. The legal heirs (sons) have definite shares after the death of the father.

- Each brother has ownership over a definite fraction of the joint family property and so can transfer his share.
- The widow has a right to succeed to husband's share and enforce partition if there are no male descendants.
- On the death of the husband the widow becomes a coparcener with other brothers of the husband. She can enforce partition of her share.

Rights and liabilities of members of HUF

As specified under the Hindu law and the codified law, various members of the family are entitled to rights, etc., as given below:

1. The coparceners of the HUF are entitled to demand partition. Besides the coparceners, the Hindu widows under the Hindu Women's Right to Property Act, 1937, are also entitled to demand partition just as her husband could have done. However, wife of a coparcener cannot claim for partition.
2. The members of the HUF which include male and female members, daughters and children of the male members are entitled to maintenance. Maintenance includes food, shelter, clothing, education, medical aid and marriage.
3. A members of the HUF is entitled to own and possess his separate property besides his interest in the HUF property.
4. The widow and children of a deceased coparcener have the right to be maintained out of the HUF property and are also entitled to demand partition.
5. If a coparcener or other member converts himself into any other religion like Islam or Christianity, he ceases to be a member of family and he cannot enjoy joint status along with other members.
6. A coparcener or member may enter into partnership with Karta of HUF by bringing his capital or even without bringing any capital but contributing his skill and labour only.

2. CHARACTERISTICS OF HUF

1. The Karta can function in Dual capacity and can claim remuneration and other benefits from the HUF.
2. Hindu Undivided family may be composed of
   - Large or
   - Small or
   - Nuclear Joint Families

3. Every above said families may hold the property in its own RIGHT, may be assessed for its income as a separate unit.

4. There need NOT be more than one MALE member to form HUF.

5. If the family is reduced to Sole - Surviving coparcener with other family members, income tax is leviable on the joint family and not on male members as individual.

6. There can be a HUF comprising only of FEMALE members.

7. A member of the family can carry on any other business individually, it will be his individual income not of family even if he borrows requisite capital from the joint family fund.

8. Mostly fees or salary earned by Karta as director or partner may be considered as his individual income.

9. Salary income of the individual will not be assessed as income of the HUF merely by the reason that the person having been educated, maintained, supported wholly by joint family funds.

3. CONCEPT OF CO-PARCENERY

The Hindu Coparcenary - a narrower body than Joint Family.

A Hindu joint family consists of the common ancestor and all his lineal male descendants upto any generation together with the wife/ wives (or widows) and unmarried daughters of the common ancestor and of the lineal male descendants. Whatever the skeptic may say about the future of the Hindu joint family, it has been and is still the fundamental aspect of the life of Hindus.

Whereas a co-parcenery is a narrow body of persons within a joint family. It exclusively consists of male members. A Hindu coparcenery is a corporate entity, though not incorporated. A coparcenery consists of four successive generations including the last male holder of the property. The last male holder of the property is the senior most member of the family.

HUF coparcenery is a limited body, a part of the HUF, smaller than the membership of HUF. It includes those persons who acquire interest in joint coparcenary property by BIRTH, namely:-

- Sons
- Grand Sons
- Great Grand Sons

Under the Mitakshara School of thoughts, a Coparcener is that member of HUF who acquires by birth an interest in the joint property of the family whether inherited or otherwise acquired by the family. The members of the family who are not Coparceners have no right to claim partition.

Characteristics of Coparcenery

A Hindu coparcenery has following essential characteristics as under according to ***CED v. Alladi Kuppuswamy (1977) 108 ITR 439 (SC)*:**

1. The male descendants as well as female descendants after the Succession (Amendment) Act, 2005, up to the third generation acquire an independent right of ownership by birth and not representing their ancestors. After the commencement of Hindu Succession (Amendment) Act, 2005, a daughter of a coparcener shall have the same right in the coparcenery as she would have had if she had been a son.
2. The members of the coparcenery have the right to work out their rights by demanding partition.
3. Until partition, each member has got ownership extending over the entire property co-jointly with the others and so long as no partition takes place, it is difficult for any coparcener to predict the share which he might receive.
4. As a result of such co-ownership, the possession and enjoyment of the property is common.
5. There can be no alienation of the property without the concurrence of the other co-parceners unless it is to be for legal necessity.
6. The interest of a deceased member lapses on his death and merges in the coparcenery property.

Rights of Mistakshara coparcener

1. A Mitakshara Coparcener has right to claim partition of the family property and to separate himself from the family.
2. A coparcener has his/her right and interest by birth in the whole of the joint family property without having a definite share in that property. According to ***Appovier v. Rama Subba Aiyan (1866) 11 MIA 75, 90***, no coparcener of an undivided family can predict in the joint and undivided property that he has a certain definite share.
3. Every coparcener has a right to be maintained out of the joint family fund. However, the extent of maintenance available to him is at Karta's sole discretion.

4. It was held in **Attorney General of Ceylon v. A.R.A Arunachalam Chettiar & Ors. (1958) 34 ITR (ED) 42 (PC),** that a coparcener can Initiate proceedings against the Karta to ensure recognition of his future maintenance rights where he is excluded entirely from the benefits of joint enjoyment of family property and income. He can also claim compensation for his earlier exclusion.

5. The coparceners are tied together with unity of interest and unity of possession between them.

6. Every coparcener has a right to challenge an improper alienation made by Karta, apart from those made for legal necessity, benefit of estate or indispensable duties or for legitimate acts of management.

7. As held in **State Bank of India v. Ghamandi Ram AIR 1969 SC 1330 and N.V.Narendra Nath v. CWT (1969) 74 ITR 190 (SC),** a Mitakshara coparcener has the right of survivorship meaning that he takes the joint family property by survivorship.

However, w.e.f. 9-9-2005 as a consequence of commencement of Hindu Succession (Amendment) Act, 2005, the interest in Joint Hindu Family shall devolve by testamentary or intestate succession and not by survivorship.

Right of coparceners under Dayabhaga School

The right of the coparceners under Dayabaga and Mitakshara Schools have many things in common. There are, however, certain points of distinction which are as under:

1. Under the Dayabhaga school, no person has any interest or right by birth. The interest of each coparcener is a specified and fixed one.

2. A coparcener under the Dayabhaga schools, has the right to joint possession and enjoyment of the HUF properties.

Chapter-II

KARTA OF HUF

The Karta is the manager of HUF and have wide powers by way of controlling the affairs of the HUF. The Karta enjoys his position in the HUF by operation of law without any agreement and consent of other members of HUF. He stands in a fiduciary relationship with other members, but he is not accountable to anyone.

Article 236 of the Mulla Hindu Law defines "Karta" as follows:

"Manager *- Property belonging to a joint family is ordinarily managed by the father or other senior member for the time being of the family: The Manager of a joint family is called Karta."*

The Karta is entrusted not only with the management of properties of the family but is also entrusted with the general welfare of the family. Karta is the head of the family and acts on the behalf of all members of the family but an agent of members of the family.

Who can be 'KARTA'?

1. **The Karta is the senior most male coparcener of the HUF.**

   Even if the Karta becomes aged, infirm, ailing, or even a leper, he may continue to be Karta. Where the senior most member is not Karta, the next senior male member takes over as Karta. ***[Man vs. Gaini ILR (1918) 40 All 77].***

2. **A junior coparcener can be Karta**

   Only if the senior most member gives up his right, a junior coparcener can become Karta of the HUF, with the consent of all other members as held by Supreme Court in ***Narendra Kumar J. Modi Vs CIT (1976) 105 ITR 109 (SC).***

3. There can be more than one KARTA of a HUF

Darshan Vs Prabhu ILR (1946) All 692

4. Only Coparcener can become Karta

The Supreme Court in ***CIT vs. Seth Govindram Sugar Mills [1965] 57 ITR 510 (SC)*** held that coparcenership is a necessary qualification for the managership of a joint Hindu family.

5. Minor as Karta

In absence of the father, the elder minor son could act as the Karta of the family. Therefore, a minor can be the managing member of a Hindu undivided family. ***[Budhi Jena v. DhobaiNaik (AIR 1958 Orisss 7)]***

POWERS OF KARTA

1. Managing the affairs of HUF
2. Control & become custodian of the finances
3. Can borrow money for & on behalf of HUF
4. Spend money for the family & not accountable for it.
5. NOT liable to submit account to anybody.
6. Can make partition of the family suo moto.
7. Quantum of partition shall be with KARTA's liking.
8. HUF cannot enter in to contracts, or form partnership firm, or represent except through Karta, however Karta may allow others to represent HUF.
9. Can Gift away the movable properties of HUF for natural love & affection but within reasonable limit.
10. May transfer immovable properties for pious purposes or for the benefit of the family.

Position of Female in HUF

After amendment made by Hindu Succession (Amendment) Act, 2005, daughter can be coparcener of HUF like the sons of HUF. After her marriage she becomes member of her husband's HUF and continues to be a coparcener of her father's family. Being a coparcener, she can also seek partition of the dwelling house where the family resides

and she can also dispose of her share in coparcenery property at her own will. If a Hindu dies, the coparcener property shall be allotted to the daughter as is allotted to sons. If a female coparcener dies before partition, then children of such coparcener would be eligible for allotment, assuming a partition had taken place immediately before her demise. A widow of a pre-deceased son even though remarried is now eligible for share in property as legal heir of the pre-deceased son of the family.

Female as Karta

Many courts had held that only a coparcener can become Karta of HUF. Since, a female was not considered as coparcener, she was not empowered to act as Karta prior to amendment in Hindu Succession Act. However, w.e.f. 6thSeptember, 2005, after amendments made by Hindu Succession (Amendment) Act, 2005 in respect of position of female member, the daughter of coparcener shall by birth become a coparcener in her own right in the same manner as the son.

Powers of Alienation

The power of alienation cannot be exercised except by Karta the joint family property can be alienated for the following three purposes only:

a. Legal necessity(Apatkale)

b. Benefit of estate of the family(Kutumbarthe)

c. Acts of Indispensable duty (Dharmamarthe)

The Karta can alienate the joint family property with the consent of the coparceners even if none of the above exceptional cases exist and if all the coparceners are adult, the alienation is binding on the entire joint family. ***[Kandasami V. Somakanda ILR (1912) 35 Mad 177]***

Legal Necessity-

The cases of legal necessity can be so numerous and varied.Some of the instances of a necessity may be outstanding revenue dues, ancestral debts, marriage expenses, discharge of outstanding decrees, personal necessities arising from poverty, sickness, incapacity for work, etc., legal expense in defending estate, litigation to protect estate, etc..

Property sold and mortgaged for an unlawful purposeand immoral purposes cannot be said to be legal necessity. As the property was alienated for the purpose of marriage of minor daughters, it cannot be called as lawful alienation. ***[DevKishan v. Ram Kishan AIR 2002 Raj 370]***

a. Alienation Is Voidable

The alienation of property by Karta without any legal necessity/ benefit of estate/ discharge of indispensable duties is only voidable at the instance of any coparcenery and not void. [***CIT v Gangadhar Sikaria Family Trust (1983) 142 ITR 677]***

Where HUF is governed by Mitakshara School of Hindu law and property is alienated by Karta without legal necessity or benefit of minors, it is only voidable and not void, and therefore, any income derived from properties so transferred is not assessable in hands of HUF. ***[R.C. Malpanivs CIT [1995] 80 Taxman 546 (GAU.)]***

b. Benefit of Estate–It includes anything which is done for the positive benefit of the joint family property.

c. Indispensable Duties - This term implies performance of those acts, which are religious, pious, or charitable.

Chapter-III

SOLE SURVIVING COPARCENER

A coparcener outliving all other coparcener is known as the sole surviving coparcener. He may be alone in the family or there may be other female member along with him in the family. The nature of property in the hands of such sole surviving coparcener is that of HUF property.

Sole Coparcener without any male or female member

- SINGLE person CANNOT constitute a family.
- If ONLY a widow was left in the family after the death of sole male coparcener. It was laid down by the court that the family was brought to an end.
- If it was not possible to add a male member by nature or by law.

  [Anant Bhikappa Patil Vs Shankar Rama chandra Patil AIR 1943 PC 196]

Other forms of Sole coparcener

- Temporary reduction to a single coparcener **[Attorney General of Ceylon Vs A.R. ArunachalamChettiar&Ors. (1958) 34 ITR (ED) 42 (PC)]**

  CANNOT convert the property of undivided family to separate property of the sole coparcener.

- Sole coparcener with a female member can constitute HUF. **[Gowli Buddanna Vs CIT (1966) 60 ITR 293 (SC)]**

Effect of Subsequent marriage of sole surviving coparcener and not getting a son

In **CIT v. Parshottamdas K. Panchal [2002] 257 ITR 0096 [Gujarat]**, it was held that:

An individual who receives ancestral property at a partition and who subsequently acquires family, but has no male issue, would hold that property only as the property of the family. Under the Hindu law the wife of the coparcener is certainly a member of the family. Whatever be the school of Hindu law by which a person is governed, the basic concept of a Hindu undivided family in the sense of who can be its members is just the same. Thus, in order to constitute a joint family, it is not always necessary that there must be two male members.

Cases where property before partition was HUF or self acquired property in father's hands, distinguishable from each other

1. Self acquired property In the hands of father. **{KalyanjiVithaldas&Ors. Vs CIT (1937) 5 ITR 90 (PC)}**
   - it's NOT a joint family property
2. HUF property in the hands of father. **{Attorney General of Ceylon Vs A.R. ArunachalamChettiar&Ors. (1958) 34 ITR (ED) 42 (PC)}**
   - it's a joint family property

Powers of Sole coparcener

- Sole coparcener can dispose of the coparcenary property as it were his separate property, he can sell or mortgage it or gift of it. **{CIT Vs Anil J. Chinai (1984) 148 ITR 3 (Bom)}**
- Sole coparcener can settle property as he likes. **{Anil Kumar B. Laskari Vs CIT (1983) 142 ITR 831 (Guj)}**
- Sole Coparcener cannot make partition of property nor he grants share. **{B.T. Ravindranath Punja Vs CIT (1989) 179 ITR 243 (Kar.)}**
- Sole coparcener can make valid gift of immovable property. **{CIT Vs Admiralty Flats Motel (1982) 133 ITR 895 (Mad)}**

CHAPTER-IV

CONSEQUENCES OF AMENDMENT IN HINDU SUCCESSION ACT, 2005

Consequence of Amendment made by Hindu Succession (Amendment) Act, 2005 - rights & liabilities of a daughter member

- Daughter shall be a Coparcener of Hindu Family Property.
- If a Hindu dies, the coparcener property shall be allotted to the daughter as is allotted to sons.
- If a female coparcener dies before partition, then children of such coparcener would eligible for allotment assuming a partition had taken place immediately before her demise.
- No recovery is made for ancestors dues from son, grandson, or great grandson by applying doctrine of pious obligation.
- A female member can also seek partition of the dwelling house where the family resides.
- A widow of a pre-deceased son even though remarried is now eligible for share in property as legal heir of the pre-deceased son of the family.
- A female can also dispose of her share in coparcenery property at her own will.

Expenses incurred on Marriage of a Daughter by HUF

Even daughter has become coparcener after Amendment of Hindu Succession Act, 1956, but marriage of daughter still an obligation of the Family under Hindu law.

Thus, reasonable amount of gift given on her marriage should not objected by the male coparcener.

Devolution of Interest in Co-parcenary Property

Section 6 as substituted by the Hindu Succession (Amendment) Act, 2005.

Section 6(1) provides that w.e.f. 06/09/2005, in a joint Hindu family governed by the Mitakshara law, the daughter of coparcener shall by birth become a coparcener in her own right in the same manner as the son. She shall have the same rights in the coparcenery property as she would have had if she had been a son and she shall be subject to the same liabilities in respect of the said coparcenary property as that of a son.

Section 6(2) of the new post amendment section 6 provides that any property to which a female Hindu becomes entitled by virtue of sub section (1) shall be held by her with the incidents of coparcenary ownership. And property is capable of being disposed of by her by testamentary disposition.

Section 6(3) *provides that*

- Where a Hindu dies after the commencement of Hindu Succession Act 2005, his interest in the property of joint family, Shall devolve by testamentary of intestate succession.
- As the case may be, under this Act and not by survivorship, & the coparcenary property shall be deemed to have been divided as if a partition has taken place and, daughter is allotted the same share as son.
- The share of the pre-deceased son or a pre-deceased daughter, as they would have got had they been alive at the time of partition, shall be allotted to the surviving child of such pre-deceased son or of such pre-deceased daughter. [---- do --- with the predeceased child of pre-deceased son or a pre-deceased daughter].

Section 6(4) provides that no court shall recognize any right to proceed against a son, grandson, or great grandson for the recovery of any debt due from his father, grand father or great grand father.

Explanation to Section 6(5) provides that partition for the purposes of this section means any partition made by execution of a deed of partition duly registered under the Registration Act, 1908 (16 of 1908) or partition effected by a decree of a court.

Section 6(6) provides that nothing contained in this section shall apply to a partition, which has been effected before the 20-12-2004.

Applicability of I.T. Act in case of deemed partition under section 6 of Hindu Succession Act

For the purpose of partition of HUF, Sec. 6 of Hindu Succession Act would govern the right of the parties, however, so far as the Income Tax Law is concerned, the matter has to be governed by Section 171(1). ***{Addl. CIT Vs Maharani Raj Laxmi Devi (1997) 224 ITR 582 (SC)}***

General Rule of Succession - Section 8

The property of male Hindu dying intestate shall devolve as per the provisions given below:-

- Firstly amongst the heirs specified in **Class I** of the schedule.
- If no heirs of class I exists than amongst the heirs of **Class II**.
- If no heirs in both classes then amongst **agnates** of the deceased.
- Lastly, if no agnates then amongst the **cognates** of the deceased.

Class I heir

→ Son
→ Son of Predeceased son.
→ Son of Predeceased son of Predeceased son.
→ Widow
→ Widow of Predeceased son
→ Widow of Predeceased son of Predeceased son
→ Mother
→ Daughter
→ Son of Predeceased Daughter.
→ Daughter of Predeceased Daughter.
→ Daughter of Predeceased Son
→ Daughter of Predeceased Son of Predeceased Son.
→ Son of Predeceased Daughter of Predeceased Daughter.
→ Daughter of Predeceased Daughter of Predeceased Daughter.
→ Daughter of Predeceased Son of Predeceased Daughter.
→ Daughter of Predeceased Daughter of Predeceased Son.

Class II heir

→	Father	→	Brothers Daughter.
→	Son's Daughter's Son.	→	Sister's Daughter.
→	Son's Daughter's Daughter.	→	Father's Father, Father's Mother.
→	Brother.	→	Father's Widow.
→	Sister.	→	Brothers Widow.
→	Daughter's Son's Son.	→	Father's Brother.
→	Daughter's Son's Daughter.	→	Father's Sister.
→	Daughter's Daughter's Son.	→	Mothers Father.
→	Daughter's Daughter's Daughter.	→	Mothers Mother.
→	Brothers Son.	→	Mother's Brother .
→	Sister's Son.	→	Mothers Sister.

Agnates

Agnates of the deceased are relatives from the parental side. 'A Person is said to be an agnate of another if the two are related to blood or adoption wholly through males'.

Cognates

Cognates of the deceased are relatives through maternal side. 'A person is said to be cognate of the deceased if the two are relative by blood and adoption not wholly through the males'.

Applicability of Section 8

Section 8 is applicable to the property of a male Hindu dying intestate.

The initial part of section 6 permits coparcenary property to devolve on heirs by survivorship, and hence where this part of section 6 applies, section 8 will have no application. In such a case section 8 applies and the divided son will get by succession as if it were the separate property of the deceased.

Distribution of property on Succession - Section 10

Following are the rules provided for the distribution of property among class I heirs:-

Rule 1- Intestate's widow – one share [if he had more than 1 widow then also 1 share in total]

Rule 2 - Surviving sons, daughters & mother of deceased –one share each

Rule 3- The heirs in the branch of each predeceased son or each predeceased daughter of the intestate shall take between them one share.

Rule 4- The distribution of the share referred to in rule 3 –

- Amongst the heirs in the **branch of the predeceased son** shall be so made that his widow (or widows) together and his surviving sons and daughter get equal portions; and the branch of his predeceased son gets the same portion;

- Amongst the heir in the **branch of predeceased daughter** shall so made that the surviving sons and daughter get equal portions.

Chapter- V

MODES OF CREATION OF HUF

A Hindu Undivided Family can be created by following ways:

A. **Blending** of individual property with the family Hotchpot

B. Receipts of **Gifts**

C. Doing **Joint labour** for the benefit of HUF

D. Inheritance through a specific bequest under a **Will**

E. **Partitio**n of a larger Hindu Undivided Family

F. **Reunion** of separated coparceners

A. Creation of HUF Corpus by Blending

Blending means transfer of one's individual property in the common hotchpot and make it a part of the common property of the HUF. There must be an intention to throw the separate property into the common stock and it is necessary to waive all separate rights in respect of the property, which must be clearly established through a declaration. Only the coparcener is entitled to throw in HUF's common property.

a. Blending can be utilized for creating smaller HUF. HUF can be created by impressing one's self acquired property with the character of HUF property by bringing in to existence an HUF comprising the person himself, his wife & children.

b. Applicability of Section 64(2) of I. T. Act, 1961

   Transfer of individual property in the common hotchpot is deemed to be a gift and income from the transferred asset is deemed to be the income of individual

under Section **64(2) of the Income Tax Act, 1961**. As per section 64(2) of the Income Tax Act, if any property has been transferred by the individual, directly or indirectly, to the family otherwise than for adequate consideration then the income derived from such property shall be deemed to arise to the individual and not to the family and where the converted property or any part thereof is received by the spouse of that individual on partition the provisions of sub-section (1) shall apply. Similarly provision was inserted in the Wealth Tax Act, 1957 under section 4(1A).

c. Rights of members of HUF do not get enlarged on throwing property into family hotchpot, income from said property had to be treated as assessee's individual income only. The property can change its legal incidents on the birth of son.

d. Partition of HUF after blending

This is for achieving distribution of immovable property among members because giving it in any other manner will require registration for effective transfer.

Each division is entitle to claim exemption under Sec 5 (vi) of the Wealth Tax Act.

B. Creation of HUF by receipts of Gifts

HUF is a creation of law and cannot be created by the act of parties, therefore, HUF cannot be created for the first time by a gift from the stranger. If HUF already exists, gift can be made by a stranger to such HUF.

The gifted property will be HUF property if the gift is made to HUF.

Intention of donor & the character of the gifted property will depend on the construction of the gift deed.

Precautions to be taken by family while accepting gifts

- Clear declaration of intention through affidavit. ***{C.N. Arunachala Mudaliar Vs C.A. Muruganatha Mudaliar & Anr. AIR 1953 SC 495: (1954) SCR 243 (SC)}***

- Gift to be valid & genuine.

No specific bar to a gift by the father to the HUF of his son, his wife & minor children. However, for avoiding the clutches of sec 64 (1)(vi) such gifts better be avoided.***{CIT Vs Smt. T. SuryamaniKothavalsala (2003) 263 ITR 271 also see CIT Vs S.N. Malhotra (1989) 178 ITR 380 (Cal)}***

- HUF can accept gifts from relative who may not be the member of the family.

C. Creation of HUF by Doing Joint labour for the benefit of HUF

Property acquired in the course of some business carried on by the persons constituting a joint Hindu family, takes the characteristic of joint family property.

As per Hindu law, in case of properties not acquired with the aid of joint family property, it is presumed that property acquired by coparceners by working together is joint family property unless the persons concerned desire to hold it as co-owners. This is valid if the coparceners are carrying on work together and belong to the same line of ancestors.

The income from such property is out of the purview of section 64(2) of the Income Tax Act, 1961 and section 4(1A) of the Wealth Tax Act, 1957.

In the cases of properties acquired with the aid of joint family property is also the joint family property.

D. Creation of HUF by Inheritance through a specific bequest under a Will

A HUF can also be created by will of a person provided the will is valid and there is a specific bequest in favour of the HUF as held by Punjab & Haryana High Court in *CIT vs. GhanshamDassMukim (1979) 118 ITR 930*. Moreover, HUF need not be in existence at the time of execution of will. Even a stranger can bring a HUF into existence by making a will in the favour of HUF of a person.

Creation by will

- No existence of HUF at the time of execution of will.
- Valid will should be there. ***{CIT VsGhanshyam Das Mukim (1979) 118 ITR 930 (Punj & Har)}***
- *An HUF is created if there exist a valid will.*

E. Creation of HUF by Partition of a larger Hindu Undivided Family

Partition of an existing HUF can also result in creation of many smaller HUFs. As per Hindu Law, the property does not change its character on partition. Property received by a coparcener having a family, continues to have characteristic of HUF. An unmarried coparcener receiving any property will own the property in the status of HUF until he acquires the status of HUF. In case of married coparceners who have no child, the property will continue with the status of HUF as held by High Court of Madhya Pradesh in ***CIT vs. Krishna Kumar (1982) 10 Taxman 292 (MP).***

However, the partition has to be total partition because the law does not recognize partial partition as per section 171(9) of the Income Tax Act, 1961.

F. Creation of HUF by Reunion of separated coparceners

Even after partition of HUF, members may re-unite to form a new HUF. However, there are certain conditions to make such reunion valid in the eyes of law. Reunion can take place only when there **was in existence a HUF** and there was **total partition** of such HUF. It can take place **only between persons who were parties to the original partition** and to support such reunion, there must be an agreement between the parties. To constitute a reunion there must be an **intention of the parties to reunite in estate & interest** and such intention is evident. As per Mitkarsha, Dayabhaga and SmritiChandrika, a member of a joint family once separated can reunite only with his

- father,
- brother or
- paternal uncle but not with any other relation.

Gems of Judiciary

1. ***Paramanand L. Bajaj Vs CIT (1982) 135 ITR 673(Kar)-*** Under the Hindu Law:
   - It is possible among persons who were on earlier date, members of HUF.
   - There must have been a partition in fact.
   - Reunion must be effected by the parties or some of them who had made their partition.
   - Must be a junction of estate & reunion of the property

   Further, share of property of reunited members got at an earlier partition &
   - its possession at the reunion
   - becomes the property of the joint family.
2. **CIT*Vs A.M. Vaiyapuri Chettiar & Anr. (1995) 215 ITR 836 (Mad)***- It is not necessary that all the property
   - Belong to HUF should be brought back
   - in to the re-united joint family
   - This reunion is said to be VALID
3. ***CIT Vs Rupchand Routhmall (1963) 50 ITR 295 (Cal) -*** The minor cannot be a part of reunion neither by self nor by someone on behalf of such minor.

Chapter-VI

SOME IMPORTANT ASPECTS OF HUF UNDER INCOME TAX, 1961

a. Partition of HUF under Income Tax Act, 1961 and its assessment after Partition.

b. Residential Status of HUF

c. Taxability of Income from house property in the name of HUF

d. Proprietorship and Partnership by HUF

e. Capital Gain Exemption available to HUF

f. Deductions under Chapter VIA

g. Taxability of gift received in cash or in kind by HUF without consideration

h. Return of Income

i. Clubbing Provisions of Section 64(2) in case of HUF

j. Miscellaneous Issues

A. Partition of HUF under Income Tax Act, 1961 and its assessment after Partition.

The Partition of HUF should be recognized as per the Income Tax Act and not as per the Hindu Law. Section 6 of the Hindu Succession Act would govern the rights of the parties but insofar as income-tax law is concerned, the matter has to be governed by section 171(1) of the Income Tax Act, 1961 **[Add. CIT *v.* Maharani Raj Laxmi Devi [1997] 091 Taxman 020 (SC)]**. The Hindu Law does not require that the property in every case be partitioned by metes and bound or physically into different portions

to complete a partition. But the Income Tax Law introduced certain additional conditions of its own to give effect to the partition u/s 171.

Section 171 of the Income Tax Act, 1961 defines the partition of HUF and deals with the provisions of assessment after its partition. Thus a transaction may be treated as severance of status under Hindu Law but not a partition under 1961 Act as physical division of property is necessary under 1961 Act **[CIT v. Smt. Meera Prem Sundar (HUF) [2005] 147 TAXMAN 535 (ALL.)].**

The various practical aspects related to partition of HUF are discussed as under:

Q1. What is the Partition of HUF?

- The Partition of HUF can be categorized as under:-

  1. **Partial Partition** - Partial partition means a partition which is partial as regards the persons constituting the HUF, or the properties belonging to the HUF, or both.

  2. **Total or Complete Partition** – Assets of HUF are physically divided. As per explanation to section 171 of the Income Tax Act,

'Partition' means

(i) where the property admits of a physical division, a physical division of the property, but a physical division of the income without a physical division of the property producing the income shall not be deemed to be a partition; or

(ii) where the property does not admit of a physical division, then such division as the property admits of, but a mere severance of status shall not be deemed to be a partition.

Therefore a transaction can be recorded as a partition u/s 171 only if, where the property admits of a physical division, such division has actually taken place. ***[Kalloomal Tapeshwari Prasad (HUF) v. CIT [1982] 133 ITR 690 (SC)]***

Q2. What is the tax implication of Partial Partition of HUF?

A Partial partition taken place after 31-12-1978 is not recognized the Income Tax Act, 1961 (Sub-section 9 of section 179. Therefore even after the Partial partition, the income of the HUF shall be liable to be assessed under the Income-Tax Act as if no partition had taken place.

Q3. What is the tax Implication of Full Partition of HUF?

After the Partition, the assessment of HUF shall be made as per the provisions of Section 171 of the Income Tax Act and order to be passed by the Assessing Officer.

Q4. What is the procedure of partition and assessment after partition of HUF under Income Tax Act

The following procedure u/s 171 is prescribed under the Income Tax Act regarding partition and assessment after partition of HUF:

1. The HUF hitherto assessed as undivided shall be deemed for the purposes of this Act to continue to be a Hindu undivided family, except where and in so far as a finding of partition has been given under this section in respect of the HUF.

2. Where, at the time of making an assessment u/s 143 or u/s 144, it is claimed by or on behalf of any member of a Hindu family assessed as undivided that a partition, whether total or partial, has taken place among the members of such family, the AO shall make an inquiry thereinto after giving notice of the inquiry to all the members of the family.

3. On the completion of the inquiry, the AO shall record a finding as to whether there has been a total or partial partition of the joint family property, and, if there has been such a partition, the date on which it has taken place.

4. Where a finding of total or partial partition has been recorded by the AO and the partition took place during the previous year,—

   (i) the total income of the joint family in respect of the period up to the date of partition shall be assessed as if no partition had taken place; and

   (ii) each member or group of members shall, in addition to any tax for which he or it may be separately liable and notwithstanding anything contained in clause (2) of section 10, be jointly and severally liable for the tax on the income so assessed.

5. Where a finding of total or partial partition has been recorded by the AO and the partition took place after the expiry of the previous year, the total income of the previous year of the joint family shall be assessed as if no partition had taken place; and each member of group of members shall be jointly and severally liable for the tax on the income so assessed.

6. Notwithstanding anything contained in this section, if the AO finds after completion of the assessment of a Hindu undivided family that the family has already effected a partition, whether total or partial, the AO shall proceed to recover the tax from every person who was a member of the family before the partition, and every such person shall be jointly and severally liable for the tax on the income so assessed.

7. For the purposes of this section, the several liability of any member or group of members thereunder shall be computed according to the portion of the joint family property allotted to him or it at the partition, whether total or partial.

8. The above provisions shall, so far as may be, apply in relation to the levy and collection of any penalty, interest, fine or other sum in respect of any period up to date of the partition, whether total or partial, of a HUF as they apply in relation to the levy and collection of tax in respect of any such period.

Q5. Whether the sum received by a member as and towards his share as coparcener of HUF, on its partition is taxable as income?

The sum received by a member as and towards his share as coparcener of HUF, on its partition cannot be brought to tax as income **[Smt. Sudha V. Iyer *v. ITO* 15 taxmann.com 234 (ITAT-Mum.)[2011]**

Q6. Whether setting apart of certain assets of HUF in favour of certain coparceners on a condition that no further claim in properties will be made by them, is a partition under Income Tax Act?

Setting apart of certain assets of HUF in favour of certain coparceners on the condition that no further claim in properties will be made by them, is nothing but a partial partition and not a family arrangement and not recognised in view of section 171(9) of the Act. **[ITO v. P. Shankaraiah Yadav 91 ITD 228 (2004) (ITAT-Hyd.)].**

Q7. Whether there is an ipso facto partition of joint family properties immediately after the death of a male coparcener having coparcenary interest in coparcenary property?

The gist of the various pronouncements of the Hon'ble Supreme Court is that there is no ipso facto partition of joint Hindu family properties immediately after the death of a male coparcener of the Mitakshara school having coparcenary interest in the coparcenary property. The fiction given by Explanation 1 to section 6 of 1956 Act has nothing to do with the actual disruption of the status

of a HUF. It freezes or quantifies the share of a female heir in the coparcenary property on account of the death of a coparcener at the relevant point of time.

Therefore, there was no partition and disruption of the HUF as per Explanation 1 to section 6 of the 1956 Act, in the instant case. **[CIT vs. Charan Dass (HUF) [2006]153Taxman 307(All.)]**

B. Residential Status of HUF

Q1. What is the residential status of the HUF under Income Tax Act?

Section 6(2) of the Income-tax Act, 1961, clearly contemplates a situation where a HUF can be non-resident also. In fact, HUF can also be Not Ordinarily Resident.

HUF will be considered to be resident in India unless, during the previous year, the control and management of its affairs is situated *wholly outside India*. In such a case, it will be treated as non-resident HUF.

Section 6(6)(b) of the Income-tax Act, 1961 further provides that, in case of a HUF whose manager has not been resident in India in nine out of ten previous years preceding the previous year or has, during the seven previous years preceding that year, been in India for a total 729 days or less, such HUF is to be regarded as not-ordinarily resident within the meaning of the Income-tax Act, 1961. As such, it is not necessary for a HUF to be resident in India.

Q2. How the residential status of the HUF can be determined in case of change of Karta of HUF during the relevant year?

In case of change of Karta of HUF during the year, the residential status of HUF can be determined by considering the period of stay in India of both Karta of HUF i.e. previous Karta and successive Karta.

Q3. Whether different residential status for HUF is possible for different years?

Under the Income Tax Act the residential status is determined with reference to the previous year relevant to a particular assessment year. Therefore the residential status of HUF may also be different for different assessment years considering the facts of relevant previous year.

Q4. Whether the non-residential status of Karta would alter the residential status of HUF?

As discussed in the earlier answer, the test is not where the Karta resides; ***the test is where the control and management of the affairs of HUF is situated.***

Even if a part of control and management is situated in India, such HUF will be treated as resident in India.

Though, generally, Karta is supposed to manage the affairs of HUF, it is not an absolute rule and, by consent, the power of control and management may be delegated to other members of the family, either fully or partially.

The relevant factor for determining the status is where the control and management of HUF is situated (even in part). Therefore the HUF may be resident even where the Karta was residing outside India for whole of the year.

Q5. Whether the income received by members from HUF is taxable?

As per Section 10(2) of the Income-tax Act, 1961, any sum received by an individual from Hindu Undivided Family of which he is member is exempt from tax.

But the amount received not as a member of Joint Family but in pursuance of some statutory provision, etc. would not be exempted in this section. Also the position of member of joint family in law to claim the right u/s 10(2) does not get affected only with the reason that they are living apart from the other members of the family.

C. Taxability of Income from house property in the name of HUF

1. Self occupied one Residential House & the tax gain specially by way of Interest on Loan & Repayment of Loan
2. Special 30% deduction on Rental Income also to HUF.
3. Exemption from Wealth-tax the real estate of HUF - One House Wealth Tax Free (Commercial / Rented Residential)

Q1. Whether the Property purchased with the joint fund is assessed in the hands of HUF only?

Property purchased with the aid of joint family funds, howsoever small that may be, still the property would be HUF income and cannot be income of the individual with major portion of purchase price.

The Hon'ble Madras High Court has held in the case of S. Periannan v. CIT (1991) 191 ITR 278, that

"When once the estate had become the property of the assessee-Hindu undivided family on its coming into existence, there could be no change in its character by reason of the fact that, subsequently, in the books of the assessee-Hindu undivided family, the account of Sathappa Chettiar was debited with the amount which have been drawn for the purchase of the estate. In these circumstances. The Tribunal rightly held that the Grove Estate should be considered as belonging to the assessee-Hindu undivided family."

Q2. Whether the Income from House property to be charged in the hands of HUF only where property is purchased in the name of HUF?

In the case of ACIT vs. Rakesh S. Agrawal [2010] 36 SOT 148 (AHD.) it was held that:

AO found that the assessee had purchased a house property from 'A'. The assessee's case was that since the investment was made in the name of HUF, it was not declared in his individual return. The AO, however, took a view that the funds for acquiring the property in question were met from the personal sources of the assessee. He thus determined annual letting value of the property resulting in certain addition to the assessee's income. On appeal, the Commissioner (Appeals) directed the AO to consider the annual letting value of the property in the hands of HUF and deleted the impugned addition.

D. Proprietorship and Partnership by HUF

Q1. Whether HUF can do a business in its own name?

1. HUF can be a Proprietor of one or more than one Business concerns.
2. Separate name can be kept of HUF business entity.
3. No tax Audit of HUF business if Turnover within Rs. 1 crore (F.Y. 2012-13).
4. Business Income Computation @ 8% without books of account in case turnover is upto Rs. 1 crore – The Presumptive Basis

Q2. Can a Karta of HUF become partner in a firm?

The Hon'ble Supreme Court in Ram Laxman Sugar Mills vs. CIT [1967] 66 ITR 613 observed that a HUF is undoubtedly a "Person" with in the meaning of section 2(31), it is however not a juristic person for all purposes and cannot enter in to an agreement of partnership either with another HUF or Individual. It is open to the manager of a Joint Hindu family, as representing the family, to agree to become a partner with another person. And therefore any remuneration received by Karta would be the personal income of Karta and not the income of the HUF as there is no real connection between the investment of the assets of HUF and remuneration received by Karta.

Q3. Whether the amount received by Karta from partnership firm as remuneration is assessed in the hands of HUF?

The remuneration received by Karta as representative of HUF cannot be treated as income of the HUF. Remuneration will be income of HUF only when there is direct nexus between family funds and remuneration paid.

In ***Brij Mohan vs. CIT 201 ITR 831 (1993), the Supreme Court*** held that where the *receipt is a compensation made for the services rendered* and not for the return of investment, it is to be treated as individual income of the partner.

However, where members of HUF become the partners in a firm by investment of family funds & not because of any Special Services rendered by them, then the income will belong to HUF. ***{Lachman Das Bhatia & Sons vs. Commissioner of Income-tax [2007] 162 Taxman 118 (Delhi)} {D.N. Bhandarkar v. CIT 158 ITR 724 Kar (1986)}***

Once the character of an individual has been treated differently than HUF for the purposes of interest, there is no reason as to why that would not extend to the salary and bonus paid to such partners on account of their personal services

rendered to the firm in contra-distinction to their capacity as representatives of HUF .

Therefore, the same reasoning would apply to the cases where payment in the form of salary and bonus has been made to a partner in his individual capacity in contra-distinction to his representative character of the HUF. **[*CIT v. Unimax Laboratories [2007] 164 Taxman 373 (P & H)].***

Q4. Whether deduction is available to partnership firm u/s 40(b) in respect of salary or commission paid to a partner who was a partner in representative capacity of HUF.

As per Section 40(b)(i)

"in the case of any firm assessable as such,—

> *any payment of salary, bonus, commission or remuneration, by whatever name called (hereinafter referred to as "remuneration") to any partner who is not a working partner"*

Partner of a firm is an individual <u>*even if he is partner as a representative of HUF*</u>

- Where assessee-firm paid salary to a partner who was actively engaged in conducting affairs of business of firm, it was to be held that requirement of Explanation 4 to Section 40(b) stood complied with, and, thus, assessee-firm would be entitled to deduction in respect of salary paid to said partner even though he was a partner in representative capacity of HUF. ***[P. Gautam & Co. vs. JCIT [2011] 14 taxmann.com 79 (Ahd.)]***

- Salary paid to working partner even though as Karta of HUF, is received as individual and as working partner, hence allowable as deduction while computing income of firm. **[*CIT vs. Jugal Kishor & Sons [2011] 10 taxmann.com 82 (All.)]***

- It is individuals of HUF who indirectly become partner in firm in which HUF is said to be partner and therefore provisions of Section 40(b) that prohibits deduction of payments of commission to any partner who is not a working partner, in computing income under the head PGBP, will not be applicable. Therefore deduction of any commission payable to any individual of HUF shall be allowable. ***[CIT v. Central Scientific Instrument Corporation [2010] 1 DTLONLINE 149 (All.)]***

Q5. Whether the Salary income of wife of Karta is club in the Income of HUF?

Where a person is a partner in a partnership firm not in his individual capacity but as the karta of the Hindu undivided family, the **<u>income accruing to his</u>**

wife on account of her being a partner in the same partnership firm cannot be included in the total income of such person in an individual assessment or in the assessment of the Hindu undivided family. **[*CIT v. Om Prakash [1996] 217 ITR 785 (SC) See also CIT v. Ram Krishna Tekriwal [2005] 274 ITR 266 , Satish Chand Gupta v. CIT [2007] 160 Taxman 224 (All.)].***

In the case of Pratap H. Desai (HUF) v. ACIT [2009] 118 ITD 29 (Pat.) it was held that:

Assessee was a partner in a firm which was dissolved with effect from 1-1-1999 and its business was taken over by the assessee in the capacity of a HUF - the assessee sought to set-off loss of the said firm against the profit of his business as HUF

Section 78(2) prohibits carry forward and set-off of losses of one person by another person except when the other person receives the losses by inheritance. Section 78 shows that where succession to business is by inheritance, then loss will be allowed to be set-off and not otherwise.

Therefore, assessee was not entitled to set-off of losses of firm against his individual income

E. Capital Gain Exemption available to HUF

General provisions applicable to HUF:

- Cost Inflation Index benefit available to Calculate Cost of the Asset.
- Tax benefit of 20% Tax on Long-term Capital Gains.
- Long-term Capital Gains Saving by investing in Residential Property u/s 54/ 54F.
- Exemption on sale of Agricultural land u/s 54B.
- Saving Tax on Long-term Capital Gain possible by investing in Capital Gains Bonds of NHAI / RECL u/s 54EC.
- Exemption from tax on LTCG on transfer of residential property if invested in a manufacturing small or medium enterprise u/s 54GB (introduced vide ***Finance Act, 2012***)

Various practical aspects of taxability of Capital gain the hands of HUF are discussed as under:

Q1. To avail the benefit of adopting market value as on 1-4-1981, upto which date the capital asset should have become property of the previous owner?

Capital asset should have become property of previous owner before 1-4-1981 to make assessee entitled to benefit of adopting market value as on 1-4-1981

but where construction of building was completed in 1988 and possession of flat was handed over to previous owner, i.e., HUF, it could not be said that flat itself became property of HUF prior to that date and, hence, assessees were not entitled to adopt market value of flat as on 1-4-1981.In view of specific provisions of Explanation (iii) to section 48, indexing had to be allowed of the financial year in which flat was held by assessee on partition of HUF. **[*DCIT v. Kishore Kanungo 102 ITD 437 (Mum.) [2006]*]**.

Q2. Whether the benefit u/s 54 can be available on purchase of more than one residential house Properties?

A plain reading of section 54(1) discloses that when an individual assessee or an HUF assessee sells a residential building or land appurtenant thereto, he can invest capital gain for purchase of a residential building to seek exemption of the capital gain tax. The expression 'a residential house' should be understood in a sense that building should be residential in nature and 'a' should not be understood to indicate a singular number.

That when an HUF's residential house is sold, the capital gain should be invested for the purchase of only one residential house, is an incorrect proposition. After all, the property of the HUF is held by the members as joint tenants. **If the members, keeping in view the future needs in event of separation, purchase more than one residential building, it cannot be said that the benefit of exemption is to be denied u/s 54(1)**.

[*CIT v. D. Ananda Basappa 180 Taxman 4 (Kar.) [2009]]*

Q3. Whether to claim benefit of section 54F, residential house which is purchased or constructed has to be of same assessee whose agricultural land is sold?

To claim benefit u/s 54F, residential house which is purchased or constructed has to be of same assessee whose agricultural land is sold.

The, it is written it same view is expressed by Delhi High Court in the case of Vipin Malik (HUF) Vs CIT 183 Taxman 296 (2009), It was held that:

> *"The agricultural land, which was sold was of the HUF of the assessee but the flat purchased in the co-operative society was not in the name of the HUF. The flat was in the individual name of the assessee along with his mother. To claim the benefit of section 54F, the residential house which is purchased or constructed has to be of the same assessee whose agricultural land is sold and it was not the case in the instant case. [Para 9]*
>
> Clearly, therefore, there was no question of applicability of section 54F in the aforesaid facts and circumstances."

Q4. Whether in terms of section 48, payment made by assessee for education, maintenance and marriage of his unmarried daughter, though under consent decree, could be said to be an expenditure wholly and exclusively incurred in connection with transfer of property?

Under section 48, any payment made by assessee for education, maintenance and marriage of his unmarried daughter, though under consent decree, could not be said to be an expenditure wholly and exclusively incurred in connection with transfer of property or could also not be considered as a cost of acquisition or cost of improvement. **[*Krishnadas G. Parikh v. DCIT [2008] 114 ITD 362 (AHD)].***

Q5. Whether the exemption u/s 54B of the IT Act is available to HUF?

Exemption under Section 54B is also available to HUF subject to the following condition:

If HUF transfer a land which is used for agricultural purposes by a HUF, **the rollover relief u/s 54B is available to the HUF.** The amendment is applicable on transfers made after **01-04-2013.**

*Even before the amendment, exemption was being allowed to HUF.

Same view is expressed in K.S. Jain & Sons (HUF) v. ITO 173 Taxman 114 (Delhi) (Mag.) [2008], it was Held, AO was wrong in denying deduction u/s 54B to assessee on ground that assessee being an HUF was not entitled to deduction u/s 54B.

Q6. Whether exemption from Capital Gain u/s 54GB newly introduced vide Finance Act, 2012 is available to HUF?

Exemption from tax on LTCG on transfer of residential property if invested in a manufacturing small or medium enterprise.

- Available to an Individual or **HUF**.
- Transfer made on or before 31st March, 2017.
- Amount is reinvested before due date of furnishing return of income u/s 139 (1)
- In Equity of a new start up SME company in the manufacturing sector in which in hold more than 50% share capital or voting rights
- Amount is utilized by the company for purchase of new plant & machinery
- The share cannot be transferred within a period of 5 years

F. Taxability of gift received in cash or in kind by HUF without consideration

1. If any sum of money exceeding Rs. 50,000 is received by the HUF without consideration then provisions of section 56(2)(vii) are applicable and the same is taxable in the hands of HUF.

2. Gift received in kind by HUF without consideration is also taxable subject to the provisions of s. 56(2)(vii).

The definition of relative provided under Explanation to Section 56(2)(vii) shall be amended by Finance Act, 2012. The amendment is as under:

The provisions of section 56 are amended so as to provide that ***any sum or property received without consideration or inadequate consideration by an HUF from its members would also be excluded from taxation [w.r.e.f. 1-10-2009].***

For this purpose, clause (e) of the *Explanation* below section 56(2)(vii) is to be substituted to provide that in case of HUF, relative means members of the HUF.

After the amendment,

"(e) "***relative***" means,—

(i) in case of an individual—

*(A) ******; and*

(ii) ***in case of a Hindu undivided family, any member thereof."***

The amendment as above is inspired by the decision of ITAT in ***Vineetkumar Raghavjibhai Bhalodia v. ITO 46 SOT 97 (Rajkot-ITAT) (2011) where it was*** held that ***Gift received from HUF is gift from relative.***

G. Deductions under Chapter VIA available to HUF

S.No.	Section	Deduction
1	Section 80C	Deduction available to HUF [Insurance Premium can be paid on the life of any member which does not exceed 10% of total sum assured for policies issued on or after 1st Apr, 2012]
2	Section 80CCF	Investment in Infrastructure Bonds up to Rs. 20,000/-
3	Section 80D	Mediclaim Policy on the health of any member of the family. Deduction for payment on account of preventive health check ups not available.
4	Section 80DD	For maintenance including medical treatment of a dependant member of the family.
5	Section 80DDB	Medical treatment for any dependant member of the HUF
6	Section 80G	Donation to certain funds, charitable institutions ,etc.
7	Sections 80IA / 80IAB / 80IB / 80IC / 80ID / 80IE / 80JJA	New Industrial undertakings

H. Return of Income

HUF is required to furnish return in Form ITR-2 or ITR-3 or ITR-4S or ITR-4, as the case may be.

However, ITR-4S (Sugam) not applicable to residents HUFs

(i) having assets (including financial interest in any entity) located outside India; or

(ii) signing authority in any account located outside India.

[Inserted vide Finance Act, 2012]

In case of above HUFs, the return to be furnished

(i) electronically under digital signature, or

(ii) transmitting the data in the return electronically and thereafter submitting the verification of the return in Form ITR-V.

Note: E- filing is mandatory if total income exceeds Rs. 10 lakhs, (*Inserted vide Finance Act, 2012).*

HUFs to whom Section 44AB is applicable, shall furnish the return electronically in ITR-4 under digital signature.

I. Clubbing Provisions of Section 64(2) in case of HUF

Where any member of HUF converts any property belonging to it, in to the common property of HUF, then :

- Individual shall be deemed to have transferred the property to the HUF i.e. to the members of the family for being held by them Jointly.
- The Income from the property so transferred shall be taxable in the hands of Individual and not in the hands of HUF.
- On partition amongst the members – the income derived from such property as is received by the spouse shall be taxable in the hands of spouse itself.

J. Miscellaneous Issues

Q1. Whether tax liability of an individual member of the HUF can be recovered in full extent from the HUF?

Demand against member of HUF can be recovered from HUF to the extent of its share in property of HUF. **[Naresh B. Chheda v. JCIT [2011] 9 taxmann.com 86 (Bom.)]**

"'N', a constituent of the HUF, would, therefore, have an undivided share in the amount lying in the bank account of the HUF. The Assessing Officer, therefore, would not be entitled to attach and appropriate entire amount which was in the account of the HUF for the liabilities of 'N' as an individual. It could attach and appropriate the amount lying in the bank account of the HUF only to the extent falling to the share of the said 'N'."

Q2. What is the scope and effect of a reopening of assessment of HUF where the notice was issued to the individual member of HUF?

The Act recognizes status of HUF different from individual status of Karta of HUF and two are treated as different legal entities, it is necessary that notice u/s 148 should be sent in correct status because jurisdiction to make assessment is assumed by issuing valid notice and it cannot be conferred by consent of parties. After having issued notice u/s 148 to individual, AO had no jurisdiction to assess HUF of assessee and that defect of jurisdiction could not be cured by obtaining consent of assessee to assess him in status of HUF. [**Suraj Mal, HUF v. ITO 109 ITD 327 (Delhi) (TM) [2007], also see CIT v. Rohtas 167 Taxman 233 (P & H) [2008]].**

Q3. Whether the HUF property loses the character of HUF merely because one male member or coparcener at one point of time?

- Bombay High Court held in the case of **Dr. Prakash B. Sultane v. CIT [2005] 148 Taxman 353** that,
- Joint family property does not lose its character merely because at one point of time there was only one male member or one coparcener.
- An assessee who has received share on partition of HUF property but subsequently gets married is entitled to be assessed in respect of the said share in said property in status of HUF.

Q4. What are the relevant provisions for unreasonable payments made by HUF under the Income Tax Act?

According to the provisions of Section 40A(2)

"Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of this sub-sec., and the AO is of opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction."

Note that the Expenditure must be unreasonable or excessive

- Provision of Sec. 40A(2) has no application unless it is first held that the expenditure was excessive or unreasonable. **[Upper India Publishing House (P) Ltd. v. CIT (1979) 117 ITR 569 (SC)].**

For the purpose of Sec. 40A(2)(a) following persons are specified:

1. where the assessee is a HUF- any member of the family, or any relative of such member;
2. HUF having a substantial interest in the business or profession of the assessee or any member of such family, or any relative of such member;

3. a HUF of which a member, has a substantial interest in the business or profession of the assessee; or any member of such family or any relative of such member;

4. any ***person who carries on a business or profession, where the assessee being HUF or member of the family, or any relative of such member, has a substantial interest in the business or profession of that person.***

Provisions related to stock market, mutual funds & HUF's

1. HUF can have a separate Demat Account.
2. Make money by investing in shares of companies:-
   (a) Primary Market
   (b) Secondary Market
3. Enjoy Tax Free Income for Long-term Capital Gains by holding shares for more than one year.
4. Enjoy lower tax rate of 15% on Short-term Capital Gains u/s 111A.
5. HUF can also invest in Mutual Fund.

Gift Vis-à-Vis HUF

- The gift made by the family of a sole coparcener to the wife of the Karta of the family is considered to be VALID. ***{M.S.P. Rajah Vs CGT (1982) 134 ITR 1 (Mad)}***
- Gift by HUF to bride of male member in the form of jewellery at the time of marriage is valid. Obligation of Karta is towards marriage of both sons & daughters. ***{CIT Vs A.K. Daga & Sons (2008) 296 ITR 623 (Mad) also see CGT Vs Basant Kumar Aditya Vikram Birla (1982) 137 ITR 72 (Cal)}***
- *Gift of HUF Property* By Father
  - Within reasonable limits
  - as a "gift of affection".

  [Gift of affection can be made to a wife, daughter & son]
- Gift to stranger
  - *Gift to Strangers void* – ***Guramma v. Mallappa AIR 1964 SC 510***
  - *Karta is NOT entitled to give any gifts to strangers, EXCEPT for pious purposes.* ***{Gangadhar Narsingda sAgarwal (HUF) Vs CIT (1986) 162 ITR 320 (Bom)}***

- *A coparcener can dispose of his undivided interest in the coparcenary property by a will, BUT he CANNOT make a gift of such interest . It is said to be void.* ***{Thamma Venkata Subbamma VsThamma Ratanamma & Ors. (1987) 168 ITR 760 (SC)}***
- *Gift to a stranger of a joint family property by the manager of the family is void. Manager has NO absolute power of disposal over HUF property* ***{Guramma Bharatar Chanbasappa Deshmukh Vs Mallappa Chanbasappa AIR 1964 SC 510}***

Who is regarded as stranger?

The other persons may be related to the Karta or the coparceners in the contest of family. Other persons means excluding relatives not being members of HUF.

Gift to coparcener & members

The gift of family property by Karta of an HUF to coparceners or non-coparceners is void ab initio & not merely voidable***.{CGT Vs TejNath (1972) 86 ITR 96 (P&H) (FB)}***

- Gift to daughter

Hindu father can make a gift of ancestral property within reasonable limits at the time of marriage or even long after marriage. ***{R. Kuppayee Vs Raja Gounder (2004) 265 ITR 551 (SC)***

- Gift to wife by Karta

The Karta is empowered to make gifts to his wife within reasonable limit of the movable assets. But the Karta CANNOT make gifts to his second wife. It is invalid. **{Commissioner of Gift Tax VsBanshilalNarsidas (2004) 270 ITR 231 (MP)}**

- Gift by Karta to nephew

Gift made by Karta to nephew & interest on the amount gifted was deposited in the firm. It was held that gift was void. **Pranjivandas S. Patel Vs CIT (1994) 210 ITR 1047 (Mad)}**

- Gift by Karta to minor children of family

Gift made by Karta from

– Natural love & Affection

– within reasonable limits

The gift was said to be Valid **{CWT/CGT Vs Shanmugasundaram (1998) 232 ITR 354 (SC)]**

- **Some other relevant issues in respect of gift**

  - *Elementary proposition that Karta of HUF cannot gift or alienate property except to the extent recognized under the Hindu Law, namely necessity etc-* ***CGT v. P. Hanumanthappa 68 ITR 363, K.P. Gupta v. CIT 233 ITR 456***

  - *Reasonable limits depends upon facts -* ***CGT v. B.V. Narasimharaju 101 ITR 74.***

  - *Karta can make reasonable gifts to daughters –* ***Sushil Kumar & Sons v. ITO 234 ITR 98***

  - *Gift on Marriage Occasion is valid –* ***S. Lakshmamma v. Kotayya AIR 1936 Mad. 825.***

  - *Gift of immovable property should be for pious purpose –* ***CIT v. Ram Gopal Rajgharia 123 ITR 693***

Expenses incurred on Marriage of a Daughter by HUF.

Marriage of daughter still remains an obligation of the Family under Hindu law. Thus, reasonable amount of gift given on her marriage should not objected by the male coparcener.

VOICE OF CA

Part-III

Taxation of Charitable Trusts

Under Income Tax Act, 1961

Chapter-I

BRIEF DESCRIPTION OF RELEVANT PROVISIONS

Sections	Brief description
2(15)	Meaning of Charitable Purpose
11	Income from Property held for Charitable or Religious Purpose
11(1A)	Capital Gains deemed to be Applied for Charitable /Religious Purpose
11(1B)	Consequences if Income not applied for Specific Purpose
11(2)	Exemption if Income accumulated for Specific Purpose

Section 2(15) - Meaning of Charitable Purpose

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

Provided that *the* ***advancement of any other object of general public utility shall not be a charitable purpose****, if it involves the carrying on of any activity in the nature of trade, commerce, or business, or any activity of rendering any service* ***in relation*** *to any trade, commerce, or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity". [****Finance Act, 2008]***

Amendment by Finance Act, 2012 - Charitable organization in case commercial receipts exceeds the specified threshold limit.

- ***A charitable trust or Institution does not get the benefit of tax exemption i.e. the benefit of Tax Exemption shall automatically forfeit in the year in which its***

receipts from commercial activities exceeds the threshold limit, whether or not the registration or approval granted is cancelled, withdrawn or rescinded.

Memorandum Explaining Finance Bill, 2012

(a) There is a need to expressly provide in law that ***No exemption would be available for a previous year, to a trust or institution to which first proviso of sub-section 2(15) become applicable for that particular previous year. However, this temporary excess in one year may not be treated as altering the very nature of the trust or institution so as to lead to cancellation of registration or withdrawal of approval or rescinding of notification issued in respect of trust or institution.***

(b) **Such denial of exemption shall be mandatory by operation of law and would not be dependent on any withdrawal of approval or cancellation of registration or a notification being rescinded.**

(c) It is, therefore, proposed to amend Section 10(23C), Section 13 and Section 143 of the Act. This amendment will take effect retrospectively from 1st April, 2009.

- **Amendment to Section 10(23C) - A new proviso to Section10 (23C) is inserted w.e.f. 1st April, 2009.**

  After the sixteenth proviso, the following proviso is inserted: ***"Provided also that the income of a trust or institution referred to in sub-clause (iv) or sub-clause (v) shall be included in its total income of the previous year if the provisions of the first proviso to clause (15) of Section 2 become applicable to such trust or institution in the said previous year, whether or not any approval granted or notification issued in respect of such trust or institution has been withdrawn or rescinded."***

- **Amendment to Section 13 - A new sub-section (8) of Section 13 is inserted w.e.f. 1st April, 2009.**

  "Nothing contained in Section 11 or Section 12 shall operate so as to exclude any income from the total income of the previous year of the person in receipt thereof if the provisions of the first proviso to clause (15) of Section 2 become applicable in the case of such person in the said previous year."

- **Amendment to Section 143(3) - After second proviso to Section 143(3), the following proviso is inserted w.e.f 1st April, 2009.**

  "Provided also that notwithstanding anything contained in the first and the second proviso, no effect shall be given by the Assessing Officer to the provisions of clause (23C) of Section 10 in the case of a trust or institution for a previous year, if the provisions of the first proviso to clause (15) of Section 2 become

applicable in the case of such person in such previous year, whether or not the approval granted to such trust or institution or notification issued in respect of such trust or institution has been withdrawn or rescinded."

- **Section 2(15)- Provided further** that

  The first proviso shall not apply if the aggregate value of the receipts from the activities referred to therein, in the previous year, is ***Twenty Five lakh rupees or less [Finance Act, 2011 w.e.f 1-4-2012 (i.e A.Y 2012-2013)]***
  [*Limit of Rs. 25 lakhs is raised from the limit of Rs. 10 Lakhs which was inserted by Finance Act, 2010.]

- **In view of Circular No.11/2008, Dated 19-12-2008 - Some Important Observations**

1. Section 2(15) of the IT Act, 1961 – Charitable purpose – Where industry or trade associations claim both to be charitable institutions as well as mutual organizations and their activities are restricted to contributions from the participation of only their members, these would not fall under the purview of the proviso to sec 2(15) owing to the principle of mutuality.

2. The newly inserted proviso to Section 2(15) will not apply in respect of the first three limbs of Section 2(15), i.e. relief of the poor, education or medical relief. **Consequently**, *where the purpose of a trust or institution is relief of the poor, education or medical relief, it will constitute `charitable purpose' even if it incidentally involves the carrying on a commercial activities*. **Harnam Singh Harbans Kaur v. Director of Income-tax (Exemption), Delhi [2012] 17 taxmann. com 103 (Delhi - Trib.)**

3. **`Relief of the poor'** encompasses a wide range of objects for the welfare of the economically, a socially disadvantaged or needy. It will, therefore, include within its ambit purposes such as relief to destitute, orphans or the handicapped, disadvantaged women or children, small and marginal farmers, indigent artisans or senior citizens in need of aid. Entities who have these objects will continue to be eligible for exemption even if they incidentally carry on a commercial activity, however, subject to the conditions stipulated u/s 11(4A) or the 7th proviso to Section 10(23C) which are:-

   i) business should be incidental to the attainment of the objectives of the entity, and

   ii) separate books of account should be maintained in respect of such business.

4. **In the final analysis**, however, *whether the assessee has for its object `the advancement of any other object of general public utility' is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or*

business or renders any service in relation to trade, commerce or business, it would not be entitled to claim that its object is charitable purpose.

Issue- Meaning of business and how it is different from Charity

- **In the case of DIT (E) v. ICAI, ITA No. 869/2011 & W.P (Civil) No. 1927 of 2010, Delhi High Court (Date of decision 19-09-2011), it was held that:**

Even if the profits earned are used for charitable purposes, but fee, cess or consideration is charged by a person for carrying on any activity in the nature of trade, commerce or business or any activity of rendering of any service in addition to any trade, commerce or business, an institution will not be regarded as established for charitable purpose/activity (it would be covered under the proviso and the bar/ prohibition will apply).

The courses of the institute, per se, it does appears cannot be equated to a private coaching institute. There is a clear distinction between coaching classes conducted by private coaching institutions and the courses and examinations which are held by the petitioner institute. [Writ Petition (Civil) No. 1927 of 2010 19/9/2011]

In I.T.A. No. 869/2011, 19th September, 2011 - Whether the same amounts to business and whether separate books of accounts were required to be maintained by the institute

The purpose and object to do business is normally to earn and is carried out with a profit motive; in some cases the absence of profit motive may not be determinative. The appellant has given no such finding as far as the activities of the institute are concerned. The CIT-appellant without examining the concept of business has held that the institute was carrying on business as coaching and programmes were held by them and a fee is being charged for the same. On the basis of the findings recorded in the order dated 29th March 2010, under Section 263 of the Act, it is not sufficient to hold that the institute is carrying on business.

Issue- Where activities are not mentioned in objectives of Trust

- **DCIT v. Sulabh International Social Service Organisation [2011] 11 taxmann. com 167 (Patna).**

Where though maintenance of toilets **did not specifically find mention in aims and objective of society** but it was an **essential and inseparable incidental activity** for attainment of objectives of assessee, held that activities of assessee were charitable in nature and it would be entitled to be exempt from tax. [Other ref: **M/s Pave v. DIT (E) ITA No.6057/Del./2010 (order dated 16-09-2011)]**

Issues on Section 2(15)

- Production of television and radio programmes for purpose of telecasting and broadcasting through assessee's own network or through network hired by it did not constitute advancement of any object of general public utility within meaning of Section 2(15). **[CIT vs A.Y. Broadcast Foundation [2011] 11 taxmann.com 240 (Ker.)]**

- **In the case of Himachal Pradesh Environment vs. CIT (ITAT Chandigarh), ITA No. 74/ Chd/ 2009, it was held that:**

The proviso to Section 2(15) inserted by F.A 2008 can apply only to entities whose purpose is "advancement of any other object of general public utility".

A profit motive was the essence of trade, commerce or business, and where the services were rendered without a profit motive, such services will not have anything in common with trade, business or commerce. Accordingly, to fall within the second limb of the Proviso to s. 2(15), '**rendering of service to trade, commerce or business' must be such that it has a profit motive;**

- **When the assessee collects money over and above the fees prescribed by the Government, whether it constitutes a charitable institution**

  In the case of ***Islamic Academy of Education v. State of Karnataka (2003) 6 SCC 697, the Apex Court*** after considering the judgment in the case of ***T.M.A. Pai Foundation v. State of Karnataka [2002] 8 SCC 481*** _ *Held that* every institution is free to devise its own fee structure subject to the limitation that there can be no profiteering and ***no capitation fee can be charged directly or indirectly, or in any form***.

  - In view of the observation of the Apex Court, it is obvious that a private aided or unaided professional institution or any other institution has to collect the fees fixed by the committee, as directed by the Apex Court.

  - Therefore, **any amount received by the educational institution over & above fee fixed by the committees has to be classified as capitation fees and the institution shall face the legal consequences. In other words, the assessee exists for profit and not solely for educational purpose.**

[Further referred **- P.A. Inamdar v. State of Maharashtra [2005] 6 SCC 537 and Vodithala Education society v. ADIT (Exemptions-II), ITAT – Hyd. 2008-TIOL-139]**

- **Whether charging fees for education deprives assessee of exemptions?**

No. [**The Institute of Chartered Accountants of India v. Director of Income Tax (Exemption), Delhi ITAT dated 18/10/2010, ITA No. 1853/Del/2010, P.C. Raja**

Ratnam Institution v. Municipal Corporation of Delhi (1990) 181 ITR 354 (SC)]

Held that mere imparting of Education is enough to claim exemption.That the test of charitable purpose is satisfied by fulfillment of any of the three conditions, namely, relief of the poor, education or medical relief. **The fact that some fee was charged from the students was not decisive** inasmuch as the proviso to Section 115(4)(a) of the Delhi Municipal Corporation Act, 1957, indicated that the expenditure incurred in running the society might be supported either wholly or in part by voluntary contributions. Besides, the Explanation to Section 115(4)(a) was, in terms, inclusive and not exhaustive.

- **[Others: Shanti Devi Progressive Education Society Vs. Asst. DIT (Exemption) [1999] 236 ITR (A.T.) 0040 (ITAT – Del),** Similar finding in **Dy. CIT v. Vellore Institute of Technology [2011] 12 taxmann.com 272 (Chennai)]**

- Merely because object of a society was also to serve Church and Nation would not mean that educational institution was not existing solely for educational purpose. **[Ewing Christian College Society v. CCIT 2 DTLONLINE 285 (2010) (All.)]**

- If a university, imparting formal education by a systematic instruction, introduces courses with objective of 'greater interface with society through extra mural extension and field action related programmes', these are not objectives independent of education but are an aid to education. In case of **Jaypee Institute of Information Technology Society v. DGIT(E) 185 Taxman 110 (2009) (Delhi)],** Held that on facts, assessee-institute fulfilled all requirement of Section 10(23C) (vi) and was, thus, entitled to grant of registration and, consequently, exemption under aforesaid provision.

Issue - Donation received by Educational Institution

- **Charging of higher fees from affluent students** or raising funds for laudable object of education, which is **traditionally a State function**, **through donations**, by an unaided self financing educational institutions cannot deter 'charitable' nature of activity and in any view make such activity 'commercial' in nature.

- **Incidence of surplus during course of activity of running educational institution** would not be a ground to state that said institution is carrying on a business activity so as to forfeit exemption under Section 11.
  [Dy. CIT v. Vellore Institute of Technology [2011] 12 taxmann.com 272 (Chennai).]

  - If a student or his parents are so particular to gain admission into an institution and for that purpose are willing to donate money for improvement of

institution, then it is a 'voluntary' act and, therefore, **even if donations were paid at time of or to secure admission into institution, it will not cease to be 'voluntary' so as to fall outside ambit of Section 11(1)(d) or 12(1).**

- **Such voluntary contribution** would not form part of income of trust but **would only be a capital receipt.**
- **Donations** collected from students/parents **after admission**, could be said **as not 'voluntary', but under compulsion.**
- **Corpus donations** received at time of admission, by an institution **for capital purposes** of trust **could not be treated as capitation fee receipt.**

*Surplus from educational activities and corpus donations received by assessee-trust which was running an engineering college would be exempt u/s 11

- Activity of giving micro-finance & earning interest is "charitable purpose"

Disha India Micro Credit vs. CIT [2011]-TIOL-119-ITAT-DEL

Facts:

The assessee, a micro-finance company, applied for registration u/s 12A for exemption u/s 11. The CIT rejected the application on the ground that

(a) the objects showed a profit motive,

(b) the assessee was charging an interest rate which was higher than that charged by banks &

(c) the activity of giving loans was a business activity and not a "charitable purpose" u/s 2(15).

On appeal by the assessee, HELD allowing the appeal:

I. On the issue whether the assessee has a "profit motive" in pursuing its objects, **the fact that the assessee is registered u/s 25 of the Companies Act prima facie shows that the assessee is set up to promote "charity or any other useful object" and intends to apply its profits in promoting those objects**. The assessee is prohibited from making payment of any dividend to its members. **The Objects provide that the assessee has to promote micro finance services to poor persons and to help them rise out of poverty without the motive of profit.**

II. On the issue whether the activity of promoting micro finance services is a "charitable purpose" u/s 2(15), as per CBDT Circular No.11 of 2008 dated 19.12.2008, **a wide range of objects for the welfare of economically and socially**

disadvantaged people are covered and entities which pursue these objects will be eligible for exemption even if they incidentally carry on a commercial activity, subject, however, to the conditions stipulated in s. 11(4A) or the seventh proviso to s.10(23C) (**Bharatha Swamukhi Samsthe** 28 DTR (Bang)(Trib) 113 followed);

III. **The fact that there is a surplus from the activity of micro financing cannot by itself be a ground to say that the assessee does not exist for charitable purpose** particularly when the MOA & AOA provide that the profit shall not be distributed amongst the members but shall be utilized towards the objects (**Thanthi Trust 247 ITR 785 (SC) &Agricultural Produce and Market Committee 291 ITR 419 (Bom) followed**)

Chapter-II

INCOME FROM PROPERTY HELD FOR CHARITABLE OR RELIGIOUS PURPOSES- SECTION 11

Section 11 vis a vis Section 10(23C)

Section 11 - Exempted income of trust i.e. not forming the part of total income	Section 10(23C) In case of institutions covered u/s 10(23C)(iiiab)/(iiiad) - 100% exemption without any condition. 10(23C)(vi) - 100% exemption subject to conditions laid down in provisos	
Section 11(1)	(i) Income derived to the extent applied for purposes of the trust	Clause (a) of 3rd proviso to Section 10(23C)
	(ii) accumulations (not in excess of 15% of income from such property) Note: Income inclusive of Voluntary contribution [clause (1) of explanation to Section 11(1)]	**Clause (a) of 3rd proviso to Section 10(23C)**
	(iii) corpus donation	**Distinction as between corpus and other funds, registration u/s 12A is inapplicable for Section 10(23C) Institution.**
Section 11(1A)	**Capital gain [Proportionately]**	***No such clause***
Section 11(2)/ 11(1B)	Income deemed to be applied [as referred in clause (2) to Explanation to Section 11(1)] However the same to be included in the income of the subsequent year as per sub-section (1B) Further such income to be invested in the modes prescribed in Section 11(5)	3rd proviso to Section 10(23C) r.w. clause(b)

Explanation to Section 11(2)	Out of income accumulated, donation to other trusts/institutions ref. in Section 10(23C), not allowed	13th proviso to Section 10(23C)
Section 11(3)	Income referred in sub-section (2) to be included in income on non fulfillment of certain conditions.	14th proviso to Section 10(23C)
Section 11(4) /(4A)	Business income of trust on fulfillment of certain conditions- separate books of account	7th proviso to Section 10(23C)
Section 11(5)	Forms & modes of investment/ deposit	Clause (b) to 3rd proviso to Section 10(23C)

Issue

- **Whether if the requirements of Section 10(23C) are not complied with, exemption can be denied u/s 11.**

NO, in **the case of CIT vs. Mahasabha Gurukul Vidyapeeth Haryana[2010] 2 DTLONLINE 283 (P & H)** it was held that once all requisite conditions for exemption u/s 11 had been met by assessee, an educational society, then there would be no bar for assessee to seek exemption u/s11 even if conditions under Section 10(23C)(vi) had not been complied with.

Chapter-III

MEANING OF WORD 'INCOME'- SECTION 11

Circular No. 5P dated 19th June 1968

1. The expression 'total income' has been specifically defined in S. 2(45) of the Act as **"total amount of income referred to in S. 5, computed in the manner laid down in this Act".** And therefore the word 'income' used u/s 11(1)(a) could not be assigned the same meaning as specifically assigned to the expression 'total income' u/s 2(45).

2. In case of business undertaking 'income' will be the income as shown in the accounts of the undertaking u/s 11(4), any income of the business undertaking determined by the AO in excess of income shown in accounts will be deemed to have been applied for purposes other than charitable or religious and will be chargeable to tax u/s 11(3). **Only income disclosed by accounts shall be eligible for exemption u/s 11(1), and permitted accumulation of 15% shall be calculated with reference to this income.**

3. Where the trust derives income from house property, capital gains, or other sources, the word 'income' should be understood in its commercial sense i.e book income, after adding back any appropriations or applications thereof towards the purpose of the trusts or otherwise, and also after adding back any debits made for any capital expenditure, any amount added back shall become chargeable to tax u/s 11(3) to the extent they represent outgoings for purpose other than those of the trust.

Note: <u>Income- Gross or net</u>

The Supreme Court in CIT v. Programme for Community Organisation [2001] 248

ITR 1, has held that the assessee-trust was entitled to exemption under Section 11 at 25 per cent **(now 15%)** of its total income derived, not on amount remained after expending money on charitable purposes out of its total income

Followed by ***the Hon'ble ITAT Lucknow Bench, in the case of Krishi Utpadan mandi samiti & Anr. V. DCIT, 136 TTJ 635***

Judiciary on Meaning of 'Income'

In the case of CIT v. Trustees of H.E.H. Nizam's Supplemental Religious Endowment Trust (1981) 127 ITR 378 (AP), it was Held:

- Only Books of accounts have to be taken into consideration for determining the income and expenditure of the trust for the purpose of Section 11(1)(a).
- Section 2(45) specifically defines "Total income" where as the expression used in the Section 11 is only "income".
- Income which is left after the expenditure is required to be set apart or such of the money, which is left with the trust after meeting all the expenditure, that can be invested in securities
- ***Therefore for the purpose of assessing total income the AO may, as per the provision of the Act, include many items on notional basis, But they do not really constitute the surplus amount or the amount that would be left for the purposes of investment.***
- Total income is not relevant for the purpose of investing the funds of the trust or for the purposes of assessing the income of the trust.

Exempt vis a vis Taxable Income.

a) Exempt Income.
Income which is applied/accumulated to/for the purposes of the trust in India during the previous year to which the income relates is exempt. Further such application/accumulation should not be less than 85% of the income derived during the P.Y.

b) Taxable Income.
Income which is not applied to the purposes of the trust in India during the P.Y. to which the income relates is taxable:
* Income received by Private religious trust.
* Income received by a trust for charitable purposes or a charitable institution created or established after March 31, 1962, is the trust or the institution is created or established for the benefit of any **particular religious community or caste or is applied for the benefit of the persons specified in Section 13(3).**

Applicability of Section 14

- **In the case of DIT [Exemption] v. Girdharilal Shewnarain Tantia Trust (1993) 199 ITR 215 (Cal.), it was Held** that the income from property held for charitable or religious purposes cannot be equated with the income which is computed under the general provisions of the Act in respect of other assessees who are not entitled to the benefit of the provisions of Sections 11(1)(a), 11(1)(b), and 11(1)(A).

- The High Court also ruled that :

  When the trust loses the benefit of accumulation, and as a result, when the trust income is brought to tax, the question of allowing any statutory deductions as contemplated by different provisions of the Act dealing with different heads of income does not arise. Therefore if a trust has property income among other receipts, it will not be entitled to a deduction of 25% for repairs and collection charges, but will be entitled to deduction of actual repairs and collection charges. **[CIT v. Estate of V. L. Ethiraj [1982] 136 ITR 12 (Mad.)]**

Example

Business Separate Books

To purchases	60000.00	By Sales	200000.00
To Other Exp.	25000.00		
To Net Profit – (A)	115000.00		
(B). Income from house property Rs. 40000.0, Municipal taxes paid Rs. 2000, (C). Income from other sources – Rs. 5000.00			

*85% shall be calculated of – Rs. 160000 (115000 + 40000 + 5000) i.e. Rs. 136000/- should be used for application during the year & not 85% of Rs. 2,45,000 (Rs.200000 + Rs.40000 + Rs.5000).

- **Treatment of Unrecorded Income.**

  CIT v. PSG and Sons Charities [1997] 223 ITR 831 (Mad.)

In case the property held under trust is a "Business Undertaking", the AO shall have power to determine the income of such undertaking in accordance with the provisions of the Act, in case the income so determined is in excess of the income as shown in the accounts of the undertaking such excess shall be deemed to be applied to purposes other than the Charitable or religious purposes.

- **Whether reflection of income in the profit & loss account is determinative?**

CIT v. M/s State Urban Development Society Date of Decision: 19.10.2011, ITA No. 210 of 2011 [P&H]

Grants received by assessee society cannot be treated as its income where the same have been received by the assessee for disbursement and cannot be utilized for any other purpose, even if the same is credited to the profit & loss account. **The entries in the books of account do not decide the nature of receipts.**

Issue

- **Income derived from property held under trust wholly for charitable or religious purposes – What the word Wholly represents here?**
  The word 'wholly' referred in the Section refers to the object and not to the property held under trust, further the word wholly cannot be treated equivalent to the word mainly, further it would not be sufficient if some of the objects are charitable or religious in nature. **[Dwarkadas Bhimji v CIT [1948] 16 ITR 160 (Bom.), East India Industries (Madras) Private Ltd V. CIT [1967] 65 ITR 611 (SC)].**

- **Real Income v. Notional Income**
  The exemption and the conditions thereof u/s 11 should be confined to the real income of the organization, Notional income cannot be considered for the purpose of accumulation and application. **[CIT v. Jayashree Charity Trust [1986] 159 ITR 280 (Cal.), Hindustan Welfare Trust v. DIT (Exemption) [1993] 201 ITR 564 (Cal.)]**

- **Interest on deposits – where deposits were the property of the assessee**
  Exempt **[CIT Vs. Haryana C. M. Relief Fund [2009] 309 ITR 0275 (P&H)]**

- **Recovery of loans whether treated as Receipt of Income?**
  Yes, should be considered as a part of income in the year of receipt. **[CIT v. Cutchi Memon Union [1985] 155 ITR 51 (Kar.), however the same is found unacceptable in CIT v. Trustees of Kasturbai Scindia Commission Trust [1991] 189 ITR 5 (Bom.)]**

- **Treatment of subscription and amounts taken to suspense account?**
  Donations received kept in suspense account, such amount should also be treated as amount of voluntary contributions, so as to require either application or accumulation with permission. **[CIT v. Divine Light Mission (2005) 278 ITR 659 (Del.)]**

Issue - Adjustments of past funds / carry forward of losses

- It is open to the assessee to explain the shortfall in distribution with reference to excess distribution of an earlier year, so that to avail such excess for set off against current shortfall.
  [CIT v. Matriseva Trust (2000) 242 ITR 20 (Mad.), CIT v. Maharana of Mewar Charitable Foundation (1987) 164 ITR 439 (Raj.) and CIT v. Shri Plot Swetamber Murti Pujak Jain Mandal (1985) 211 ITR 293 (Guj.)]
  Judgement in against: Pushpawati Singhania Research Institute for Liver, Renal and Digestive Diseases vs DDIT [2009] 29 SOT 316 ITAT (Delhi).

- A Trust can be allowed to carry forward deficit of current year and to set off same against income of subsequent years.

- Adjustment of deficit of current year against income of subsequent year **would amount to application of income** of trust for charitable purposes in subsequent year within meaning of Section 11(1)(a).
  [DIT vs. Raghuvanshi Charitable Trust [2011] 197 Taxman 170 (Delhi), Management Development Institute, National Institute Of Urban affairs and; others, ITA No. 1075 of 2008, 930 of 2009, 30 of 2010 and others]

***Other references: CIT* vs. *Maharana of Mewar Charitable Foundation* [164 ITR 439 (Raj.)] , *CIT vs. Institute of Banking* [264 ITR 110 (Bom.)]; *CIT* vs. *Siddaramanna Charities Trust* [96 ITR 275 (Mys); and *CIT* vs. *Matriseva Trust* [242 ITR 20 (Mad.)]. Gujarat High Court in *Shri Plot Swetamber Murti Pujak Jain Mandal , Commissioner of Income Tax* vs. *Shri Plot Swetamber Murti Pujak Jain Mandal* [211 ITR 293].**

- **Is Earmarking of funds possible?**

No.

Merely making an entry in the accounts cannot be taken as any application of the income for any charitable purpose. Such entries could have been reversed if and when the trust chooses to do so.

[CIT v. Thanthi Trust [1999] 239 ITR 502 (SC), Nachimuthu Industrial Association v. CIT (1999) 235 ITR 190 (SC)]

- **Issues- Application of income**

Should Receipt of Income precede Application of Income?

Not necessary, emphasize is on the spending of the income and not on coffining the source of the amount spent to the income earned during the previous year. **[Chotanagpur Diocesan Trust v. ITO [1986] 19 ITD 175 (Patna – Trib)]**

Is it necessary that the money should be actually spent?

No, if a liability for expenditure has been incurred, the same is enough. [**CIT v. Trustees of H.E.H the Nizam's Charitable Trust [1981] 131 ITR 497 (AP).]**

Issues - Payment amounts to Application of Income

- **Payment of Taxes?**

  Yes. [**CIT v. Trustees of H.E.H the Nizam's Supplemental Religious Endowment Trust [1981] 127 ITR 378 (AP), CIT v. Janaki Ammal Ayya Nadar Trust [1985] 153 ITR 159 (Mad.)]**

- **Repayment of Loans?**

  Yes, if loan is for purposes of trust. [**CIT v. Maharana of Mewar Charitable Foundation [1987] 164 ITR 439 (Raj.), [2009]315 ITR 237(Mad) Director of Income-tax (Exemption) v. Govindu Naicker Estate]**

- **Grant of Loans?**

  Yes**. [CIT Vs. Saraswath Poor Students Fund [1984] 150 ITR 0142 (Kar)]**

- **Expenditure for Revenue or Capital purpose?**

  Application of the amount can be for revenue or capital purpose towards object of the trust. [**S.RM. M.CT.M Tirupanni Trust v. CIT [1998] 230 ITR 636 (SC)]**

- **Donation to other Trusts?**

  Yes, if such donation should be utilized for charitable purpose only. [**CBDT Instruction No. 1582 dated 19/10/1984.]**

[CIT v. J.K. Charitable Trust [1992] 196 ITR 31 (All.), CIT v. Indian National Theatre Trust [2008] 305 ITR 0149 (Del), ACIT v. U.P. Cricket Association [2011] 9 taxmann. com 102 (Luck-ITAT), CIT v. Market Committee Narwana [2011] 10 taxmann.com 211 (P & H)]

- **Legal Expenses for defending specified persons?**

  Yes. [**Ananda Marga Pracharaka Sangha v. CIT [1994] 76 Taxmann 88 (Cal.)]**

- **Remuneration to specified persons?**

  Yes, if reasonable. [**Director of Wealth Tax v. R.P. Kayan Trust [2002] 253 ITR 30 (Cal.)]**

- **Advancement of loans by an educational institution to its employee.**

  Advancement of loans by an educational institution to its employees, cannot be regarded as mis-application of funds for purpose of Section 10(23c)(vi) of I. T.

Act. Facilities like housing, loan, car loan etc., given by an educational institution would be regarded as expenditure spent on the object of education and not to any other purpose. **[Kashatriya Sabha v. UOI 194 Taxman 442 (2010) (P & H)]**

- **Depreciation?**

  When a depreciable asset is created out of the corpus or the capital of the organization, and where the cost of the asset is not shown as an application of funds then depreciation can be shown on the normal basis as an application for charitable or religious purposes. **[DIT (Exemp.) v. Framjee Cawasjee Institute [1993] 109 CTR 463 (Bom.), CIT v. Society of the Sisters of St. Anne [1984] 146 ITR 28 (Ker.), Institute of Banking [2003] 264 ITR 110]**

In the case of DDIT (Exemption) v. Lissie Medical Institutions [2010] 8 Taxmann. com 82 (Coch. - ITAT), it was held that

A charitable institution u/s 12A is **not eligible to claim depreciation in respect of capital assets, cost of which stands already allowed** by way of application of income u/s 11 on account of incurring capital expenditure towards and in furtherance of its objects

Different view adopted by the Hon'ble Punjab & Haryana High Court in the case of CIT v. Tiny Tots Education Society [2011] 330 ITR 0021, that

Application of income is not computation of income of the charitable institution. Therefore, the question whether depreciation is to be allowed or not has nothing to do with the application of income. Income is always to be computed on commercial principles and as per the system of accounting followed by the assessee, subject always to the statutory provisions.

Also followed in ***CIT v. Market Committee Narwana, [2011] 10 taxmann.com 211 (P & H).***

- **Establishment or administrative expenses.**
  - These are considered as a charge to the income of the organization and therefore, only the net income after such expenses is available for charitable purposes. ***Board Circular No. 5-P(LXX-6) of 1968 dated 19/06/1968,*** however where certain elements of expenses could be directly attributed to the earning of income of a charitable trust, such expenses should be treated as application of income. **[CIT v. Birla Janahit Trust [1994] 208 ITR 372 (Cal.)]**
  - Accumulation of income u/s 11(1)(a) to be calculated on the basis of total income of trust & not its income as determined for the purpose of assessment of income tax after deducting administrative expenses. **As held in Krishi Utpadan mandi samiti & Anr. V. DCIT, 136 TTJ 635**.

- **Whether Investment in specified assets u/s 11(5) could be treated as application?**

  Section 11(1) requires application of income of the year for the objects of the trust or institution, while Section 11(5) deals with investment of the available funds with it. **Investment therefore, need not be out of income, even if such investment is made out of income, it cannot be construed as application.**

- **Whether expenses incurred outside India be considered as application for the purposes of trust.**

  Yes. [**The Institute of Chartered Accountants of India v. Director of Income Tax (Exemption), Delhi ITAT dated 18/10/2010, ITA No. 1853/Del/2010]**

  There is no such requirement u/s 10(23C)(iv) of obtaining a prior permission of the CBDT as required u/s 11(1)(c) and as such the objection that overseas expenses could not have been incurred by the assessee without permission of the CBDT is not sustainable. **The expenditure has been incurred on overseas travel, etc. and is for the purposes of its object** Further, **the mere fact that expenditure has been incurred on foreign travel does not mean that the assessee has incurred expenses for purposes which are not for India** . Instead, the assessee has to maintain status and standard of professional qualification of chartered accountancy and observe developments taking place in the world.

Application of income outside India

Application of Income outside India does not disentitle educational institution exemption u/s 10(23C)(vi), however the prescribed authority is always empowered to grant registration subject to certain conditions.

The third proviso does not use the words in India in the matter of application or accumulation of income though in several other Sections like Sections 10(20A), 10(22B) and 11(1)(a) etc., Parliament has used the words in India**. *Therefore, the words in India cannot be read into the third proviso to s.10(23C).***

[American Hotel Lodging Association Education Institute v. CBDT 2008-TIOL-115-SC-IT]

Chapter-IV

TREATMENT OF CAPITAL GAINS - SECTION 11(1A)

The capital gains will be deemed to have been utilized for the purpose of Section 11(1)(a), if the net consideration received is reinvested in another capital asset.

- Section 11(1A) first caters to main situations, viz,
  - (i) Where the capital asset is property held under trust wholly for charitable or religious purposes;
  - (ii) Where the capital asset is held under trust in part only for such purposes.
- **Within these main situations, the provision also caters to the following sub-situations:**
  - (i) Where the whole of the net consideration is utilized in acquiring the new capital asset.
  - (ii) Where only a part of the net consideration is utilized for acquiring the new capital asset.

Issues

- **Is Benefit of Indexation available /when the indexation could be done?**

  The indexation benefit will not be available if the entire sales proceeds is used for purchase of another capital Asset, Indexation Benefit should be claimed only when the capital gain is offered for taxation under normal provisions.

- **Is Capital Gains, income from property held under trust?**

  Yes, as per definition of income u/s 2(24).

- **Is Benefit u/s 11(1A) optional**?

  Yes, if assessee does'nt exercise option available u/s 11(1A) then it cant utilize the capital gains for charitable purposes under Section 11(1)(a).

- **Time limit for reinvestment?**

  No time limit, thus to be invested within the same year unless the option is exercised as per Explanation of S.11(1).

- **Is Sec 11(1A) distinguish between long term and short term capital gains asset?**

  NO

- **Is fixed deposit a capital asset?**

  CBDT vide Instruction No. 883, dated 24/09/1975, has clarified that investment in FD with a tenure of more than 6 months are considered as capital assets for the purposes of S. 11(1A), However in **CIT v. Hindustan Welfare Trust [1994] 206 ITR 138 (Cal.) it** was opined that the term of the deposit could not be the test of its being an asset, whereas **in DIT (Exemp) v. DLF Qutab Enclave Complex Medical Charitable Trust [2001] 167 CTR (Delhi) 120** it was opined that the investment for a fixed term in Scheduled bank is enough.

- **Time limit for retention of Asset?**

  No time limit has been provided u/s 11(1A), for retention of the new asset.

Explanation 2 to S. 11(1) - Treatment of Income not received or applied during the Previous Year

- Treatment of income Accrued but not received ?
- Treatment of income Received but not Applied due to any other reason ?
- Procedure to apply in succeeding year ?
- If income not applied on receipt in succeeding years ?
- The assessee is at liberty to wait for any number of years for the receipt of income. In case the income is not received in future assessment years then there is no obligation on the part of the assessee to spend such income.**[CIT v. Jayashree Charity Trust [1986] 159 ITR 280 (Cal.)]**

Issues

- **If Accumulation over and above 15 % is possible?**

A charitable organisation is unconditionally allowed to accumulate 15% of its income annually and the provisions of S.11(2) and 11(3) would apply only to accumulations made over and above this 15% limit. **[Addl. CIT v. A.L.N. Rao Charitable Trust[1995] 216 ITR 697 (SC)]**

- **CIT v. National Institute and Financial Management [2010] 322 ITR 694 P&H**

The AO rejected the claim of the assessee for exemption under Section 11 on the ground that the assessee accumulated profits without providing an explanation. The Commissioner (Appeals) held that the utilization of accumulation was on the agenda of the governing body, the purpose of expenditure for accumulation was for building fund and equipment fund and the period was less than ten years. The Tribunal upheld the order of the Commissioner (Appeals). Held, dismissing the appeal, **that when the assessee had specified the purpose and there was no fault in utilisation of the amount, the assessee was entitled to accumulation of income.**

- Condition for excluding accumulated income of a charitable institution from total income is specification of purpose for which income was accumulated and deposited in specified mode. **[CIT v. Market Committee, Tohana [2011] 12 taxmann.com 252 (P & H)]**

Issue - Section 11(2)

- **Is Form No. 10 is mandatory?**

  Yes, however CIT has power to condone delay. ***CBDT circular No. 273, dated 03/06/1980, however in CIT Vs. G.R. Govindarajulu and Sons Charities [2004] 271 ITR 0145 [Mad],*** hon'ble High Court has held that it is enough for the assessee to submit a statement along with the return to exercise such option.

- **Modification in purposes if possible?**

  Yes, Section 11(3A) permits the modification of the purposes specified in Form 10, under various circumstances.

- **Effect of order of court or Injunction?**

  Period of 5 years will exclude any period during which the income could not be applied due to an order or injunction of any court. ***CBDT Circular No. 657 dated 30/08/1993.***

- **If Notice in form No. 10 to be given only in first year of accumulation or all in subsequent years also?**

  The assessee could file notice in Form No. 10 in respect of each year along with the return of income whenever the assessee was unable to apply its income to the extent of 75 per cent. to the charitable or religious purposes. But there was nothing in the provisions which prohibited the assessee from filing the notice in Form No. 10 for more than one year. It has been provided in Form No. 10 itself that an assessee can give notice in writing not only for the current year but also for subsequent previous years. The claim of the assessee could not be denied merely on the ground that In the subsequent year no further notice was given by the assessee. if notice is given in respect of all previous years commencing from the first assessment year, the authorities are not justified in denying the benefit of accumulation for the year under consideration. However, the AO would be at liberty to examine whether the provisions of Section 11(5) had been complied with by the assessee or not.

  [Cotton Textiles Export Promotion Council v. ITO (Exemptions) [2009] 308 ITR (A.T.) 0182 ITAT (Mum.)]

- **Is benefit of Accumulation is available for more than one purpose?**

  Yes.

  [DIT (Exemption) v. Eternal Science of Man's Society [2007] 290 ITR 535 (Del.), Director of IT (Exemption) v. Daulat Ram Education Society [2005] 278 ITR 0260 (Del)]

- **If income is accumulated for more than one purpose, than is it necessary to specify all of those purposes particularly?**

  No, It is enough if the assessee seeks accumulation for the objects of the trust. That the assessee had sought to accumulate the sum for purposes of the trust and had specified such objects.

  [Bharat Krishak Samaj v. Dy. IT (Exemption) [2008] 306 ITR 153 (Del), Director of Income-tax v. Mitsui and Co. Environmental Trust [2008] 303 ITR 0111 (Del), Bharat Kalyan Pratisthan v. Director of Income-tax (Exemption) [2008] 299 ITR 0406 (Del)]

- **Non-specification of purpose of accumulation in Form 10**

  Assessee's claim for **accumulation under Section 11(2) can't be denied** merely on ground that Form No. 10 filed by assessee did not specify purpose for accumulation of unspent money where Commissioner (Appeals) had gone through issue in depth, analyzed objects of trust and also Form No. 10 furnished

by assessee-trust. **[DDIT (Exemptions) v. Envisions [2011] 45 SOT 57 (Bang.) (URO)].**

- **Merely because an educational institution accumulates income, it does not go out of consideration of Section 10(23C)(vi).**

  It goes out only if application of income is for purposes other than education. If accumulation of surplus by assessee, an educational trust, is within parameters of Section, it will be entitled to benefit of Section 10(23C)(vi). **[Maa Saraswati Educational Trust v. Union of India 194 Taxman 84 (2010) (HP)]**

Chapter-V

SECTION-11(1)(D) VOLUNTARY CONTRIBUTION

Voluntary Contribution with the specific direction, that it will form part of the Corpus of the trust.

- **Whether Voluntary contributions shall be treated as income u/s 2(24)?**

  Section 12 was inserted by the Finance Act 1972, w.e.f. 1/04/1973 and the insertion of this Section was supported by insertion of clause (iia) to Section 2(24) i.e definition of income, where in voluntary contribution received by trust has been held as income.

  [CBDT Circular No. 108, dated 20/03/1973]

- **If Voluntary contribution has to be considered on receipt basis or accrual basis ?**

  Section 12 uses the word "received" as against Section 11(1), which uses the word "derived" and therefore Section 12 provides a separate treatment to voluntary contribution i.e. on receipt basis only.

- **Whether Government Grants are voluntary in nature and whether such grants qualify for exemption?**

  Held yes. if same has been granted for a particular purpose of public utility or public importance, or to alleviate a situation affecting general public, and cannot be used for any other purpose. **[Bihar State Text Book Publishing Corpn. V. CIT,**

Misc. Appeal No. 425 of 2010]

- **CIT vs. Gem & Jewellery Export Promotion Council [1983] 13 Taxmann 13 (Bom.)**

  It is well known that the grants in aid are made by the Government to provide certain institutions with sufficient funds to carry on their charitable activities. On reading the conditions on which those grants in aid were given, it was obvious that the institutions or associations to which the grant was made had no right to ask for the grant and it was solely with in the discretion of the governments to make grants to institutions of charitable nature. Again, the Government did not expect any return for the grants given by it to such institutions and there was nothing which was required to be done by these institutions for the Government, which could be considered as consideration for the grant.

  Therefore, none of the conditions attached to the grant affected the voluntary nature of the contribution. Hence, the impugned grant was exempt under Section 12.

- **Difference between voluntary contributions and subscription.**

  There is a distinction between voluntary contributions and subscription. When the sum is paid in the nature of gifts or a gratuitous payment to the trust without any consideration, it would be considered as voluntary contribution. Subscription is not to be treated as voluntary Contribution. **[CIT v. Divine Light Mission [2005] 146 Taxmann 653 (Delhi.), Trustees of Shri Kot Hindu Steel Mandal v. CIT [1994] 73 Taxmann 648 (Bom.)]**

Corpus-Nature

- **Asst. CIT v. Nagarjuna Educational Society [2011] 12 taxmann.com 375 (Visakhapatnam)**

  Whether it is only prerogative and privilege of concerned donor to specify purpose for which voluntary contributions are given and, hence, **neither assessee nor Assessing Officer is authorized to change character of voluntary contribution from 'Corpus' to 'ordinary contribution' or vice versa - Held, yes**

- Any Contribution, which is for specific purpose and not for general purpose should be treated as corpus. **[CIT v. Sri Plot Swetamber Murti Pujak Jain Mandal [1995] 211 ITR 293 (Guj)]**

- Donation received towards the corpus of the trust could not be taxed as deemed income of the trust under Section 12(2). **[CIT v. Amar Charitable Trust [1989] 42 Taxmann 101 (Bom), CIT Vs. Sthanakvasi Vardhman vanik Jain Sangh [2003] 260 ITR 366 (Guj)]**

Inter charity donations

- **Inter charity donations even could be towards corpus.**

CIT v. Sarladevi Sarabhai Trust [1988] 172 ITR 698 (Guj.)

CBDT Instruction No. 1132 (1978), has clarified that if the donee organization does not utilize in the year of receipt, then the exemption to donor will not be effected.

- The Finance Act, 2002 has inserted an Explanation to S. 11(2), that prohibits the donations to other charitable trusts out of accumulated funds.
- The Finance Act, 2003 has inserted another proviso to sub Section (3A) to Section 11 which provides that inter charity donations out of accumulated funds will be permissible in case of dissolution of charitable organization.

- **Gagan Education Society v. Addl CIT [2011] 10 taxmann.com 156 (Agra)**

The amendment by Finance Act, 2002 is applicable only to the payment made to other trusts/institutions out of amount accumulated ***u/s 11(2) and not to payment out of current year's income,*** *which will continue to be treated as application of income.*

Refer: **Aryan Educational Society v. CIT 281 ITR (A.T.) 0072 (2006) [ITAT-Delhi].**

- **Donation by a charitable trust to other charitable institution cannot result in same becoming income of donor-trust**

  If the assessee-trust either itself uses any part of its income for charitable purposes or donates the same to any other charitable trust, such income is exempt from inclusion in the total income of the assessee trust for the relevant year. [**D.D. Foundation Trust Society v. ITO, [2011] 10 taxmann.com 128 (Delhi - ITAT), CIT v. Shamnur Savithramma, [2011] 11 taxmann.com 59 (Kar.)]**

Foreign Trust & application on activities outside India

- **Whether foreign trust can claim exemption?**

  Yes, Section 11 does not require the trust should be established or registered in India.

- **Income applied on activities outside India?**

  The Provisions of S. 11(1)(c.) are attracted only if actual expenditure is incurred outside India. Section 11(1)(c.) cannot be invoked only on the ground that the trust deed provides for activities outside India. [**CIT v. State bank of India [1988] 169 ITR 298 (Bom.)]**

If an organization incurs expenditure outside India in contravention of Section 11(1)(c) then the entire exemption will not be lost. Income to the extent not applied in India will not be eligible for exemption. **[CWT v. Trustees of the Nizam's Religious Endowment Trust [1977] 108 ITR 229 (AP)]**

Other issues

- **Establishment of educational activities taking place in India is required-Oxford University Press v. CIT 247 ITR 0658 (2001) [Supreme Court of India]**

  a) That for the purpose of exemption under Section 10(22) of the I.T. Act, 1961, the University or other educational institution need not exist in India,

  b) That, however, the university or other educational institution has to engage in educational activity in India not for profit. It is not beyond the bounds of possibility that Parliament should be willing to forgo a very small percentage of its revenue for the purposes of education, even though it might mean the education of people outside India, if that education was being provided by a university or other educational institution whose sole purpose was to provide education and not at all to make a profit.

  c) Even a university or other educational institution established or incorporated outside India can be eligible for the exemption under Section 10(22) provided that it exists solely for educational pur-poses and not for purposes of profit.

  d) Interpretation of a statutory provision granting exemption which does not stand the test of rationality and will lead to absurd results cannot be accepted.

  e) Each one of the exemptions in Section 10 is intended to serve a definite public purpose and is meant to achieve a special object.

  f) The expression "existing solely for educational purposes and not for purposes of profit" qualifies "a university or other educational institution".

  g) Giving a purposeful interpretation of Section 10(22), it will be reasonable to hold that in order to be eligible to claim exemption there under the assessee has to establish that it is engaged in some educational activity in India and its existence in this country is not for profit only.

  h) In a case where a dispute is raised whether the claim for exemption from tax by the assessee is admissible or not, it is necessary for the assessee to establish that it is a part of a university which is engaged solely or at least primarily for educational purposes and not for purposes of profit and the income in respect of which exemption is claimed is part of the income of the university. The label "university press" is not sufficient to establish that the assessee is engaged in any educational activity.

The imparting of education is service to the society. From the language of Section 10(22), it does not appear that without any such service in India, the Legislature intended to exempt the total income of the assessee. The requirement of imparting education or some other educational activity in this country can be read into Section 10(22). That is the basic assumption of Section 10(22). A university established in a foreign country is not excluded from the ambit of Section 10(22) in case it is imparting education in India or has some educational activity in India. It is evident that for the purposes of granting exemption under Section 10(22) the Legislature assumed the existence of educational activity in India by a university or other educational institution. The basic requirement of the Section is the existence of "educational purpose" which, in other words, means the imparting of education which has to be in India. The absence of the words "India" in this provision is inconsequential. It has to be read into Section 10(22).

Chapter-VI

SECTION 11(4) & SECTION 11(4A) - INCOME FROM BUSINESS ACTIVITIES

Issues- income from Business activities

- Sub-section (1) or sub-section (2) or sub-section (3) shall not apply in relation to any income of a trust or an institution, being profits and gains of business, **unless the business is incidental to the attainment of the objectives of the trust or, as the case may be, institution, and separate books of account are maintained** by such trust or institution in respect of such business. [**CIT v. Seethakathi Trust [2007] 295 ITR 520 [Mad.]]**
- To judge the incidentally of business activity it is necessary to see the primary purpose of the organization and not the source of the income. **[Asstt CIT v. thanthi Trust [2001] 247 ITR 785 (SC)]**
- Once exclusion contemplated under Section 11(4A) is not applicable, exemption has to be allowed as sub-sections (1), (2) and (3) of Section 11 become applicable even in respect of profits and gains. **[CIT v Manav Mangal Society [2009] 184 Taxman 502 (P&H.)]**
- **Whether Section 11(4A) and Section 11(4) are complementary to each other and Section 11(4A) does not restrict power under Section 11(4)**

  Held, when a business income is used towards achievement of an object of a trust, it would amount to being incidental to achievement of object of trust, notwithstanding profit and gain involved therein and would be eligible for exemption under Section 11(4A). **[DIT (Exemptions) v. Willington Charitable Trust [2010] 195 Taxman 232 (Mad.)]**

- **CIT v. P. Iyya Nadar Charitable Trust [2006] 284 ITR 0404 (Mad.)**

  The exemption u/s 11 will not be available to a trust that carries on any business unless the business is carried on "in the course of the actual carrying out of the primary purpose of the trust", that is to say, unless the business is carried on in the course of actually accomplishing a primary purpose of the trust ; the business must, therefore, be carried on in the course of the actual accomplishment of relief of the poor, education or medical relief. *That where the business was held by the trust as a part of the corpus and, hence, the trust did not directly accomplish any object or carry on the business in the course of the actual accomplishment of its objects. The assessee was not entitled to exemption u/s 11.*

- **Is letting of property is a business activity?**

  That the object of the assessee was education and the activities of the assessee in letting out properties and receiving lease rental was an activity carried on only to fulfil the object of the assessee. Hence, the income derived by letting out the properties could not be treated as business income of the assessee. **[CIT v. Sri Rao Baghadur Adk Dharmaraja Educational Charity Trust [2008] 300 ITR 365 (Mad), CIT v. Jyoti Prabha Society [2009] 177 Taxmann 429 (Uttarakhand)]**

  - **D.D.I.T.(E), v. PHD Chamber of Commerce & Industry 2011] 12 taxmann. com 161 (Delhi) -** As admittedly assessee was carrying on business activities, only thing which could be done on facts of case was to ascertain business income, whether such income was incidental to objects, whether books were maintained for business and quantum thereof.

Circumstances of forfeiture of Exemption u/s 13

Analysis of provisions

- **Section 13(1)(a)- Income not applied for public benefit.**

  For the purpose of Section 13(1)(a), is that the element of public benefit has to be satisfied. **It does not matter where the control lies, if the benefit accrues to public at large but the control is with specific group of persons then Section 13(1)(a), will not be attracted. [Smt. Ganesh Devi Rami Devi Charity Trust v. CIT [1969] 71 ITR 696 (Cal.)]**

- **Section 13(1)(b) - Income applied for particular religious community or caste.**

  Denial of exemption will not be applicable to organizations created for the benefit of scheduled castes, backward classes, and schedule tribes, or woman and children. ***(As per explanation 2 to Section 13.)***

- **Section 13(1)(b) is applicable only to those organizations which have been established for charitable purposes and is not applicable to organisations which are established specifically for religious purposes.**

  [CIT v. Barkate Saifiyah Society [1995] 213 ITR 492 (Guj.), CIT v. Shri Maheshwari Agarwal Marwari Panchayat [1982] 136 ITR 556 (MP), CIT v. Chandra Charitable Trust [2007] 294 ITR 0086 (Guj)]

- **Section 13(1)(c)- Benefit to Interested persons.**

  In case donation of shares by the concern, in which the founder had substantial interest received by the trust as donation did not amount to investment u/s 13(2)(h) and therefore exemption could not be denied. **[CIT v. J.K. Charitable Trust [1992] 196 ITR 31 (All.), CIT v. Shreyas Nidhi, Swasti Hidhi, Venu Nidhi and Swasthya Nidhi [2002] 258 ITR 0712 (Guj)]**

- Where huge sums of money advanced to company having substantial interest in trust without charging any interest and adequate security taken, exemption was properly denied. ***Kanahya Lal Punj Charitable Trust Vs. Director of Income-tax (Exemption) [2008] 297 ITR 0066 (Del)***

- Funds Diverted to business organizations where trustees were having substantial interest, since interest @ of 18% was charged, the educational institution shall not be disentitled from exemption u/s 10(23C). **[A. R. R. Trust vs. Assistant CIT (ITAT-Chennai) [2006] 280 ITR (A.T.) 0152]**

- **Section 13(1)(d) - Investment other than Specified manner.**

Violation related with Section 11(5) i.e. investment in non – specified securities, should always be read with Section 13(1)(d) because for violation of Section11(2) only the contravened portion of the income will be taxed but for violation u/s 13(1)(d), the entire exemptions may be lost. Therefore in case of withdrawal of exemption u/s 11(3) only contravened portion of income shall be taxable, however u/s 13 whole of the exemption available u/s 11 & 12 shall be forfeited.

- **ITO v. Human Resource Development & Management Trust (ASBM Trust) [2011] 12 taxmann.com 478 (Cuttack - ITAT)**

  - Once it is held that trust exists for purpose for which it is registered u/s 12AA and there is no violation u/s 13, capital expenditure incurred by trust has to be allowed as application of funds.

  - Provisions contained in Section 13(1)(c) do not , payment of reasonable salary for services rendered by an interested person and, it is only when such payment is found unreasonable or excessive that stipulation of clause (c) of Section 13(2) would be attracted.

Other Issues

Special provision relating to voluntary contributions received by electoral trust - Section 13B

[Inserted by Finance (No.2)Act, 2009 w.e.f. 1-4-2010]

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

a) Such electoral trust distributes to any political party, registered u/s 29A of the Representation of the People Act, 1951, during the previous year , 95% of the aggregate donations received by it during the 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.

Anonymous donations - Section 115BBC

[Inserted vide Finance Act, 2006 w.e.f 01/04/2007 **]**

Provision of Section 115BBC

1. Where the total income of assessee, being a person in receipt of income on behalf of any university or other educational institution referred to in sub-clause (iiiad) or sub-clause (vi) or any hospital or other institution referred to in sub-clause (iiiae) or sub-clause (via) or any fund or institution referred to in sub-clause in (iv) or any trust or institution referred to in sub-clause (v) of clause (23C) of Section 10 or any trust or institution referred to in Section 11, includes any income by way of any anonymous donation, the income tax payable shall be the aggregate of –

   (i) The amount of income-tax calculated at the rate of 30% of the aggregate of anonymous donation received *in excess of the higher of the following, namely:- (w.e.f 1-4-2010)*

      A. 5% of the total income of the assessee or

      B. Rs. 1,00,000/-; and

   (ii) The amount of income tax with which the assessee would have been chargeable had his total income been reduced by the aggregate of anonymous donations received.

   * Prior to Finance (No.2) Act, 2009, whole of the anonymous donation were taxable @30%

2. The provision of sub Section (1) shall not apply to any anonymous donation received by –

   a) Any trust or institution created or established wholly for religious purposes;

   b) Any trust or institution created or established wholly for religious and charitable purposes other than any anonymous donation made with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution.

3. For the purposes of this Section, **"anonymous donation"** means any voluntary contribution referred to in sub clause (iia) of clause (24) of Section 2, where a person receiving such contribution does not maintain a record of the identity indicating the *name and address* of the person making such contribution and such other particulars as may be prescribed.

Analysis of Provisions

- Provisions applicable to institutions referred u/s 10(23C)(iiiad), (iiiae), (vi), (via), (v), (iv) and u/s. 11.
- Anonymous donations includible on total income.
- **Taxability:** income tax payable shall be aggregate of :

  i) Income tax calculated @ 30%.on excess of anonymous donation over 5% of total donations received by the assessee or Rs. 1,00,000/-, ***whichever is higher***

  ii) The amount of Income tax on income other than anonymous donation.[***as amended by Finance Act(No.2), 2009]***

- Provisions of Section 115BC shall not apply to Trust or Institutions created or established wholly for religious purpose.

Issues

A. Whether anonymous donation is subject to condition of accumulation?

B. If violation given u/s 13, in respect of anonymous donation, would it be subjects to double taxation.

C. Can provisions of Sec 68,69A to 69C be applicable in case of anonymous donation?

D. Can project donations may be anonymous donation?

View on Issue A & B

A. As per sec 13(7) nothing contained in Sec 11 or 12 shall operate to exclude anonymous donation from total income and provisions of Sec 11/12 are for claiming exemptions, since in case of Anonymous Donation NPO have to pay tax at a specified rate. there will be no limit of accumulation as given in Sec 11.

B. As per sec 13(7) provisions of sec 11 & 12 not applicable and it will be subject to tax at specified rate. **SC in Laxmipat Singhania VS CIT (1969) 72 ITR** held that income can't be taxed twice unless there is express provision for double taxation in the tax Law itself . Since there is no express provision for double taxation therefore AD shall be subject to single taxation u/s 115 BBC.

C. Sections 68 and S. 69A to 69C will be applicable only if assessee does not treat particular receipts as income in the books of account. Therefore the assessee NPO must account for the receipt as income in order to avoid provisions to sec 68 & 69C.

D. In case of project grant / donation there is specifies donor and conditions of donor therefore such grant / donation can't be within meaning of Anonymous donation.

Issues- Anonymous donations to be taxed in certain cases

Hans Raj Samarak Society v. ACIT [2011] 16 taxmann.com 103 (ITAT-Delhi)

- Where a person receiving contribution does not maintain name and address of contributor and other particulars, such contribution would fall within ambit of 'anonymous donation'
- Benefit of accumulation of income u/s 11(2) **cannot** be availed in absence of filing of form No. 10 before completion of assessment

Facts:

Assessee-society was running a middle school. It had received donations of Rs. 20,39,547. Out of it amount of Rs. 19,25,047 was considered as anonymous donation by AO liable to be taxed u/s 115BBC.

Held:

Since assessee had filed, donation receipts containing details in respect of name and address of contributor and same were in possession of AO amount-in-question could not be taxed u/s 115BBC .

Taxability of a Trust

Taxability of a Public Trust at a glance

Sources of Income	U/S	Tax Rates
Voluntary Contributions (being corpus donations)	11(1)(d)	Exempt
Income not applied / accumulated to the extent > 15%	11(1)(a)	AOP Rate
Income received on 31st March carried forward to next year for utilization but not utilized in that next year [Explanation 2(b) to Section 11(1)(d)]	11(1B)	AOP Rate
Income accumulated u/s 11(2) is not invested / utilized / donated to another trust	11(3)	AOP Rate
Excess Business Income as assessed by the AO	11(4)	AOP Rate
Income derived u/s 13(1)(a) & 13(1)(b)		AOP Rate
Income derived u/s 13(1)(c) & 13 (1)(d)		MMR
Anonymous Donations u/s 115BBC		30%

Applicability of Section 60 to 63

Issues

- **Whether lawful ownership of the property held in the trust is compulsory?**

  The Trust should be the lawful owner of the property from which the income is derived. If the property belongs to the settler and only income from such property is assigned for charitable purposes then the exemptions u/s 11 would not be available in terms of Section 60.

  [CIT v. Maharajadhiraj Sir Kameshwar Singh [1953] 23 ITR 190 (Patna), Ganpatri Sagarmall (Trustees) for Charity Fund v. CIT [1963] 47 ITR 625 (Cal.)]

- **Taxability of income in case of, Revocation of property?**

  If any clause of the trust deed empowered the author to revoke the properties vested in the trust then the income from such properties will be taxable at the hands of transferor. [**CIT v G.D. Naidu Industrial Educational Trust [1942] 10 ITR 358 (Mad.)]**

  The Trust deed provided that the property would be revocable at the discretion of a central council. Further, the deed provided that the properties could go only to religious and charitable trust bodies. The Supreme Court held that even if the trust was revocable, the properties were not going back to the Central Council on revocation and therefore provision of Section 61 could not be applied. ***Radhasoami Satsang V. CIT [1992] 193 ITR 321 (SC).***

ISSUES

- **How trust deed could be treated as revocable or irrevocable?**

  Supreme Court in CIT v. Jayantilal Amratlal [1968] 67 ITR 1, laid down the principles, based on which trust deed could be treated as revocable or irrevocable.

  - The presence of term 'reassumes power directly or indirectly' – Trust deed shall become revocable
  - A discretion to the settler to choose the charitable activities would not vitiate the concept of an absolute transfer for charitable purposes – Trust deed shall not become irrevocable.
  - Veto power of the settler in the Management and administration of the trust in a particular manner cannot be construed as a provision for retransfer or revocation of property. The same would be true for any special power with regard to investment of funds in any particular manner. - Trust deed shall not become irrevocable.

Other Miscellaneous Issues

- **Sale & purchase of mutual funds- whether a business activity?**

  NO

ITO v. Jesuit Conference of India [2011] 12 taxmann.com 297 (Delhi)- ITAT

- Assessee had invested surplus money in mutual fund units and had been entering into frequent transactions related to purchase/switchover from one such mutual fund scheme to another.
- Held that **sale and purchase of mutual fund are not treated as business activity and, accordingly, benefit of Sections 11 and 12 not denied.**

Whether **since investments were made with intention of getting a better yield upon appreciation/dividends from such mutual funds,** in order to augment resources of trust and proceeds of mutual funds were applied by assessee for charitable purposes, in compliance of provisions of Sections 11 and 12 , it could not be said that assessee had been carrying on business activity which was not incidental to its charitable activities and that such activity was carried on with sole objective of earning profits - Held, yes

- **Can the exemption u/s 11 be denied if identity of donors was not proved?**

  If donations received were applied for charitable purposes are per law, the exemption under s.11 could not be denied if identity of donors was not proved. **The assessee had produced PAN and confirmations from donors.** The AO relied

on statement of some donors .However, no cross examination was allowed to the assessee. Some donors had admitted making donations. The exemption from tax could not be denied.

CIT vs. Geetanjali Education Society [2008] 174 Taxmann 440 (Raj.)

The CIT had rejected the assessee's application for registration under s.12A. The appeal against CIT's order was pending before the Tribunal. It was not entitled to claim exemption from tax under s.11. The assessee would be at liberty to get the appeals revived in case the matter was decided in its favour by the Tribunal. **[U.P. Forest Corpn. vs DCIT 295 ITR 1 (SC)]**

- Delay in presenting application for approval to avail exemption u/s 10(23C)(vi) cannot be condoned as there is **no provision for condonation of delay** in the Act. **[*Roland Educational and Charitable trust v. CCIT & 221 CTR 88 (2009) (Ori)]***

  Distinguished from Padmashree Krutarth Acharya Institute of Engineering and Technology v. Chief CIT 309 ITR 13 (2009) (Orissa) Wherein it was held, that the Commissioner was to decide the application for condonation of delay on the merits.

- There cannot be any limit on the fees charged in order to fulfill such object of setting up an educational institution. **[Sikkim Manipal University of Health, Medical & Technological Sciences v. CIT, Siliguri [2010] 8 Taxmann.com 279 (Kol. - ITAT)]**

- Only authority empowered to grant approval can do so. Power cannot be delegated.**[Maharashtra Academy of Engineering and Educational Research v. DGIT (Invest) 319 ITR 399 (2009) (Bom.)]**

- Lease rent to the sons and wife of the school principal- whether a ground for denying exemption.

Shree Saket Mahavidyalaya Samiti v Dy. CIT (2010) 132 TTJ (Lucknow) (UO) 39.

Exemption under Section 10 (23C) (iiiad) could not be denied the assessee society established for educational purposes on the ground that the society had paid lease rent to the sons and wife of the principal of the school who were owners of the land on which school building was constructed where such lease rent was reasonable. Salary to the principal also cannot be aground for refusing the exemption.

- **Whether non availability of evidence can be a reason of denying the exemption u/s 10 Ajay Jadeja v Dy CIT (2010) 5 ITR (Trib) 233 (Del)**

Where the objects and activities of the assessee institution are educational in nature and the revenue has not brought any material on record to show that the college account was having surplus or profit, year after year and the revenue has not disputed

that surplus was only because of salary grant from the State Government and another grant from UGC , revenue 's plea that the college run by assessee was for profit motive cannot be accepted .Expenditure on conducting entrance examination being application of income, **non availability of evidence cannot be reason of denying the exemption under Section 10 (23C)(iiiab).**

- **Whether claim for exemption u/s 10(23C)(iiiad) can be considered at appellate stage.**

  Al-Farook Educational Centre v. ITO [2009] 124 TTJ 286(Coch. Trib.)

  Where assessee had in fact filed its return on ground that assessee was claiming exemption under Section 11 but assessee's claim under Section 11 was rejected, as assessee was otherwise coming within ambit of Section 10(23C)(iiiad), it was permissible in law that claim of assessee under Section 10(23C) being backed by provisions of law, could be considered even at appellate stage.

- **Does Educational activity necessarily to be taken place for claiming exemption u/s 10(23C)?**

  No, where assessee-trust was existing solely for educational purposes and not for purposes of profit, then it was entitled to exemption u/s 10(23C)(iiiad). **[ITOv. Baba Dhall Educational Society of India [2009] 27 SOT 391 (DELHI - ITAT)]**

- **Whether exemption can be denied on disallowance of certain expense?**

  No. **[ITO v. Virendra Singh Memorial Shiksha Samiti 121 TTJ (Luck.) 829 (2009)/ [2009]18 DTR 502] Other rulings [2010]001 ITR(Trib.)0527(ITAT Coch.) DIT (Exemption) v. Raunaq Education Foundation [2004] 294 ITR 76 (Delhi)]**

- **City Montessori School (Regd.) v. Union of India[2009] 315 ITR 048(All)**

  Society providing not only traditional education but also preparing students by providing guidelines to get admissions in professional institutions to pursue their higher studies--Society engaged in educational activities falling under "charitable purpose"--Society satisfying all statutory requirements for getting exemption under Section 10(23C)(vi)--No material to prove surplus earned by society utilised for personal profit or gain of anyone including founder-manager/director--Chief Commissioner directed to grant approval under Section 10(23C)(vi) .

- Exemption u/s 10(23C)(vi) cannot be denied solely on the foundation that there has been some surplus profit? **[St. Lawrence Educational Society (Regd.) v. CIT [2011] 9 Taxmann.com 233 (Delhi)]**

- **Society running educational institution is also entitled to exemption**

Section 10(22) of the Income-tax Act, 1961, exempts income of a "University or other educational institution existing solely for educational purposes" from income-tax. The word "institution" has not been defined in the Act. There is no reason why an educational society cannot be regarded as an educational institution if that educational society is running educational institutions.

[The High Court directed the Income-tax Officer to consider afresh whether the assessee, a society running educational institutions, came within the ambit of Section 10(22)]

[Katra Education Society v. ITO [1978] 111 ITR 0420 [All.] further approved Aditanar educational Institution vs. Add. CIT in (1997) 90 Taxman 528 (SC)]

- **A society with a main object of spreading education has opened 3 schools, where in the turnover from the schools individually do not exceed Rs. 1 crore, however on aggregate basis it exceeds Rs. 1 crore. Application of S. 10(23C) (iiiad) or S. 10(23C)(vi) ?**

The limit of one crore shall be considered with regard to any university or other educational institution. In the instant case education society is itself an educational institution. **[Aditanar Educational Institution v. Addl. CIT [1997] 224 ITR 310 (SC)]**

- **A trust or a society which runs, maintains or assists such institution may well be eligible for exemption, even if it does not own the institution, If its sole object is education.**

Refer: ***Secondary Board Of education v. ITO (1972) 86 ITR 408 (Ori.), Katra Educational Society v. ITO [1978] 111 ITR 420 (All.), CIT v. Sindhu Vidhya Mandal Trust [1983] 142 ITR 633 (Guj), Director of Income-tax Vs. Sir Shri Ram Education Foundation [2003] 262 ITR 0164, DCIT vs Mahathama Educational Society 2007 15 SOT 44 ITAT - Hyderabad.***

- **Where the institution is in process of starting educational activity but not yet commenced any such activity.**

Shavak Shiksha Samiti vs CIT 104 TTJ 127 (ITAT – Delhi)

The applicant trust was a society registered under the Societies Registration Act 1860 and was in the process of setting up a school on a plot allotted to it. The trust's main object of imparting education came within the purview of charitable purpose and it did not exist for profits, since the surplus, if any, were not to be distributed among its members. Therefore, the trust was entitled to registration under s.12A.

Petitioner-board was set up by Government of India as an autonomous society under Societies Registration Act, 1860, to promote integrated development in Horticulture -

Petitioner further submitted that it was exempt under Section 10(23C)(iv) in years from 1987-88 to 2007-08 and was also registered as a trust under Section 12A - However, after amendment of Section 10(23)(iv) on 30-3-2007, authority to grant exemption was vested in Chief Commissioner instead of Central Government and petitioner made an application to said authority. **[National Horticulture Board v. CCIT 176 TAXMAN 167 (2009) (P & H)]**

Chief Commissioner dismissed application on ground that audit reports in Form No. 10BB were not filed with returns and same were filed later, but were not dated as required under 10th proviso to said provision. Whether provision having been substantially complied with, audit report should have been taken into account even if, strictly speaking, it was not filed with return and not in Form No. 10BB but in Form No. 10B as stated in impugned order. Held, yes.

Pinegrove International Charitable Trust vs unionof India 188 TAXMAN 402 (2010) (P & H).

- To decide entitlement of an institution for exemption u/s 10(23C)(vi), test of predominant object of its activity has to be applied by posing question whether it exists solely for education and not to earn profit and merely because profits have resulted from activity of imparting education would not result in change of character of an institution that it exists solely for educational purpose .
- And that capital expenditure incurred wholly and exclusively for objects of education is entitled to exemption and would not constitute part of total income.
- Educational institutions, which are registered as societies, would continue to retain their character as such and would be eligible to apply for exemption under Section 10(23C)(vi).

Ruling followed in: Vanita Vishram Trust v. CCIT (Bombay High Court)

- **ITO vs. Sir Kikabhai Premchand Trust [2010] 8 Taxmann.com 70 (Mum.-ITAT), ITA No. 5308 (Mum) of 2009**

Where assessee did not file audit report in Form No. 10B along with return of income due to oversight, rather it filed report of auditor required to be given under Bombay Public Trust Act, 1950, in view of fact that report in Form No. 10B was similar to report under Bombay Public Trust Act, 1950, it was to be held that assessee had complied with provisions of Section 12A(1)(b) and therefore, it was entitled to exemption u/s 11.

- **Assam State Text Book Production and Publication Corporation Ltd. v. CIT 319 ITR 317 (2009) (SC)**

Held, reversing the decision of the Gauhati High Court in CIT v. Assam State Book Production and Publication Corporation Ltd. [2007] 288 ITR 352 , that the assessee was entitled to the exemption under Section 10(22). The assessee was a Govt. company and it was controlled by the State of Assam ; the Central Board of Direct Taxes had granted similar exemption by letter dated August 19, 1975 to the Tamil Nadu Text Books Society which performed activities similar to those of the assessee ; and the Central Government had by letter dated July 9, 1973, stated that all State-controlled Educational Committees/Boards had been constituted to implement the educational policy of the States and consequently they should be treated as educational institutions. [Matter remanded.]

[CIT v. Rajasthan State Text Book Board [2000] 244 ITR 667 (Raj) and Secondary Board of Education v. ITO [1972] 86 ITR 408 (Orissa) followed]

- **For purpose Section 10(23C), annual receipt is to be considered without excluding contribution towards corpus of trust.**

Indian Medical Trust v. ITO [2012] 18 taxmann.com 223 (Jaipur - Trib.)

Facts:

Assessee-trust was running hospital and medical college. It claimed exemption u/s 10(23C) as gross receipt of assessee were below 1 crore. AO rejected same. Assessee contended that donation received could not be included in gross receipt because said donations were received towards corpus of trust.

- **Whether for purpose Section 10(23C), annual receipt is to be considered without excluding contribution towards corpus of trust - Held, yes**
- **Whether since receipt were more than 1 crore, exemption could not be granted to assessee-trust - Held, yes**
- **Whether, even if assessee-trust was not entitled to exemption u/s 10(23C) still it will be entitled to claim benefit given u/s 11 to 13 - Held, yes**

- **Institution availing exemption u/s 10(23C)(vi) can validly apply for registration u/s 12A to avail exemption u/s 11 & 12.**

Income derived by a trust running an educational institution or by an educational institution per se is deemed to be the income derived by such trust or institution from property held under trust and will be exempt from income subject to the exceptions provided in Section13(3) of the Act - Merely because Section10 (23C) provides for exemption of the income of an educational institution, it does not follow that such

institution cannot avail exemption u/s 11/12 subject to conditions being fulfilled – Appeal of the Department dismissed by the Tribunal by following the Supreme Court's decision in CIT Vs Bar Council of Maharashtra (130 ITR 28) **Asstt. DIT (Exemptions) v. rajasthani Shiksha Samithi, Nizamabad in the ITAT–Hyd, ITA Nos. 80 &81/Hyd/08.**

- Rejection of application for grant of exemption under Section 10(23C)(vi) cannot be a basis for cancelling registration under Section 12A. **[The Sunbeam English School Society v. CIT [2011] 9 taxmann.com 228 (All. - ITAT)]**

- Order rejecting application for exemption under Section 10(23C)(vi) must be a reasoned order. **[Sahitya Sadawart Samiti v. CCIT, 2011] 12 taxmann.com 248 (Raj.)]**

- Order denying exemption to state reasons

  - There must be some reasons recorded in order passed by Commissioner while withholding exemption under Section 10(23C)(vi).

  - When no reasons had been assigned for declining exemption for A.Y. 2007-08 and % of surplus income of assessee, after deducting all expenses including depreciation was less than previous A.Y., i.e., 2006-07 for which exemption had been granted, action of Commissioner denying exemption for A.Y. 2007-08 was arbitrary and illegal and not sustainable. **[Dalhousie Public School Educational Society v. CCIT [2011] 9 taxmann.com 15 (Punj. & Har.)**

- Assessee-trust, formed for propagation of Vedas, is entitled to registration under Section 12A in status of a religious and charitable trust. **[Kasyapa Veda Research Foundation v. CIT [2011] 12 taxmann.com 286 (Cochin - ITAT)- 139 TTJ 641]**

- Whether once a trust is duly registered under Section 12AA, unless and until, it violates terms and conditions stipulated in Section 12 or 13, exemption cannot be denied - **Held, yes**

  [Gagan Education Society v. Addl. CIT [2011] 10 taxmann.com 156 (Agra)]

- **For purpose of granting registration u/s 12AA, a single non-operative clause of commercial nature could not obliterate whole range of charitable activities undertaken by assessee-society**

  Baba Amarnath Educational Society v. CIT [2012] 18 taxmann.com 222 (Chandigarh - Trib.).

  - Assessee-society was formed with object of imparting education including technical and vocational education.

- ❖ Assessee filed an application seeking registration u/s 12AA - Commissioner finding that a particular clause in object clauses mentioned to promote exports of computers hardware/software, telecommunication, internet, e-commerce and allied services, took a view that objects of assessee were not charitable in nature within meaning of Section 2(15). He thus rejected assessee's application for registration. It was apparent from records that assessee had carried out concrete activities to achieve charitable purpose of imparting education. Moreover, impugned object clause had been deleted in accordance with Section 12 & 12A of the Societies Registration Act, 1860, as was applicable to State of Punjab.

- ❖ Whether on facts, single non-operative and deleted object clause could not obliterate whole range of charitable activities undertaken by assessee-society - Held, yes

- ❖ Whether, therefore, impugned order passed by Commissioner was to be set aside and, registration applied for by assessee was to be granted - Held, yes

- **CIT v. Spring Dale Educational Society [2012] 204 Taxman 11 (P. & H.) (Mag.)**

  While examining application seeking registration under Section 12AA, ***manner of application of funds of trust do not fall within purview of Commissioner.*** Commissioner should only satisfy himself about genuineness of aims and objects of trust/institution and genuineness of its activities as enumerated in clause (b) of sub-Section(1) of Section 12AA.

- **Institute of Self Management Vs. CIT [2011] 16 taxmann.com 331(ITAT-Chennai)**

  Where assessee society, managed by highly qualified persons, filed an application for registration under Section 12AA after 21 years of its formation, assessee's plea of ignorance of law could not be accepted and, thus, registration could not be granted to it with retrospective effect.

  Fact:

  Assessee-society was registered under Tamil Nadu Societies Registration Act, 1975 on 24-1-1983 - Declared objects of assessee were providing adult education, community development especially in rural areas and also providing education and healthcare and self employment to rural women. It applied for registration u/s 12AA after a delay of 21 years. According to Commissioner, delay was not properly explained by assessee. Thus, Commissioner held that registration could not be granted to assessee since its inception and registration could be granted only with effect from assessment year 2006-07. Assessee filed instant appeal contending that it could not file application earlier because it was not aware of an

independent procedure necessary for registration under Act.

- **Nooral Islam Trust v. CIT [2012] 18 taxmann.com 110 (Ker.)**

While disposing of assessee's application for registration under Section 12AA, an opportunity was to be granted to it to get amendment in trust deed declared valid by a competent civil court.

Facts:

Assessee, a public charitable trust, was running educational institutions. Assessee having applied for registration u/s 12AA, withdrew its registration application. Thereafter trust deed was amended elaborating object clause specifically including its main object as running a dental college. When amended deed was presented for registration, Commissioner rejected it for reason that original deed did not contain any provision for amendment of deed. On appeal, Tribunal upheld order of Commissioner (Appeals). On instant appeal, assessee pointed out that u/s 92 of Code of Civil Procedure, 1908, read with Section 26 of Specific Relief Act, 1963, it was entitled to file scheme suit and get amendment declared valid by a competent civil court.

Issues

- **Nellai Tuticorin Nadar v. DIT(Exem.) [2011] 13 taxmann.com 23 (Chennai-ITAT)**

  - Whether a charitable trust cannot totally rely on donations and there has to be a perennial source of income for a charitable trust to carry out its objects - **Held, yes**

  - Whether since assessee-society ran activity of general public utility surplus from which was used for charitable purpose, approval under Section 80G in respect of donations to be received, could not be denied - **Held, yes**

- **Circular No. 7/2010 [F.No.197/21/2010-ITA-I], Dated 27-10-2010.**

Clarification regarding period of validity of approvals issued under Section 10(23C) (iv), (v), (vi) or (via) and Section 80G(5) of the Income-tax Act.

It appears that some doubts still prevail about the period of validity of approval under Section 80G subsequent to 1.10.2009, especially in view of the fact that no corresponding change has been made in Rule 11A (4). To remove any doubts in this regard, it is reiterated that any approval under Section 80G (5) on or after 1.10.2009 would be a one time approval which would be valid till it is withdrawn.

- Where assessee carrying on charitable work received grants for specific purposes from certain agencies, these grants could not be considered voluntary contribution as per Section 12.

DIT v. Society for Development Alternatives [2012] 18 taxmann.com 364 (Delhi)

- Assessee-society was registered under Sections 12A and 80G. It was carrying on charitable work. It received grants from certain agencies and maximum amount of grants remained unspent at end of year. AO invoked provision of Section 12 and added said amount to income of assessee.
- Whether since (i) assessee had received grants for specific purposes, (ii) these grants were to be spent as per terms and conditions of grants, and (iii) amount, which remained unspent at end of year, got spilled over to next year and was treated as unspent grant, these grants were not voluntary contributions as per Section 12 - Held, yes
- **Mere publishing newspapers or amending original content of trust deed cannot by themselves be a ground to deny registration to charitable trust.**

DIT (Exemptions) v. Vallal MD Seshadri Trust [2012] 19 taxmann.com 114 (Mad.)

Assessee-trust moved an application under Section 12AA for registration. Application was rejected on ground that one of object clause of assessee-trust spoke about publishing newspapers which was in nature of commercial activity; and that original contents of trust deed were amended which is not permissible in law. However, Tribunal found that the trust deed could be amended. That apart, Tribunal, found that publishing of newspapers and periodicals does not ipso facto become commercial activity. Whether since authorities below could not find any fault with genuineness of trust, rejection of application under Section 12AA was not justified - Held, yes

Legal Compliances

Basis of Differences	Section 10(23C)	Section 12 AA	Section 80G
When is Application required to be made?	**Required to be made by educational institutions where:** **Gross annual receipt exceeds Rs. 1 crore; or Is not substantially financed by the Government.**	**Required to be made by all NGOs in order to claim exemption u/s 11**	**Required to be made by all NGOs which wishes to take the benefit under this Section**
Form for the above Application	**Form 56 D**	**Form 10 A**	**Form 10 G**
Rules applicable	**2CA**	**17A**	**11AA**

Time limit for filing of application	**On/ before 30th sep. of the relevant A.Y (i.r.o appl. On or after 1-06-2007)**	**No time limit. However, in view of s.12AA(2), exemption be available from the immediately following A.Y to F.Y in which appl. Is made**	**NA.**
Time limit for approval	**Within 12 months from the end of the month in which application is received [9th proviso]**	**Within 6 months from from the end of the month in which application is received [s.12AA(2)]**	**Within 6 months from date of application**
Time period for exemption	**Lifetime** *Circular No. 7/2010 [F.No.197/21/2010-ITA-I], Dated 27-10-2010*	**Lifetime**	**Lifetime** ***Time limit of Upto 5 Years is omitted by Finance (No.) 2 Act,2009***
Withdrawal of approval	**By CCIT**	**By CIT**	**By CIT/CCIT**

*Registration procedure as provided in s.12AA are also applicable to institutions covered in s. 10(23C) in view of 1st & 2nd proviso to Section 10(23C).

Application for exemption u/s 11 (on or after 1-06-2007) can be made without any time limit. However, u/s 10(23C) in view of 1st proviso r.w. 15th proviso, application to be made on/before 30th Sep. of the relevant A.Y i.r.o which application is made.

The Time limit specified u/s12A(1)(a) for making the application within 1 year of creation of trust relates to period prior to 1-06-2007 only.

Legal Compliances

Basis of differences	**Section 10(23C)**	**Section 12**	**Section 80G**
Exemption w.e.f.	The year in which it is granted and thereafter	The year in which it is granted and thereafter	
Appeal on rejection	Not provided. However writ can be filed in the High Court	Lies to Appellate Tribunal	Lies to Appellate Tribunal
Form of Audit Report	Form 10BB (Rule 16CC) [10TH PROVISO TO S. 10(23)(C)]	Form 10B (Rule 17B) [s.12A(1)(B)]	
Form of Application for accumulation	Not prescribed	Form 10	
Last date of filing of form for accumulation	Before the due date of filing of return u/s 139 **[ref: s. 139(4C)/(4D)]**	Before the due date of filing of return u/s 139 **[s.139(4A)]**	
Power to condone belated application	No	No	
Form for filing of return	ITR 7	ITR 7	

Note: In case of Private Trusts the Return has to be filled in ITR-5

VOICE OF CA

Part-IV

Various Aspects of Taxability of Deemed Dividend

Under Section 2(22)(e) of Income Tax Act, 1961

Chapter-I

BASIC CONCEPTS

Taxability

Dividend u/s 2(22)(e) of the Income Tax act, 1961 is taxable in the hands of

- **Shareholder** at normal tax rate u/s 56 of Income Tax Act, 1961, and
- Company shall not required to pay tax on such deemed dividend u/s 115 O of Income Tax Act, 1961.

*Whereas dividend u/s 2(22) (a), (b), (c), or (d) is exempt in the hands of shareholder u/s 10 (34) and company shall pay CDT on it u/s 115 O of the Act.

*Deemed dividend is taxable on Accrual basis i.e. in the "previous year" in which the payment was made (Section 8(a)).

Provisions of Deemed Dividend u/s 2(22)(e) of the Income Tax Act, 1961

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

Shareholder	• being the beneficial owner of shares • holding not less than 10% of voting power
Any Concern	• in which such shareholder is a member or a partner • and in which he has a substantial interest
Any Person	• on behalf or for the individual benefit of any such shareholder

To the extent to which the company possesses Accumulated profits.

Explanation 3 of Section 2(22)(e) - "Substantial interest" in a concern

A person shall be deemed to have a substantial interest on satisfying the following conditions:

- In case of concern other than a company, if he is, *at any time* during the previous year, beneficially entitled to not less than 20% of the income of such concern.
- In the case of Company, a person should be beneficially if holds at least 20% Equity Share capital of the company.
- To determining the Total number of shares held in a company- shares held by a shareholder in his own name and held as guardian to be considered. **[CIT v. Sokkalal (T.P.S.H) 236 ITR 981 (Mad.)(1999)]**

Explanation 3 of Section 2(22)(e) - Meaning of "Concern"

- For this purpose "Concern" may be
  - HUF
  - Sole Proprietor
  - Firm
  - AOP
  - BOI
  - Company
- To determined the substantial interest of a person in a concern-*share held by him/ her in two different capacities, e.g. as individual and as HUF cannot be clubbed.* **[CIT v. Kunal Organics (P.0 Ltd. 164 taxman 169 [2007] (Ahd)]**

Following conditions are required to be fulfilled for the applicability of Section 2(22)(e):

- **Company**-should be one in which the public are not substantially interested i.e. should be a **closely held company**.
- **Person-**should be a shareholder having not less than 10% of voting power.
- **Payment**-should be by way of **advance** or **loan**.

  and

  made out of **accumulated profits** of the company.
- **In case loan or advance is to a concern**, shareholder should have a **substantial interest** in that concern ***at any time during the year*.**

Chapter-II

ANALYSIS OF THE PROVISIONS OF SECTION 2(22)(e) OF THE INCOME TAX ACT, 1961

A. Shareholder Must be Both - Registered & Beneficial Shareholder

- Where a loan is advanced to a shareholder, he/it Must be the registered as well as a beneficial owner of shares.

  The expression **"shareholder being a person who is the beneficial owner of shares" referred to in the first limb of Section 2(22)(e) refers to both a registered shareholder and beneficial shareholder**.

- If a person is a registered shareholder but not the beneficial then the provision of Section 2(22)(e) will not apply.

  [Rameshwarlal Sanwarmal v. CIT 122 ITR 1 [1980] (SC) further referred in Deputy CIT v. National Travel Services, [2009] 31 SOT 76 (Delhi)] also see ITO v. Sagar Sahil Investment (P.) Ltd [2010] 37 SOT 1 (Mum.) (URO) DCIT v. Madhusudan Investment & Trading Co. (P.) Ltd. [2011] 15 taxmann.com 252 (ITAT-Kol.)]

- Similarly if a person is a beneficial shareholder but not a registered shareholder then also the first limb of provisions of Section 2(22)(e) will not apply. **[CIT v. Standipack (P.) Ltd. [2012] 20 taxmann.com 19 (Delhi)]**

- **Loan to HUF, where members are shareholders.**

  The Tribunal held that the loan advanced by a private company to HUF of which the members were directors in the company cannot be deemed as 'Dividend' in the hands of HUF as HUF was not a registered shareholder. **[ITO v. S.S. Shetty 14 TTJ 71 (Bom) also see Harish Chand Golecha v. CIT [1981] 132 ITR 0030 (Raj).]**

B. Taxable in the Hands of Ultimate Recipient - who must be a Shareholder

- **Deemed dividend u/s 2(22)(e) is taxable in hands of the Ultimate Recipient of the loan amount**

  Deemed dividend can be assessed only in hands of a person who is a shareholder of lender company and not in hands of a person other than a shareholder.

- Where a loan or advance is made to a concern in which shareholder as referred in the Section is substantially interested, taxability should not arise in the hands of that concern but in the hands of the shareholder having beneficial interest in the concern and that **too when the money is finally received by that shareholder.**

  [Asst. CIT v. Bhaumik Colour P. Ltd. 313 ITR 146 (ITAT-Mum.)(S)(2009) further approved by Mumbai High Court in CIT v. Universal Medicare Private Limited (324 ITR 263) also see ACIT v. M/s M J International 2010 TIOL 693 ITAT-Mum, C R Building, New Delhi vs M/s Madhur Housing & Development Co 2010-TIOL-635-ITAT-Del, ACIT v. M/s Shiva Commodities & Derivatives, 2010 TIOL 388 ITAT Del, see also CIT v. Ankitech PVT. Ltd. ITA No.462 of 2009 (Del), [2011] 199 Taxman 341]

***Deeming fiction of Section 2(22)(e) can be applied only in the hands of the shareholder and not the non-shareholder.[Sadana Brothers Sales (P.) Ltd. v. Asstt. CIT [2011] 10 taxmann.com 122 (Indore - ITAT)**

C. Shareholding of common shareholder could not be taken into consideration for applying Section2(22)(e)

- **Where assessee-company received unsecured loan from its sister- concern and 'A' was holding more than 20% shares in both sister-concern and assessee-company, provisions of Section 2(22)(e) were not attracted.**

- **CIT v. MCC Marketing (P.) Ltd. [2011] 16 taxmann.com 411 (Delhi)**

  Facts:

  Assessee, a private limited company, received a certain amount as unsecured loan from its sister concern by name MIPL. AO having noticed that A was holding more than 20% shares in both MIPL and assessee-company invoked provisions of Section 2(22)(e) & made addition of aforesaid amount to income of assessee. In view of judgment of Delhi High Court rendered in case of **CIT v. Ankitech (P.) Ltd. [2011] 199 Taxman 341** provisions of Section 2(22)(e) were not attracted in instant case.

- **Where assessee-company was not shareholder of lending company, loan advanced by lending company could not be treated as deemed dividend u/s 2(22)(e) in hands of assessee-company on ground that shareholders of both companies were same.**

- **CIT v. Sharman Woolen Mills Ltd. [2011] 16 taxmann.com 171 (P & H)**

  In terms of Section 2(22)(e) dividend income is assessable **only in hands of shareholders of lending company and since assessee was not a shareholder of lending company amount of loan could not be assessed in hands of assessee in terms of Section 2(22)(e).**

- **CIT v. Gopal Clothing Company (P.) Ltd. 21 taxmann.com 65 (Delhi) [2012]**

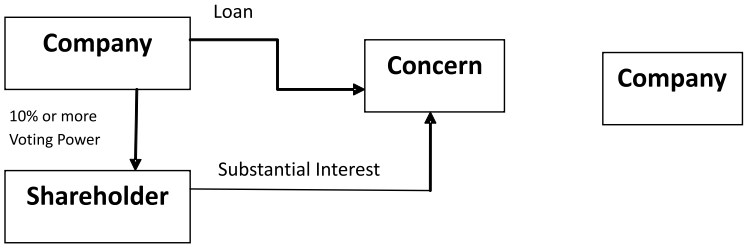
  Fact:

  Assessee-company, holding less than 10 % shares in company 'E', took unsecured loans from said company. AO found that 'S' who was holding more than 10 % shareholding in 'E' had substantial Interest in assessee-company & that company 'E' had sufficient accumulated profits & general reserves to pay dividend as per its books of account.

  Accordingly, he brought to tax said loans as deemed dividend. However, Tribunal deleted additions on ground that provisions of Section 2(22)(e) were not attracted as assessee was not holding requisite voting rights though 'S' had such right. Tribunal further held that shareholding of common shareholder could not be taken into consideration for applying Section 2(22)(e). Further, Delhi High Court in ***CIT v. Ankitech Pvt. Ltd. (P.) Ltd. [2011] 199 Taxman 341 (Delhi)*** has held that fact that shareholders of assessee-company were also shareholders of company which had given 'loan/advances' is not suffice and does not meet requirement of Section 2(22)(e).

- **ITO v. Anand Rathi Direct India (P.) Ltd. [2012] 23 taxmann.com 212 (ITAT-Mum.)**

  Where shareholding of a common shareholder in assessee-company and lender company was less than 20% as prescribed in Section 2(32) deemed dividend could not be said to have accrued



D. A loan/advance made by a company to a concern in which its shareholder has a substantial interest

Is Not taxable in the hands of Concern as deemed dividend u/s 2(22)(e).

[CIT v. Hotel Hilltop 313 ITR 116 (Raj.) (2009) and Shruti Properties P. Ltd. V. ITO 004 ITR 186 (ITAT-Mum.)(2010)]

Practical Issues on Section 2(22)(e) of the Act

- Interest free advance to sub contractor i.e. firm – No deemed dividend in the hands of the firm. **[CIT v. Raj Kumar Singh & Co. 149 Taxman 254 [2005] (All.)]**
- **An advance is made by a closely held Indian company to a foreign subsidiary – No deemed dividend in the hands of Foreign Subsidiary,** where it not itself hold any shares in it but its foreign holding company together with other subsidiaries has substantial interest in the Indian company. **[Madura Coats P. Ltd. 274 ITR 609 AAR (2005)]**
- A company has made a loan to its shareholders who are the partners of a firm. The shares held by them are shown as stock in trade of the firm and the amount received by the partners are shown as deposit made by the company in the books of the firm. Then the loan could not be deemed dividend in the hands of the firm u/s 2(22)(e). **[ITO v. Chandmull Batia 115 ITR 388 (1978)]**
- A company made a loan to the HUF and a member of HUF purchased shares of the company with the funds of family. The said amount could not be considered as deemed dividend in the hands of the firm. **[CIT v. Sarathy Mudaliar (C.P) 83 ITR 170 (1972)]**
- Income tax - Sec 2(22)(e) - held, deemed dividend cannot be assessed in the hands of a person other than a shareholder of the lender company - since the assessee is not a shareholder, Sec 2(22)(e) is not applicable in this case. **[ACIT Vs CARGO MOTORS PVT LTD 2009 TIOL 539 (ITAT-Del)]**

E. Loan & Advances - Whether covered under Deemed Dividend?

Meaning of Loan & advances:

According the Black's Law Dictionary

- **Loan** means a lending, delivery by one party to and receipt by another party of sum of money upon agreement, express or implied, to repay it with or without interest.

- **Advances** mean something which is due to a person but which is paid to him ahead of time when it is due to be paid.

Some Important point to be considered

- If loan amount < Accumulated profits

  then **entire** amount of loan is considered as deemed dividend.

- If a loan is given by a company to a shareholder, the amount of **loan to the extent of entire Accumulated profits** (and not to the extent of his share in Accumulated profits) will be treated as dividend. **[CIT v. Arati Debi [1978] 111 ITR 277 (Cal.) & CIT v. Mayur Madhukant Mehta [1972] 85 ITR 230 (Guj.)]**

Issues

- Every debt does not involve a loan. **[Bombay Steam Navigation Co. (P) Ltd. V. CIT 56 ITR 52 (1953) (SC)]**

- Duration of Loan is not material. **[Walchand & Co. Ltd. v. CIT (1975) 100 ITR 598 (Bom) & CIT v. Bhagwat Tiwari (105 ITR 62)]**

- An overdraft taken by shareholder from the company is treated as loan and taxable as deemed dividend. **[CIT v. K. Srinivasan 50 ITR 788 (1963) (Mad.)]**

- Loan obtained through proprietary concern would be treated as deemed dividend u/s 2(22)(e). **[CIT V. K. Srinivasan 50 ITR 788 (1963) (Mad) & Nandlal Kanoria v. CIT 122 ITR 0405 [1980] (Cal)]**

- Withdrawal over and above of credit balance is to be treated as deemed dividend. **[CIT V. P. Sarada (1998) 229 ITR 444 (SC)]**

- Payment towards the personal expenses of the shareholder would be treated as deemed dividend. **[CIT V. K. Srinivasan 50 ITR 788 (1963) (Mad)]**

- Loans made by the company to the employee i.e. managing director, therefore, assessable as deemed dividends in his hands. **[CIT V. L. Alagusundaram Chattier 252 ITR 893 (SC)]**

- Amounts advanced by a company to its director under a Board resolution, for specific purpose, would not fall under mischief of Section 2(22)(e). **ACIT v. Harshad V.Doshi [2011] 9 taxmann.com 48 (Chennai - ITAT)]**

- **A loan in kind attract the provisions of deemed dividend** - Any payment by a company of any sum representing a part of the assets by way of advance made by the company to the shareholder by the transfer of goods would come in to the

provisions of Section 2(22)(e). **[M.D. Jindal v. CIT 164 ITR 028 (Cal.)(1987)]**

- When a Shareholder doing business with company & always having debit balance, the amount would be regarded as loan by the company and to the extent of Accumulated profits to cover the debit balance, would be regarded as deemed dividend u/s 2(22)(e).

  [CIT v. Jamnadas Khimji Kothari 92 ITR 105 (1973) (Bom), CIT v. Mrs. Maya B. Ramchand (1986) 162 ITR 460 (Bom), Sadhana Textiles Mills (P) Ltd. v. CIT (1991) 188 ITR 318 (Bom), CIT v. P.K. Badiani (1970) 76 ITR 369 (Bom) also affirmed by SC]

- Repayment of an earlier loan could not be adjusted against advancement of fresh loan, which had been deemed to be dividend under Section 2(22)(e) of the Income-tax Act. **[ITO v. Kalyan Gupta[2007] 293 ITR (A.T.) 0249-ITAT (Mum)]**
- Provisions of Deemed Dividend shall not be applicable to loan received prior bearing substantial and beneficial interest in a concern. **[Ravindra D. Amin v. CIT [1994] 208 ITR 0815 (Guj)]**

Other Miscellaneous Issues

- Section 2(22)(e) covers **only the amount received during the previous year by way of loans/advances** and not amounts received in an earlier year. Further, increase in the outstanding on account of provision for interest is not covered. **[CIT V. Parle Plastics Ltd [2011] 332 ITR 63(Bom.) see also (ITO v. Usha Commercial (P.) Ltd., (2009) 120 TTJ (Kol.) 1004; A.R Chadha & Co. India (P.) Ltd. V. Dy. CIT (2010) 133 TTJ (Del.) 490]**
- Amount credited in the loan account by way of remuneration to the a shareholder cannot be set off against loan. **[Rajesh P. Ved v. Asst. CIT 001 ITR 275 (2010) (ITAT-Mum.)]**
- Repayment of loan can not be reduced from deemed dividend. **[Rajesh P. Ved v. Asst. CIT 001 ITR 275 (ITAT-Mum.)(2010)]**
- Repayment of a deposit made by a shareholder with the company does not attract the provisions of Section 2(22)(e). **[Mohan Anand v. CIT 82 ITD 708 (Del.)(2002)]**
- In the case where there was no finding that payment is made out of Accumulated profits or the company possessed accumulated profits, then the loan to the shareholder is not assessable as deemed dividend. **[CIT v. Nitin Shantilal Parikh 319 ITR 437 (2009) (Guj.)]**
- Receipt in the nature of share application money cannot be construed as loan or advance and therefore, it falls beyond the Ken of S. 2(22)(e). **[Ardee Finvest (P) Ltd v. DCIT – ITAT - 70 TTJ (Del) 378]**

- **Amounts given by a company to an assessee against his debenture account**

Amounts given by a company to an assessee against his debenture account cannot be treated as loans or advances for purposes of Section 2(22)(e). **[Anil Kumar Agrawal v. ITO [2011] 9 taxmann.com 131 (MUM. – ITAT)]**

F. Provisions of Section 2(22)(e) gets attracted even if

- Company charges interest equal to the market rate of interest from its shareholder on loans or advances given to him.

  Advance is given for expense & advance is adjusted against expense.

  Loan is repaid before the end of the previous year .i.e. liability is attracted at the movement the loan is given. **[Tarulata Shyam v. Cit 108 ITR 345 (1977) (SC)]**

  *Note: TDS shall be deducted by the company on such payment.

- A closely held company paid a sum to a firm in which its major shareholder is a partner and he withdraw a sum from his capital account and make investment. Then said sum is assessed as deemed dividend in the hands of the shareholder. **[CIT v. Mukundray K. Shah 290 ITR 433 (2007) (SC)]**

- Amount received by a firm from a company in which partners of firm were holding more than 10% shares, is to be treated as deemed dividend **[CIT v. Bharti Overseas Trading Co. [2012] 21 taxmann.com 543 (Delhi)]**

- Company paid any amount to a shareholder and the same is disclosed by the shareholder as **loan** in his balance-sheet, subject to fulfillment of the conditions of Section 2(22)(e) is deemed dividend. **[Asst. CIT V. Ajay Jadeja 005 ITR 233 (2010) (ITAT-Del.)]**

- Where Shareholders were given huge deposits in the imprest account but there was no withdrawal indicating utilization of those funds during the year under consideration, such funds was in fact a short term loan and therefore this amount is liable to tax as deemed dividend in the hands of said shareholder. **[ITO v. Ajanta Cycle (P) Ltd. 99 TTJ 1159 (Chd).]**

- **In the case of Dr. Shiv Kant Mishra v. DCIT 118 ITD 347 (Luck) it was held that**

  Advance made by the company to the assessee director under a MOU whereby assessee was to purchase land and transfer a portion thereof under a lease to the company could not be regarded as a genuine transaction as no action has

been taken either by the company or by the assessee either for getting lease deed executed in favour of the company after purchasing the land or returning the advance and the MOU is merely a colourable device whereby accumulated profits of the company have been transferred to the assessee as a loan for indefinite period and therefore advance given to the assessee constituted deemed dividend under Section 2(22)(e).

G. Issues - when provisions of Section 2(22)(e) are not attracted.

- **Amount given as advance for entering in to dealings through shareholder**.

  If an amount is given to a Shareholder for the purposes of making an advance in respect of certain land dealings which were proposed to be entered into by the company through him. The same could not be treated as deemed dividend under Section 2(22)(e) of the said Act. **[CIT V. Sunil Sethi 26 SOT 95 (ITAT-Del.) (2010)]**

- **Amount given as Imprest under Board Resolution.**

  The amount of Rs. 30 Lac was handed over to assessee, the director of company, under Board resolution as an imprest amount to enter into a transaction for benefit of company which was returned within a week when the transaction was not materialized, the same could not be treated as deemed dividend in the hands of the assessee. **[Sunil Chopra v. DCIT, 26 SOT 95 (Del)]**

- **Mere book entries do not constitute payment by the company.**

  On death of a shareholder, debit balance standing in his account was transferred to account of his wife. Department wanted to tax it as deemed dividend. High Court held it could not be done so and observed "it is difficult to introduce another fiction in respect of the words 'Payment by the Company' by construing even a transfer entry as amounting to payment**. [CIT v. Smt. Savithri Sam (1998) 144 CTR (Mad) 17/ (1999) 236 ITR 1003 (Mad.)]**

- **Transaction of Purchase of Car in the name of Director**

  Where loan for the car, repayment of the installment of loan, showing loan as secured liability and the car as an asset in the books of the company do not suggest that the transaction of the company with the Director was in a way arranged to give any benefit to the Director of the company, and accordingly the amount cannot be considered as deemed dividend in the hands of the assessee and hence deleted.

  [Shri Brij Securities (P) Ltd. (2009) TIOL 720 ITAT (Mum)]

- Any money transferred to any concern in which the shareholder had a substantial interest, from the funds defalcated by the said shareholder and allowed as business

loss to the company. The said amount is not a deemed dividend in the hands the concern. **[CIT V. Universal Medicare Pvt. Ltd. 324 ITR 263 (2010)(Bom.)]**

- Payment of interest free security deposits for the purpose of leasing of the property credited to the account of the Director on which date he was holding shares less than 10% and against the aforesaid amount further shares were allotted which had made the shareholding 44.57% was not taxable as deemed dividend. **[CIT v. Late Shri C.R. Dass (2012) 17 taxmann.com 76 (Delhi)]**

Other Miscellaneous Issue

- **Advance given to company's director cannot be treated as deemed dividend u/s 2(22)(e) to extent it was adjusted against incentives payable to him.**

  Facts:

  Assessee was a whole-time working director in a company drawing monthly remuneration for services rendered. During the year, assessee took salary advance of Rs. 11 lakhs which was adjusted against incentives paid to assessee after deducting TDS from amount paid. AO treated advance amount as deemed dividend. On appeal, Commissioner (Appeals) found that out of payment of Rs. 11 lakhs, Rs. 6.82 lakhs was towards salary and incentives on which TDS was duly deducted and, therefore, Rs. 4.17 lakhs only could be treated as deemed dividend. **[DCIT v. N. Pramodh [2012] 21 taxmann.com 98 (ITAT-Chennai)]**

- **Recipient should be a Shareholder *on the date* the loan was advanced. [CIT v. Mittal (H.K.) 219 ITR 420 (All.)(1996)]**

- **Subsequent adjustments in the shareholder's account** on the last day of accounting year would not alter the position that the shareholder had received notional dividends during the relevant period. **[Sarada (P.) (Miss.) v. CIT 229 ITR 444 (SC)(1998)]**

- **Deemed dividend assessed, if any in the hands of the shareholders in the past assessment years** should be deducted from the surplus while determining the accumulated profits in the hands of the company. **[CIT V. G. Narasimhan 102 Taxman 66/236 ITR 327 (1999) (SC)]**

- **If there is no transaction between shareholder and company during the relevant accounting period.** The debit balance of shareholder's account in the books of a company is not assessed as deemed dividend u/s 2(22)(e). **[ACIT v. Smt. Lakshmikutty Narayanan 303 ITR 212 (ITAT- Coch.)]**

CHAPTER-III

EXCEPTIONS TO SECTION 2(22)(e) OF THE INCOME TAX ACT, 1961

1. **Business Transactions are out of the preview of provisions of Section 2(22(e)**

   As per the exceptions to clause (e) to Section 2(22) provides as under:

- But "dividend" **does not include** ----

  *"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**."*

  What constitutes "Substantial part of the company's business"?

  "Substantial part of the company's business" has not been defined under the I.T. Act.

- Ratio of money lending business should be 20% or more to be considered "substantial part of the company's business. *[Mrs. Rekha Modi v. ITO 13 SOT 512 (2007)(ITAT-Delhi)]*

Note: Factual position of the company for the relevant 'previous year' i.e., the year in which the loan or advance was made, should be considered.

- **In the case of CIT v. Parle Plastics Ltd [2011] 196 Taxman 62 (Bom.), It was held that:**

  "Substantial part" does not connote an idea of being the "major part" or the part that constitutes majority of the whole. Any business which the company does not regard as small, trivial, or inconsequential as compared to the whole of the business is substantial business.

Various factors and circumstances such as **turnover, profit, employees, capital employed etc** are required to be looked into while considering whether a part of the business of a company is a "substantial part of its business"

- Therefore, the provisions of Section 2(22)(e) shall not apply if

  1. Payment is in the nature of an **advance or loan**

  and

  2. Loan is in the **ordinary course of business** of money lending.

  [ITO v. Krishnonics Ltd 308 ITR 008 (ITAT-Ahm.) (2009)]

- **In the case of CIT v. Badiani (P.K.) 76 ITR 369 (1970) (Bom.), it is held that**

  "What has to be considered is not the balance in account but the position of every payment, and , therefore, the debit balance of the shareholder with the company at any point of time could not be taken to represent an advance or loan by the company to the shareholder; nor could the amount outstanding at the end of the accounting year alone be taken as loan within the meaning of Section 2(22)(e)."

- **Onus is on the Assessee to prove the fact** that the loan or advance is in the "Ordinary Course of Business" and Lending of money constitutes substantial part of the company's business. **[Walchand & Co. Ltd. V. CIT 100 ITR 598 (1975) (Bom.)]**

- No interest is charged by a company on loan/advance made by it in the "Ordinary Course of Business" and Lending of money is the sole business activity but charged commission, etc even then it is not covered under deemed dividend. **[Jhamu U. Sughand v. Dy. CIT 284 ITR 082 (ITAT-Mum.) (2006)]**

Issues

- Amount received by assessee-shareholder from a company as a result of trading transaction could not be regarded as deemed dividend *merely because it had been shown as 'unsecured loan' in assessee's books of account*

  Where assessee holding 50% shares in a company, received certain amount from said company on account of trading transaction between parties, amount so received could not be added to assessee's income as deemed dividend merely because said amount had been reflected as 'unsecured loan' in assessee's books of account. [CIT v. Arvind Kumar Jain [2012] 18 taxmann.com 132 (Delhi)]

- **ACIT v. Sanjiv Gupta [2011] 14 taxmann.com 153 (ITAT- Chd.)**

  Facts:

  Assessee was a sole proprietor of company 'XYZ' and also a consignee agent of

'R' Ltd. It also held shares to extent of 50% in 'P' Ltd. which was also consignee agent of 'R' Ltd. During year assessee made purchases from 'R' Ltd. but payment was made by 'P' Ltd. for said purchases. However, assessee repaid said amount to 'P' Ltd. on reconciliation of account on year end.

In the facts of the instant case, the transaction **in question is relatable to the carrying on of business by the assessee.** The aforesaid payment was made by 'P' Ltd. as the demand was raised by the consignor 'R' Ltd. after debiting the account of the said company, though the said transaction related to the assessee. Thereafter, on reconciliation of statement of accounts, the said amount was repaid by the assessee to the said company and the same does not partake the character of loan as contemplated under Section 2(22)(e).

Since on reconciliation of statement of accounts, amount was repaid by assessee to 'P' Ltd., same would not partake character of loan as contemplated u/s 2(22)(e).

- **Financial Transactions in day to day business will not attract provisions of S. 2(22)(e) of IT Act.**

  The assessee was a travel agency and the above two concerns that it had dealings with, that is, M/s. Holiday Resort (P.) Ltd. and M/s. Ambassador Tours (I) (P.) Ltd. were also in the tourism business. The assessee was involved in the booking of resorts for the customers of these companies and entered into normal business transactions as a part of its day-to-day business activities. The financial transactions cannot in any circumstances be treated as loans or advances received by the assessee from these two concerns. **[CITv. Ambassador Travels (P.) Ltd. [2008] 173 Taxman 407 (Delhi)**

- **The law does not prohibit business transaction between related parties and, therefore, payment made in ordinary course of business cannot be treated as loans and advances.**

  Payment made by a company through a running account in discharge of its existing debts or against purchase or for availing of services, in the ordinary course of business carried on by both the parties, could not be treated as deemed dividend for the purpose of Section 2(22)(e).

  [MTAR Technologies (P.) Ltd. *V.* Asst. CIT [2010] 39 SOT 465 (Hyd.), also see Mr Ohanlal Pillai vs ITO 2011 TIOL 90 (ITAT-Mum), Dy. CIT vs Gharda Chemicals Ltd 2011 TIOL 127 (ITAT-Mum), NH Securities Ltd. vs Dy. CIT [2007] 11 SOT 302 (Mum), Sri Satchidanand S. Pandit v. ITO19 SOT 213 (Bom.)]

- **Whether receipt of money as advance towards sale of land falls outside the purview of Section 2 (22) (e).**

CIT v. Shri Satyanarayan Nuwal, 2010-TIOL-673-HC-Mum.

Assessee had agreed to sell a plot of land to SEL & he had agreed to sell the land against part consideration at the time of agreement and remaining during final sale deed, that the amount was advanced by SEL towards part consideration of a property intended to be sold by assessee to SEL, *it cannot be said that the SEL had advanced money to its shareholders within the meaning of Section 2(22)(e) merely because the seller of the property happens to be the shareholder of SEL*.

Assessee was also transporting goods belonging to SEL. The total amount outstanding on the relevant day was approximately Rs.17,00,000/- and in those circumstances, it was quite natural for the assessee to ask SEL to clear its outstanding bills and give some advance against the transportation work to be done.

2. Trade Advances given by the company - will not attract provisions of Section 2(22)(e).

- The advances which are in the nature of trade advances are outside the ambit of provisions of Section 2(22)(e) of the I.T. Act, 1961. **[CIT v. Rajkumar 318 ITR 462 (Del) (2009) also see CIT v. Nagindas M. Kapadia 177 ITR 393 (Bom) (1989)].**

- Any advance paid by a company to its sister concern holding 50% of shareholding in the company and latter adjust the advance against dues for job work to be done by the company, is a business transaction. **[CIT v. Creative Dyeing and printing Pvt. Ltd. 318 ITR 476 (Del) (2009) also see Bharat C. Gandhi v. ACIT [2009] 178 Taxman 83 (Mum.)(Mag.)]**

- **Amount received as advance for investment in Real Estate against brokerage– Section 2(22)(e) will not attract.**

  Where nature of assessee's business was such that he was earning income from brokerage of real estate and he claimed that companies in which he had substantial investment, had advanced money for investment in real estate, addition of such loan amount as deemed dividend in assessee's hands was not justified. **[ITO vs M/s International Land Development (P) Ltd2011-TIOL-343-ITAT-Del]**

- **Secured deposit given coupled with certain obligation.**

  - Where the assessee-firm (Concern) was not the shareholder of the lender company the amount received by the assessee as security deposit under an agreement coupled with certain obligations to be complied with could not be regarded to be the payment by the company by way of advance or loan to a shareholder and therefore, could not be assessed to tax in the hands of the assessee u/s 2(22)(e). **[DCIT v. Atul Engineering Udyog [2011] 10 taxmann.**

com 162 (ITAT-Agra)]

- Security Deposit by exporters with assessee, buying agent of foreign principal in India to ensure quality of goods exported after securing clearance from the principal and linked with the endorsement of letter of credit cannot be treated as loan or advance for purpose of s. 2(22)(e). **[ACIT v. Global Agencies (P) Ltd. 87 TTJ 1086 (Del.)]**

- The advances cannot be deemed to be dividend where monies were advanced in pursuance of the memorandum of agreement for developing plots of land into commercial buildings.

  ACIT v. S. Joginder Singh, [2012] 18 taxmann.com 143 (ITAT- Delhi)

  The plots belonged to the assessee which were to be handed over to the company for construction as per approved plans. It was the business of the company to undertake real estate construction business. In a way, the assessee became a partner with the company to carry on real estate business, during the course of which the advances were received.

- **Nexus of Funds have to be established**.

  The Tribunal held that when loan granted to managing director by firm holding funds on behalf of company as collection agent, the loan was not held to be deemed dividend as there was no linkage that the funds were exclusively advanced out of the funds collected by the firm on behalf of the company. It was further held that the burden is on the Revenue to prove that the case fell within the mischief of deeming provisions. **[Subrata Roy Sahara v. ACIT 109 ITD 1 (Luck) (TM)]**

3. Inter-Corporate Deposits (ICDs)

- ICDs are different from loans or advances & would not come within preview of deemed dividend u/s 2(22).**[Bombay Oil Industries Ltd. V. Dy. CIT 28 SOT 383 (Mum) (2009)]**

4. Financial Transactions

- Financial transactions in any circumstances could not be treated as loans or advances and therefore not come into the provisions of deemed dividend. **[CIT v. Ambassador Travels P. Ltd. 318 ITR 376 (Del) (2009)]**

Chapter-IV

ACCUMULATED PROFITS

Meaning of Accumulated Profits:

- *"Accumulated profits within the meaning of clause (e) will necessarily be comprised of the amount available for being distributed as profits. The word 'accumulated' means the profit earned bit by bit and accumulated. It does not mean that it should be carried forward from year to year. Profits can accumulate even within a single year. The entire amount which is available for distribution as profits on a particular date would be the accumulated profit and any amount paid as advance or loan to the shareholder to the extent of this amount of accumulated profits will be dividend within the meaning of Section 2(6A)(e)."*

  [CIT v. Roshan Lal 98 ITR 349 (1975) (ALL.)]

Income shall be excluded from Accumulated profits

a) Non-taxable Accumulated Capital Gains

Accumulated profits would not include capital gains which are not chargeable to tax even during the period the capital gains tax is in force. Distribution made to the shareholder of a company out of non-taxable accumulated capital gains of a company would not be dividend. **[Tea Estate India P. Ltd. v. CIT 103 ITR 0785 (1976) (SC)]**

b) Tax Free Income

The basic intention behind the Section is to tax that part of parts which could otherwise be distributed as dividend reach in the hands of shareholders in the

form of loan or advances.

Thus, it was to tax that income which could be taxed. In view of this, where a part of that profits comprises of the income which is not chargeable to tax or which is tax free, same should be excluded while applying the provisions of Section 2(22)(e). **[CIT v. Mangesh J. Sanzgiri 119 ITR 0962 (1979)(Bom.)]**

c) Share Premium Account

The Income Tax Act, 1961 does not specifically define accumulated profits

- But Explanation 2 to Section 2(22) of the Act, provides to include in the accumulated profits, **all the profits up to the date of distribution.**
- **Share forfeiture receipts** – are not accumulated profits.

  [Jai Kishan Dadlam (2005) 4 SOT 138 (Mum)]

- **As per Schedule VI of the Companies Act, 1956, Accumulated profits is not defined but it considers Reserves and Surplus comprising of the following:**

(1) Capital Reserves

(2) Capital Redemption Reserve

(3) **Share Premium Account**

(4) Other reserves specifying the nature of each reserve and the amount in respect thereof, less debit balance in Profit and Loss Account (if any).

(5) Surplus, i.e., balance in profit and loss account after providing for proposed allocations, namely:-

Dividend, bonus or reserves

(6) Proposed additions to reserves

Thus, reserves in (1) to (3) are specifically assigned for a purpose. However, reserves from (4) to (6) are the reserves which can be used for distribution of dividend i.e. these are distributable profits of the company.

- **Provisions of Sub Section (2) of Section 78 of the Companies Act, 1956**

Specifically imposes a restriction on the utilization of Securities Premium Account providing as under:

The "Securities Premium Account" may, notwithstanding anything contained in sub Section (1), be applied by the company-

- In paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares;

- In writing off the preliminary expenses of the company;
- In writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; or
- In providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company.

"Since Section 78 of Companies Act, 1956 puts a statutory bar on share premium account being used for distribution of dividend, deeming provisions of Section 2(22)(e) cannot apply and, hence, payment made by a company out of its share premium account could not be brought to tax in hands of receiver as deemed dividend under Section 2(22)." **[DCIT v. MAIPO India Ltd., 116 TTJ 791 (Del-ITAT) and CIT v. Urmila Ramesh (1998) 230 ITR 422 (SC)]**

Accumulated profits include:

- General Reserve **[CIT v. K. Srinivasan 50 ITR 788 (Mad.)(1963)]**
- Development Rebate reserve, Development Allowance Reserve and Investment Allowance Reserve, as these reserves are in the nature of any expenditure or outgoing. **[P.K. Badiani v. CIT 105 ITR 642 (1976)(SC)].**
- Building Reserve Fund **[CIT v. Jaldu Rama Rao 11 Taxman 203 (1982)(AP)]**
- While calculating Accumulated profits an allowance for **Depreciation and additional depreciation** at the rates provided by the I.T. Act itself has to be made by way of deduction.
- **[Navnital C. Jhaveri V. CIT 80 ITR 582 (1971) (Bom) also see Asst. CIT v. Yasin Hotels (P.) Ltd [2009] 121 TTJ 713 (Chennai), CIT v. Jamnadas [1973] 92 ITR 105 (Bom.)].**

Therefore, dividend can be declared by the company only out of revenue reserves and not from the capital reserves.

- Further, **Notification [GSR No. 427(E), dated July 24, 1975] of Companies (Declaration of Dividend out of Reserves) Rules, 1975,** puts a restriction on the utilization of capital reserves for the purpose of dividend declaration.

Accumulated profits does not include:

- Provisions for Taxation & Dividend. **[CIT v. Damodaran 85 ITR 590 (1972)(Ker.)]**
- Balancing charge u/s 41(2) is not part of accumulated profits. **[CIT v. Urmila Ramesh 96 Taxman 533 (1998)(SC)]**

- Subsidy on capital account. **[CIT v. Rajasthan Wires (P.) Ltd 130 Taxman 93 (2003) (Jp.) (Mag.)]**

Issues

- **Reduction of Accumulated Profits**

Once an amount goes out of accumulated profits as a loan and the loan is to be deemed to be dividend, the same amount when repaid cannot again be capable of attracting the fiction and be deemed to be dividend. "To illustrate, suppose accumulated profits are Rs. 10000. A shareholder having substantial interest in the company takes a loan of Rs. 7000. this is deemed dividend. It is returned in the same year and another loan of Rs. 5000 is taken. The second loan will be hit by the provisions of Section 2(22)(e) to the extent Rs. 3000 only because the earlier loan returned by the shareholder does not augment accumulated profits. But if accumulated profits are capitalized, there can be no deemed dividend as the words "whether capitalized or not" which occur in clauses (a) to (d) of Section 2(22)(e) are conspicuously absent from clause (e). **[P.K. Badiani v. CIT (1976) 105 ITR 642 (SC)]**

Chapter-V

MISCELLANEOUS ISSUES

- **Deemed Dividend in the hands of a Non-Resident Shareholder**

  Section 2(22)(e) does not distinguish between a Resident or Non-resident shareholders.

  Further, it is pertinent to note that by virtue of Clause (iv) sub-Section (1) of Section 9,

  "any dividend paid by an Indian company outside India" is 'Income deemed to accrue or arise in India'.

  Therefore, Deemed Dividend u/s 2(22)(e) is subject to tax in India in the hands of a Non-resident shareholder subject to DTAA relief.

- Where the applicant had no permanent establishment in India, whether the applicant would be taxable in India in respect of such dividends.

  X Ltd., The Netherlands, In Re v. **Syed Shah Mohammed Quadri J. (Chairman) and Narang A.S. (Member) JJ. [2005] 275 ITR 0327- [Authority for Advance Ruling]**

  That the germane parts of Section 245N(a)(ii) were : (a) a transaction undertaken or proposed to be undertaken by a resident with the non-resident applicant ; (b) the determination of the Authority should relate to the tax liability of such non-resident on the application of the resident. Though the applicant was a non-resident and the transaction of loan was undertaken by two Indian companies of which the applicant was the holding company, the non-resident and the residents

were independent legal entities. The question of taxability of the non-resident did not arise on that transaction. Therefore, no determination under sub-clause (ii) of Section 245N(a) could be made.

- **Reporting of Deemed Dividend by the Auditor – in case of Audit u/s 44AB of the Income Tax Act**

  - There is no specific provision in the Audit Report Form No. 3CD prescribed by the I.T. Rules, 1962 for reporting of 'Deemed Dividend' paid by a Company.

  - **Clause 27 of Form No. 3CD** requires the auditor to disclose whether the assessee has complied with the provisions of Chapter XVII-B relating to Deduction of Tax at Source.

  - Since, Tax is required to be deducted by the principal officer of an Indian Company u/s 194, the Auditor is obliged to report of Non-deduction of TDS u/s 194 in the Audit Report Form No. 3CD.

    [Anz Reality (P) Ltd. V. ITO – ITAT, 120 TTJ 142 (Jaipur)]

VOICE OF CA

Part-V

Analysis of Provisions of Section 14A

Under Income Tax Act, 1961

INTRODUCTION

Section 14A was introduced in the Income Tax Act, 1961 vide Finance Act, 2001 w.r.e.f. 01-04-1962. This section originally provided that

> "For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act."

Section 14A was inserted to nullify the decisions of the Apex Supreme Court in *CIT v. Maharashtra Sugar Mills Ltd. [1971] 82 ITR 452* and in *Rajasthan State Warehousing Corpn. v. CIT [2000] 242 ITR 450*. In the former case it was held that if any assessee carried out two business activities constituting one business, the entire expenditure incurred for the business is allowed for deduction even if any part of the income from such business is not exigible to tax and in the latter case it was held that if the exempted income and the taxable income are earned from one and indivisible business, then the apportionment of the expenditure cannot be sustained and the entire expenditure would be deductible. The intention behind introduction of this section was to prevent the deduction of expenses incurred to earn the exempt income against taxable income. By introduction of this section it was made clear that expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income. According to the basic principles of taxation only net income, i.e. gross income minus the expenditure is taxed and accordingly, the exemption is also in respect of the net income. Therefore, the section was inserted with retrospective effect from the inception of the Income-tax Act, 1961 so as to clarify the intention of legislature.

Proviso to section 14A

Proviso to section 14A was introduced vide Finance Act, 2002 with retrospective effect from 11-05-2001, to clarify the intention of the legislature which was to set the existing controversy on this issue at rest and not to unsettle the cases by raising the issue afresh. The proviso provided as under:

*"**Provided that** nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before the 1st day of April, 2001."*

Analysis of proviso:

To provide clarification regarding restriction on re-opening of completed assessments on account of provisions of section 14A, ***Circular No. 11/2001, dated 23-7-2001*** was inserted wherein it was directed that the assessments, where the proceedings have become final before the first day of April, 2001 should not be re-opened under section 147 of the Act to disallow expenditure incurred to earn exempt income by applying the provisions of newly inserted section 14A of the Act. The same view has been expressed by Delhi High Court in *CIT vs. PNB Finance & Industries Ltd [2012] 340 ITR 50 (Delhi).*

The proviso to section 14A only bars reassessment/ rectification and not in case of fresh assessment on the basis of the retrospective amendment in the section as held in the case of *Honda Siel Products Ltd. vs. Dy. CIT (2012) 340 ITR 64 (SC) and ACIT v. Tube Investments of India Ltd. (2011) 133 ITD 79 (Chennai) (TM) (Trib.).* Also the cases where assessment was pending finalization after remand by first appellate authority in an appeal filed by assessee, bar under this circular would not be applicable [*Catholic Syrian Bank Ltd. vs. CIT (2011) 330 ITR 556 (Ker.)]*

The proviso to section 14A would not apply to the case were the order of the Commissioner of Income Tax under section 263 was passed prior to the existence of the said provision. *Mahesh G. Shetty vs. Commissioner Income Tax (2011) 238 CTR 440 (Kar.)*

Sub-section (2) & (3) of Section 14A

The existing provisions of section 14A only provided the disallowance of the expenditures incurred in respect of exempt income against the taxable income. However, it did not provide any method to determine the expenditure incurred in relation to income which does not form part of the total income due to which there were considerable disputes between the tax payers and the Department on the method of determining such the expenditure. Therefore, vide Finance Act, 2006, this section was amended to insert sub-section (2) and (3) with effect from 01-04-2007, so as to provide that it would be mandatory for the Assessing Officer to determine the amount of expenditure incurred in relation to such income which does not form part of the total income in accordance with such method as may be prescribed. The sub-

sections read as under:

" (2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.

(3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act."

By virtue of this amendment, powers were conferred in the hands of Assessing Officer to determine the expenditure which had been incurred in relation to income which does not form part of the total income under this Act. Further, under sub-section (3), it was made clear that this section is also made applicable to the cases where assessee claims that no such expenditure has been incurred. However, there was no such prescribed method which could facilitate the Assessing Officer to determine such amount of expenditure, which still remained the reason for dispute. These sub-sections were introduced with effect from 01-04-2007 however, the method prescribed i.e. Rule 8D under the sub-section (2) was introduced in the Income Tax Rules, 1962 with effect from 24-03-2008.

Introduction of Rule 8D

Rule 8D was introduced by the Central Board of Direct Taxes vide Notification No. 45/2008, dated 24-03-2008, which provided the method for determining amount of expenditure in relation to income not includible in total income in accordance with section 14A of the Act. The Rule 8D provides as under:

***"8D.** (1) Where the Assessing Officer, **having regard to the accounts** of the assessee of a previous year**, is not satisfied with**—*

(a) the correctness of the claim of expenditure made by the assessee; or

(b) the claim made by the assessee that no expenditure has been incurred,

in relation to income** which does not form part of the total income under the Act for such previous year, **he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2).

*(2) The expenditure in relation to income which does not form part of the total **income shall be the aggregate of following amounts**, namely:—*

(*i*) *the amount of* ***expenditure directly*** *relating to income which does not form part of total income;*

(*ii*) *in a case where the assessee has incurred expenditure by way of interest during the previous year which is* ***not directly attributable to any particular income or receipt****, an amount computed in accordance with the following formula, namely :—*

A ×	*B*	
	C	
Where	*A* =	*amount of expenditure by way of interest other than the amount of interest included in clause (i) incurred during the previous year ;*
	B =	*the average of value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year ;*
	C =	*the average of total assets as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year ;*

(*iii*) *an amount equal to* ***one-half per cent of the average of the value of investment****, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year.*

*(3) For the purposes of this rule, the "****total assets****" shall mean, total assets as appearing in the balance sheet* ***excluding*** *the increase on account of revaluation of assets but including the decrease on account of revaluation of assets."*

Therefore, method prescribed under Rule 8D can be applied only when

(i) The assessee has made a claim of expenditure in relation to any income which does not form part of the total income and

(ii) The Assessing Officer is not satisfied about the correctness of such claim.

Therefore, the satisfaction of the AO as to the incorrect claim made by the assessee is sine qua non for invoking the applicability of Rule 8D. **The AO cannot proceed with Rule 8D automatically irrespective of the genuineness of the assessee's claim that no expense has been incurred in relation to exempt income as held in** *Auchtel Products Ltd. vs. ACIT , I.T.A No. 3183 /Mum/2011, date: 30/04/2012, ITAT-Mumbai.*

Rule 8D cannot be automatically invoked overlooking the amount expenditure disallowed by assessee u/s 14A himself. In *DCIT vs. M/s Orient Craft Ltd. I,T.A.No.3864/Del/2009 (Del-ITAT),* it has been held that the alternative methods for making disallowance u/s 14A as given in Rule 8D can be restored to **only where the A.O. is not satisfied with the working of disallowance given by the assessee**. Where

the Assessing Officer has not demonstrated any such dissatisfaction and has nowhere carved out the total quantum of interest bearing funds, used for investment purposes which has generated interest free income, Rule 8D cannot be resorted to. Therefore, if the working of the disallowance by the assessee is not found to be correct by the Assessing Officer, only then Rule 8D can be applied.

Analysis of Provisions & Issues on Section 14A read with Rule 8D

1.1 Constitutional validity of provisions of sec. 14A

In ***ITO vs. Daga Capital Management (P.) Ltd. [2009] 117 ITD 169***, the Special Bench of mumbai of Income Tax Appellate Tribunal held **that sub-sections (2) and (3) of section 14A are procedural in nature and have retrospective effect**. It further held that:

Section 14A was inserted with a view to clarify the intention of making disallowance in respect of 'expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act' since the inception of the Act. These sub-sections simply lay down the procedure and mechanism for working out the expenditure in relation to income which is exempt from tax and there is no substantive liability imposed through these sub-sections (2) and (3). It was further held that the method of computing the expenditure as relatable to the exempt income as provided in rule 8D, would become meaningless and the words 'in accordance with such method as may be prescribed' in sub-section (2) for determining the amount disallowable would require obliteration, which is not possible. Therefore, sub-sections (2) and (3) are retrospective in nature and the resultant rule 8D would also fall on the same line and the disallowance is required to be computed with reference to the mandate of these provisions.

However, the Hon'ble Bombay High Court in a writ petition has overruled the above decision of the Mum. ITAT (SB) in this context in case of Godrej & Boyce Mfg. Co. Ltd. v. DCIT [2010] 194 Taxman 203/ 328 ITR 81 [*SLP pending with Supreme Court, No. 36516 of 2010***]**. The Bombay High Court held that

- Provisions of sub-sections (2) and (3) of section 14A and Rule 8D are **constitutionally valid** having a prospective effect i.e. the provisions of rule 8D which have been notified with effect from 24-3-2008 are **not retrospective in nature and shall apply with effect from assessment year 2008-09.**
- *Even prior to the assessment year 2008-09, when rule 8D was not applicable,* **the Assessing Officer has to enforce the provisions of sub-section (1)** *of Section 14A* by adopting a reasonable basis or method consistent with all relevant facts and circumstances

- The power of the AO to apply Rule 8D is not automatic and the AO is bound to give an opportunity to the taxpayer to prove the correctness of his claim. It is only where the AO is not satisfied with the claim of the taxpayer he can apply Rule 8D after recording reasons.

The above mentioned case has been relied by Delhi ITAT in *Remfry & Sagar Consultants Pvt. Ltd. v. DCIT, I.T.A. No. 4643/Del/2009*, *Om Era Engineering Pvt. Ltd., v. ITO, I.T.A. No. 3913/Del/2010 and Global Aviation Services P. Ltd. vs. ACIT, ITA No.: 5281/Mum/2010*. Further, the Ahmedabad ITAT in *ACIT vs. Ahmedabad Steel Craft Ltd 2010-TIOL-767-ITAT-AHM* and Mumbai ITAT in *Glenmark Pharmaceuticals Ltd. vs. DCIT, 2010-TIOL-775-ITAT-MUM* followed the above mentioned decision of the Bombay High Court and further held that even prior to AY 2008-09, when Rule 8D was not applicable, the Assessing Officer has to enforce the provisions of Section 14A (1).

Further in **Maxopp Investment Ltd. vs CIT, New Delhi [2011] 15 taxmann.com 390**, the Hon'ble High Court of Delhi held that **the provisions of sub-sections (2) and (3) of section 14A would be workable only with effect from the date of introduction of rule 8D**. This is so because prior to that date, there was no prescribed method and sub-sections (2) and (3) of section 14A remained unworkable.

[*CIT vs. Walfort Share & Stock Brokers (P.) Ltd. [2010] 326 ITR 1 (SC)* and *Godrej & Boyce Mfg. Co. Ltd. (supra)* followed.]

1.2. Nexus between the expenditure incurred and exempt income

Section 14A provides that expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income. If the expenditure incurred is towards both taxable and non-taxable income, the expenditure has to be apportioned on a reasonable basis and only that expenditure which is incurred in relation to taxable income has to be allowed as deduction. In *Walfort Share and Stock Private Limited (supra),* the Supreme Court held that 'for attracting section 14A, there has to be a proximate cause for disallowance, which is its relationship with tax exempt income and since pay-back or return of investment is not such proximate cause, section 14A is not applicable in such cases." Therefore there has to be a nexus between the expenditure incurred and the exempt income for making disallowance under this section. When it has been brought on record that no expenditure actually incurred for earning the exempt income, then only the provisions of sec. 14A cannot be invoked. This view has been taken in *DCIT vs. M/s HDFC Bank Ltd. (2011) TIOL-691-ITAT-MUM, DCIT vs. M/S Maharashtra Seamless Ltd. (2011) TIOL-53-ITAT-DEL, Balarampur Chini Mills Ltd. vs. DCIT [2012] 20 taxmann.com 117 (Kol.-ITAT), Space Financial Services vs. Asst. CIT [2008] 115 TTJ 165(Del)* and *Maruti Udyog Ltd. v. Dy. CIT [2005] 92 ITD 119 (Delhi - Trib.).*

In *CIT vs. Hero Cycles Ltd. [2010] 323 ITR 518*, the Hon'ble Punjab and Haryana High Court held that **disallowance u/s 14A required finding of incurring of expenditure and where it was found that for earning exempted income no expenditure had been incurred, disallowance under section 14A could not stand.** Consequently, the disallowance was not permissible. Further, in *Minda Investments Ltd. vs. DCIT, I.T.A. No. 4046/Del/2009*, the Delhi ITAT held that disallowance on the basis of adhoc estimate is not sustainable in the light of *Hero Cycles Ltd (supra)*. Further followed in *ACIT vs. Sun Investments P. Ltd. [2011] 008 ITR (Trib) 0033 (ITAT-Delhi)*. The same view had been taken in *CIT vs. Hindustan Co-op. Society Services Co. Ltd. [2008] 170 Taxman 458 (Delhi)* holding that no artificial disallowance can be made invoking this section in the absence of any specific finding. Same view in *Voltas Ltd. v. Asst. CIT [2009] 125 TTJ 601 (MUM.).*

In *CIT v. Reliance Utilities & Power Ltd. [2009] 313 ITR 340*, Bombay High Court held that if there were funds available, both interest free and interest bearing, then a presumption would arise that interest free funds have been generated for investments and no disallowance of interest could be made under section 14A. (A. Y. 2004-05). The decision was further followed by Mumbai Bench of ITAT in *Bunge Agribusiness (India) (P) Ltd. v. Dy. CIT (2011) 14 taxmann.com 71*.

In *Daga Capital Management (P.) Ltd. (supra),* it was also held that in the case of an assessee carrying on a business activity, any expenditure incurred by him even though allowable under section 36(1)(iii) or section 37 can be disallowed under section 14A if such expenditure has been incurred in relation to the income not forming part of total income i.e. **even when shares are held as stock-in-trade or as investment.** Followed in *ITO v. Sanatan Textrade Ltd. 4 ITR(Tri) 593[2010] Mum-ITAT*.

Where the expenses debited to the P&L Accounts are only those expenses which were incurred for day to day business operations and were duly verified that these have no relation with earning of exempt income, the disallowance cannot be made due to absence of nexus between the expense and exempt income. As held by Mumbai ITAT in *Search Enviro Ltd. vs. ACIT, ITA No.3464/Mum/2011*.

1.3 Onus is on the revenue to establish the nexus.

For making disallowance under this section, the Assessing officer has to bring on record that the claim made by the assessee that no expenditure has been incurred in relation to the exempt income is incorrect. In *ACIT vs. Sun Investments (P.) Ltd. (supra)*, Delhi ITAT has held that for the purpose of making a disallowance under section 14A, **a finding of incurring the expenditure for earning the exempt income is absolutely necessary.** Where the Assessing Officer had not brought out any specific expenditure, disallowance u/s 14A cannot be made.

In *CIT v. Hindustan Co-op. Society Services Co. Ltd. [2008] 170 Taxman 458 (Delhi),* it was held that in the absence of any specific finding that any particular expenditure was incurred by the assessee in relation to exempted dividend income, no artificial disallowance can be made invoking section 14A of the Act. The finding has also to be supported by some evidence. Same view was taken in *DLF Ltd. v.CIT [2009] 27 SOT 22 (Delhi)*. As held in *Hero Cycles Ltd. (supra)* unless there is some evidence to show that such interest bearing funds had been invested in the investments which had generated the "tax exempt dividend income', the Assessing Officer is not justified in making disallowance under this section. Similar decisions were taken in *DCIT vs. Jindal Photo Ltd., [2011-TIOL-25-ITAT-DEL] I.T.A. No. 4539/Del./2010* and *K.J. Arora v. Dy. CIT 180 Taxman 131 (2009) (Delhi) (Mag.)*]. Also in *ACIT vs. SIL Investment Ltd. ITA No. 2431(Del) 2010*, the Delhi ITAT following the decisions in *Jindal Photo (supra), Hero Cycles (supra) and CIT vs. Wimco Seedlings Ltd., [2012] 17 taxmann.com 83 (Delhi)* held that the AO has to show the nexus between the borrowed funds and the tax free investments by bringing some material on record to show that expenditure was incurred for earning the exempt income and in absence of any finding, disallowance cannot be made.

1.4 Issues on Expenditure

The term 'expenditure' occurring in section 14A would take in its sweep **not only direct expenditure** but also all forms of expenditure regardless of whether it is fixed, variable, direct, indirect, administrative, managerial or financial. *[Kalpataru Construction Overseas (P.) Ltd. v. Dy. CIT [2007] 13 SOT 194 (Mum. - Trib.), Parry Agro Industries v. Asst. CIT 314 ITR (AT) 181(2009) (Cochin)]*

Expenditure to be incurred actually and not notionally. The words 'in relation to income which is exempt under the Act', no doubt, appear to be broad at first impression, but on deeper examination, and read in conjunction with the word 'incurred', it seems that these are respective words, restricting the power of the AO to estimate a part of the expenditure incurred by the assessee as relatable to the exempted income. It seems that implicit in the expression 'in relation to' is the concept that the AO should be in a position to pinpoint, with an acceptable degree of accuracy, the expenditure which was incurred by the assessee to produce non-taxable income. *[ACIT v. Eicher Ltd. [2006] 101 TTJ (Delhi - Trib.) 369, Wimco Seedlings Ltd. vs. (supra)]*

Expenditure vs. Disallowance. Section 14A permits a disallowance of "expenditure incurred by the assessee" and not of "allowance admissible" to him. The expression "expenditure" does not include allowances such as depreciation allowance. Accordingly, depreciation cannot be the subject matter of disallowance under section 14A. Similarly, **it was further held** that the deduction u/s 80D is not expenditure for

earning tax-free income but is a permissible deduction from gross total income under Chapter VIA. *Hoshang D. Nanavati vs. ACIT [ITA NO.3567/Mum/07](ITAT Mumbai) (Trib).*

1.5 **Section 14A in the context of Minimum Alternate Tax (MAT)**

Section 115 JB provides for increasing the book profit by the amount of expenditure relatable to any income to which section 10 [other than 10(38)] applies and reducing the book profit by the amount of income to which section 10 [other 10(38)] applies. Now that the "method" is in place, the rigmarole of determining the amount of expenditure to be added and year of applicability of the "prescribed method" has to be undergone.

In *Goetze (India) Ltd. Vs CIT (2009) 32 SOT 101 (Del)*, the Delhi ITAT held that "Since we are dealing with the issue of expenditure relating to dividend income, a matter falling under Chapter III, it becomes clear on perusal of these two provisions that they are similar in nature. Clause (*f*) uses the words "expenditure relatable to any income", while section 14A uses the words "expenditure incurred by the assessee in relation to income". These words have the same meaning. We may also add here that section 14A contains two more sub-sections, sub-section (2) and sub-section (3), which do not find a place in the clause (*f*). **Therefore, insofar as computation of adjusted book profit is concerned, provisions of sub-section (2) and sub-section (3) of section 14A cannot be imported into clause (*f*).** Further relied in *Quippo Telecom Infrastructure Ltd. vs. ACIT, I.T. A. No.4931/Del/2010* and *Essar Teleholdings Ltd. vs. DCIT ITA Nos. 3850 /Mum/2010.*

Therefore, no addition to the book profit can be made on account of alleged expenditure incurred to earn exempt income while computing income u/s 115JB of the Act.

1.6 Reconciliation of sections 14 and 94(7)

In *Walfort Share & Stock Brokers (P.) Ltd. (supra),* Supreme Court reconciled the two section stating that the two operate in different fields. Section 14A deals with disallowance of expenditure incurred in earning tax-free income against the profits of the accounting year under sections 30 to 37. On the other hand, section 94(7) refers to disallowance of the loss on the acquisition of an asset which situation is not there in cases falling under section 14A. Therefore, Section 14A comes in when there is claim for deduction of expenditure whereas section 94(7) comes in when there is claim for allowance for the business loss. One must keep in mind the conceptual difference between loss, expenditure, cost of acquisition, etc., while interpreting the scheme of the Act.

1.7 Requirement of Tax auditor reporting in Form 3CD for Tax Audit

Expenditures disallowed in view of section 14A are disclosed in clause 17(l) of Form 3CD (Tax audit report)

'**Clause 17** Amounts debited to the profit and loss account, being:-

(l) Amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income which does not form part of the total income"

1.8 Section 14A disallowance cannot exceed the amount of exempt income

In *Gillette Group India Pvt. Ltd. vs. ACIT ITA No.267/Del/2012*, the Delhi ITAT has held that the disallowance cannot exceed the expenditure actually claimed by the assessee.

1.9 Applicability of Provisions of Section 271(1)(c)

By applying the prescribed method under rule 8D, addition by way of disallowance of expenditure under section 14A is made, *we have to ascertain whether or not the assessee has furnished inaccurate particulars in the course of assessment proceedings*. If the assessee offers an explanation which is not found by the AO to be false there is no need to invoke this penal provision. No Penalty if no disallowance is made in tax audit report Held in DCIT vs. *Nalwa Investments Ltd.: ITA No. 3805(Del)/2010***.**

No penalty prior to insertion of Rule 8D. Where the disallowance is made for proportionate expenses claimed in respect of exempted income, no penalty can be levied u/s 271(1)(c) as prior to insertion of Rule 8D by the Finance Act 2008, the question of disallowance and its quantification was contentious. *ACIT vs M/s Jindal Equipment Leasing & Consultancy Services Ltd. (2011-TIOL-305-ITAT-DEL) ITA No. 3808-3809/Del/2010*

1.10 Expenditure incurred in relation to exempt income on account of statutory compliances

Section 14A is applicable on the expenditure incurred for borrowing funds for the purchasing the tax free bonds to meet Statutory Liquidity Ratio (SLR) by the Banks. The object or purpose of the investment does not affect the operation of section 14A in as much as any expenditure incurred for earning tax free income is not an allowable expenditure, therefore, even though purchase of tax free bonds was for meeting SLR requirements, interest and other expenses incurred on borrowals for investment in tax free bonds was to be disallowed. *CIT v. State Bank of Travancore (2011) 203 Taxman 639 (Ker.)(High Court).*

1.11 Maintenance of Separate books- whether mandatory

Section 14A authorises AO to make disallowance of expenditure incurred for earning tax free income, irrespective of whether assessee maintained separate accounts or not with regard to expenditure incurred for earning non-taxable income. *CIT v. The catholic Syrian Bank Ltd. [2011] 9 taxmann.com 148 (KER.)*

Further in *CIT vs. Dhanalakshmy Bank Ltd, [2011] 10 taxmann.com 213(Ker.),* it was held that non maintenance of separate accounts by assessee with regard to expenditure incurred for earning non-taxable income was not any justification to claim immunity from operation of section14A.

1.12 Other Issues

1. Disallowance u/s 14A can be made even in a year in which no exempt income has been earned or received by the assessee. Thus proportionate interest pertaining to investment for earning of dividend was disallowable even though exempt income was not earned during the year. [*Cheminvest Ltd. V. ITO 121 ITD 318 (2009)(Delhi-ITAT)*]

2. The issue of disallowance under section 14A **cannot be raised for the first time before the Tribunal** where the provision of Section 14A were not invoked against the assessee by the AO while making the disallowance of interest expenditure under section 36(1)(iii) and CIT (A) also at no stage considered the application of section 14A. *ACIT v. Delite Enterprises (P.) Ltd. (2011) 50 DTR 193 (MUM.)(Trib.)*

   However according to Delhi **Bench of ITAT in** *Aquarius Travels P. Ltd. Vs ITO* [2008] 111 ITD 53 (Delhi) (SB), where assessment proceedings pertaining to AY 2001-02 and earlier years have not been concluded or finalized and matter is pending before Tribunal involving issue relating to deduction of expenses which also includes expenses incurred in relation to exempted income, Tribunal can invoke provisions of section 14A in appeals pending before it.

3. Provisions of section 14A have overriding effect over section 36(1)(iii) and section 57. *Paharpur Cooling Towers Ltd v. ACIT [2011-TIOL-292-ITAT-KOL]*

VOICE OF CA

Part-VI

PRACTICAL ASPECTS OF CAPITAL GAINS

Under the Income Tax Act, 1961

(As Amended by Finance Act, 2012)

Chapter-I

BASIC CONCEPTS-I

Q. When does Capital Gain arises?

- The capital gain can arise when either of the section 45(1)/ (1A)/ (2)/ (3)/ (4) or (5) gets attracted;

- **As per section 45 (1)** - "Any profit/gain arising from the ***transfer of any capital asset*** is chargeable to tax in the previous year in which the transfer took place such gains are taxable only if no exemption is available u/s 54,54B,54D,54EC ,54F,54G,54H,54GA, 54GB (newly inerted by Finance Act, 2012)."

- **As per section 45(1A)**, notwithstanding anything contained above where any person receives at any time during any previous year any money or other assets under an insurance from an insurer on account of damage to, or destruction of, any capital asset, as a result of—

  1. flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or
  2. riot or civil disturbance; or
  3. accidental fire or explosion; or
  4. action by an enemy or action taken in combating an enemy (whether with or without a declaration of war),

  then, any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head "Capital gains" and shall be deemed to be the income of such person of the previous year in which such money or other asset was received.

- **As per section 45(2)**, notwithstanding anything contained in section 45(1), Where any person has had at any time during previous year any beneficial interest in any securities, then, any profits or gains arising from transfer made by the depository or participant of such beneficial interest in respect of securities shall be chargeable to income-tax as the income of the beneficial owner of the previous year in which such transfer took place and shall not be regarded as income of the depository who is deemed to be the registered owner of securities.

- **As per section 45(3)**, The profits or gains arising from the transfer of a capital asset by a person to a firm or other association of persons or body of individuals (not being a company or a co-operative society) in which he is or becomes a partner or member, by way of capital contribution.

- **As per section 45(4)**, the profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or a co-operative society) or otherwise, shall be chargeable to tax as the income of the firm, association or body, of the previous year in which the said transfer takes place.

- **Section 45(5)**, notwithstanding anything contained in section 45(1), when capital gain arises from transfer of capital asset by way of compulsory acquisition under any law.

Q. What is meant by Capital Asset?

- Any income profit or gains arising from the transfer of a capital asset is chargeable as capital gains. Now let us understand the meaning of capital asset. Under Section 2(14)- Capital Assets means:

  Property of ***any kind*** held by an assessee, whether or not connected with his business or profession.

  Property of any kind is wide term and include all

  - Movable assets – shares, securities , gold , silver etc..
  - Immovable assets – land ,building
  - Tangible / intangible assets – goodwill, patents ,copyrights etc
  - Any right in an asset- tenancy right , right of a lessee etc.

Held by the assessee means either

- he is a legal owner in possession of the property
- has a legal right to take possession

Capital Assets exclude the following:

- Stock in trade held for business
- Agricultural land in India not in urban area i.e., an area with population more than 10,000.
- Items of personal effects*, i.e., personal use excluding jewellery, costly stones, silver, gold
- Special bearer bonds 1991
- 6.5%, 7% Gold bonds & National Defense Bonds 1980.
- Gold Deposit Bonds 1999.

Some Practical Issues

- Property transferred must be capital asset on the date of transfer, however it may not be a capital asset on the date of acquisition. ***[Nachiappan (M.) v CIT (1998) 230 ITR 98 (Mad). Also see Alexander George V CIT (2003) 262 ITR 367 (Ker) and Arun Sunny v CIT (2009) 184 Taxmann 498 (Ker)].***
- The word held by assessee include physical, actual, constructive and also symbolic possession of property of any kind. ***[CIT v All India Tea and Trading Co. Ltd. (1979) 117 ITR 525(Cal.)]***
- In case of sale of land and building, a capital gain is bifurcated between LTCG & STCG. ***[CIT V. C. R. Subramanian 242 ITR 342 (KAR) (2000)]***

*Personal Effects

Q. Do Personal Effects also comes under the ambit of Capital Assets?

The transfer of personal asset does not attract the provisions of section 45. ***Personal effects have been held to be the property***

- which is **'movable' and**
- which is **used by the assessee for his/her own personal needs**.

But excludes (w.e.f. 01-04-2008)

i. Jewellery	ii. Archaeological collections
iii. Drawings	iv. Paintings
v. Sculptures	vi. Any work of art

For the purpose of this sub-clause 'Jewellery' includes:-

1. Ornaments made of gold, silver, platinum or any other precious metal or alloy.
2. Precious or semi-precious stones – *[includes embedded in to any furniture, utensils or other articles or worked or sewn in to any wearing apparel.]*

Some Practical Issues

Issue 1- What Constitute or do not constitute - personal effects

- Silver utensils of the type which were used in the kitchen by the assessee are personal effects and not capital assets. ***[CIT V. Sitadevi N. Poddar 148 ITR 506 (Bom.) (1984)]***
- Silver bars, sovereign, bullion and silver coins were held not to be personal effects. ***[Maharaja Rana Hemanth Singhji (H E G) V. CIT 103 ITR 61(SC) (1976)]***
- Gold caskets, gold tray, gold cups, saucers, spoons and photo frames were not regarded as personal effects. ***[Poddar (GS) V. CWT 57 ITR 207(Bom.) (1965)]***

Q. What are the types of capital asset?

- There are two types of Capital Assets:

1. Short Term Capital Assets (STCA): An asset, which is held by an assessee for less than 36 months, immediately before its transfer, is called Short Term Capital Assets. In other words, an asset, which is transferred within 36 months of its acquisition by assessee, is called Short Term Capital Assets.**[Section 2(42A)]**
2. Long Term Capital Assets (LTCA) : An asset, which is held by an assessee for 36 months or more, immediately before its transfer, is called Long Term Capital Assets. In other words, an asset, which is transferred on or after 36 months of its acquisition by assessee, is called Long Term Capital Assets. **[Section 2(29A)]**

- The period of 36 months is taken as 12 months under following cases:
  - Equity or Preference shares,
  - Securities like debentures, government securities, which are listed in recognized stock exchange,
  - Units of UTI
  - Units of Mutual Funds
  - Zero Coupon Bonds

Note: ***The entire period of holding i.e. from the date of initial acquisition upto the date of transfer has to be taken into account, although it may not have held as capital asset initially*. [Keshavji Karsondas v. CIT 207 ITR 737(Bom.)(1994)]**

Q. How to compute the Holding Period of the asset?

a) For computing period of holding the following point should be considered:

b) For computing holding period of asset both date on which asset is acquired & date on which said asset is sold or transferred are not to be excluded. ***[Bharti Gupta Ramola v. CIT [2012] 20 taxmann.com 762 (Delhi)]***

c) Expression 'immediately preceding date of transfer, in section 2(42A) is a cut off point for determining and deciding period during which asset was held by an assessee.

d) Section 2(42A) refers to holding period and for computing said period date on which asset is acquired is not to be excluded because holding starts from said date; further, date of sale/transfer is also not to be excluded.

Therefore, if an asset is sold very next day after period of 12/36 months is over, asset would be treated as a long-term capital asset.

Exclusion/Inclusion of certain period

Particular	Exclusion/Inclusion of period
Shares held in a company in **liquidation**	Exclude the period subsequent to the date of liquidation.
Property acquired in any mode given u/s 49(1) i.e. **by way of gift / will**	Include the holding period of previous owner also.
Shares in an Indian Amalgamated Company acquired in a scheme of Amalgamation.	Include the holding period of shares in the Amalgamating Company by the assessee.

Shares in Indian Resulting Company acquired in case of demerger.4	Include the period for which the person was a member of the recognized stock exchange in India.
Equity shares in a company acquired by a person pursuant to the demutualization or corporatization of recognized stock exchange.	Include the period for which the person was a member of the recognized stock exchange in India.

Some Practical Issues

Q. In Case of adverse possession by a tenant what should be taken as date of transfer for the assessee?

A. Where an assessee entered in to an agreement to purchase property in adverse possession of a tenant, but ultimately succeeded in taking possession from the tenant, the date of transfer is the date on which the assessee had entered in to an agreement for purchase of property. Indexation has to be given from this date. The date of the assessee getting possession from the tenant does not postpone date of ownership to date of possession.**[Ms. Nita A Patel V Income Tax Officer 007 ITR 0659 (ITAT – Mum) [2011]]**

Q. If right in the property is transferred but the property is not in existence on the date of transfer of such right then which date is to be considered for the purpose of determining period of holding?

A. In case where assessee acquires right to possession and right to title in a property but there was no actual possession or title, since the immovable property is not in existence, the period of holding of immovable property will be calculated since the assessee actually held the asset. **[DCIT v Kishore Kanungo 290 ITR (AT) 0298 (ITAT–Mum)(2007)]**

Q Whether the date of allotment should be considered for the calculation of period of holding or the date of payment of last instalment?

A. The date of allotment of flat should be considered for the calculation of period of holding and not the date of payment of last instalment. **[Jagdish Chander Malhotra v ITO (1998) 64 ITD 251 (Del)]**

Q. Whether capital gain is to be determined separately for land and building in case of combined sale?

A. Capital gains to be determined separately in respect of both land & building on the basis of period of holding. **[CIT v. lakshmi B Menon 184 CTR 52 (Ker)(2003), CIT v Citibank N.A. 261 ITR 570 (Bom)(2003).** Also see **CIT v Vimal Chand Golecha (1993) 201 ITR 442 (Raj)]**

Q. What is the period of holding in case of Lease cum sale agreement?

A. Lease cum sale agreement - Where lease hold right had sunk or drowned in the larger interest and extinguished. Period of holding will be considered from the date of superior right comes in to existence and not from the date that the earlier inferior right was acquired.**[CIT v Mody (VV) 218 ITR 1 (Karn)[1996]].**

Q. From which date period of holding is to be considered in case of co-operative housing societies?

A. Period of holding in case of cooperative housing society shall be reckoned from the date on which the member acquires shares in the cooperative housing society. **(CIT v Anilben Upendra Shah 262 ITR 657 (Guj) (2003)]**

Q. What will constitute as transfer?

A. Transfer includes:

- Sale of asset
- Exchange of asset
- Relinquishment of asset (means surrender of asset)
- Extinguishments of any right on asset (means reducing any right on asset)
- Compulsory acquisition of asset.

The definition of transfer is inclusive, thus transfer includes only above said five ways. In other words, transfer can take place only on these five ways. If there is any other way where an asset is given to other such as by way of gift, inheritance etc. it will not be termed as transfer.

Q. What are the transactions which are not regarded as transfer?

As per the provisions of Section 47 of Income Tax Act, 1961, the following transactions are not regarded as transfer:

Section	Transaction not regarded as Transfer	COA in the hands of Transferee	Period of holding by Previous owner to be included.
47(i)	Distribution of capital asset on total or partial partition of HUF **[Mrs. P Sheela V ITO [2009] 308 ITR (A.T.) 0350 ITAT (Bang), see also CIT v Kay Arr Enterprises [2008] 299 ITR 0348 (Mad) SLP pending].**	Cost to Previous owner	YES
47(ii)	Transfer of capital asset under a gift or will or an irrevocable trust.	Cost to Previous owner	YES
47(iii)	Transfer under a scheme of amalgamation of a capital asset by the amalgamating company to the amalgamated provided amalgamated company is an Indian company.	Cost to Previous owner	YES
47(iv)	Transfer of Capital asset by company to its 100% Subsidiary.	Cost to Previous owner	YES
47(v)	Transfer of capital asset by 100% subsidiary company to its holding company.	Cost to Previous owner	YES
47(vi)	Transfer of capital assets in a scheme of amalgamation.	Cost to Previous owner	YES
47(via)	Transfer of shares in an Indian company held by a foreign company to another foreign company under a scheme of amalgamation of the two foreign companies.	Cost to Previous owner	YES
47(viaa)	Capital assets transferred in a scheme of amalgamation of a banking company with a banking institution.	Cost to Previous owner	YES
47(vib)	Transfer in a demerger of a capital asset by the demerged company to a resulting company.	Cost to Previous owner	NO
47(vic)	Transfer of shares held in an Indian Company by a demerged foreign company to resulting foreign company.	Cost to Previous owner	NO
47(vica)	Any transfer in a business reorganization of a capital asset by the predecessor cooperative bank to the successor cooperative bank.	Cost to Previous owner	NO

47(vicb)	Any transfer of shares in a predecessor cooperative bank by a shareholder in case of a, business reorganization, if the transfer is made in consideration of the allotment to him of any share or shares in the successor cooperative bank.	Cost to Previous owner	NO
47(vid)	Transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company.	Proportionate COA of shares in demerged Co.	YES
47(vii)	Allotment of shares in amalgamated company in lieu of shares held in amalgamating company.	Cost of shares in the amalgamating co.	YES
47(viia)	Transfer of a capital asset being foreign currency convertible bonds or GDR by a non resident to another non – resident.		NO
47(viii)	Transfer of agricultural land in India before March 1970.		
47(ix)	Transfer of capital asset being work of art, manuscript, painting etc.) to Government / University		
47(x)	Transfer by way of conversion of bonds or debentures in to shares.	Cost of shares would be cost of bonds / debentures.	NO
47(xa)	Transfer by way of conversion of bonds [referred to in section 115AC(1)(a) in to shares or debentures of any company.	Cost of shares / debentures would be cost of original bonds.	NO
47(xi)	Transfer by way of exchange of a capital asset being membership of a recognized stock exchange for shares of a company.		NO
47(xii)	Transfer of land by a sick industrial company which is managed by its workers cooperative.		NO
47(xiii)	Transfer of a capital asset by a firm to a company in the case of conversion of firm in to company.		NO
47(xiiia)	Membership right held by a member of recognized stock exchange in India for acquisition of shares and trading or clearing rights acquired by such member in that recognized stock exchange in accordance with a scheme for demutualization or corporatisation.	In case of Shares, the cost of acquisition would be cost of acquisition of original membership of the exchange. Cost of trading & clearing right would be Nil.	

Some Practical Issues

ISSUE 1 – Do transfer of RIGHTS attract capital gain?

- Right to possession and enjoyment of property and such rights were in nature of capital assets for purpose of section 45 and therefore consideration received by assessee for transfer of his rights in property was liable to be treated as long term capital gains. ***[ITO v Balram Bhasim 154 Taxmann (118) (Delhi – Trib) (2006)].***
- The right to obtain conveyance of an immovable property was held to be a capital asset. **[CIT v Tata Services Ltd. 122 ITR 594 (Bom) (1980)].**
- Right to claim specific performance of an agreement was held to be a capital asset. ***[K.R. Srinath V ACIT 268 ITR 436 (Mad) (2004].***

Amendment made by Finance Act, 2012 in definition of capital asset and transfer

Prior to the amendment made by the Finance Act, 2012 in Section 2(14) and Section 2(47), there is no transfer of shares of the Indian Company on transfer of shares of a foreign company to a non-resident offshore, though held by the foreign company, in such a case it cannot be contended that the transfer of shares of the foreign holding company, results in an extinguishment of the foreign company control of the Indian company and it also does not constitute an extinguishment and transfer of an asset situate in India. Transfer of the foreign holding company's share offshore, cannot result in an extinguishment of the holding company right of control of the Indian company nor can it be stated that the same constitutes extinguishment and transfer of an asset/ management and control of property situated in India- *Vodafone International Holdings B.V.*

- **Section 2(14)**- Explanation to Section 2(14) [Newly Inserted, w.e.f. 1st April, 1962]

  Explanation.—For the removal of doubts, it is hereby clarified that "property" includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever."

- **Amendment in definition of transfer in Section 2(47)** - Explanation to Section 2(47) renumbered as explanation 1 and new explanation 2 inserted w.e.f 01.04.1962.

  Explanation - "transfer" includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (whether

entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India"

- ***Brief of Amendment-*** To be classified as capital asset under the act the precondition is that it has to be property of any kind held by the assessee. The amendment seems to overcome famous Judgment in so far it alluded to distinction between legal or contractual rights to constitute property. The amended provisions provide that property shall include and shall always deemed to have been included *any rights in or in relation* to an Indian company including rights of management or control or any other rights whatsoever. Noteworthy is the Fact that such deeming will not happen when such rights are held in the company but also when such rights are held in relation to an Indian Company. The implication of the amendment will abound not only for non residents assesses but for resident assessee as well.

LONG TERM & SHORT TERM CAPITAL GAINS

Q. What are the types of Capital Gain?

- There are two types of Capital Gains:

  1. Long Term Capital Gain;
  2. Short Term Capital Gain

  As per Section 2(29B) – "**Long term Capital gain**" means capital gain arising from the transfer of a long term capital asset.

  As per Section 2(42B) - "**Short term capital gain**" means capital gain arising from the transfer of a short term capital asset.

Q. Difference between short term and long term capital gains?

S. No	Short Term Capital Gain	Long Term Capital Gain
I	STCG is included in the Gross total income of the assessee and taxed as per rate applicable to that assessee	LTCG is in Gross total income and) s taxed on the flat rate of 20% (10%in certain case or Nil in certain cases
Ii	Deductions u/s 80C TO 80U are available	Deductions u/s 80C TO 80U are not available
Iii	Set off of minimum exemption limit is available from all STCG for resident as well as Non-resident.	Set off of minimum exemption limit is available only for resident.
Iv	STCL can be set off against STCG and LTCG	LTCL can be set off against only LTCG
V	Cost of acquisition & Cost of improvement are not indexed in case of STCG.	Cost of acquisition & Cost of improvement are indexed in case of long term capital gains

Q. At what rate do "Short Term Capital Gain" is taxed?

- Where the *total income* of an assessee *included* any income chargeable under the head *"Capital Gain"* arising from the transfer of a *short term capital asset*, being an *equity share in a company or a unit of an equity oriented fund* **and**

  a) The transaction of sale of such asset is entered on or after 1-10-2004, and

  b) Such transaction is chargeable to STT

The tax payable by the assessee on the total income shall be aggregate of -

i) the amount of income-tax calculated on such ***STCG at the rate of 15%*** *(as amended by F. Act, 2008)* ***and***

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.

- **STCG u/s 111A – taxed @ 15% as per Income Tax Act.**
- **STCG other than 111A- Will be included in total income and taxed as per applicable slab rate.**

Q. What is the rate of tax for "Long Term Capital Gain"?

As per Section 112, Where the total income of an assessee includes any income, arising from the transfer of a LTC asset, which is chargeable under the head "Capital Gain", the tax payable by the assessee on the total income shall be the aggregate of:

(a) In case of an individual or HUF, being a resident :

- the amount of income tax payable on the total income as reduced by the amount of such LTCG, had the total income as so reduced been his total income, and
- 20% of LTCG included in total income.

(b) In case of a domestic company

- the amount of income tax payable on the total income as reduced by the amount of such LTCG, had the total income as so reduced been his total income, and
- 20% of LTCG included in total income

(c) In case of a NR or a Foreign company :

- the amount of income tax payable on the total income as reduced by the amount of such LTCG, had the total income as so reduced been his total income, and
- 20% of LTCG included in total income

Proviso to sec 112 (applicable for resident as well as non-resident)

The tax on capital gains from listed securities or units or zero coupon bonds being long term shall be the lower of the following:

- tax on capital gains computed normally @20%
- tax on capital gains computed normally but without giving the benefit of indexation @10%

After introduction of exemption u/s10(38) by Finance Act, 2004, the proviso to section 112 applies in the following cases:

- Where listed equity shares are sold on or after 1-10-2004 other than through recognized stock exchange.
- Where units of equity oriented fund are sold on or after 1-10-2004 other than through recognized stock exchange or other than to mutual fund.
- Where listed debentures/bonds are sold since exemption u/s 10(38) is not available for listed debentures/bonds.
- Where units of a mutual fund other than equity oriented fund are sold since exemption u/s 10(38) is not available to units of a mutual fund other than equity oriented fund.

Chapter-II

BASIC CONCEPTS-II

I. SECTION 48- COMPUTATION OF CAPITAL GAIN

Q. What is the mode of computation of capital gain?

- The capital gain can be computed by subtracting the cost of capital asset from its transfer price, i.e., the sale price. The computation can be made by making a following simple statement.

Statement of Capital Gains

Particulars	Amount
Full Value of Consideration	-
Less: Cost of Acquisition*(COA)	-
Cost of Improvement*(COI)	-
Expenditure on transfer	-
Capital Gains	-
Less: Exemption U/S 54	-
Taxable Capital Gains	-

** To be indexed in case of LTCA*

The benefit of indexation is not available in the following cases:

- An assessee mentioned u/s 115AB,115AC,115AD & 115D
- benefits of indexing is not available for transfer of bonds and debenture of any company whether public or private or govt. co. or bonds of govt. [however, benefit is available to capital indexed bonds issued by govt.]
- no indexation in case of slump sale
- no indexation in case of depreciable asset
- No indexation incase of STCA

Q. What is the method of computing capital gain in case shares or debentures of Indian Company sold by a non – resident?

The computation of capital gains in case of non – resident is explained in Proviso 1 to sec 48. Where assessee who is a **non resident**, the capital gain arising from the transfer of shares or debentures in an Indian Company, shall be computed by converting

1. COA
2. Expenditure on transfer.
3. Sale Consideration.
4. **In to the same foreign currency, in which the asset was purchased.**
5. **The capital gain so computed in the foreign currency shall be reconverted in to Indian Currency.**

Note:

1. Debentures includes bonds
2. Shares, debentures and bonds of Government company are also covered by the first proviso. However the bonds of CG, SG and RBI are not covered.
3. Proviso shall not apply to units of UTI and Mutual Funds.
4. Application of proviso is mandatory under respective circumstances.
5. This proviso is applicable for computing both STCG and LTCG.

"Assessee should be NR (may be foreign or Indian citizen, corporate or non corporate assessee) in the year the shares or debentures are sold. "

Q. How do determine whether the person is non - resident?

Section 6 of the Income Tax Act contains the provisions regarding the determination of residential status of a person in India in the following manner:

Individuals

An individual shall be regarded as non – resident if he does not satisfy any of the two conditions specified below:

He is a Non-Resident in India in 9 out of 10 previous years preceding the previous year; or

He has stayed in India for 729 days or less during 7 years preceding the previous year.

HUF/FIRM/AOP

Non-resident: They will be regarded as non-residents, if control and management is wholly outside India.

COMPANY

An Indian company is always treated as resident. Any other company would be a resident if the control and management of its affairs is situated wholly in India.

Q. Method of conversion to be applied in case of non – resident.

The following rates are required to be applied for computing capital gains in case on non – residents:

1. COA (conversion) – Average of **Telegraphic Transfer Buying Rate** (TTBR) and the **Telegraphic Transfer Selling Rate** (TTSR) as on the date of acquisition of shares / debentures.
2. Expenditure on Transfer (conversion) – **Average** of TTBR and TTSR as on the date of transfer.
3. Sale Consideration (conversion)– **Average** of TTBR and TTSR as on the date of transfer.
4. Capital Gain (Conversion) – TTBR **as on date of Transfer**.

Some Practical Issues

ISSUE 1 - Some related issues

- Benefit of Indexation- in case assessee made payment in installments after issuance of allotment letter

  Where after issuance of allotment letter of a plot, assessee made payments from time to time in installments, in view of fact that assessee sold said plot after holding it for more than three years, long term capital gain was to be calculated taking into account indexed cost of acquisition as per payment schedule. ***[Nirmal Kumar Seth v. CIT 17 taxmann.com 127 (All) [2012]]***

- Amount paid to tenant for vacating the property is a expenditure incurred wholly and exclusively in connection with the agreement of sale which preceded the transfer and in fulfillment of a condition of sale. Therefore, the same will be treated as expenditure u/s 48(i). ***[CIT v . A. Venkataraman, [1982] 10 Taxman 298 (Mad.). See also Seventh ITO v. L.K.M. Hussain Beevi 1988] 26 ITD 17 (MAD.)]***

- Indexations have to be done from the date of allotment of land and not on the basis of actual payments made by assessee. ***[Charanbir Singh Jolly v ITO (Eigth) 5 SOT 89 (Mum-Trib) (2006), M. Syamala Rao v. CIT 234 ITR 140 (AP) (1998), Smt. Lata G. Rohra v Dy. CIT 22 (II) ITCL 250 (Mum- Trib) (2008)]***

2. SECTION 55- COST OF ACQUISITION

Q. What is meant by cost of acquisition?

- Cost of Acquisition (COA) means any capital expense at the time of acquiring capital asset under transfer, i.e., to include the purchase price, expenses incurred up to acquiring date in the form of registration, storage etc. expenses incurred on completing transfer.

Cost of Acquisition with Reference to Certain Modes of Acquisition (Section – 49)

1. Where the capital asset became the property of the assessee:

   a. on any distribut + fer in a scheme of amalgamation;

   i. by an individual member of a Hindu Undivided Family giving his separate property to the assessee HUF anytime after 31.12.1969,

In all above cases, the ***cost of acquisition of the asset shall be the cost for which the previous owner of the property acquired it***, as increased by the cost of any improvement of the asset incurred or borne by the previous owner or the assessee,

as the case may be, till the date of acquisition of the asset by the assessee.

If the previous owner had also acquired the capital asset by any of the modes above, then the cost to that previous owner, who had acquired it by mode of acquisition other than the above, should be taken as cost of acquisition.

2. Where shares in an amalgamated Indian company became the property of the assessee in a scheme of amalgamation the cost of acquisition of the shares of the amalgamated company shall be the cost of acquisition of the shares in the amalgamating company.

3. Where a share or debenture in a company, became the property of the assessee on conversion of bonds or debentures the cost of acquisition of the asset shall be the part of the cost of debenture, debenture stock or deposit certificates in relation to which such asset is acquired by the assessee.

4. Where shares, debentures or warrants are acquired by the assessee under Employee Stock Option Plan or Scheme and they are taken as perquisites u/s 17(2) the Cost of Acquisition would be the valuation done u/s17(2).

5. Cost of Acquisition of shares in the Resulting Company, in a demerger.

Net book value of asset		cost of acquisition of shares
Transferred in a demerger	X	in demerged company
Net worth of demerged company		
Immediately before demerger		

The cost of acquisition of the original shares held by the share holder in the demerged company will be reduced by the above amount.

6. Where Capital Gains is not levied on a transfer of capital asset between a Subsidiary Company and a Holding Company or vice-versa but the conditions laid down are violated subsequently and Capital Gains is to be levied, the cost of acquisition to the transferee company would be the cost for which such asset was acquired by it.

7. Where the capital asset is goodwill of a business or a Trade Mark or Brand Name associated with a business, right to manufacture, produce or process any article or thing, right to carry on any business, tenancy rights, stage carriage permits or loom hours, the cost of acquisition is the purchase price paid by the assessee and in case no such purchase price is paid it is nil.

8. Where the cost for which the previous owner acquired the property cannot be ascertained, the cost of acquisition to the previous owner means the Fair Market Value on the date on which the capital asset became the property of the previous owner.

9. Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation cost of acquisition of such asset is the Fair Market Value of the asset on the date of distribution.

10. Where share or a stock of a company became the property of the assessee on:

    a. the consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares;

    b. the conversion of any shares of the company into stock;

    c. the re-conversion of any stock of the company into shares;

    d. the sub-division of any of the shares of the company into shares of smaller amount; or

    e. the conversion of one kind of shares of the company into another kind. Cost of acquisition of the share or stock is as calculated from the cost of acquisition of the shares or stock from which it is derived.

11. The cost of acquisition of rights shares is the amount which is paid by the subscriber to get them. In case a subscriber purchases the right shares on renunciation by an existing share holder, the cost of acquisition would include the amount paid by him to the person who has renounced the rights in his favor and also the amount which he pays to the company for subscribing to the shares. The person who has renounced the rights is liable for capital gains on the rights renounced by him and the cost of acquisition of such rights renounced is nil.

12. The cost of acquisition of bonus shares is nil.

13. Where equity share(s) are allotted to a share holder of a recognised stock exchange in India under a scheme of demutualisation or corporotisation approved by SEBI, the cost of acquisition of the original membership of the exchange is the cost of acquisition of the equity share(s). The cost of acquisition of trading or clearing rights acquired under such scheme of demutualisation or corporatisation is nil.

14. Where any other capital asset has become the property of the assessee before 1st day of April, 1981, the cost of acquisition of the asset to the assessee or the previous owner (depending upon the mode of acquisition) or the fair market value of the asset on 1.4.1981, at the option of the assessee would be its cost of acquisition.

15. Where the capital gain arises from the transfer of specified security or sweat equity shares, the cost of acquisition of such security or shares shall be the fair market value which has been taken into account while computing the value of the respective fringe benefit.

16. Where the capital asset, being a share or debenture of a company, became the property of the assessee in consideration of transfer of bonds or debentures or Global Depository Receipts purchased in foreign currency, the cost of acquisition shall be deemed to be that part of the cost of debentures or bond or deposit certificate in relation to which such asset is acquired by the assessee.

Q. What is meant by cost of improvement?

- Cost of improvement is the capital expenditure incurred by an assessee for making any addition or improvement in the capital asset. It also includes any expenditure incurred in protecting or curing the title. In other words, cost of improvement includes all those expenditures, which are incurred to increase the value of the capital asset. However, any expenditure which is deductible in computing the income under the heads Income from House Property, Profits and Gains from Business or Profession or Income from Other Sources (Interest on Securities) would not be taken as cost of improvement.

  - Cost of Improvement in relation to below mention shall be taken to be nil.

    i) Goodwill.

    ii) Right to manufacture, produce or process any article or thing.

    iii) Right to carry on any business.

  - Any other capital asset.

    i) In case asset acquired before 01/04/1981 – Cost of Improvement incurred since 01/04/1981 either by previous owner or assessee.

    ii) In case asset acquired after 01/04/1981 – All cost incurred by previous owner and assessee.

Q. If the assessee acquires any asset by way of inheritance, partition of HUF or by any other mode specified in sec 49(1) and sec 47 then do the cost of acquisition of previous assessee shall be considered?

- When a capital asset is acquired by an assessee by gift, inheritance, or partition of Hindu Undivided Family or under any of the modes specified in Sec 49(1), or some other mode specified in certain clauses of Sec 47 under explanation 1 to Sec 2(42A), the period for which the asset was held by the earlier owner or in the

earlier form is also to be included as part of the holding period of the assessee for determining whether the capital asset is a long term capital asset or a short term capital asset.

U/s 49(1), where the capital asset became the property of the assessee on the distribution on partition of an HUF, under a gift or will, by succession, inheritance or devolution, on distribution on dissolution of a firm to 1st April 1987, on distribution of assets on liquidation of a company, under transfer to a revocable or irrevocable trust, or under transfers referred to in Sec 47(iv), (v), (vi), (via), (viaa), (vica) or (vicb), the cost of acquisition of the previous owner is deemed to be the cost of acquisition of the assessee.

U/s 55(2)(b)(ii), where a capital asset became the property of the assessee by any of the modes specified in Sec 49(1), and the capital asset was acquired by the previous owner prior to 1St April, 1981, the assessee is entitled to substitute the fair market value of the asset as on 1ST April, 1981 for the actual cost.

Some Practical Issues

ISSUE 1 – Mortgage & interest expenses to form part of cost of acquisition.

Where assessee purchased a property and on same day mortgage it to raise loan to pay part consideration of property, mortgage expenses incurred in connection with the acquisition of the property and the interest payable on the mortgage amounts, which had been utilized as part of the consideration, would form part of the COA of the property for the purpose of computation of cpital gain.***[CIT V. K. Raja Gopala Rao 252 ITR 459 (MAD) (2001)].***

ISSUE 2 – Compensation paid for eviction.

Compensation paid for eviction of hutment dwellers from land which is sold would be allowable as Cost of improvement. ***[CIT V. Miss Piroja C. Patel 242 ITR 582 (BOM) (2000)].***

Chapter-III

CAPITAL GAIN OR BUSINESS INCOME

Q. When does income be taxed as Capital gain or Business income?

When the transaction involves transfer of capital asset then that will constitute capital gain, whereas transaction which is entered into normal course of business shall constitute business income.

Some Practical Issues

ISSUE - 1

- Where agreement for construction of hostel building, agreement for lease of hostel building and agreement for provision of facilities in hostel building during lease period were part of one composite arrangement for provision of hostel facilities by assessee to lessee, entire income under three agreements was to be assessed as business income. **[*Kenton Leisure Services (P.) Ltd. v. DCIT 18 taxmann.com 158 (ITAT-Cochin) [2012]]***

ISSUE -2 - Taxability of waiver of loan taken for acquiring capital asset.

Section 41(1) -Remission or cessation of trading liability

When loan is taken for acquiring capital asset, waiver thereof would not amount to any income eligible to tax; on other hand, if loan is for trading purpose and has been treated as such from very beginning in books of account, waiver thereof may result in income, more so when it is transferred to profit and loss account.

Bombay Gas Co. Ltd. V ACIT [2012] 23 taxmann.com 22 (Mum-ITAT)]

Facts:

Loans/advances were taken by assessee-company from company B in course of its business activity. Company B approached assessee-company to clear its dues as they had immediate business obligation. Old outstanding dues of Rs. 1,20,67,817 was settled for Rs. 85,00,000. Balance amount of Rs. 35,67,817 was waived by company B. ***Assessee credited this amount into capital reserve account.*** Advance received by assessee from company B had never been allowed as a deduction in any of previous financial year. *It was a case of loan liability and not trading liability.*

Waiver of loan liability credited by assessee under capital reserve account in its books of account would be a capital receipt and could not be deemed as remission or cessation of liability and consequently no benefit would have arisen to assessee in terms of section 41(1).

ISSUE 3 - Investment of land or sale of land after plotting - whether Business Income or Capital Gain.

- A transaction of purchase and sale of land cannot be assumed, without more, to be a venture in the nature of a trade. ***[CIT vs. Jawahar Development Association 127 ITR 431 (MP)(1981)]***
- The activity of an assessee in dividing the land in to plots and not selling it as a single unit as he purchased, goes to establish that he was carrying on business in real property and it is a business venture. ***[Raja J. Rameshwar Rao v CIT 42 ITR 179 (SC)(1961)] also see CIT vs Tridevi (V.A.) (1988) 172 ITR 95 (Bom)]***
- Mode of payment i.e. payment in installments is not a determinative factor if the income is in the nature of trade or capital gain. ***[CIT v Radha Bai 272 ITR 264 (Del) (2005)]***
- Where assessee constructed shops which were let out and rent has been received for 3 years, thereafter the shops were sold – Income from sale of shop is capital gain. ***[ACIT v Janak Raj Chauhan 102 TTJ 297 (Asr.)(2006)]***
- The assessee, after dividing the land into plots, sold the land situated in a village which was beyond 8 kms, of the municipal limit. Such land was sold pursuant to an agreement to sell executed earlier. It was held that land in question was rural agriculture not eligible to capital gain. ***[CIT vs Sanjeeda Begum 154 Taxman 346 (All) (2006)]***

- When the land was acquired on the basis of a will on the death of her husband & she sold the same in parcels because the huge area could not be sold in one transaction. Such an activity could not amount to trade or business within the meaning of the Act. ***[CIT v Sushila Devi Jain 259 ITR 671 (P&H) (2003)]***

- Selling of own land after plotting it out in order to secure a better price is not in the nature of trade or business, more so when the land was gifted to the assessee. ***[CIT v Suresh Chand Goyal 209 CTR 410 (MP)(2007) see also Ram Saroop Saini (HUF) v ACIT 15 SOT 470 (Del)(2007)]***

- Relinquishment of right in property against consideration shall attract capital gain. ***[CIT v Smt Laxmidevi Ratani 296 ITR 0363 (MP)[2008]]***

Issue 4 – Whether Income from sale of shares are to be taxed as capital gains or as business income.

- Where assessee held shares from seven to eleven months, earned dividend and entered into a few transactions of sale of such shares during relevant year even though he held a huge number of shares, income arising from sale of shares would be taxable as short-term capital gain. ***[CIT v. Vinay Mittal [2012] 22 taxmann.com 151 (Delhi)]***

- Where assessee-company's main business was investment in shares & securities, shares could not be treated as business assets but income from sale of shares was liable to capital gains. ***[CIT v. Trishul Investments Ltd.(2008) 305 ITR 434 (Mad.)]***

Guiding Principles to determine whether sale of shares is taxable as business income or short term capital gains.

Asst. CIT v. Om Prakash Arora [2011] 16 taxmann.com 396 (ITAT-Delhi)

Following principles can be applied on the facts of a case to find out whether transaction(s) in question are in the nature of trade or are merely for investment purposes:

1. What is the intention of the assessee at the time of purchase of the shares (or any other item). This can be found out from the treatment it gives to such purchase in its books of account. Whether it is treated as stock-in-trade or investment. Whether shown in opening/closing stock or shown separately as investment or non-trading asset.

2. Whether assessee has borrowed money to purchase and paid interest thereon. Normally, money is borrowed to purchase goods for the purposes of trade and not for investing in an asset for retaining.

3. What is the frequency of such purchases and disposal in that particular item? If purchase and sale are frequent, or there are substantial transactions in that item, it would indicate trade. Habitual dealing in that particular item is indicative of intention of trade. Similarly, ratio between the purchases and sales and the holdings may show whether the assessee is trading or investing (high transactions and low holdings indicate trade whereas low transactions and high holdings indicate investment).

4. **Whether purchase and sale is for realizing profit or purchases are made for retention and appreciation in its value?** Former will indicate intention of trade and latter, an investment. In the case of shares whether intention was to enjoy dividend and not merely earn profit on sale and purchase of shares. A commercial motive is an essential ingredient of trade.

5. **How the value of the items has been taken in the balance sheet?** If the items in question are valued at cost, it would indicate that they are investments and where they are valued at cost or market value or net realizable value (whichever is less), it will indicate that items in question are treated as stock-in-trade.

6. **How the company (assessee) is authorized in memorandum of association/ articles of association**? Whether for trade or for investment? If authorized only for trade, then whether there are separate resolutions of the board of directors to carry out investments in that commodity and vice versa.

7. **It is for the assessee to adduce evidence to show that his holding is for investment or for trading and what distinction he has kept in the records or otherwise, between two types of holdings**. If the assessee is able to discharge the primary onus and could prima facie show that particular item is held as investment (or say, stock-in-trade) then onus would shift to revenue to prove that apparent is not real.

8. The mere fact of credit of sale proceeds of shares (or for that matter any other item in question) in a particular account or not so much frequency of sale and purchase will alone will not be sufficient to say that assessee was holding the shares (or the items in question) for investment.

9. **One has to find out what are the legal requisites for dealing as a trader in the items in question and whether the assessee is complying with them.** Whether it is the argument of the assessee that it is violating those legal requirements, if it is claimed that it is dealing as a trader in that item? Whether it had such an intention (to carry on illegal business in that item) since beginning or when purchases were made?

10. **It is permissible as per CBDTs Circular No. 4 of 2007 of 15-6-2007 that an assessee can have both portfolios, one for trading and other for investment provided it is maintaining separate account for each type, there are distinctive features for both and there is no intermingling of holdings in the two portfolios.**

11. Not one or two factors out of above alone will be sufficient to come to a definite conclusion but the cumulative effect of several factors has to be seen.

Some Practical Issues

ISSUE – 1 – Default in payment of call money

When the assessee commits a default in payment of call money and consequently the share application money is forfeited by the company, it would be extinguishment of a right and consequently there will be short term capital loss. ***[DCIT v BPL Sanyo Finance Ltd (2009) 312 ITR 63 (Kar.)].***

Chapter-IV

CAPITAL GAINS IN CASE OF DEPRECIABLE ASSETS

Section 50 - Special provision for computation of capital gains in case of depreciable assets

Q. Provisions relating to capital gains in case of depreciable assets.

- **Capital gains in case of depreciable assets** : According to section 50 of Income tax act if an assessee has sold a capital asset forming part of block of assets (building, machinery etc) on which the depreciation has been allowed under Income Tax Act, the income arising from such capital asset is treated as short term capital gain.

  Where some assets are left in block of assets: If a part of such capital asset forming part of a block of asset has been sold and after deducting the net consideration received from sale of such asset from the written down value of the block of such asset the written down value comes to NIL then the gain arising shall be treated as short term capital gain and in such case where written down value has become NIL no depreciation shall be available on such block of asset even if some assets are physically left in the block of assets.

  When no assets are left in block of assets: If the whole of the capital assets forming part of a block of assets have been sold during a year and the assessee has suffered a loss after deducting the net sale consideration from the written down value of the block of assets then such loss shall be treated as short term capital loss and no depreciation shall be allowed from such block of assets.

  It was decided by **Chandigarh tribunal in (2004) 3 S.O.T. 521/ 83 T.T.J. 1057** if the whole of capital assets in a block have been sold in a year and some gain

arises after the sale such gain shall not be treated as short term capital gain if some new asset has been purchased within the same year in the same block of assets and the total value of new and old capital assets in the same block is more than the sale consideration of the assets sold, since the block of asset does not cease to exist in such case as is required u/s 50(2).

Statement for Computing Capital Gain in case of depreciable asset

Particulars	Amount
Opening WDV as on 1st April of the relevant PY	-
Add: Actual cost of asst purchased during the year	-
COST OF BLOCK	-
Less: Money Received for asset sold, discarded, demolished, destroyed	
VALUE OF BLOCK	-
Less: Depreciation as per rates under Income Tax Act	-
CLOSING VALUE OF WDV AS ON 31st MARCH	-
	-

Some Practical Issues

ISSUE 1 – Asset on which no depreciation was ever claimed, could not be assessed u/s 50.

- During relevant A.Y., assessee sold certain plant & machinery (not in use) which was partly acquired in year 1997-98 and partly in year 1998-99. AO, by applying section 50, assessed gain arising on transfer of aforesaid plant and machinery as short-term capital gain. On appeal, Tribunal held that section 50 did not apply and plant and machinery (not in use) had to be regarded as long-term capital assets, when they were sold because no depreciation on those assets was ever claimed by assessee. ***[CIT v. Santosh Structural & Alloys Ltd. [2012] 20 taxmann.com 501 (P & H)].***

ISSUE 2 – Applicability of Section 50 in case of Sale of Land

- Since land is not a depreciable asset & it cannot form part of block of assets in absence of rate of depreciation having been prescribed **therefore, provisions of section 50 cannot be invoked in case of sale of land.**

- Land, having been held for a period of more than 36 months, surplus of sale price over indexed cost of acquisition of land was to be taxed as long-term capital gain. ***[CIT v. I.K. International (P.) Ltd. [2012] 20 taxmann.com 197 (Delhi)].***

ISSUE 3 – 'Block of assets' for purpose of section 50 would mean assets of all units of assessee having same rate of depreciation and not assets of one division or unit having same rate of depreciation

CIT v. Ansal Properties & Infrastructure Ltd. [2012] 20 taxmann.com 770 (Delhi)

- Section 2(11), which defines term 'block of assets,' does not make any distinction between different units or different type of businesses, which may be carried on by an assessee. Only requirement is that in respect of assets which form block of assets, same percentage of depreciation should be prescribed.
- All assets, which may be of different types, but in respect of which same percentage of depreciation is prescribed, are to be treated and form part of block of assets.

Chapter-V

COMPUTATION OF CAPITAL GAIN IN CERTAIN CASES

1. Section 51 – Advance Money Received
2. Section 50D- Fair Market Value deemed to be full value of consideration in certain cases
3. Section 50 B – Special provision for computation of capital gains in case of Slump Sale

SECTION 51 - ADVANCE MONEY RECEIVED

Q. What is the treatment of advance money received by the assessee in respect of capital asset?

- Where on any capital asset, on any previous occasion, for the subject of its transfer, any advance or other money received and retained by the assessee in respect of such negotiations, shall be deducted from the COA
  - ❖ Advance or other money will be deducted from COA only if it was received and retained or forfeited by the assessee himself and not by the previous owner
  - ❖ If the advance money forfeited was received by the assessee before 1-4-1981 and the assessee has assumed the FMV of the asset as on 1-4-1981 as the COA ,such advance will still be deducted from FMV.

Q. What if advance money forfeited is more than cost of acquisition?

In such a case the excess of the advance money forfeited over the cost of acquisition of such asset shall be a capital receipt not taxable. ***[Travancore Rubber & Tea Co. Ltd v. CIT (2000)243 ITR 158 (SC)]***

Some Practical Issues

ISSUE 1 – Treatment in the hands of buyer

- Forfeiture of earnest money by the vendor if due to default on the part of vendee, will not amount to relinquishment of a right in that asset .Therefore the amount forfeited will not be allowed as a capital loss under the head capital gains. ***[CIT V. Sterling Investment Corporation Ltd (1980)123 ITR 441 (BOM)]***

- Due to default on the part of vendor : vendee receives some compensation besides the refund of the earnest money paid by him, such compensation shall be subject to capital gains as it will amount to relinquishment of a right by the vendee. ***[CIT V. Vijay Flexible Container (1990)186 ITR 693(BOM) and K.R.Srinath v. Asst.CIT (2004)268 ITR 436 (MAD)].***

SECTION 50D- FAIR MARKET VALUE DEEMED TO BE FULL VALUE OF CONSIDERATION IN CERTAIN CASES

Prior to section 50D, capital gains are calculated on transfer of a capital asset, as sale consideration minus cost of acquisition. In some recent rulings, it has been held that where the consideration in respect of transfer of an asset is not determinable or ascertainable, then, as the machinery provision fails, the gains arising from the transfer of such assets is not taxable and also that fair market value cannot be taken as deemed full value of consideration unless there is a specific provision in this respect. This particularly happens when shares in Indian companies are transferred 'without consideration' by companies as part of restructuring exercise. Obviously, these transfers are not "gifts" but consideration for them is general improvement in business/synergies etc. which is not "ascertainable" or "quantifiable"

In order to overcome the judicial decisions, new section 50D is inserted with effect from A.Y. 2013-14 to provide that fair market value of asset shall be deemed to be the full value of consideration if actual consideration is not attributable or determinable. This amendment takes a cue from the following observations of **ITAT in *Dy. CIT* v. *Summit Securities Ltd.* [2012] 19 taxmann.com 102 (Mum.)(SB).**

Provisions of Section 50D are as under as inserted by the Finance Act, 2012, w.e.f. 1-4-2013:

> **"***Where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of the consideration received or accruing as a result of such transfer"*.

SECTION 50 B - SPECIAL PROVISION FOR COMPUTATION OF CAPITAL GAINS IN CASE OF SLUMP SALE

Q. What is meant by slump sale?

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 is such sales.

Q. Whether sale of undertaking be taxable as 'Business Income' or 'Capital Gain'?

The **Supreme Court in PNB Finance Ltd. V. CIT (175 Taxman 242)** after considering Sections 41(2), and 45, held that gain from slump transactions is neither taxable as business income u/s. 41 (2) nor as Capital gains u/s. 45 of the Act.

To attract section 41 (2), the subject matter should be depreciable assets and the consideration received should be capable of allocation between various assets. In case of a slump sale, there is an undertaking which gets transferred (including depreciable and non-depreciable assets) and it is not possible to allocate slump price to depreciable assets and therefore, the same cannot be taxed u/s. 41 (2).

To attract Capital Gain, held that the charging section and the computation sections are integrated code and if one fails other fails. If the computation sections fail then even the Charging section fails.

Conclusion

In case of slump sale, there are bundle of assets (including intangible assets like goodwill) that are transferred and in absence of any specific provision like Section 50B, it is not possible to determine the cost of the said assets and thus, the computation mechanism fails and so does the charging section. Therefore, it was held that the gains from the transfer of a bundle of asset on a slump basis are not chargeable to capital gains also. Thus, the slump sale was held to be not chargeable to tax prior to insertion of Section 50B

Q. Is the benefit of indexation is available in case of slump sale?

As per Sec 50B, no indexation benefit is available on cost of acquisition, i.e. net worth.

Q. Whether transfer of assets without transfer of liabilities regarded as Slump Sale?

Slump sale provisions do not apply where assets of an undertaking are transferred without transfer of liabilities. This is clear from the following

Definition of 'undertaking': 'include any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole'

As per Explanation 1 to S. 50B: Net worth is the difference between 'aggregate value of total assets of the undertaking or division' and 'value of liabilities of such undertaking or division'.

Therefore, transferring the asset without transferring the liabilities shall not be regarded as Slump Sale.

Some Practical Issues

ISSUE 1 – If the transfer of the property in goods is not pursuant to a contract but pursuant to a Court Order?

- The transfer of the property in goods pursuant to an order of a court cannot be regarded as 'Sale'. This is quite clear from definition of "Sale" that only contractual transfer is regarded as 'Sale' and thus, the statutory transfers or transfer effected by orders of the court or operation of law cannot be regarded as Sale.

ISSUE 2 – if undertaking is transferred for a consideration other than 'money consideration', say for allotment of shares in transferee company ?

- The transfer of the property in goods for other than 'money consideration' would be regarded as 'Exchange' and not 'Sale' and therefore wouldn't be covered in the ambit of Slump sale and consequently would not be taxable under the IT Act. Such transaction could be regarded as 'Slump Exchange'. ***[Supreme Court case in CIT vs. R. R. Ramkrishna Pillai]***

Chapter-VI

FULL VALUE OF CONSIDERATION & REFERENCE TO VALUATION OFFICER

I. SECTION 50 C – SPECIAL PROVISION FOR FULL VALUE OF CONSIDERATION IN CERTAIN CASES

Applicability of Section 50C

As per Sec 50C, where the consideration received or accruing as a result of the transfer of land and/or building is less than the value adopted or assessed or assessable by an authority of the state govt. for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration received or accruing as a result of such transfer for computing capital gain.

Sub section (2) of said section provides that where the assessee claims before any assessing officer that the value adopted or assessed by the authority exceeds the fair market value of the property as on the date of transfer and the value so adopted or assessed by the authority has not been disputed in any appeal or revision or no reference has been made before any other authority, court or a high court , the Assessing offer may refer the valuation of the capital asset to a valuation officer.

Q. If the transaction falling u/s 50C then whether section 56(2) also get attract to such transaction?

As per Finance Act, 2010, cases of transfer of immovable property for **inadequate consideration** are no longer covered by the provisions of sec. 56(2) i.e. taxability in the hands of buyer as deemed income. The transactions would fall squarely within the ambit of sec. 50C.

Some Practical Issues

ISSUE 1 – Section 50C has no application for determination of sale price of stock-in-trade/ Business assets.

- Where there was no dispute as to fact that property owned by assessee was its inventory and as such forming part of its stock-in-trade, profit on sale of said stock-in-trade was assessable u/s 28 and AO could not make addition on ground that its sale consideration was understated. ***[Asst. CIT v. Excellent Land Developers (P.) Ltd. 1 ITR 563 (DELHI-ITAT) [2010]]***

- Where property is treated as business asset and not as capital asset, S 50C cannot be invoked. ***[CIT v. Thiruvengadam Investments (P.) Ltd320 ITR 345 (Mad.) [2010]]***

ISSUE 2 – Section 50C does not apply to transfer of "leasehold rights" as it is not "land or building".

- Lease right in a plot of land cannot be included within scope of 'land or building or both' and, thus, in case of transfer of leasehold rights in land, provisions of section 50C cannot be invoked. **[*Atul G. Puranik vs. ITO [2011] 11 taxmann.com 92 (ITAT-Mum.)]***

ISSUE 3 – Section 50C is applicable to depreciable assets

- The harmonious interpretation of sec 50 and sec 50C, it is clear that there is no exclusion of applicability of one fiction in a case where other fiction is applicable. Thus, provisions of sec 50C can be applied to the transfer of depreciable capital assets covered by sec 50 and in computing the capital gain arising from the transfer by adopting the stamp duty valuation. ***[ITO v. United Marine Academy 9 ITR 639 (Mum. ITAT) (2011)]***

ISSUE 4 – Legal fiction created by sec. 50C is limited to purposes of sec.48 alone and does not displace legal fiction created by sec. 69, 69A & 69B

- The consideration, which is deemed by sec. 50C to have been received by the transferor, is for the limited purpose of computation of capital gain u/s 48 and for no other purpose. It cannot and does not mean that the said amount of consideration has been actually received by the assessee or actually paid by the transferee to him so as to be available in his hands for investments or for meeting the expenses. "Deemed consideration" u/s 50C for computation of capital gain u/s 48 is quite different from actual consideration or actual availability of money for the purpose of making investments or for meeting the expenses. Deemed

consideration within the meaning of sec. 50C cannot and does not mean that the amount of deemed consideration has actually been paid by the transferee or actually received by the assessee. ***[Subash Chand v. ACIT 18 taxmann.com 149 (ITAT-Chandigarh) [2012]]***

ISSUE 5 – Some other related issues

- In absence of any material to effect that assessee had received any amount over and above value on which stamp duty was payable, Full value of consideration would be the value adopted for purpose of stamp valuation. ***[ITO v. Ms. Namita Singh 15 taxmann.com 19 (ITAT-Delhi) [2011]]***
- While computing capital gains u/s 45, FVC has to be taken as per circle rates prescribed by the State Government for the purpose of stamp valuation unless the AO has material in his possession to prove that the assessee had received higher amount than the circle rates.
- Adoption of the DVO's report without providing opportunity of being heard is also against the principles of natural justice. ***[ADIT v. Ranjay Gulati -TIOL -528 (ITAT-Delhi)(2011)]***
- Value adopted or assessed by any authority of the State Government for purpose of payment of stamp duty in respect of land or building at the time of execution of the transfer deed, cannot be taken as sale consideration received for the purpose of section 48. ***[CIT v. Smt. Shweta Bhuchar 192 Taxman 67 (P&H) [2010]]***
- The deeming fiction of Sec. 50-C could not be applied for ascertaining the undisclosed investment of assessee under Sec. 69-B. Further, in absence of any evidence for applying S 69B, difference b/w value for purpose of stamp duty and value shown in sale deed cannot be added in the income of assessee. ***[ITO v. Fitwell Logic System (P.) Ltd. 1 ITR (TRIB.) 286 (Delhi) [2010] and CIT-II Vs Harley Street Pharmaceuticals Ltd TIOL-391-(Ahm) (2011)]***
- Where the assessee objects to stamp duty valuation, the AO is required to call for report of DVO, and even if the valuation report is received after the assessment, the value determined may be rectified u/s 154. ***[Mrs. Nandita Khosla v. ITO Taxman 344 (ITAT-Mum.)[2011] and Kanai Lal Sharma Vs ACIT TIOL-324-ITAT-(Kol) (2011)]***

II. SECTION 55A – REFERENCE TO VALUATION OFFICER

Applicability of Section 55A of the Act

- With a view to ascertaining the FMV of a capital asset for the purposes of this Chapter, the AO may refer the valuation of capital asset to a Valuation Officer—

(a) In a case where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the AO is of opinion that the value so claimed ***is at variance with its fair market value." (amendment by Finance Act, 2012)***

(b) In any other case, if the AO is of opinion—

(i) that the fair market value of the asset exceeds the value of the asset as claimed by the assessee by more than such percentage of the value of the asset as so claimed or by more than such amount as may be prescribed in this behalf ; or

(ii) that having regard to the nature of the asset and other relevant circumstances, it is necessary to do so,

Where any such reference is made, the provisions of sub-sec. (2), (3), (4), (5) and (6) of sec. 16A, clauses (ha) and (i) of sub-sec. (1) and sub-sec. (3A) and (4) of sec. 23, sub-sec. (5) of sec. 24, sec. 34AA, sec. 35 and sec. 37 of the Wealth-tax Act, 1957 (27 of 1957), shall with the necessary modifications, apply in relation to such reference as they apply in relation to a reference made by the AO under sub-sec. (1) of sec. 16A of that Act.

Some Practical Issues

- Where valuation report of approved valuer submitted by assessee suffered from grave infirmity, in as much as it did not take into account a number of items used by assessee for construction of property, AO can adopt the value determined by DVO. ***[Krishan Kumar Jhamb v. ITO 179 Taxman 141 (P& H) [2009]]***

- Where there is nothing on record, to show that the assessee received consideration for the sale of the property in excess of which has been shown in the agreement to sell. Thus the actual sale consideration recorded in the agreement to sell and received by the assessee could not be substituted by the value as adopted by the District Valuation Officer u/s 55A for the purpose of computing the capital gains chargeable to tax. ***[Dev Kumar Jain V ITO 309 ITR 0240 (Del) [2009] see also CIT v Smt. Nilofer I. Singh 309 ITR 0233 (Del) [2009]].***

Chapter-VII

CAPITAL GAIN ON SALE OF AGRICULTURAL LAND

Q. What is the test that determines land is agricultural land?

The Gujrat HC in **CIT v Siddhartha J. Desai 139 ITR 628 (Guj)(1983)** has laid down the following tests for determining whether the land is agricultural or not:

a) Whether, the land was classified in the revenue records as agricultural and whether it was subjected to payment of land revenue? ***[CIT vs. Smt. Debbie Alemao 331 ITR 0059 (Bom) [2011]]***

b) Whether, the land was actually or ordinarily used for agricultural purposes at or about the relevant time?

c) Whether, such user of the land was for a long period or whether it was of temporary character or by way of stop gap arrangement?

d) Whether the income derived from the agricultural operations carried on in the land bore any rational proportion to the investment made in purchasing land?

e) Whether the land, on the relevant date, had ceased to be put to use? If so, whether it was put to an alternative use? Whether such lessor and/ or alternative user was of permanent or temporary nature?

f) Whether the land, though entered in revenue record, had never been actually used for agriculture, i.e., it had never been ploughed or tilled?

g) Whether the owners meant or intended to use it for agricultural purposes?

Some Practical Issues

ISSUE 1 – Issues related to Agricultural Land

- The use to which the transferee put the land is immaterial and not relevant.
- What is relevant is that, in the hands of transferor, the land must be agricultural in nature at the time of transfer.
- If the transferee converts the agricultural land into non agricultural land or divides it into two plots and sells the same as house sites, the transfer of the land would not give rise to capital gains tax in the hands of transferor. ***[Motibhai Patel v CIT 131 ITR 120 (Guj)(1981)].***
- It was held that the purchaser who had no intention of carrying on agricultural operations, the seller assessee should not loose the benefit as long as he had been using the land for agricultural purposes. ***[M.S. Srinivasa Naicker V ITO 292 ITR 0481 (Mad)[2007]].***
- If the land was put to agricultural use for a long period and the agricultural operations were temporarily suspended, the land does not cease to be agricultural. ***[Ranganatha Sastri (M) V CIT 119 ITR 488 (Mad) (1979)].***
- Where agricultural land which is outside the scope as per section 2(14)(iii) is sold along with standing trees, there will be no liability to capital gains tax even in respect of the standing trees. On the other hand, if the standing trees are sold separately after they are cut and removed, they do not partake of the nature of the land and there will be liability to tax on capital gains arising from the sale. ***[Gokul Rubber and Tea Plantations Ltd. V CIT 172 ITR 197 (Ker)(1988)].***
- Where land was shown as agricultural land in the revenue records and was never sought to be used for non-agricultural purposes by the assessee till it was sold, it was held that such land has to be treated as agricultural land even though no agricultural income is shown by the assessee as the assessee stated that the agricultural income derived by sale of coconut grown on the land was just enough to maintain the land and there was no surplus. ***[CIT v Debbie Alemao 46 DTR 341 (Bom.)(2010)]***
- Agricultural land not covered under specified urban areas and therefore not a capital asset. ***[Ramjibhai P. Chaudhry v DCIT 314 ITR (AT) 0259 ITAT – Ahm.] [2009] .***
- How the distance is to be measured - Distance to be taken by approach road and not as a straight line. ***[Radhasoami Satsang v. CIT 193 ITR 321 (SC) (1992), CIT v. Satinder Pal Singh 188 Taxmann 54 (P&H)(2010)]***
- Jurisdictional Municipality has to be considered for calculating the distance. ***[DCIT v. Capital Local Area Bank Ltd 29 SOT 394 (ASR)(2009) & Srinivas Pandit HUF v. ITO 39 SOT 350 (Hyd.)(2010)]***

Chapter-VIII

SECTION 45(5) - COMPULSORY ACQUISITION

Q. Do consideration received from Government against compulsory acquisition attracts capital gain?

- As per section 45(5), consideration **received** against Compulsory acquisition by the Central Government shall also attract Capital Gain. ***[Jehangir P. Vazifdar V ITO (1992) 42 ITD 67 (Bom-Trib) – Received would mean when it has become finally receivable or the same is received unconditionally.]***

Q. What will be the treatment of consideration further enhanced or reduced?

- Enhanced & further enhanced compensation will also be considered for the purpose of Capital gain in the below mentioned manner:
  - Consideration **determined / awarded / approved at first instance** shall be chargeable in the P.Y. in which, wholly or partly, was **first received.**
  - **Enhanced & Further enhanced compensation** shall be chargeable in the **Year of receipt.**
  - *In case the amount of **compensation** or enhanced compensation is **subsequently reduced** the capital gain shall be **recalculated by the taking the compensation or enhanced compensation so reduced. (Refer Sec 155(16).***

Q. What will be the COA and COI while calculating the enhanced consideration?

- COA & COI shall be taken to be nil while calculating CG from enhanced compensation or further compensation.

Some Practical Issues

ISSUE 1 – Enhanced Compensation 45(5)

- Enhanced compensation received by assessee during pendency of dispute before Court cannot be deemed to be his income for purpose of computation of capital gain in year of receipt, in terms of provisions of sec. 45(5). ***[Hari Kishan v. Presiding Officer (2008) 172 Taxman 219 (P & H)]***

ISSUE 2 – Taxability of interest on enhanced compensation

- Interest on enhanced compensation is taxable on accrual basis but only if it is undisputed. ***[ITO vs. Amarlal (2007) 14 SOT 239 (Del-Trib)]***
- Interest received on delayed payment of compensation is determined and taxable under the head income from other sources on year to year basis. ***[CIT v Ghanshyam (HUF) (2009) 315 ITR 1 (SC)].***
- Interest on enhanced compensation is not taxable on lumpsum basis under mercantile system, however spread over on annual basis over the period starting from the date of compulsory acquisition to the date on which court makes an order for enhanced compensation. ***[Rama Bai V CT (1990) 181 ITR 400 (SC), see also CIT vs Hardwari Lal, HUF [2009] 312 ITR 0151 (P&H)].***
- Where assessee follows cash system of accounting, interest on enhanced compensation on acquisition of land shall be taxable in year of receipt. ***[CIT v Smt Burfi [2011] 331 ITR 001 (P&H)]***

ISSUE 3 – Date of transfer

- If property acquired under Requisitioning and Acquisition of Immovable Property Act, 1952 – Date of publication of the notification for acquisition would be the date of Transfer. ***[G.M. Omer Khan v CIT (1992) 196 ITR 269 (SC) see also Omar khan (G.M.) v Addl CIT (1992) 195 ITR 269 (SC)]***
- If property acquired under Land Acquisition Act, 1894 (The Central Act) or any other state Act – Date of transfer would be the date of actual possession by declaring it to do so. ***[CIT v Shaggy Abdulla (Smt) (2000) 108 Taxman 249 (Ker)]***
- In case of emergency acquisition, effective date of transfer is the date of taking possession under section 17 of the Land Acquisition Act, 1894 and not the date of award of compensation. ***[BC Gupta & Sons Ltd. v CIT (1996) 221 ITR 53 (Gau.) also see Alexander George V CIT (2003) 128 Taxman 851 (Ker)]***

ISSUE 4 - Other related issues

- The Supreme Court in the case of **CIT V Hindustan Housing and Land Development Trust (1986) 161 ITR 524** has held that :
  - Where additional compensation awarded to the assessee has been made subject matter of appeal by the Government then such amount shall be taxable as capital gain only.
  - In the year in which additional compensation is received.
  - In the year in which the dispute is finally settled.

  Whichever is later.

  [New friends Co-operative House Building Society Ltd. v CIT (2010) 327 ITR 0039 (P&H) also see CIT vs. Ghanshyam (HUF) [2009] 315 ITR 0001 (SC), Chandi Ram v CIT [2009] 312 ITR 0139, Anil Kumar Forma (HUF) V. CIT [2007] 289 ITR 0245 (Mad), G.M. Omar Khan V. Addl CIT (1992) 196 ITR 269 (SC)].

- If any amount is received after stay of the award, in pursuance of any interim order, as a payment subject to the final result, it will not be an amount received as 'enhanced compensation' contemplated u/s 45(5)(b), but only an interim payment received subject to final decision. ***[CCIT & Anr v. Smt. Shantavva (2004) 267 ITR 67 (Karn).]***

- Solatium awarded by competent authority constitutes part of consideration for compulsory acquisition. ***[CIT v. Smt. Subaida Beevi (1986) 160 ITR 557 (Ker) see also Vadilal Soda Ice Factory v CIT (1971) 80 ITR 711 (Guj), K.C. Mahajan (1998) 234 ITR 235 (P&H).***

- Expenses for realization of enhanced consideration is allowable in terms of S. 48(1). ***[Chakiri Ashok Kumar v ITO (2002) 80 ITD 410 (Hyd).].***

- The compensation due to injurious effect on the unacquired portion is also taken in to account, the amount awarded for such compensation shall also be a part of the full consideration price for computing the capital gain for the portion acquired. ***[P. Mahalakshmi and Others v CIT (2002) 255 ITR 647 (SC)].***

Chapter-IX

EXEMPTION FROM CAPITAL GAIN

Part-I **Exemption from capital gain is available under Section 10, 11(1A) & Section 13A. Exemptions can be divided in to following two categories - Exemptions allowed to**

A.	B.
only to a specified assessee	***either to all assesses or to more than one assesses***

Exemption to Specified Assessee

Assessee	Section
Local Authority	10(20)
Research Association	10(21)
Notified News Agency	10(22B)
Notified Institution for controlling, supervising, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture or such other profession.	10(23A)
Institution solely for development of Khadi or village industries or both.	10(23B)
Certain Funds and Institutions	10(23C)
Mutual Funds	10(23D)
Venture Capital Company or Fund (VCC/VCF)	10(23FB)
Funds established under section 10(25) & 10(25A)	10(25) & 10(25A)

Charitable or religious trust or institutions subject to certain conditions being satisfied.	11(1A)
Political Parties	10(13A)

Exemption allowed either to all assesses or to more than one assesses

Sections	Brief of the Section
10(33)	Capital gain on transfer of units of US 64 exempt if transfer takes place on or after 01/04/2002.
10(37)	Exemption of capital gains to an individual or HUF on compensation received on compulsory acquisition of agricultural land situated within specified urban limits as per Section 2(14)(iii)(a) &(b).
10(38)	Exemption of long term capital gain arising from sale of equity shares and units of the equity oriented fund.

Exemption in respect of CG in case of units of US-64 - Sec. 10(33)

Any income arising from the transfer of a capital asset, being a unit of the Unit Scheme, 1964 referred to in schedule I to the UTI Act, 2002 & where the transfer takes place on or after 1st day of April 2002.

Note:

1. Income arising from the transfer of unit held as Stock in trade shall be taxable as business income.
2. The capital loss arising on the transfer of such units shall not be included in the computation of capital gains under sec. 45 and will not be available for set off or carry forward in accordance with sec. 70 and 74.

Section 10(37)-Exemption in respect of CG in case of Urban agricultural Land

In case of an assessee being an **individual or an HUF**

- any income chargeable under the head 'Capital Gains' arising from the transfer of agricultural land , where -
  - i) Such land is situated in any area which is comprised within the jurisdiction of a municipality (having population of not less than 10,000) or a cantonment board.
  - ii) Such land during the period of 2 years immediately preceding the date of transfer, was being used for agricultural purposes by such an HUF or individual or a parent of such individual.

iii) Such transfer is by way of compulsory acquisition under any law, or a transfer for which the consideration is determines or approved by the CG or RBI,

iv) Such income has arisen from the compensation or consideration for such transfer received on or after 1st day of April,2004.

Explanation: For the purpose of this clause, the expression "compensation or consideration "includes the compensation or consideration enhanced or further enhanced by any court, tribunal or other authority.

❖ **Exemption in respect of LTCG in case of specified securities - Sec. 10(38)**

Any income arising from

- The transfer of LTCA.
- Being an equity share in a company.
- A unit of an equity oriented fund where-

  (a) the transaction of sale of such equity share or unit is entered into on or after 1-10-2004, and

  (b) such transaction is chargeable to STT.

Note:

1. Such LTCG shall be taken into account in computing the book profit and income tax payable under section 115JB.
2. Exemption is available for all assessees whether R or NR, FII, etc.

Points to be considered:

- The exemption is available to all assessees including FIIs and NR.
- The exemption is available to an investor who holds the equity shares/units of equity oriented fund as capital asset not as stock-in-trade.
- The exemption is not available to securities other than equity shares and units of equity oriented funds
- The exemption is available if the sale transaction is chargeable to securities transaction tax
- The acquisition may not be through a recognized stock exchange (i.e. Purchase of asset)
- Loss from sale of securities- if income from a particular source is altogether exempt, then loss from that source cannot be set off.

PART-II EXEMPTIONS SECTION 54, 54EC & 54F OF INCOME TAX ACT, 1961

The assessee can claim exemption from capital gains on sale of residential house property under the following sections:

Particulars	Sec. 54	Sec. 54EC	Sec. 54F
Exemption claimed	Individual/ HUF	Any person	Individual/ HUF
POH of Capital asset	Long-Term	Long-Term	Long-Term
Eligible specific asset	A residential house property	Any LTC asset	Any LTC asset (other than a residential house property) provided on the date of transfer the tax payer do not own more than one residential house property from the A.Y. 2001-02 (except the new house as stated in 4 infra)
Type of asset should be acquire to get the benefit of exemption	Residential house property	Bonds of national highway authority of India or Rural Electrification Corporation.	A residential Property
Time limit for acquiring the asset	*Purchase:* 1 yr backward or 2 yrs forward. *Construction*: 3yrs forward	6 months forward	*Purchase:*1 yr backward or 2 yrs forward. *Construction:* 3yrs forward
Relevant date for acquiring the new asset	From the date of transfer of house property but in case of compulsory acquisition from the date of compensation.	From the date of transfer of long term capital asset but in the case of compulsory acquisition from the date of receipt of compensation.	From the date of transfer of capital asset but in case of compulsory acquisition from the date of receipt of compensation.
Amount exempted	Investment in the new asset or capital gain, whichever is lower.	Investment in the new asset or capital gain, whichever is lower.	Investment in the new asset/ net sale consideration capital gain

Exemption revoke in a subsequent year	If the new asset is transferred within 3 yrs of its acquisition.	If the new asset is transferred or it is converted in to money or a loan is taken on security of the new asset within 3 yrs of its acquisition.	If the new asset is transferred within 3 yrs of its acquisition. If another residential house is purchased within 2 yrs of transfer of original asset, or If another residential house is constructed within 3 yrs of the transfer of original asset.

Different questions	**Sec. 54**	**Sec. 54EC**	**Sec. 54F**
When the exemption is revoked it is taxable as LTCG/STCG in the year in which the default is committed.	STCG	LTCG	LTCG
Scheme of deposit is applicable	Yes	No	Yes

Some Practical Issues

Q. What is Capital Gain Account Scheme?

- If the new asset is not acquired up to the date of submission of return of income, then the tax payers will have to deposit money in "Capital Gain Deposit scheme" with a nationalized bank. The proof of deposit should be submitted along with return of income. On the basis of actual investment and the amount deposited in the deposit account, exemption will be given to the tax payer.

Q. Is the relief under section 54 is available to multiple sales & purchases of residential houses?

- In case of multiple sale and purchase of residential houses, the exemption cannot be calculated considering the aggregate of capital gain and aggregate of investment in the residential houses. The exemption will be available in relation to each set of sale and corresponding investment in the residential house and the combination which is beneficial to the assessee has to be allowed. **[Rajesh Keshav Pillai v. ITO 7 Taxmann.com 11 (Mum.) (2010)]**

Q. Whether deduction u/s 54 is available for capital gains arising from sale of more than one house, however the sale proceeds are invested in one house?

- There is no restriction placed in section 54 which restricts exemption only in respect of sale of one residential house. Even if assessee sells more than one house in the same year and the capital gains is invested in a new residential house, the claim of exemption cannot be denied if other conditions are fulfilled. **[DCIT v. Ranjit Vithaldas [2012] 23 taxmann.com 226 (ITAT-Mum)]**

Q. Can assessee claim exemption under section 54 for acquisition of more than one house?

- Where more than one residential house is purchased out of the sale proceeds of one residential house, exemption u/s 54 can be claimed only in respect of one house, provided the other conditions of Sec 54 are satisfied.**[K.C. Kaushik v ITO 185 ITR 499 (Bom.)(1990)].**

  In **Gulshanbanoo R. Mukhi v. JCIT 83 ITD 649 (ITAT- Mum) (2002),**it was held that exemption is allowed only for one flat.

  However, two or more residential houses purchased can be classified as one single residential house, the exemption under section 54 can be allowed. Some of the relevant judicial pronouncements are:

  - Two adjacent residential units but used as one single residential house, exemption allowed. **[D. Anand Basappa v. ITO 309 ITR 329 (Kar.) (2009)]**
  - Fact that residential house consists of several independent units cannot be a hindrance to allowance of exemption u/s 54 - Held, yes **[Prem Prakash Bhutani Vs. CIT 110 TTJ (Del) 440 (2007)]**
  - Two adjoining flats converted into single residence, exemption allowed. **[ACIT v Mrs. Leela P. Nanda 286 ITR (AT) 113 (Mum)(2006)]**
  - Four flats purchased in same building but on different floors because of large size of family, which maintained a common kitchen and a common ration card, exemption allowed. **[Vyas (K.G.) v ITO 16 ITD 195 (Bom.)(1986)]**
  - Allowable in the case of adjacent & contiguous flats.**[ITO v. Mrs. Sushila M. Jhaveri 107 ITD 327 (ITAT- Mum. SB)(2007)]**
  - Several self occupied dwelling units which were contiguous and situated in the same compound and within the common boundary having unity of structure should be regarded as one residential house. **[Shiv NarainChoudhary v. CWT 108 ITR 104 (All)(1997)]**
  - More than one units converted into one single house allowed for the purpose of sec. 54F as well. **[Neville J. Pereira v. ITO 8 Taxmann.com 68 (Mum. ITAT) (2010)]**
  - Two flats which were not adjacent to each other and were separated from each other by common passage, lobby, staircase, etc., they could not be regarded as a single unit and, therefore, assessee was entitled to benefit of deduction under section 54F in respect of one of those two units. **[ACIT vs Sudhakar Ram [2011] 16 taxmann.com 175 (Mum.-ITAT)]**

- However, the claim for exemption u/s 54 is not admissible in respect of two independent residential houses situated at different locations. **[PawanArya v. CIT 11 taxmann.com 312 (P&H) [2011]]**

Q. Whether the property purchased in the joint name with wife is eligible for exemption u/s 54/54F?

- Section 54F mandates that house should be purchased by assessee and it does not stipulate that house should be purchased in name of assessee. Property purchased by assessee in joint name with his wife for 'shagun' purpose because of fact that assessee was physically handicapped and the whole consideration was paid by assessee, assessee entitled to exemption u/s 54F. **[CIT Vs Ravinder Kumar Arora 15 taxmann.com 307 (Delhi) [2011])]**

Other relevant judicial pronouncements

- ❖ Merely because sale deed is in joint name, assessee could not be denied benefit of deduction u/s 54. **[DIT v. Mrs. Jennifer Bhide 15 taxmann.com 82 (Kar.) [2011]]**
- ❖ House property in the name of HUF sold but new house purchased in the name of Karta and his mother to claim the benefit of sec. 54F. The residential house which is purchased or constructed has to be of the same assessee. **[Vipin Malik (HUF) Vs CIT 183 Taxman 296 (Delhi)(2009)]**
- ❖ Exemption u/s 54F is allowed only when the new residential property is purchased by the assessee in his own name and not in name of his adopted son. **[Prakash v. ITO 173 Taxman 311 (Bom.) [2008]]**
- ❖ Sec. 54 clearly says that if the assessee is owner of the property, he is entitled to exemption even if the new property purchased is in the name of his wife but the same is assessed in the hands of the assessee. **[CIT v. V. Natarajan 154 Taxman 399 (Mad.) [2006]]**

Q. Whether the nexus between capital gain and amount of investment u/s 54 is necessary?

- Assessee is not required under the provision for section 54 to establish the nexus between the amount of capital gain and the cost of new asset.

Held that the assessee had initially utilized the sale proceeds on sale of its residential flat in commercial properties and, later on, he purchased two residential flats within a period specified in sub-section (2) of section 54. The Revenue's main dispute was that the sale proceeds were utilized for purchase of a commercial property and residential house was purchased out of the funds

obtained from different sources, as such, the identity of heads has been changed. **[Ishar Singh Chawla Vs. CIT 130 TTJ (Mum) (UO) 108 (2010) and Ajit Naswanit Vs. CIT 1127 Taxman 123 (Delhi) (Mag.) (2001)]**

Q. To avail exemption u/s 54F, the residential property should be acquired out of personal funds or sale proceeds?

- If the assessee constructs or purchases a residential house out of the borrowed funds, he is not eligible for deduction u/s 54F of the Act. If it is not construed in such a manner the object of introduction of the beneficial provisions would be frustrated. The fiscal provisions are to be construed in such a manner, so that its objects of introduction can be achieved. **[Milan Sharad Ruparel 005 ITR 0570 (ITAT – Mum) [2010]**.

  However a different view was taken in **Bombay Housing Corporation v. Asst. CIT 81 ITD 545 (Bom.-ITAT) (2002)**, Where assessee utilized the sale consideration for other purposes and borrowed the money for the purpose of purchasing the residential house property to claim exemption under section 54,it was held that the contention that the same amount should have been utilized for the acquisition of new asset could not be accepted.

  Other relevant judicial pronouncement:

  There is no requirement for claiming exemption under section 54 that same amount of sale consideration should be utilized for acquisition of property, even borrowed funds can be utilized for that purpose. **[Prema P. Shah Vs ITO 101 TTJ 849 (Mum-ITAT)(2006)].** Also see **J.V. Krishna Raovs DCIT [2012] 24 taxmann. com 104 (Hyd.-ITAT).**

Q. Whether exemption under section 54 is allowable if residential units of a house property are purchased from different persons?

- Execution of four different sale deeds in respect of four different portions of property did not materially effect nature of transaction or nature of property acquired since property in question was being used by assessee for her own purposes and investment made in purchase of same was, therefore, eligible for deduction under section 54.**[CIT V. Sunita Aggarwal (2006) 284 ITR 20(Del)]**

  In **CIT vs Smt. Jyothi K. Mehta [2011] 12 taxmann.com 440 (Kar.),** it was also held that the fact that the assessee could not have purchased both the flats in one single sale deed or could not have narrated the purchase of two premises as one unit in the sale deed could not make any difference. The two flats purchased were situated side by side. Builder also stated that he had effected modifications to the flats to make them one unit by opening the door in between the two apartments.

Q Whether exemption u/s 54 can be claimed on the basis of a mud structure?

Exemption u/s 54 cannot be allowed for sale of a mud structure whereupon there was never any structure fitting to be described as "habitable residential house". **[M.B. Ramesh vs ITO 320 ITR 451 (Kar.) [2010]]**

Q Whether benefit u/s 54(1) is available in case of sale of land adjoining to the building?

The land appurtenant to the building means that the ownership of building and land appurtenant should be of same person. If building is owned by one person and land is owned by another, it will be the case of land adjoining to the building and by no stretch of imagination it can be called land appurtenant to the said building and therefore, benefit of section 54(1) would not be available to such land adjoining to a building.**[P.K. Lahri v. CIT 146 Taxman 349 (ALL.)(2005)]**

Q Is it necessary that a person should reside in the house to call it a residential house.

The popular meaning of words 'residential house' is a place or building used for habitation of people. It is not necessary that a person should reside in a house to call it a residential house. If it is capable of being used for the purpose of residence then the requirement of the section 54F is satisfied and benefit could not be denied. **[Amit Gupta v. DCIT 6 SOT 403 (Delhi)(2006) & Mahavir Prasad Gupta 5 SOT 353 (Del)(2006)]**

Q Can the assessee claim exemption under section 54 in respect of investment in modification or renovation of the existing house?

Exemption is available only when the investment is in the consideration of a house and not for investment in modification or renovation. Admitted facts are that the assessee had a fairly big house to which the assessee made addition of 140 sq. meters of plinth area. However, it is the conceded position that the assessee has not constructed any separate apartment or house. Section 54F does not provide for exemption on investment in renovation or modification of an existing house. On the other hand, construction of a house only qualifies for exemption on the investment. Even addition of a floor of a self contained type to the existing house would have qualified for exemption. However, since the assessee has only made addition to the plinth area, which is in the form of modification of an existing house, she is not entitled to deduction claimed u/s 54F of the Act. **[Mrs. Meera Jacob vs ITO 313 ITR 411 (Kerala) (date of order 9/06/2008)]**

Q Whether exemption under section 54 is allowable for addition of floor to the existing house from the sale proceeds of residential house sold?

Assessee owned two residential houses. He sold one house and utilized its sale proceeds to construct first floor on his second house after demolishing old structure, in this case exemption will be allowable under section 54. **[CIT vs P.V. Narsimhan [1989] 47 Taxman 89 (Mad.)**

However, in **CIT v. V. Pradeep Kumar [2007] 290 ITR 90/ [2006] 153 Taxman 138 (Mad.)**, it was held that a mere extension of existing building would not give benefit to assessee under section 54F. Section 54F emphasizes construction of residential house and such construction must be real one and should not be a symbolic construction. Followed by **ACIT vs T.N. Gopal [2009] 121 ITD 352 (Chennai-ITAT) (TM)**

Q Whether the expenditure to make a residential house habitable will be included in the cost of new asset?

The words used about the amount spent on purchase of new asset are '**cost thereto'** and not '**price thereto'**. The cost includes purchase as well. Consequently, the words used signify that the amount of purchase will include other necessary expenditure in this behalf to make a residential house habitable and taken together that will be the cost of the new asset. The Tribunal had perused the items of the report of the architect. The residential house was in a state of general disrepair and was inhabitable. Consequently, the necessary repairs carried out to make the same habitable would constitute part of the cost of new house. **[Gulshanbanoo R. Mukhi v. JCIT 83 ITD 649 (ITAT- Mum) (2002)]**

Q Whether exemption under section 54F would be allowable where assessee is already a co-owner of another flat?

The word 'own' appearing in section 54F includes only such residential house which is fully and wholly owned by one person and not a residential house owned by more than one person. The assessee was already a co-owner of another flat. Being a co-owner, assessee was not the absolute owner of another residential flat, and exemption under section 54F could be denied on this ground. **[ITO vs Rasiklal N. Satra [2006] 98 ITD 335 (Mum.-ITAT)]**

Q Whether determination of title to the property would commence from the first date of allotment or the subsequent date of allotment of the actual flat number and delivery of possession for the purpose of assessing long term capital gains.

Title to the property is transferred with the issuance of the allotment letter and payment of installments is only a follow up action and taking of the delivery of possession is only a formality. **[Vinod Kumar Jain Vs CIT TIOL-706-P&H (2010)]**

Q Whether exemption under section 54 would be allowable where residential house property is purchased within time limit specified under section 139(4)?

The due date for furnishing return of income as per section 139(1) is subject to extended period provided under sub-section (4) of section 139 and, if a person had not furnished return of previous year within time allowed under sub-section (1), assessee could file return under sub-section (4) before expiry of one year from end of relevant assessment year. Therefore, section 54 deduction could not be denied to assessee on this count. **[CIT v. Ms. Jagriti Aggarwal 15 taxmann.com 146 (P & H) (2011)].** Also see **ITO vs Smt. Sapana Dimri [2012] 19 taxmann.com 15 (Delhi), Kishore H. Galaiyavs ITO [2012] 24 taxmann.com 11 (Mum.)**

Q Is there any requirement that the assessee should file the return before the due date under section 139(1) to claim exemption under section 54/54F?

Where the assessee had fulfilled the condition for depositing the amount of capital gain in a specified bank account before the due date prescribed for furnishing the return of income under section 139(1),there is no requirement that the assessee should file her return of income before the due date prescribed under section 139(1). **[Esther Christopher Mascarenhas v. ITO 9 Taxmann.com 99 (Mum.-ITAT) (2011)]**

Merely because investment is made after due date of filing of return, section 54F exemption cannot be denied where investment is made prior to filing of return under section 139(4). **[R.K.P. Elayarajan vs DCIT [2012] 23 taxmann.com 206 (Chennai-ITAT)]**

Q Whether property purchased in foreign country is also eligible for exemption u/s 54?

Section 54 does not exclude the right of the assessee to claim property purchased in a foreign country, if all other conditions laid down in the section are satisfied. Merely because the property acquired was in a foreign country, the exemption under section 54 cannot be denied.The new house may be in India or outside India. **[Prema P. Shah Vs. ITO 101 TTJ 849 (Mum-ITAT)(2006)]**

However, in **Leena J. Shah vs ACIT [2006] 6 SOT 721 (Ahd.-ITAT)**, it was held that the benefit under section 54F is not allowable for a residential house purchased/ constructed outside India.

Q Whether cost of residential house includes the cost of plot?

The cost of the plot together with cost of the building will be considered as cost of new asset provided the acquisition of the plot and also the construction thereon are completed within the period specified in these sections. **[Circular no. 667, dated 18-10-1993]**

Q Whether the deemed cost of new asset means the amount which has already been utilized by assessee for purchase or construction of new asset or it also includes the amount deposited as per requirements of sub-section (4) of section 54F?

For purposes of sec 54F, deemed cost of new asset is amount which has already been utilized by assessee for purchase or construction of new asset plus amount deposited as per Capital gain account scheme, 1988. **[ACIT v. Vikas Singh 16 taxmann.com 127 (Delhi) [2011]]**

Q Whether booking of flat with a builder amounts to construction or purchase?

Booking of flat with a builder is a case of construction and not purchase of residential flat and therefore, time period 3 years is applicable. **[Kishore H. Galaiyavs ITO [2012] 24 taxmann.com 11 (Mum.)]**

Q Is allotment of flat under self-financing scheme treated as construction or purchase of a house?

Under Government schedules confining to two years' period for construction and handing over possession thereof is impossible and unworkable under section 54 and, thus, if substantial investment is made in construction of house, it should be deemed that sufficient steps have been taken satisfying requirement of section 54 **[Smt. Shashi Varma vs CIT [1997] 224 ITR 106 (MP)]**

Q Whether deduction under section 54 be available where builder have not even allotted the plot within 3 years?

The main thrust of the section 54F is construction of a residential house; the Legislation in its wisdom has specifically provided the period of three years, it cannot be enlarged to indefinite period for the reason that no construction activity could be started within a period of 3 years by the builder because of which no plot was ever handed over to the assessee. **[Pankaj Wadhwani *vs* CIT 18 Taxmann. com 33 (Indore- ITAT)[2012]]**

Q Whether for purpose of claiming exemption under section 54, possession of flat booked with builder had to be taken within the time period specified?

If the assessee had made investment within period of three years, exemption under section 54 could not be denied for the reason that possession had not been taken. There may be delay in taking of possession because of many factors not under control of assessee, merely because of this exemption could not be denied. **[Kishore H. Galaiyavs ITO [2012] 24 taxmann.com 11 (Mum.)]**

In **CIT vs R.L Sood [2000] 108 Taxman 227 (Delhi),** it was held that on payment of substantial amount in terms of purchase agreement within four days of sale of his old house, assessee acquired substantial domain over new residential flat within specified period, it could be said that assessee complied with requirements of section 54. Merely because builder failed to hand over possession of flat within specified period, assessee could be denied benefit of benevolent provision of section 54.

Q Does exchange of old flat with a new flat under a development agreement amounts to construction of new flat for purpose of claiming deduction under section 54?

Exchange of old flat with a new flat to be constructed by the builder under development agreement amounts to transfer under section 2(47) of the Income Tax Act, 1961. The acquisition of a new flat under a development agreement in exchange of the old flat amounts to construction of new flat. The provisions of section 54 are applicable and assessee is entitled to exemption if the new flat had been constructed within a period of 3 years from the date of transfer. **[Jatinder Kumar Madan vs ITO [2012] 21 taxmann.com 316 (Mum.)]**

Q Can deduction u/s 54 be claimed for purchase of a share in the residential house property where the assessee presently resides?

Section 54 nowhere states that a residential house which is purchased by an assessee so as to enable the assessee to get exemption under the provisions of section 54 should not be the one in which the assessee was residing. Merely because the assessee was residing in a residential house which was purchased by her, exemption under section 54 could not be denied. **[CIT vs Chandan Ben Magan Lal 245 ITR 182 (Guj) (2000)].** Also see **CIT vs TN Arvinda Reddy 120 ITR 46 (SC) (1979), ITO vs RasikLal N Satra 98 ITD 335 (Mum) (2006)]**

Q Whether transfer of only interest in flats under construction could be treated as transfer of residential house?

Where the assessee transferred only his interests in two flats under construction of which possession was not taken and was not fit for human habitation, such transfer could not be treated as transfer of residential house. Hence, the capital gain derived by the assessee related to a capital asset held by him for a period of more than 36 months and, therefore, the gain arising from the transfer of his rights in the said flats constituted long-term capital gains. The assessee would, therefore, be entitled to grant of exemption under section 54F. **[Jagdish Chander Malhotra v ITO (1998) 64 ITD 251 (Del)]**

Q Whether the assessee is entitled to deduction under section 54F for purchase of flat under construction before the expiry of statutory period of two years from the date of the capital gain?

Where assessee invested amount of capital gain on sale of shares in purchase of flat before expiry of statutory period, benefit of deduction under section 54F could not be denied to assessee on ground that building was under construction stage and assessee had chosen to pay entire advance. **[ACIT vs Sudhakar Ram [2011] 16 taxmann.com 175 (Mum.-ITAT)]**

Section 54F does not prescribe completion of construction of residential house and thrust of said section is on investment of net consideration received on sale of original asset and start of construction of a new residential house. **[Smt. Rajneet Sandhu vs DCIT [2011] 16 taxmann.com 210 (Chd.-ITAT)]**

Q Can construction of house property start before the date of transfer.

Exemption on capital gains under section 54 cannot be refused merely on ground that construction of new house had begun before sale of old house.**[CIT v. HK Kapoor 150 CTR 128 (All) (1998)]**

Q Can the assessee simultaneously take benefit of both purchase and construction of residential house property?

If an assessee is entitled to relief on fulfillment of either of the two conditions specified under section 54, i.e., either purchasing a house property within one year or constructing the house within two years, it would be improper to read that on fulfillment of both the conditions, he would be disentitled to that relief. Section 54 does not contemplate two kinds of relief; it only contemplates fulfillment of two alternative conditions. If both the conditions are satisfied within the time stipulated, the assessee does not become disentitled to the relief if the other conditions are fulfilled. If a floor is constructed to the new house or if it is renovated it remains as one house only, especially when there is no evidence that two different houses bearing two different municipal numbers were constructed. Therefore, benefit can be availed jointly. **[BB Sarkar v. CIT 132 ITR 150 (Cal) (1981)].**

Q Where the minor has transferred an asset, will the exemption under section 54F/54EC be allowed to the minor or the parent.

Provisions of section 64(1A) i.e. clubbing of income of the minor with the income of the parent have to applied in the end after computing income of minor under Income Tax Act.

Where proceedings under Act for assessment of income of a minor child are required to be taken, minor child can be treated as an assessee under section 2(7) for purposes of section 54F. Benefit under section 54F cannot be denied to minor child on ground that father of minor child has a residential house at time of transfer of capital asset. **[ACIT vs Madan Lal Bassi [2004] 88 ITD 557 (CHD.)]**

In case of clubbing of income of minor child, deduction under section 54EC is to be allowed on minors' income from LTCG separately and only net income is to be clubbed **[DCIT vs Rajeev Goyal [2012] 22 taxmann.com 34 (Kol.-ITAT)]**

Q What is the date of investment in respect of section 54EC?

For the purposes of the provisions of Section 54EC, the date of investment by assessee must be regarded as date on which payment was made and received by the National Housing Bank. **[Hindustan Unilever Ltd. v. DCIT 191 Taxman 119 (Bom) [2010]]**

Q Whether the benefit under section 54EC could be availed where bonds are purchased in joint name?

Merely because bonds are in joint name, assessee could not be denied benefit of deduction u/s 54EC. As far as it is established that the complete consideration has flown from the assesse, the benefit could not be denied on this ground. **[DIT vs Mrs. Jennifer Bhide 15 taxmann.com 82 (Kar.) [2011]]**

Q Can exemption under section 54EC be claimed where REC Bond were purchased prior to date of sale of property?

Section 54EC clearly states that the investment in specified bonds is to be made "*within a period 6 months* ***after the date of such transfer***", the intention of the legislature is clear. Had the legislature wanted to give liberty to the assessee to invest before or after the date of transfer, they would have explicitly said so, as has been provided in section 54 & 54F of the Act. Since such specific words are not used in section 54EC, deduction cannot be allowed to the assessee. **[Smt. Dakshaben R. Patel vs ACIT [2012] 22 taxmann.com 237 (Ahd.-ITAT)]**

Q Is exemption u/s 54EC is available from capital gains on deemed transfer u/s 46(2) of the Income Tax Act 1961?

Capital Gains in the hands of shareholder on distribution of assets by company in liquidation u/s 46(2) is a deemed transfer not an actual transfer which has specifically been taxed under that section. Exemption u/s 54EC is available from gains on actual transfer and not from gains u/s 46(2).**[CIT V. Ruby Trading Co.Ltd. 32 Taxman 500 (Raj) [1987]]**

Q Whether the benefit under section 54EC and 54F can be taken simultaneously?

Deduction under section 54EC cannot be denied on ground that assessee has availed exemption under section 54F also in respect of a part of capital gains. **[ACIT vs Deepak S. Bheda[2012] 23 taxmann.com 159 (Mum.)]**

Q Whether the benefits u/s 54, 54F & 54EC are available from gains of depreciable capital asset?

In **CIT V. Assam Petroleum Industries Pvt. Ltd. 131 Taxman 699 (GAU.) [2003],** it was held that, where a depreciable asset is held for more than 36 months before its transfer, then such depreciable capital asset is Long Term Capital Asset. However, according to section 50(1)&50(2), the gains or loss on DCA shall always be short term.

It was further held that benefit u/s 54,54F & 54EC which are available from gains of a LTCA shall be available from gains of Depreciable capital asset.

PART -III OTHER EXEMPTIONS AVAILABLE FROM CAPITAL GAIN U/S 54B, 54D, 54G, 54GA & SECTION 54GB

SECTION	54B	54D	54G	54GA
Which Capital asset is eligible for exemption -LT/ST	ST/LT	ST/LT	ST/LT	ST/LT
When available	Transfer of Land used for Agricultural purposes by assessee/his parents for atleast 2 years	On compulsory acquisition of land and building forming part of an industrial undertaking	On shifting of industrial undertaking from urban area to rural area	On shifting of industrial undertaking from urban area to SEZ
Asset	Any Agriculture Land	Land/building Land/building	Land/building/ P&M Land/building/ P&M	Land/building/ P&M Land/building/ P&M
Person	IND/HUF*	Any person	Any person	Any person
Period within which to purchase	2 years after	3years after the date of transfer	1year before or 3years after the date of transfer	1year before or 3years after the date of transfer
Deposit money before due date of return is compulsory	Yes	Yes	Yes	Yes

Exemption under Section 54GB [Inserted w.e.f. 1st April, 2013]- Capital gain on transfer of residential property not to be charged in certain cases

- Relief from long-term capital gains tax on transfer of residential property
- If sale consideration invested in a manufacturing small or medium enterprise.

Exemption of **Long term Capital Gain Tax** to an **Individual or HUF** on **transfer of residential property** (a house or a plot of land) **on or before 31st March, 2017** upon **reinvestment** of sale consideration **before the due date of furnishing the return of income as specified section 139 (1)** in the **Equity of ELIGIBLE BUSINESS** (a new start up SME company in the manufacturing sector which is utilized by the company for the purchase of new plant & machinery as specified in the section in which it holds more than 50% share capital or voting rights) and The share cannot be transferred within a period of 5 years . The relief is available for any transfer of property made on or before 31.03.2017.

Some Practical Issues

ISSUE on Section 54B

Q. Whether the assessee would be entitled to get exemption under section 54B for purchase of land in name of his son and daughter-in-law?

The word "assessee" used in the Income Tax Act needs to be given a 'legal interpretation' and not a 'liberal interpretation', if the word 'assessee' is given a liberal interpretation, it would tantamount to give a free hand to the assessee and his legal heirs and it shall curtail the revenue of the Government, which the law does not permit. Consequently, an assessee would not be entitled to get exemption under section 54B for land purchased by him in name of his son and daughter-in-law. **[Kalyavs CIT [2012] 22 taxmann.com 67 (Raj.)]**

Q. Whether the assessee would be entitled to get exemption under section 54B for purchase of land in his name and in name of his only son?

When the purchased land was being used by assessee only for agricultural purpose, merely because in sale deed his only son was also shown as co-owner, assessee could not be denied deduction under section 54B. **[CIT vs Gurnam Singh [2008] 170 Taxman 160 (Punj. & Har.)]**

Q. If no agricultural activities are performed on land in past two years preceeding date of sale of land, the claim for exemption under section 54B allowable?

When as per revenue records no agricultural activity was undertaken on land owned by assessee in past two years preceding date of sale and the assessee

failed to prove that land in question was agricultural land, assessee's claim for exemption under section 54B cannot be accepted.**[G. Ramkumar vs DCIT [2012] 20 taxmann.com 522 (Chennai-ITAT)]**

Q Is the assessee eligible for exemption under section 54B, where capital gains from sale of agricultural land was invested in purchasing non-agricultural land?

The land revenue authorities had categorically stated that as per revenue records no crop was cultivated/agricultural activity was undertaken on the land owned by the assessee. No concrete evidence has been brought on record by the assessee to controvert the findings of fact recorded by the lower authorities, except production of statements of neighbours of the assessee. Since the assessee has miserably failed to prove that the land in question was agricultural land and he had cultivated crops in the land, assessee is not eligible for exemption under section 54B.**[G. Babuvs ITO [2012] 24 taxmann.com 36 (Chennai-ITAT)]**

Q. Whether word 'parent' as appearing in section 54B includes an 'uncle' within its ambit?

The word 'parent' does not stand defined in the Act. Once this is so, the general definition of the word 'parent' is to be taken into consideration and even the general definition does not include an 'uncle'. Thus, the land having not been exploited for agricultural purposes by a parent of the assessee, the exemption under section 54B would not accrue to him.**[Jarnail Singh vs ITO [2009] 31 SOT 8 (Asr.-ITAT)(URO)]**

Chapter -X

MISCELLANEOUS ISSUES

Some Practical Issues

Q. If the sales proceeds realized is utilized for the purpose of repaying the bank loan, then will the assessee get any deduction for repayment of loan out of sale proceed of the property?

The assessee was a partner in a firm which took loan from the bank against mortgage of house property belonging to the assessee. The bank enforced the recovery of loan against the firm by sale of the property mortgaged. The house was auctioned by the assessee and out of the total sale consideration received, he discharged mortgaged debt and received balance amount.

The assessee was not entitled to the deduction as claimed on account of discharge of mortgage debt to the bank. In fact, the entire amount of sale consideration had been received by the assessee and thereafter part of it was applied for discharge of the mortgage debt. It was, thus, a case of application of income received. ***[*CIT v. Sharad Sharma, 169 Taxman 67 (All.) [2008]]**

Q. Whether the amount paid to clear the mortgage can be said to be cost of acquisition of cost of improvement.

In case the mortgage is created by the assessee himself, amount paid to clear the mortgage debt cannot be said to be COA or COI.**[V.S.M.R. Jagadishchandran V. CIT 227 ITR 240 (SC) 1997]**

However, where the assessee has acquired his property from the previous owner and the previous owner had taken a mortgage against the property, which was not settled at the time of transfer of property. Now if assessee pays the mortgagee

& acquire a better title to the property, such amount paid will be treated as cost of acquisition in the hands of assessee. **[CIT vs Arunachalam 227 ITR 223(SC) (1997)]**

Q. Whether the exemption under section 54D is allowable in case the amount of compensation is invested into land taken on lease or the purpose of business?

The words 'industrial undertaking' should be understood to have been used in section 54D in a wide sense, taking in their fold any project or business a person may undertake. Since the assessee had set up industrial undertaking by investing certain sum on land acquired by it on lease, the assessee was entitled to exemption under section 54D. **[CIT v Hemsons Industries 118 Taxman 903 (AP)]**

Q. What is the taxability of unutilised deposit under the Capital Gains Accounts Scheme, 1988 in the hands of the legal heirs of the assessee?

The unutilised amount in Capital gain account scheme cannot be taxed in the hands of the deceased. This amount is not taxable in the hands of legal heirs also as the un utilised portion of the deposit does not partake the character of income in their hands but is only a part of the estate devolving upon them. **[CBDT circular No 743 dated 6.5.1996]**

Q. What are the consequences where the amount deposited in capital gain account scheme remains unutilised within the specified period?

Where the assessee had not utilized the amount deposited in capital gain account as required within the prescribed period of three years, the same was taxable in the relevant year irrespective of whether the same amount was withdrawn by the assessee or not and irrespective of as to whether this non-withdrawal from capital gain account was for the fault of the assessee or of the Assessing Officer. Further, the withdrawal of the unutilized amount from the capital gain account is not pre-requisite for taxing the same in the relevant year.

Q. In whose hands capital gain will be taxed in case of transfer of property u/s 64(1)?

Where a property has been transferred to the spouse under section 64(1), any capital gain arising to the spouse from such asset would be includible in the total income of the transferor.**[Sevantilal Mankelal Sheth vs CIT 68 ITR 503 (SC) [1968)].**

Q. Does the transfer made by way of Family Arrangement attract capital gain tax?

No, transfer by way of Family Arrangement does not attract capital gain tax. **[Ram Charan Das v GirjaNandini Devi AIR 1966 SC 323,** see also **CIT v. A.N. Naik**

Associates and Anr (2004) 265 ITR 346 (Bom), CIT v AL Ramanathan (2000) 245 ITR 494 (Mad).

Other Issues

- **Circular No. 471 dated 15/10/1986 and Circular no. 672 dated 16/12/1993,** treating payment towards allotment to housing board as reinvestment to be required for purpose of section 54, period of holding should be reckoned from the date of agreement. It may also be pointed out that it is not the title, but the beneficial right, that is considered to be relevant for the purpose of taxation. **[CIT v. Poddar Cement Pvt. Ltd. 226 ITR 625 (SC)(1997)]**

- Amount received by the society from the builder for permitting him to construct additional floors on existing building of the society utilizing TDR FSI belonging to him is not chargeable to tax since there is no cost of acquisition. **[Om Shanti Co-op Society Ltd. V ITO (ITA No. 2550/Mum/2008)]**

- The assessee, to avoid the sale by the Court, sold the house himself with the consent of the bank on the assurance that out of the sale proceeds, the bank loan would be paid directly by the purchaser. Therefore, it was to be held that the bank had an overriding title over the property and the real value to which the assessee was entitled was only Rs. 45,000 and not the balance of Rs. 1.50 lakhs which was directly paid to the bank. **[Kanti Swaruoop Sharma v. ITO 41 ITD 246 (All.) [1992]]**

VOICE OF CA

Part-VII

An Overview of Wealth Tax

(As amended by Finance Act, 2012)

Chapter-I

APPLICABILITY

The Wealth Tax Act is applicable to whole of India and came into force on 1st April, 1957. The following are the persons covered under Wealth Tax Act –

- Individual –
  a) Legal hires of an individual
  b) Holder of an impartible estate
  c) Hindu Deities
  d) Trustees of a trust who are liable u/s 21A of Wealth Tax Act.
  e) Trade unions
- HUF
- Company
- AOP chargeable u/s 21A of Wealth Tax Act

- **Wealth Tax Act not to apply in certain cases - Section 45**
  - Company registered u/s 25 of Companies Act, 1956
  - Co-operative society
  - Social Club

- Political Party
- Mutual fund specified u/s 10(23D) of the Income Tax Act, 1961
- Reserve Bank of India.

Taxability of assets located outside India and in India [Section6]

S.No	Citizenship/ Residential Status	Asset Located		Debts Located	
		In India	Outside India	In India	Outside India
1.	Individual Indian national and HUF				
	a. R & OR	Taxable	Taxable	Deductible	Deductible
	b. R but not OR	Taxable	Not Taxable	Deductible	Not Deductible
	c. NR & OR	Taxable	Not Taxable	Deductible	Not Deductible
2.	Individual foreign national	Taxable	Not Taxable	Deductible	Not Deductible
3	a. Resident Company	Taxable	Taxable	Deductible	Deductible
	b. Non-resident company	Taxable	Not Taxable	Deductible	Not Deductible

*Therefore the assets located out-side India shall be included only in the following case:

Individual	Citizen of India, Resident and ordinary resident
HUF	Resident and ordinary resident
Company	Resident

Meaning of Valuation date, Net Wealth, Debt and Assets

- **"Valuation date" - Section 2(q)**

In relation to any year for which an assessment is to be made under this Act, means the last day of the previous year as defined in Sec. 3 of the Income-tax Act, if an assessment were to be made under that Act for that year.

- **"Net Wealth"- Section 2 (m)**

- the amount by which the aggregate value computed in accordance with the provisions of this Act
- of all the assets, ***wherever located***, *belonging to the assessee on the valuation date*, including assets required to be included in his net wealth as on that date under this Act,
- is in excess of the aggregate value of *all the debts owed by the assessee* on the valuation date which have been incurred in relation to the said assets.

Net Wealth

Value of all the taxable assets	XXX
Less: Exemption under section 5	(XXX)
Less: Debts incurred in relation to assets	(XXX)
Net Wealth	XXX

- **"Debt"- Section 2(m)**

- Debt is deductible only when it is

  - **outstanding on valuation date *and***
  - **debt is incurred in relation to assets included in the net wealth.**

Some Practical Issues:

Debt secured on the assets are not deductible- A debt secured on or incurred in relation to property in respect of which wealth-tax is chargeable, will not cease to be a debt or will not change its character to one of a non-deductible debt merely because it is invested in an instrument which is not chargeable to wealth-tax. **[Miss Deanna J. Jeejeebhoy v. WTO [2009] 180 Taxman 586 (Bom.)]**

Tax liability resulting on account of settlement pertaining to earlier assessment years arrived at with Commissioner during relevant assessment year is allowable as a deduction.**[CWT v. Manna Lal Surana] [2009] 184 Taxman 448 (Raj.)**

As per Circular No. 663 dated 28.09.1993, **liability under the Wealth Tax Act is not a debt.**

- **"Assets" covered under Section 2(ea)**

The following are the assets covered under Wealth Tax Act:

i. Any building or land appurtenant thereto

ii. Cars

iii. Jewellery, bullion, Gold/Silver utensils etc.

iv. Yachts, boats & aircraft

v. Urban Land

vi. Cash in hand

The related provisions are analyzed as under:

- **Section 2(ea)(i) – Any land or building appurtenant thereto**

"any building or land appurtenant thereto (hereinafter referred to as "house"), whether used for residential or commercial purposes or for the purpose of maintaining a guest house or otherwise including a farm house situated within twenty-five kilometres from local limits of any municipality (whether known as Municipality, Municipal Corporation or by any other name) or a Cantonment Board, but does not include—

(1) ***a house meant exclusively for residential purposes and which is allotted by a company to an employee or an officer or a director who is in whole-time employment, having a gross annual salary of less than five lakh rupees.*(10 lakhs as amended w.e.f. 1st April, 2013).**

(2) ***any house for residential or commercial purposes which forms part of stock-in-trade.***

(3) any house which the assessee may occupy for the purposes of any business or profession carried on by him**.**

(4) any residential property that has been let-out for a minimum period of **three hu*ndred days in the previous year.***

(5) ***any property in the nature of commercial establishments or complexes."***

Therefore, any building or land appurtenant thereto is an asset, whether used for:

- Residential purpose
- Commercial purpose
- Maintaining of guest house
- Otherwise
- including a farm house situated within 25 kilometres from local limits of any municipality (whether known as Municipality, Municipal Corporation or by any other name) or a Cantonment Board.

is treated as asset.

But does not include –

a) a house meant exclusively for **residential** purposes and which is allotted ***by a company to an employee or an officer or a director*** who is in whole-time employment, having *a gross annual salary of less than 5 lakhs*. [10 lakhs as amended w.e.f. 1st April, 2013]

b) any house which forms part of **stock-in-trade**.

c) any house **occupied by the assessee for his business or profession**.

d) any **residential property let-out for a minimum period of 300 days** in the P.Y.

e) any property in the nature of commercial establishments or complexes.

Note :-

1. Unauthorized building is also a house.
2. Commercial property let out for more than 300 days in the P.Y. is also an asset.

- **Section 2(ea)(ii) - Motor Cars**

"motor cars (other than those used by the assessee in the business of running them on hire or as stock-in-trade)"

Therefore, motor car includes all motor cars whether Indian or imported, *other than* those used by the assessee for the following purpose –

- In the business of running them on hire; or
- As stock-in-trade

Note:

1. Motor cars leased out by leasing company constitute assets in the hands of leasing company.
2. In case hire purchase, the motor cars shall be included in the wealth of hire purchaser.
3. Buses and Trucks are not motor cars but Jeep and Jonga constitute motor cars.
4. Delivery vans, ambulances, 2/3 wheelers, Display vans, tractors and lorries are not cars.

- **Section 2(ea)(iii) – Jewllery, bullion etc**

"jewellery, bullion, furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals :

Provided that where any of the said assets is used by the assessee as stock-in-trade, such asset shall be deemed as excluded from the assets specified in this sub-clause."

Therefore

- Jewellery, bullion & furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metals are assets.

- but it does not include stock in trade.

Note: "Jewellery" not includes Gold deposit Bonds under Gold deposit scheme, 1999 notified by Central Government.

- **Section 2(ea)(iv) – yachts, boats and aircrafts**

"yachts, boats and aircrafts (other than those used by the assessee for commercial purposes)"

Therefore, yachts, boat and aircraft do not include those used for commercial purposes. And commercial purpose includes stock-in-trade. Ship is not an asset but helicopter is an asset under Wealth Tax Act.

- **Section 2(ea)(v) - Urban Land (vacant land)**

"urban land" means land situate—

(i) in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the valuation date ; or

(ii) in any area within such distance, **not being more than eight *kilometres from the local limits of any municipality or cantonment board referred to in sub-clause (i), as the Central Government may, having regard to the extent of, and scope for, urbanisation of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette,***

but does not include land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated or the land occupied by any building which has been constructed with the approval of the appropriate authority or any unused land held by the assessee for industrial purposes for a period of two years from the date of its acquisition by him or any land held by the assessee as stock-in-trade for a period of ten years from the date of its acquisition by him. [Explanation 1 to section 2(ea)]

Therefore, *"urban land" means land—*

- which comprised **within** the jurisdiction of municipality whose population **exceeds 10,000**.

- situated within and not being **more than 8 k.m.** from the local limit of any municipality.

Not include the followings:

- Land on which *construction is not permissible*.
- Land *occupied by building constructed with approval of appropriate authority*.
- *Unused land for industrial purpose for 2 years from acquisition.*
- Land held by the assessee as *stock-in-trade for 10 years from acquisition*.

- **Section 2(ea)(vi) - cash in hand**

"Cash in hand, in excess of fifty thousand rupees, of individuals and Hindu undivided families and in the case of other persons any amount not recorded in the books of account."

Therefore, cash is an asset in case of

- **Individual/HUF -** excess of Rs. 50,000/-
- **Others -** not recorded in books (found in search & seizure)

Some Practical Issues

- The assessee in the business of letting out properties. The commercial property used by the assessee in business is not liable to wealth tax. [**Shankaranarayana Industries & Plantations (P.) Ltd. vs. CWT (2010) 194 Taxman 189 (Kar.)]**
- Property used in business, would be exempt from wealth-tax **[CWT vs. Sohna Forge (P.) Ltd. [2012] 19 taxmann.com 29 (Delhi)]**
- The assessee was in the business of printing and also in leasing out properties. The assessee had 3 properties. Out of three, one is used in residential accommodation to the directors of the company, another property is given on leased out and derived some benefits and the third property is leased out to a company.

  The revenue was of the opinion that the residential property given to director is not in accordance with section 40(3)(vib) of the Finance Act, 1983 and the other two property leased out should also be regarded as asset in wealth tax.

  Held, company is eligible for exemption for all the above mentioned properties. **[Kumudum Printers (P.) Ltd. v. CWT [2012] 20 taxmann.com 517 (Mad.)]**
- Where assessee had given **gold** to third party from whom it had been seized and being a contraband article had been handed over to Gold Control Authorities,

it **could not be held to be an asset of assessee on relevant valuation date** and its value was not includible in net wealth of assessee; further gold given on trust to third party which was neither recovered by police, nor returned to assessee and whose recovery had become time barred, could not be included in assessee's wealth. [**Meghji Girdhar (HUF) v. CWT [2012] 20 taxmann.com 744 (MP)]**

- Building in process of construction cannot be understood as a building which has been constructed, in terms of meaning given to 'urban land' as defined u/s 2(ea)(b). 'Constructed' would mean 'fully constructed' as understood in common parlance. Since wordings 'urban land' would mean a land on which complete building stands, such land alone would qualify for exemption. **[CWT v. Giridhar G. Yadalam] [2007] 163 Taxman 372 (Kar.)**

- Deposit under Compulsory Deposit Scheme (Income-tax Payers) Act, 1974, constitutes an asset under section 2(e) and the same is liable to wealth tax.

- Income-tax refund, which is merely claimed but not assessed, has an unascertainable value on date of valuation and cannot form part of taxable asset. **[Smt. Smitaben N. Ambani v. CWT [2009] 181 Taxman 233 (Bom.)]**

- Mere right to receive enhanced compensation for acquired land of assessee can not be treated as an asset, includible in wealth of assessee. **[CWT v. Nand Lal, Mohan Lal [2010] 191 Taxman 152 (Punj. & Har.)]**

- The period of two years' tax exemption period qua industrial plots held by assessee would be reckoned from date of acquisition of plots by it and not from date when permission to change land use for industrial purpose was granted. [**Rockman Cycle Industries Ltd. vs. CWT [2010] 191 Taxman 399 (Punj. & Har.)]**

- Where assessee was a partner and firm in which she was partner had received cash incentive/duty drawback as a personal reward for promotion of export of handloom goods given by Handloom Export Promotion Council, such rewarded remittance did not fall within purview of movable or immovable property and could not possibly be termed as 'assets' as defined under section 2(e) and, hence, share of assessee in cash incentive/duty drawback due to firm was not includible in her net wealth [In favour of assessee - **CWT** *v.* **Smt. Kamal Saroj [2010] 325 ITR 341 (Punj. & Har.)]**

Deemed Assets under Section 4

1. The following assets shall be included in the net-wealth of the individual, whether the assets are held in the form in which they were transferred or otherwise:

Section	**Assets held by**	**Type of assets**
4(1)(a)(i)	Spouse	Assets transferred by individual, directly or indirectly, otherwise than for adequate consideration or in connection with agreement to live apart.
4(1)(a)(ii)	Minor child, not being a married daughter or physically or mentally handicapped minor child	All assets other than that acquire by him through manual work done by him or activity involving application of his specialised knowledge and skill. [Section 64(1A) of Income Tax Act, 1961] *Note: assets shall be included in net-wealth of parent whose net wealth excluding assets of the minor is greater, if the marriage subsists or in the net wealth of the parent who maintains the minor child if the marriage of the parents does not subsist.*
4(1)(a)(iii)	Person or association of person for the immediate or deferred benefit of the individual, his or her spouse	Assets transferred by individual, directly or indirectly, otherwise than for adequate consideration
4(1)(a)(iv)	Person or association of person	Assets transferred by individual, otherwise than under an irrevocable transfer
4(1)(a)(v)	Son's Wife	Assets transferred by individual, directly or indirectly, otherwise than for adequate consideration
4(1)(a)(iv)	Person or association of person for the immediate or deferred benefit of the son's wife of such individual or both	Assets transferred by individual, directly or indirectly, otherwise than for the adequate consideration

2. In computing the net wealth of partner of a firm or member of an AOP, the **interest of partner or member of AOP in assets of a firm /AOP** shall be included. (Value of interest shall be computed as per Schedule III**) [Section 4(1)(b)]**

3. Member of HUF **converts his self acquired property in to the HUF property** otherwise than adequate consideration.**[Section 4(1A)]**

4. The value of any **assets transferred under an irrevocable transfer** shall be liable to be included in computing the net wealth of the transferor as and **when the power to revoke arises to him. [Section 4(5)]**

5. A gift of money from one person to another is made by means of entries in the books of account maintained by the person making the gift or by an individual

or a Hindu undivided family or a firm or an AOP or BOI with whom or which he has business or other relationship, the value of such gift shall be liable to be included in computing the net wealth of the person making the gift unless he proves. **[Section 4(5A)]**

6. The holder of an impartible estate shall be deemed to be the owner of all the properties of the estate**. [Section 4(6)]**

7. **Member of cooperative housing society, company or other association of persons and a building or part thereof** is allotted or leased to him under a house building scheme of the society, company or association, as the case may be, the assessee shall, be deemed to be the owner of such building or part and the value of such building or part, shall be included in computing the net wealth of the assessee, even if that flat is not registered in his name.

   In determining the value of such building or part, the value of any outstanding instalments of the amount payable under such scheme by the assessee to the society, company or association towards the cost of such building or part and the land appurtenant thereto shall, whether the amount so payable is described as such or in any other manner in such scheme, be deducted as a debt owed by him in relation to such building or part. **[Section 4(7)]**

8. Immovable property obtained in **part performance of contract**. **[Section 4(8)]**

9. Any rights (excluding any rights by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building or part thereof by virtue of any such transaction as is referred to in clause (*f*) of section 269UA of the Income-tax Act, 1961 (43 of 1961). **[Section 4(8)]**

Note:

1. The value of interest of minor determined as per schedule III and included in the net wealth of parents.

2. Accretion to the assets transferred to spouse for inadequate consideration is not to be clubbed with the wealth of the transferor.

Some Practical Issues

- Asset from which assessee was deriving rental income would be deemed to be 'belonging to' assessee even if legal ownership of said property had not yet been passed to assessee. [**H.P. Small Industries & Export Corp. v. CWT[2012] 22 taxmann.com 32 (HP.)]**

- For the purpose of levying tax on the assessee in case of a flat in a co-operative society, two conditions are required to be fulfilled on valuation date –

(i) The assessee must be a member.

(ii) Assessee should be allotted a building or part of building.

When these two conditions get satisfied the assessee becomes liable to pay wealth tax. **[Bennett Coleman & Co. Ltd. v. Asst. CWT [2008] 170 Taxman 491 (Bom.)**

Land used for internal roads of factory and playground for workers of factory was taxable as wealth of company. [**Motwane Manufacturing Co. (P.) Ltd. *v.* CWT [2009] 222 CTR 462 (Bom)]**

Exemptions in respect of certain assets under Section 5

S. No.	Section	Description of assets
1.	5(1)(i)	**Property held under trust for public purpose of a charitable/religious nature in India** but excludes assets of a business carried on by an institution, fund or trust referred to in any property forming part of any business, not being a business referred to in Section 11(4A)(a)/(b) in respect of which separate books of account are maintained or a business carried on by institution, fund or trust referred to in Section 10 (23B)/(23C) of the Income-tax Act
2.	5(1)(ii)	Interest in the coparcenary property of any HUF
3.	5(1)(iii)	Any one building in the occupation of a former Ruler as his official residence declared by Central Govt.
4.	5(1)(iv)	Heirloom Jewellery in possession of a Ruler subject to condition of CBDT.
5.	5(1)(v)	**Money/ assets brought by a person of Indian origin/citizen of India** (returning to India with the intention of permanently residing therein), **into India and the assets acquired by him out of such moneys**, **within one year immediately preceding the date of his return and at any time thereafter**. [The exemption is available for 7 successive assessment years] ***Note:*** *Even if the assessee has converted assets, which were brought by him from outside India, into money, and has used that money for acquisition of other asset, the asset which is acquired with the sale consideration of original asset, is also eligible for exemption.*
6.	5(1)(vi)	**One house** or **part of a house** or **a plot of land comprising an area of 500 square metres or less** **belonging to an individual or HUF**.

Important Points to be considered:

i. Where trust deed provides that trust property can be used for other than charitable or Religious purposes, exemption u/s 5(i) shall not available.

ii. In case a palace consists of number of buildings out of which some were actually occupied and few of them were let out, then exemption u/s 5 (iii) is allowed only

in respect of self occupied building.

iii. **Exemption u/s 5(vi) is available for any house, whether**

a. residential or commercial or

b. let out or self occupied.

iv. **Exemption u/s 5(vi) can also be availed for Guest House or Farm House.**

v. Where the assessee is claiming exemption u/s 5(iii) for one house, he shall not be entitled to seek exemption for another house u/s 5(vi). **[Gaj Singh (2000) 113 Taxman 32 (Supreme Court)]**

Some Practical Issues

- Where movable and immovable properties of a hotel were transferred to assessee-trust for providing catering education therein and in hands of doner said transfer was not treated as gift on ground that it was only a permission granted for a college, said property could not be treated as assessee's wealth in its wealth tax assessment. **[CWT *v.* Manipal Hotel & Restaurant Management College Trust [2011] 15 taxmann.com 279 (Kar.)]**

- In respect of valuation of assessee's interest in immovable properties of firm, a separate deduction u/s 5(1)(iv) was admissible to assessee as a partner to extent of his share in said firm and Appellate Tribunal was justified in holding that firm in which assessee was partner was an industrial undertaking and that assessee was entitled to exemption u/s 5(1)(xxxii).

[CWT*v.* **Manna Lal [2010] 2 DTLONLINE 101 (Raj.)**

Chapter-II

VALUATION OF ASSETS

Value of assets, how to be determined- Subject to the provisions of sub-section (2), the value of any asset, other than cash, for the purposes of this Act shall be its value as on the valuation date determined in the manner laid down in Schedule III [Section 7(1)].

Nature of Assets	**Rule No.**
Valuation of **Immovable Property**	3 to 8
Global valuation of **Business**	14
Valuation of **Interest in Firm / AOP**	15 & 16
Valuation of **Life Interest**	17
Valuation of **Jewellery**	18 & 19
Valuation of **Other Assets**	20
Restrictive Covenants to be ignored	21

determined in the manner laid down in Schedule III [Section 7(i)]

- **Valuation of Immovable Assets - Rule 3 to 8 of Schedule III r. w. Section 7(2) of the Act.**

a) **The value of any immovable property** being a building or land appurtenant thereto shall be determined **as per Part B of Schedule III as on Valuation date**.

b) Option under Section 7

If a house belonging to the assessee and exclusively used by him for **residential purposes throughout the period of 12 months** immediately preceding the valuation date, may, at the option of the assessee, be taken to be the value determined

- As per Schedule III as on the valuation date or
- As per part B of Schedule III as on Valuation date next following the date on which he became the owner of the house or

  the valuation date relevant to the assessment year commencing on the 1st day of April, 1971,
  whichever valuation date is later.

Note:

(*i*) Where the house has been constructed by the assessee, he shall be deemed to have become the owner thereof on the date on which the construction of such house was completed.

(*ii*) "House" includes a part of a house being an independent residential unit.

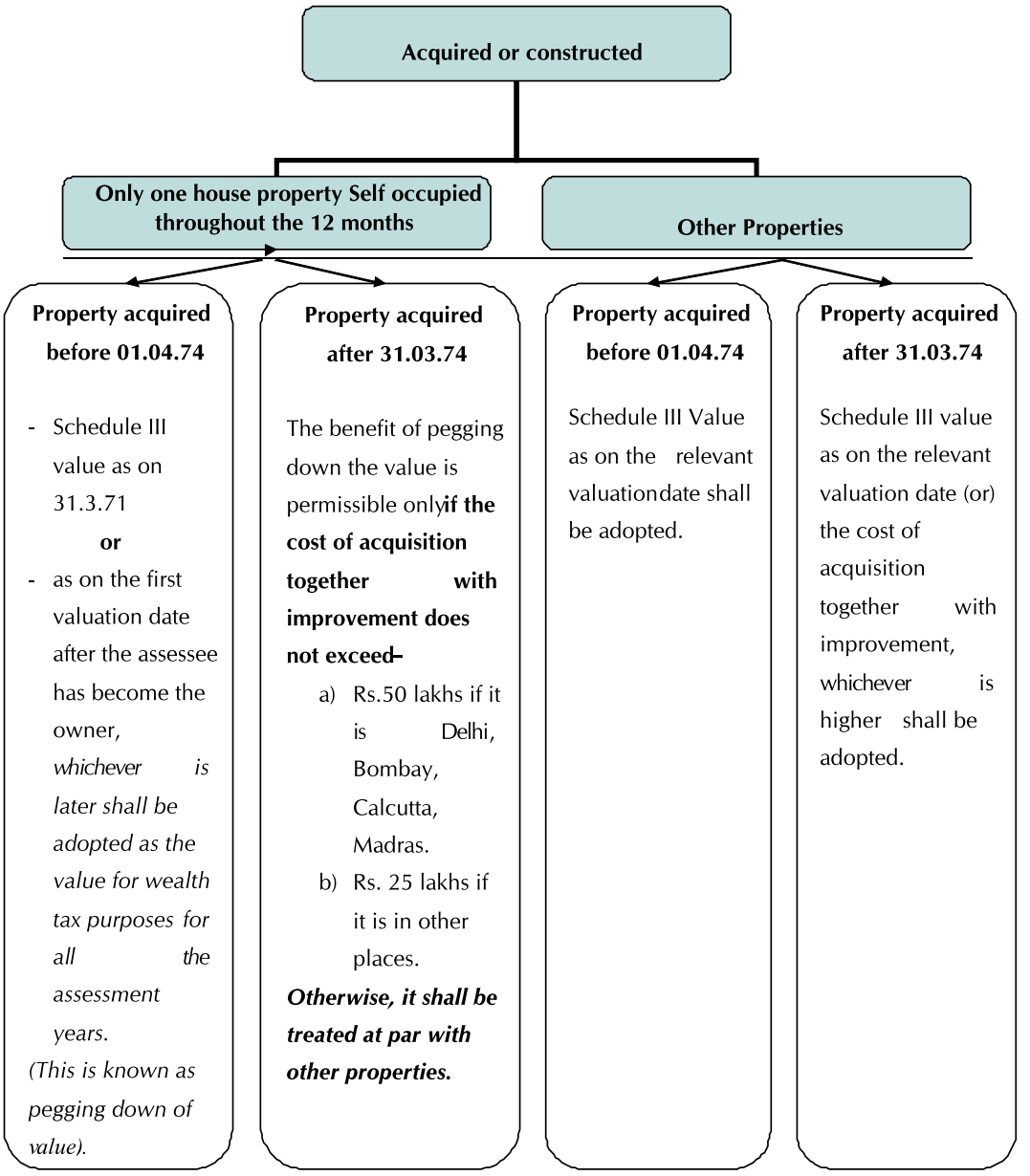
Valuation as per Rule 3, 4, 5, 6 & 7

Value (as per Rule 3, 4, 5)	=	XXX
Add: Adjustment for unbuilt area (Rule 6)	=	XXX
Less: Adjustment for unearned increased (Rule 7)	=	XXX
Value of the house property	**=**	**XXX**

Valuation as per Rule 3, 4, & 5

- **Step 1 - Gross maintainable rent:**

- If property is **not let out** - annual value assessed and in case no such assessment then annual rent (Fair Value)


Acquired or constructed
Only one house property Self occupied throughout the 12 months
Other Properties
Property acquired before 01.04.74
- Schedule III value as on 31.3.71
or
- as on the first valuation date after the assessee has become the owner, *whichever is later shall be adopted as the value for wealth tax purposes for all the assessment years.*
(This is known as pegging down of value).
Property acquired after 31.03.74
The benefit of pegging down the value is permissible only **if the cost of acquisition together with improvement does not exceed–**
a) Rs.50 lakhs if it is Delhi, Bombay, Calcutta, Madras.
b) Rs. 25 lakhs if it is in other places.
Otherwise, it shall be treated at par with other properties.
Property acquired before 01.04.74
Schedule III Value as on the relevant valuationdate shall be adopted.
Property acquired after 31.03.74
Schedule III value as on the relevant valuation date (or) the cost of acquisition together with improvement, whichever is higher shall be adopted.

- If the property is **let out** - annual rent **or** annual value assessed by local authority whichever is higher

Annual rent shall be computed as follows:-

Actual rent received or receivable	XXX
Add:	
1. The amount of taxes borne by the tenant, if any	XXX
2. If the repairs are borne by tenant then 1/9 of actual rent	XXX
3. If any deposit is accepted (not being rental advance, if any, for 3 months or less) amount calculated at 15% p.a. as reduced by actual interest paid.	XXX
4. If premium for leasing of the property is received, amount obtained as premium divided by the number of years of the period of lease.	XXX
5. The value of any benefit or perquisite derived as consideration for leasing of the property.	XXX
6. Any sum paid by a tenant or occupier in respect of any obligation payable by the owner.	XXX
Annual Rent (Gross Maintainable Rent)	**XXX**

Step 2 – Net Maintainable Rent (NMR):

Gross Maintainable Rent	XXX
Less:	
a) Municipal taxes levied by local authority (not actually paid)	XXX
b) A sum equal to 15% of the Gross Maintainable Rent	XXX
Net Maintainable Rent (NMR)	**XXX**

Step 3 – Valuation by capitalization:

A. If the property is constructed on free hold land then the value	NMR x 12.5
B. If such property is constructed on lease hold land, then	
i. Where the unexpired lease period is 50 years or more	NMR x 10.0
ii. Where the unexpired lease period is less than 50 years	NMR x 8.0

Step 4: Further adjustments to be made[Rule 6]

Value as computed under step 3	XXX
If the unbuilt area of the plot of land on which the property is constructed exceeds the specified area, addition is to be made on the following basis i.e., (unbuilt aggregate specified Area)	XXX

If the excess is –	Addition to be made
above 5% upto 10%	20% of the above value
above 10% upto 15%	30% of the above value
above 15% upto 20%	40% of the above value
Above 20% of the aggregate area	This rule is not applicable

Adjusted Net Maintainable Rent	XXX

Note: **'Unbuilt area'** in relation to the aggregate area of the plot of land on which the property is constructed, means that part of such aggregate area on which no building has been erected

'Specified area' is determined as under:

	Location of Property	Specified Area
A	Mumbai, Calcutta, Delhi or Chennai	60% of the aggregate area
B	Agra, Ahmedabad, Allahabad, Amritsar, Bangalore, Bhopal, Cochin, Hyderabad, Indore, Jabalpur, Jamshedpur, Kanpur, Lucknow, Ludhiana, Madurai, Nagpur, Patna, Pune, Salem, Sholapur, Srinagar, Surat, Tiruchirapalli, Trivandrum, Vodadara or Varanasi.	65% of the aggregate area
C	Any other place	70% of the aggregate area

Note: 'Aggregate area' in relation to the plot of land on which the property is constructed, means the aggregate of the area on which the property is constructed and the unbuilt area.

Step 5- Deduction of unearned increase[Rule 7]

Adjusted Net Maintainable Rent		XXX
Less: lower of the following:		
1. Amount liable to be claimed and recovered as unearned increase or	XXX	
2. An amount equal to 50% of the value arrived in Step 4 (i.e value as per Rule 3,4,5 & 6)	XXX	
		XXX
Value of immovable property as per Wealth Tax Act.		**XXX**

Some Points to be considered

- Assets not to be considered for Valuation
  - Advance tax paid
  - Bad debts allowed as deduction under IT act
  - Assets which is not liable for wealth tax
  - Assets shown in balance sheet not relating to business
  - Balance in P&L a/c shown in assets side of B/S
- Liabilities not to be considered for Valuation
  - Capital employed other than borrowed money
  - All reserves
  - Provisions for contingent liabilities
  - Liabilities not pertaining to business
  - Liabilities in relation to assets which are not liable for wealth tax
- **Some Practical Issues**
  - Land allotted to assessee which is declared as surplus land under Urban Land (Ceiling and Regulation) Act, 1976, is not marketable and for purpose of wealth-tax, its value has to be determined as per compensation payable by Government under said Act. **[AIMS Oxygen (P.) Ltd. *v.* CWT [2012] 23 taxmann.com 185 (Guj.) (FB)]**
  - In accordance with provisions of Schedule III, Rule 5 to Wealth-tax Act, 1957, AO is justified in adding interest on security deposits to annual rent in order to compute fair market value of property. [**CWT *v.* MG Builders Co. [2011] 16 taxmann.com 241 (Delhi)]**
  - Application of consumer price index in a reversed manner for computing the value of the land of earlier years and reopen the wealth-tax assessments on that basis, was procedural irrationally and on the basis of a totally extraneous factor.

Facts:

Assessee applied for clearance certificate under section 230A of the Income-tax Act regarding a piece of land intended for sale - Taking sale price declared therein as base, AO applied cost inflation index and working backwards found that land was valued lower in earlier duly completed assessment proceedings. He reopened such completed wealth-tax proceedings relating to assessment years 1982-83 to 1991-92 on ground that taxable wealth escaped assessment. [**Jogat Mohan Kapur**

***v.*WTO [1995] 211 ITR 721(CAL.)]**

- In absence of a rule which can apply to valuation of a particular asset, that asset must be valued in the ordinary way by determining what it would fetch if it was sold in an assumed market, therefore value being what an assumed willing purchaser would pay for it. **[CWT *v.*Prince Muffakham Jah Bahadur Chamlijan [2001] 247 ITR 351(SC)]**

- **CIT v. Smt. P. Bhagawati Ammal [2003] 262 ITR 622 (MAD.)**

  - Right to receive rent is a statutory right, merely because tenant has disputed quantification of fair rent, it will not mean that assessee does not have any right to receive fair rent for that building.
  - When Court passed order fixing fair rent assessee has right to receive fair rent from date of petition
  - It is right to contend that gross maintainable rent under rule 5 of Schedule III should be determined on basis of rent as enhanced by Rent Control Appellate Authority and confirmed by High Court and Supreme Court and not the rent fixed under original rent agreement between landlord and tenant.
  - Assessee disclosed an amount under Voluntary Disclosure Scheme and invested same in construction of a house. Assessee was entitled to deduction of said amount out of value of house in question. **[CWT v. Vallabh Das [2003] 262 Taxman 319 (RAJ.)]**
  - Assessee is not entitled to deduction of amount representing notional amount of capital gains tax (section 7). **[Smt. Sushila Devi Singhania v.CWT [2003] 130 Taxman 584 (All.)]**

Rule 14 - Valuation of Business Assets

The value of the business is computed as under:

Step-1

Nature of Asset	Value to be Considered
Depreciable asset	**Written down value** as on the valuation date
Non- Depreciable assets	**Book value** as on valuation date
Urban land held as Stock-in-trade after 10 years from the date of its acquisition.	**Value adopted for IT purpose for that previous year**
Value of the **asset not disclosed in the Balance sheet**	Determined **in accordance with provisions of schedule III**

Note: Only Assets as defined in Section 2(ea) should be considered.

Step-2

Determine the value of the said assets as per schedule III as under:

a)	House	-	Rule 3 to 8
b)	Jewellery	-	Rule 18 and 19
c)	Urban Land, Motor Car, Yachts, boats & Aircrafts	-	Rule 20 (FMV)

Step-3

- If the value as per step 2 is more than the value computed as per step 1 by more than 20% of the value as per step 1, then the value as per step 2 to be taken.
- In the reverse case i.e. value as per step 2 does not exceed the value as per step 1 by more than 20% as per step 1, then value as per step 1 to be taken.

Rule 15 & 16 - Interest in firm and association of persons

a) Determine the net wealth of the firm/AOP/BOI as if it were an assessee as per Rule 14 and no exemption to be availed u/s 5.

b) Net wealth computed above as is equal to the capital of the Firm/AOP/BOI should be allocated to the partners/members in the ratio of capital contribution.

c) The residual net wealth to be allocated in dissolution ratio and if there is no dissolution ratio then in profit sharing ratio.

d) Interest in the firm is aggregate of (b) & (c).

Note: Where partner is a NRI/ R & NOR/ non citizen, following shall not be included in the net wealth of such partner.

$$\text{Share of Such partner as computed under Rule 15 \& 16} \times \frac{\text{Asset of the firm located outside India}}{\text{Net wealth of Firm}} - \text{Debt incurred in respect of such asset}$$

Rule 17 - Valuation of life interest

- Life interest = Average annual income* X Capitalisation factor

  [*Average annual income (last 3 years) = Average gross income – Average expenses]

Note:

1. The expenses shall not exceed 5% of the average of the annual gross income.
2. The value of life interest shall, in no case, exceed the market value of the trust corpus on the valuation date.

Rule 18 & 19 - Valuation of Jewellery

The value of jewellery shall be estimated to be the price which it would fetch if sold in the open market on the valuation date.

- The return of wealth shall be supported by
  - Where the value of jewellery does not exceed Rs. 5 lakhs on the valuation date, a statement in prescribed form i.e. Form No. O-8A.
  - Where the value of jewellery exceeds Rs. 5 lakhs, a report of a registered valuer in the prescribed form.
- The value determined by valuation officer or registered valuer shall be adopted for subsequent 4 assessment years. However,
  - Adjustment shall be made in respect of any acquisition or sale of jewellery since the last valuation date.
  - Market value of gold/silver /any alloy containing gold /silver as on next valuation date shall be substituted.

Rule 20 - Valuation of Other Assets

The value of other assets shall be the value it will fetch if sold in open market.

Rule 21 - Restrictive Covenants

The price or other consideration for which any property may be **acquired by or transferred** to any person **under the term of a trust deed or under any restrictive covenant in any instrument of transfer shall be ignored for the purposes of determining the value of the property under the schedule.**

Assessment Procedure under Wealth Tax Act

Provisions of Wealth Tax Act, 1957	Particulars	Corresponding Provisions of Income Tax Act, 1961
14(1)	Obligation to file returns	139(1)
15	Belated Return	139(4)
15	Revised Return	139(5)
15A	Signing of Return	140
15B	Self assessment	140A
16(1)	Intimation / Deemed intimation	143(1)
16(2)	Notice for making scrutiny assessment	143(2)
16(3)	Scrutiny assessment	143(3)
16(5)	Best Judgment assessment	144
17	Income escaping assessment	147 to 152
17A	Time limit for completing assessment or reassessment.	153
17B	Interest on late filing of return	234A
18 (1) (c)	Penalty for concealment	271 (1) (c)
18B	Power to reduce or waive penalty in certain cases	273A
25(2)	Revision for orders prejudicial to revenue by commissioner	263
25(1)	Revision of other orders by commissioners	264

Note: There is no provision for payment of advance tax in the Wealth Tax Act,1957

Other Specific provisions of wealth Tax [Different form Income Tax Act]

Section 18(1)(c)- Penalty for concealment of wealth: 100% to 500% of tax sought to be evaded.

Explanation 4 to Section 18(1)(c) – Where value of asset returned is less than 70% of value of assets determined in assessment, then it is deemed to have furnished inaccurate particulars unless he proves.

Section-19- Penalty of deceased can not be levied on legal heir.

Analysis of provisions of Section 14, 16A, 17, 17(1A), and 17A of the Wealth Tax Act, 1957

- **Section 14 - Return of Wealth Tax**
  - It is statutorily obligatory for Every person to file the return if his net wealth exceeds maximum amount which is not chargeable to wealth tax.
  - Assesee can file a belated or revised return at any time before the expiry of *one year from the end of the relevant assessment year or before the completion of assessment, whichever is earlier*.
  - A return of net wealth which shows the net wealth below the maximum amount which is not chargeable to tax shall be deemed never to have been furnished. [This provision shall not apply to a return furnished in response to a notice u/s17]

Note: "due date" in relation to an assessee under this Act shall be the same date as that applicable to an assessee under the Income-tax Act under the *Explanation* to sub-section (1) of section 139 of the Income-tax Act.

- **Section16A - Reference to Valuation Offer**

AO may refer the valuation of any asset to a Valuation Officer in the following cases—

a. Where the value of the asset as returned **is in accordance with the estimate made by a registered valuer**, if the AO is of opinion that the value so returned is **less** than its FMV.

b. In any other case, if the AO is of opinion that -

   i) FMV of the asset **exceeds** the value of the asset as returned **by more than 33 1/3% of the value of the asset as returned** or **by more than 50,000/- such amount as may be prescribed in this behalf** or

   ii) Having regard to the nature of the asset and other relevant circumstances, it is necessary so to do.

Some Practical Issues

- While adopting value estimated by DVO, AO is not obliged to confront report of DVO to assessee.**[*CWT* v. *Vardhman Polytex Ltd.* [2010] 186 Taxman 454 (Punj. & Har.)]**
- Refernce to the Valuation officer after the completion of asseement proceedings is bad in Law. **[CWT v. Malhar Rao Tatya Saheb Holkar [1996] 220 ITR 466 (M.P.)]**

- **Section 17- Provision of Wealth Escaping Assessment**

If the AO has reason to believe that the net wealth of any person has escaped assessment for any assessment year, he may be subjected to the provisions of the Act serve on such person a notice requiring him to furnish within such period as specified in the notice, a return in the prescribed form and prescribed manner setting forth the net wealth of such person is assessable as on the valuation date mentioned in the notice.

No action shall be taken under this section after the expiry of 4 years from the end of the relevant assessment year.

Some Practical Issues

- **Issue of notice in case of reassessment u/s 17**

  Notice issued upon a company which was not in existence at time of issuance of notice due to its winding up, was insufficient to initiate proceedings against assessee who had taken over liability of said company earlier to issue of said notice and such fact was also made known to revenue. [**I.K. Agencies (P.) Ltd. *v.* CWT [2012] 20 taxmann.com 731 (Cal.)]**

- It is not open to AO to **call for report of Valuation Officer after assessment proceedings are completed and use that report to commence proceedings for reassessment;** however in cases where report was called for during pendency of proceedings but received subsequent to completion of assessment, law is that such report/order can be basis for issuing notice for reopening assessment u/s 17(1). [**CWT v. Sona Properties (P.) Ltd.] [2008] 216 CTR 217 (Bom.)**

- **Section 17(1A) - Time limit for Notice**

  No notice under sub-section (1) of Section shall be issued for the relevant assessment year,—

  a) **if 4 years have elapsed from the end of the relevant assessment year, unless the case falls under clause (*b*) or clause (*c*)**

  b) **if 4 years, but not more than 6 years,** have elapsed from the end of the relevant assessment year unless the net wealth chargeable to tax which has escaped assessment amounts to or is **likely to amount to rupees ten lakhs or more for that year**.

  c) if 4 years, but not more than 16 years, have elapsed from the end of the relevant assessment year unless the net wealth in relation to any asset (including financial interest in any entity) located outside India, chargeable to tax, has escaped assessment for any assessment year. **[Inserted by the**

Finance Act, 2012, w.e.f. 1-7-2012]

Explanation 1 - For the purposes of sub-section (1) and sub-section (1A) of section 17, the following shall also be deemed to be cases where net wealth chargeable to tax has escaped assessment, namely :—

a) where no return of net wealth has been furnished by the assessee although his net wealth or the net wealth of any other person in respect of which he is assessable under this Act on the valuation date exceeded the maximum amount which is not chargeable to wealth-tax ;

b) where a return of net wealth has been furnished by the assessee but no assessment has been made and it is noticed by the Assessing Officer that the assessee has understated the net wealth or has claimed excessive exemption or deduction in the return.

c) where a person is found to have any asset (including financial interest in any entity) located outside India.

Explanation 2 - *For the removal of doubts it is hereby clarified that the provisions of this section, as amended by the Finance Act, 2012, shall also be applicable for any assessment year beginning on or before the 1st day of April, 2012.*

- **Section 17A - Time limit for completion of Assessment or Reassessment under**
  - No order of assessment shall be made at any time after the expiry of 2 years from the end of the assessment year in which the net wealth was first assessable.
  - No order of assessment or reassessment shall be made u/s 17 after the expiry of one year from the end of the financial year in which the notice u/s 17(1) was served.

MISCELLANEOUS ISSUES

❖ **Exemption from Wealth Tax - Reserve Bank of India**

A new clause (k) to section 45 shall be inserted. [w.e.f. 1st April, 1957]

"(k) the Reserve Bank of India incorporated under the Reserve Bank of India Act, 1934."

Therefore wealth tax shall not applicable in respect of net wealth of RBI.

❖ Where return is not filed pursuant to notice u/s 16(4), no further notice is mandatory u/s 16(5) prior to passing of best judgment assessment**.[CWT v. Motor & General Finance Ltd. [2011] 11 taxmann.com 62 (Delhi)]**

- Assessment order passed without issuing a notice under section 16(2) or notice as contemplated in proviso to section 16(5), is violative of principles of natural justice. [**Smt. Prameela Krishna v. CWT [2012] 18 taxmann.com 181 (Kar.)** (**HC**)]

- Where a suit is pending before the court, the lessee will not be called up for the payment of wealth tax. The position of the lessee as of now is a precarious position and it is not possible to predict with certainty as to what the outcome of the suit will be.[**George Oakes Ltd. V. Dy. CWT [2012] 21 taxmann.com 158 (Mad.)**]

VOICE OF CA

Part-VIII

SERVICE TAX

(Covering Amendments upto 31st August, 2012)

Chapter-I

NEGATIVE LIST ON SERVICE TAX

In the earlier system the services only listed in sec 65(105) of Finance Act 1994 were chargeable to tax u/s 66.

However, the service tax has witnessed a great wave of change. The Union Finance minister has announced implementation of a new system for the taxation of service known as 'Negative List' where all the services provided or agreed to be provided in the taxable territory other than in –ve list shall be chargeable to tax u/s 66B.

Notification 19/2012-ST dated 05.06.2012 was issued notifying 1st July, 2012 as the date of implementation of Negative List after the enactment of Union budget 2012 as on 28th may,2012.

"MEANING OF SERVICES"

Sec 65B(44) defines service as follows:

- Any activity
- For consideration
- Carried out by a person for another and
- Includes a declared services

Thus the taxable services would be the following:

- Services satisfying the definition of service
- Declared services
- Exclusion from the negative list

This has resulted in the paradigm shift in the way the services were being charged to Service tax. This method does not differentiate between the organized & unorganized sector and covers all the service providers.

STEP 1: To determine whether the assessee is providing service

S.No.	Question	Answer
1	If he is doing any activity	Yes
2	Doing activity for a consideration	Yes
3	Does act involves only the transfer of rights in goods or immovable property by way of sale, gift or in any other manner	No
4	Activity consists of only transaction in money or actionable claim	No
5	Consideration for the activity is in the nature of court fees for a court or a tribunal	No
6	Service provided by an employee of such person	No

STEP 2: To determine whether service provided is taxable

S.no.	Question	Answer
1	Is the assessee providing service	Yes
2	Is he providing service in taxable territory	Yes
3	Is the activity entirely covered in negative list	No

The introduction of the negative list wef 1st july, 12 necessitated the need of making consequential amendment in ST.

The newly inserted section 66D comprises list of 17 services which comes under the preview of 'Negative List' which are as follows:

(a) Services by Government or a local authority excluding the following services to the extent they are not covered elsewhere—

(i) services by the Department of Post 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

(iv) support services, other than services covered under clauses (i) to (iii) above, provided to business entities;

Analysis

Meaning of Govt

'Government' has not been defined in the act, and therefore the definition of the 'Government' as contained in the General Clause Act, 1897 would be applicable as per which, 'Government' includes both Central and State Government.

Further, as per the General Clause Act, 1897, State includes Union Territory (U.T). Government would also include various departments and offices of the Central or State Government or the U.T. Administrations which carry out their functions in the name and by order of the President of India or the Governor of a State.

*Various corporations formed under **Central Act** or **State Act** or various government companies registered under the Companies Act, 1956 or autonomous institutions set up by a special Act are not covered under the definition of 'Government.*

Meaning of Local Authority

'Local authority' is defined in section 65B of Finance Act 1994, as amended, and means the following:-

- A Panchayat
- A Muncipality
- A Municipal Committee and a District Board, legally entitled to, or entrusted by the Government with, the control or management of a municipal or local fund.
- A Cantonment Board
- A regional council or a district council constituted under the Sixth Schedule to the Constitution
- A development board constituted under article 371 of the Constitution, or
- A regional council constituted under article 371A of the Constitution.

As per the above said provision of the negative list, service provided by government or local authority is exempted from service tax. However, it do not exempt every service provided by government or local authority.

Liability of a department of the Government need to get itself registered for each of the services listed above.

For the support services provided by the Government to business entities government departments will not have to get registered because service tax will be payable on such services by the service receiver i.e. the business entities receiving the service under reverse charge mechanism in terms of the provisions of section 68 of the Act and the notification proposed to be issued under the said section. For services mentioned at (a) to (c) of the list tax will be payable by the concerned department.

The services mentioned above are taxable when provided to any person, but support services mentioned in clause (iv) are taxable only when provided to a business entity.

(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;

The following services provided by department of posts are covered under the negative list entry and are not liable to service tax:

1. Postal Services such as post card, inland letter, book post, registered post provided exclusively by the department of post to meet the universal postal obligation.

2. Transfer of money through money orders, operation of saving accounts, issue of postal orders, pension payments and *other such services* (this other such services is a wide term and further can bring more services in its preview so it's still not clear what all type of services can be exempt)

(ii) Services in relation to an aircraft or a vessel, inside or outside the precincts of a port or an airport;

The word **"**Precincts**"** means – area / boundary / limits. The phrase inside or outside the precincts of port or an airport is too broad and mean any service provided anywhere in the taxable territory.

(iii) Transport of goods or passengers;

Under this clause, all the services of transport of goods or passengers have been brought under tax net. This means that transport by the Government including services vide Indian railways, buses etc gets covered under this taxable clause.

However, the clause (p) of the negative list and some exemptions are issued by the government which do exempts the levying of service tax on some transportation services which will be discussed later in this chapter.

(vi) support services, other than services covered under clauses (i) to (iii) above, provided to business entities;

SUPPORT SERVICE [Section 65B (49)]:-

- Infrastructural, operational, administrative, logistic, marketing or
- any other support of any kind comprising functions that entities carry out in the 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.

the main part of the definition of Support Services covers the following services

- Infrastructure
- Operational
- Administrative
- Logistic
- Marketing; or
- Further it is not intended to restrict the scope to the above elements only mentioned in the first part and this is indicated by the following:
- **Any other support services** (it covers the support service the entities should themselves carry out in the ordinary course of their business but somehow outsource them to Government or Local Authority; It is not very clear as to which activities are being referred here. A clarification is required from the board on this)

the second part of definition includes:

- Advertisement and promotion
- Construction or work contract
- Renting of movable or immovable property
- Security
- Testing and analysis

(b) Services by Reserve Bank of India

Analysis

Taxable service provided or to be provided to any person by RBI is exempt from service tax. However, services provided to the Reserve Bank of India are not in the

negative list and would be taxable unless otherwise covered in any other entry in the negative list.

Services provided by banks to RBI would be taxable as these are neither in the negative list nor covered in any of the exemptions.

(c) services by foreign diplomatic mission located in India

Analysis

Any service 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.

Foreign Diplomatic mission: A **diplomatic mission** is a group of people from one state or an international inter-governmental organisation (such as the United Nations) present in another state to represent the sending state/organisation in the receiving state.

(d) services relating to agriculture or agricultural produce by way of—

(i) agricultural operations directly related to production of any agricultural produce including cultivation, harvesting, threshing, plant protection or seed testing;

(ii) supply of farm labour;

(iii) processes carried out at an 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 the essential characteristics of agricultural produce but make it only marketable for the primary market;

(iv) renting or leasing of agro machinery or vacant land with or without a structure incidental to its use;

(v) loading, unloading, packing, storage or warehousing of agricultural produce;

(vi) agricultural extension services;

(vii) services by any Agricultural Produce Marketing Committee or Board or services provided by a commission agent for sale or purchase of agricultural produce;

Analysis

Let's understand some Relevant Terms used above:-

As per section 65B(3), "agriculture" means the cultivation of plants and rearing of all life forms of animals, except the rearing of horses, for food, fiber, fuel, raw material or other similar products

Agriculture produce (Section 65B(5) – means any produce of agriculture on which either no further processing is done or such processing is done as usually done by a cultivator or producer which does not alter its essential characteristics but makes it marketable for primary market.

Cultivation – farming, crop growing, gardening, nurturing

Harvest – yield, produce, gather, collect, bring in

Threshing - Threshing is the process of loosening the edible part of cereal grain (or other crop) from the scaly, inedible chaff that surrounds it. It is the step in grain preparation after harvesting and before winnowing, which separates the loosened chaff from the grain. Threshing does not remove the bran from the grain.

Plant Protection - a branch of agricultural science that devises ways and means of controlling diseases, pests, and weeds of crops and trees, as well as a set of measures used in agriculture and forestry to prevent and eliminate the damage done to plants by harmful organisms.

Seed Testing – Seed testing is performed in dedicated laboratories by trained and usually certified analysts. The tests are designed to evaluate the quality of the seed lot being sold.

Tending – treatment, nurture, attention

Pruning – trimming, reducing, shorting

Fumigating – disinfecting, sterilizing

Curing – recovery from disease

Sorting – categorization, organization

Grading – Classifying on the basis of quality

Cooling – giving relief from heating

It is clarified by the department following shall be included in within the ambit of term 'agriculture'-

- Breeding of fish (Pisciculture)
- Rearing of Silk Worms (Sericulture)
- Cultivation of ornamental flowers (Floriculture)
- Horticulture
- Forestry

"(iii) processes carried out at an 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 the essential characteristics of agricultural produce but make it only marketable for the primary market"

The processes specified above tending, pruning, cutting, harvesting, drying, cleaning, trimming, sun drying, fumigating, curing, sorting, grading, cooling or bulk packaging should be carried out at the agriculture farm only in order to get the exemption.

The above clause includes *'such like operations which do not alter the essential characteristic of agricultural produce'*. Therefore, activities like the processes carried out in agricultural farm would also be covered even if the same are performed outside the agricultural farm provided such processes do not alter the essential characteristics of agricultural produce but only make it marketable in the primary market.

The processes like grinding, sterilizing, extraction packaging in retail packs of agricultural products are not covered in negative list. As only such processes are covered in the negative list which make agriculture produce marketable in the primary market.

(iv) renting or leasing of agro machinery or vacant land with or without a structure incidental to its use;

If any agricultural machine is leased out or a vacant land is leased out with or without some structure like storage shed or a green house built on it which is incidental to its use for agriculture then its lease would be covered under the negative list entry.

(v) Loading, unloading, packing, storage or warehousing of agricultural produce;

The work "Packing" should be interpreted with regard to clause (iii). The packing should be such which make the agricultural produce marketable for the primary market.

(vi) agricultural extension services;

As per section 65B (4) of the act, "agricultural extension" means application of scientific research and knowledge to agricultural practices through farmer education or training.

(vii) services by any Agricultural Produce Marketing Committee or Board or services provided by a commission agent for sale or purchase of agricultural produce;

Agricultural Produce Marketing Committees or Boards are set up under a State Law for purpose of regulating the marketing of agricultural produce. Such 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.

Service provided by commission agent for sale or purchase of agricultural produce is also exempted from service tax

(e) trading of goods;

Analysis

The above entry has two aspects:-

i. The activity should be trading ("Retail trade" & "Wholesale trade".) and

ii. Trading should be of goods.

Trading Activity

Transfer of title of goods is one of the essential conditions for a transaction to come under the ambit (scope) of trading.

Following shall not be covered

- Any transfer of rights to use the goods is specifically liable to VAT and no ST shall be charged.
- the services supporting or ancillary to the trading
- Auxiliary service relating to future contracts or commodity futures

Example:

- Activities of a commission agent or a clearing or a forwarding agent for commission is supporting or ancillary to the trading
- Appointment of any person as commission agent for sale and purchase of goods is not covered under trading of goods as there is no transfer of ownership in goods.

Trading of Goods

Section 65B (25)] defines goods as –

Goods means - every kind of property other than actionable claim and money;

and include securities, growing crops, grass, and things attached to or forming part of land which are agreed to be severed before or under the contract of sale.

It shall also include:

- Future contracts as they involve transfer of title in goods on a future date at a pre determined price.
- Commodity futures in which although no actual physical delivery takes place and purchase obligations are set off by selling an equal quantity of goods.

(f) any process amounting to manufacture or production of goods;

The phrase 'processes amounting to manufacture or production of goods' has been defined in section 65B (40) of the Finance Act 1994, which means"

- Process on which duties of excise are leviable under section 3 of the Central Excise Act, 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 for the time being in force.

On perusal of above definition, it is required to be noted manufacturing process on which the Central Excise duty is leviable, even if exempt or chargeable to NIL rate of duty, is included in the negative list entry. Further, it may be noted that above definition do covers the case of job work basis provided duties of excise are leviable on such processes under the Central Excise Act, 1944 or any of the State Acts.

The Manufacturing process under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955 are still covered under the purview of taxable services.

(g) selling of space or time slots for advertisements other than advertisements broadcast by ra-dio or television;

"Advertisement" means any form of presentation for promotion of, or bringing awareness about, any event, idea, immovable property, person, service, goods or actionable claims through newspaper, television, radio or any other means but does not include any presentation made in person.

On the basis of this clause the following shall be concluded:

Non taxable services

- Sale of space for advertisement in print media.
- Sale of space for advertisement in bill boards, public place, building, cell phones, automated teller machines, internet.
- Aerial advertising – use of aircraft, balloons or airship to create transfer and display, advertising media. The media can be static.

Taxable Services

- Sale of space or time for advertisement to be broadcast on radio or television.
- Services provided by advertisement agencies relating to making or preparation of advertisements would be taxable.
- Broadcasting organisation will also be taxed.

(h) service by way of access to a road or a bridge on payment of toll charges;

Analysis

This entry exempts the levy of service tax on toll charges. In other word, no service tax shall be charged on toll charges.

Access to a road or a bridge on the payment of toll charges is covered under –ve list and shall not be liable to Service Tax. it shall also cover access National Highways or State Highways.

If in lieu of providing some exempted services another person is appointed to provide his services then, the services provided by such person in providing the exempted services will not be exempted, if otherwise specified.

Example:

If an independent entity is appointed to collect toll charges from users on behalf of SPV and a part of toll collection is retained by that independent entity as a commission or is compensated in any other manner, then the service tax liability shall arise on such commission or charges under the Business Auxiliary Service i.e. the collecting agency would be liable to pay service tax on its charges.

(i) betting, gambling or lottery;

Analysis

"Betting or Gambling' has been defined in section 65B of the Finance Act 1994, 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'. The State Government levy a betting tax on such activities.

A **lottery** is a form of gambling which involves the drawing of lots for a prize.

The transactions of betting, gambling or lottery are exempted from service tax. However, the services auxiliary to these games of chances are not covered under the negative list entry and are thus taxable. These services are in the nature of providing the negative list of services of betting or gambling. For example – payment made by a person for admission to a horse race as a spectator is not covered under this entry as the amount paid by such person is not for the purpose of betting or gambling. So, the same is liable to service tax. However, the same will get exempted as the entry relating to "admission to entertainment event or access to amusement facility" (discussed later).

(j) admission to entertainment events or access to amusement facilities;

Analysis

Entertainment event' has been defined in section 65B of the Finance Act 1994 as amended '**an event** or **a performance** which is intended to provide recreation, timepass, 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 program.

'Amusement facility' has been defined in the Finance Act 1994 as amended '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 place but does not include a place within such facility where other services are provided'.

Services covered by this entry

- The services provided by an event manager in relation to an entertainment event is covered under this entry and exempted from service tax.
- The performance made by an artist in an entertainment event is also exempted from service tax.
- Bungee jumping and any other form of amusement ride in a mall is exempted from service tax. As fun or recreation is provided by means of ride.

Services not covered by this entry

- The entry fees at amusement park are liable to service tax as the amount received is not for access to amusement facility.
- Membership of a club will not qualify as access to an amusement facility.
- Person taking admission right in an entertainment event for the purpose of display of his product or advertising of his company or product is not exempted from service tax. Since the purpose of the person is not recreation, timepass, fun or enjoyment.

(k) transmission or distribution of electricity by an electricity transmission or distribution utility;

Analysis

As per section 65B (23) of the act an 'electricity transmission or distribution utility' means 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

It is required to be noted, that the generation of electricity is manufacturing process and entry (f) of negative list is applicable for the same.

(i) services by way of—

(i) pre-school education and education up to higher secondary school or equivalent;

(ii) education as a part of a curriculum for obtaining a qualification recognized by any law for the time being in force;

(iii) education as a part of an approved vocational education course;

Analysis

(i) pre-school education and education up to higher secondary school or equivalent;

Pre-school education and education up to higher secondary school or equivalent are exempted from service tax.

Boarding schools provide service of education coupled with other services like providing dwelling units for residence and food. This may be a case of bundled services if the charges for education and lodging and boarding are inseparable. Their taxability would be determined in terms of the principles laid down in section 66F of the Finance Act, 1994 as amended. Such services in the case of boarding schools are bundled in the ordinary course of business. Therefore, the bundle of services would be treated as consisting entirely of education service. But the other dominant service of providing residential dwelling is also covered in a separate entry of the negative list. Therefore, entire bundle is a negative list of services. Hence, all the services provided by a boarding school are exempted from service tax

(ii) *education as a part of prescribed curriculum for obtaining a qualification recognized by any law for the time being in force;*

- Education as a part of prescribed curriculum – means education provided on some set syllabus.
- Qualification recognized by any law for the time being in force - means "Indian Law' recognizing some qualification.

Education provided on some set syllabus which is recognized by Indian Law for the time being in force is exempted from service tax. Degree courses by colleges, universities or institutions which lead to grant of qualification recognized by law are covered in this entry and is exempted from service tax.

Services not covered under this entry

- Training given by private coaching institutes would not be covered as such training does not lead to grant of a recognized qualification. Hence, service tax is leviable on such services.
- Services provided by way of education as a part of a prescribed curriculum for obtaining a qualification recognized by a law of a foreign country are not covered in the negative list. To be covered in the negative list a course should be recognized by an Indian Law.

(iii) education as a part of an approved vocational education course;

Approved vocational education courses have been specified in section 65B of the Act. These are –

- a course run by an industrial training institute or an industrial training centre affiliated to the National Council for Vocational Training, offering courses in designated trades as notified under the Apprentices Act, 1961(52 of 1961)
- a Modular Employable Skill Course, approved by the National Council of Vocational Training, run by a person registered with the Directorate General of Employment and Training, Ministry of Labour and Employment, Government of India;
- a course run by an institute affiliated to the National Skill Development Corporation set up by the Government of India.

(m) services by way of renting of residential dwelling for use as residence;

Analysis

'Renting' has been defined in section 65B of Finance Act, 1994 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'.

If any residential house is given on rent for residential purpose then no service tax shall be charged on rent.

Where residential house partly used for residential purpose and partly for non residential purpose then taxability of such bundled services has to be determined in terms of the principles laid down in section 66F of the act. The taxability would be based on the predominant service.

(n) 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;***

Analysis

(i) *extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount;*

The service of providing deposits, loans or advances are exempted from service tax irrespective of the fact whether the deposits, loans or advances are provided by banking or financial unit or not.

(ii) inter se sale or purchase of foreign currency amongst banks or authorised dealers of foreign exchange or amongst banks and such dealers;

(o) service of transportation of passengers, with or without accompanied belongings, by—

(i) ***a stage carriage;***

(ii) ***railways in a class other than—***

(A) first class; or

(B) an air-conditioned coach;

(iii) metro, monorail or tramway;

(iv) inland waterways;

(v) public transport, other than predominantly for tourism purpose, in a vessel, between places located in India; and

(vi) metered cabs, radio taxis or auto rickshaws;

Analysis

(i) a stage carriage;

Stage carriage means a motor vehicle constructed or adapted to carry more than six passengers excluding the driver for hire or reward at separate fares paid by or

for individual passengers, either for the whole journey or for stages of the journey.

(ii) railways in a class other than—

(A) first class; or

(B) an air-conditioned coach;

Journey made in railways in sleeper or local class is exempted from service tax, travelling in other classes with attract service tax. In simple words, travelling in non air conditioned coaches\train will be exempted from service tax.

(v) public transport, other than predominantly for tourism purpose, in a vessel, between places located in India;

Transportation of a passenger on a vessel will be covered in the negative list entry, provided the transportation is not predominantly for tourism purpose. This means normal public ships or other vessels that sail between places located in India would be covered in the negative list.

(p) services by way of transportation of goods—

(i) by road except the services of—

(A) a goods transportation agency; or

(B) a courier agency;

(ii) by an aircraft or a vessel from a place outside India upto the customs station of clearance in India ; or

(iii) by inland waterways;

Analysis

The above entry hardly provides any relief. *Transportation of goods not covered in negative list* is:-

- Railways
- Air within the country or abroad
- By a vessel in the coastal waters
- Service provided by GTA

Transportation of goods covered in negative list is:

*(i) by **road** except the services of—*

(A) a goods transportation agency; or

(B) a courier agency;

"Goods Transport Agency" as defined in section 65B (26) of the act means any person who provides service in relation to *transport of goods by road* and *issues consignment note*, by whatever name called.

"Courier Agency" as defined in sec 65B (20) of the act means any person engaged in the door-to-door transportation of time-sensitive documents, goods or articles utilizing the services of a person, either directly or indirectly, to carry or accompany such documents, goods or articles.

(ii) by an aircraft or a vessel from a place outside India upto the customs station of clearance in India ;

The negative list covers the following services:-

- Transportation of goods by aircraft from a place outside India to custom station of clearance in India.
- Transportation of goods by Vessel from a place outside India to custom station of clearance in India.

However, transportation of goods from custom station of clearing to domestic territory through road transport will attract service tax.

(iii) by inland waterways;

"Inland waterway" means national waterways as declared by the Government or other waterway on any inland water like canal, river, lake or other navigable water. In simple words, any water transport within India will get covered under the negative list.

(q) funeral, burial, crematorium or mortuary services including transportation of the deceased.

Analysis

Any service performed for a deceased person in relation to crimination is exempted from service tax.

Chapter-II

MEGA EXEMPTION NOTIFICATION

Notification No – 25/2012-ST, Dated 17-03-2012

Under Section 93(1) of the Finance Act, 1994 the government have the power to exempt any service from the service tax, on being satisfied that it is necessary in the public interest so to do. The following are the services which shall be exempted from service tax under section 66B of the said act:-

1. Services provided to United Nations or specified International Organizations;
2. Health care services provided by a clinical establishment, an authorized medical practitioner or para-medics;
3. Services by a veterinary clinic in relation to health care of animals or birds;
4. Services provided by an institution registered u/s 12AA of the Income Tax Act, by way of charitable activities;
5. Services of renting of religious place or conducting religious ceremonies;
6. Services provided by individual advocate/arbitrator to any person other than business entity; services provided by advocate to advocate; services provided by advocates and arbitral tribunals to business entities upto a turnover of Rs. 10 lakh in preceding financial year ; services provided by person represented on arbitral tribunal to an arbitral tribunal .
7. Services of technical testing and analysis of newly developed drugs etc, by an approved clinical research organization;
8. Service of training and coaching in recreational activities relating to arts, culture or sports;

9. Auxiliary education services and renting of property provided by educational institutions in respect of education exempt from tax including catering under mid-day meals scheme of government;
10. Services provided, to or by a specified educational institution, by way of 'transportation of students or staff' or 'services in relation to admission';
11. Service to a recognized sports body:-
    (i) individual as a player, referee etc. for participation in a tournament
    (ii) by another recognized sports body;
12. Sponsorship service for tournaments and championships organized by specified bodies;
13. Services of erection, installation, commissioning, completion, fitting out, construction, maintenance or alteration provided –
    (i) to government or local authority or governmental authority in relation to specified structures like historical monuments, canal, dams etc.;
    (ii) in relation to specified structures like road, bridge, tunnel, etc.;
    (iii) in relation to works contract under JLNURM or Rajiv Awaas Yojana
14. Erection or Construction service in relation to original works pertaining to airport, port, railways or single residential unit etc.;
15. Service of temporary transfer or permitting use of copyrights relating to original literary, dramatic, musical, artistic works or cinematograph films;
16. Services by a performing artist in folk or classical art forms of (i) music, (ii) dance or (iii) theatre, excluding when provided as a brand ambassador;
17. Service of collecting or providing news by independent journalist/specified bodies;
18. Service of renting of a hotel, inn, guest house etc. meant for residential or lodging purposes, having declared tariff of a room below Rs. 1000 per day;
19. Restaurant services other than those having air conditioning facility and having license to serve alcohol;
20. Service of transportation of specified goods by rail or vessel from one port in India to another port;
21. Services provided by GTA for transportation of fruits, vegetables etc. or where amount charged for transportation is upto a given monetary limit;
22. Services of giving on hire a means of transportation to State Transport Undertaking or GTA;
23. Services of transport of passengers :-

(i) by air embarking or terminating in specified eastern States of India; or

(ii) by a contract carriage excluding conducted tour or charter on hire;

(iii) ropeway, cable car or air tramway

24. Services by way of motor vehicle parking to general public excluding leasing of space to an entity for providing such parking facility;
25. Specified services provided to government or local authority or governmental authority
26. Services of general insurance business provided under certain specified schemes;
27. Services provided by an incubatee subject to certain conditions;
28. Services by an unincorporated body or nonprofit entity registered under law to own members by way of reimbursement of charges or share of contribution subject to conditions;
29. Services provided by person in specified capacities such as sub broker, mutual fund agent, selling or marketing agent of lottery tickets, SIM cards, business facilitator or business correspondent, sub contractor etc.
30. Service of carrying out job work in relation to agriculture, printing, textile, diamonds/jewellery, cycle or sewing machines or any goods on which duty is paid by principal manufacturer;
31. Services by an organizer in respect of business exhibition held outside India;
32. Service of making telephone calls from specified places like free telephone at airport and hospitals etc.
33. Services by way of slaughtering of bovine animals;
34. Services received from a service provider located in a non-taxable territory by any person for non-commercial purpose or by a Charitable Institution or to person located in non taxable territory.
35. Services of public libraries by way of lending of books, publication or any other knowledge enhancing content or material.
36. Services by Employees State Insurance Corporation (ESIC) to eligible person.
37. Services of transfer of going concern as a whole or independent part thereof.
38. Services of public conveniences such as provision of facilities of bath room, wash room, lavatories, urinals or toilets.
39. Services by governmental authority in relation to any function as constitutionally entrusted to a municipality.

Chapter-III

PLACE OF PROVISION OF SERVICE RULES, 2012

Introduction

The Place of Provision Rules 2012, have been issued vide notification No. 28/2012 dated 20th June, 2012 for the determination of the jurisdiction where a service shall be taxable.

i.e. these new rules shall determine the place where the service shall be deemed to be provided in terms of section 66C of the Finance Act 1994.

Under section 66B of the Finance Act, 1994 the service is taxable if it is provided or agreed to be provided in the taxable territory there by brings into play the place of provision of service i.e. the taxability of a service shall be determined on the basis of "Place of Provision".

These rules are based on a concept that service tax is a consumption based tax and thus service shall be taxable in the jurisdiction of its place of consumption

"Taxable and Non Taxable Territory"

Taxable territory has been defined under section 65B (52).

It means a territory to which the provisions of the FA 1994 shall apply i.e. the whole of India excluding the state of Jammu and Kashmir whereas, Non Taxable territory is defined as the territory other than taxable territory.

Rules covered in this chapter:-

- Rule 3 – Place of Provision

- Rule 4 - Performance Based Service
- Rule 5 - Service relating to immovable property.
- Rule 6 - Services relating to events
- Rule 7 - Place of provision of services provided at more than one location.
- Rule 8 - Services where the Provider as well as Receiver is located in Taxable territory
- Rule 9 - Place of provision of specified services
- Rule 10 - Place of provision of goods transportation service
- Rule 11 - Passenger Transportation Service
- Rule 12 - Services provided on board conveyances
- Rule 13 - Power to notify services or circumstances
- Rule 14 - Order of application of rules

Rule 3 - Place of Provision

- Rule 3 is the main rule. i.e. where the service is not covered by an exception under one of the later rules shall be consequently covered under this default rule
- According to this rule the *location of service receiver* shall be the place of provision of service, in absence of which and subject to Rules 4 to 12 of the POPSR , POP shall be the location of service provider.
- Location of service recipient means –
  a. Business Establishment;
  b. Fixed Establishment;
  c. Establishment most directly concerned with the provision or use of the service in certain cases
  d. In the absence of such places, usual place of residence.
- However, if the location of the service receiver is not available in the ordinary course of business, the place of provision shall be the location of the provider of service.

Rule 4 - Performance Based Service

<u>This rule cover the services</u>

1. which are provided "in respect of the goods that are made physically available by the receiver to the Service provider in order to provide the service.
   - Services must be related to Goods
   - Goods must be made available to the service provider or any other person acting on his behalf so that services can be rendered.
   - Goods must come temporarily in to the physical possession or control of service provider
   - For example - services are repair, reconditioning, or any other work on goods (not amounting to manufacture), storage and warehousing, courier service, cargo handling service (loading, unloading, packing or unpacking of cargo), technical testing/inspection/certification/ analysis of goods, dry cleaning etc.

   It will not cover the following:

   - Services where the supply of goods by the receiver is not material to the rendering of the service.
   - Goods that are temporarily imported in India for repairs, reconditioning etc.

2. Services requiring the physical presence of receiver

    - It also covers the cases where physical presence of the receiver or the person acting on behalf of the receiver is necessary for the purpose of providing the services. For example - cosmetic or plastic surgery, beauty treatment services, personal security service, health and fitness services, photography service (to individuals), internet cafe service, classroom teaching, are examples of services that require the presence of the individual receiver.

3. Being an individual or an agent services are provided electronically from a remote location

    - Provided further that where the services are provided from a remote location by way of electronic means, the place of provision shall be the location where goods are situated at the time of provision of service.

Rule 5 - Service relating to immovable property

This covers a service which is in direct relation to an Immovable Property and thus the place of provision shall be the place where immovable property is located irrespective of the location of the service provider or receiver.

i.e. this rule does not apply if a provision of service has only an indirect connection with the immovable property, or if the service is only an incidental component of a more comprehensive supply of services.

For example :-

the services of an architect contracted to design the landscaping of a particular resort hotel in Goa would be land-related. However, if an interior decorator is engaged by aretail chain to design a common décor for all its stores in India, this service would not be land related.

The default rule i.e. Rule 3 will apply in this case.

the following criteria will be used to determine if a service is in respect of immovable property located in the taxable territory:

1. The service consists of lease, or a right of use, occupation, enjoyment or exploitation of an immovable property;

2. the service is physically performed or agreed to be performed on an immovable property (e.g. maintenance) or property to come into existence (e.g. construction);

3. the direct object of the service is the immovable property in the sense that:

    - the service enhances the value of the property,

- affects the nature of the property,
- relates to preparing the property for development or redevelopment or the environment within the limits of the property (e.g. engineering, architectural services, surveying and
- sub-dividing, management services, security services etc);

Examples of land-related services

1. Services supplied in the course of construction, reconstruction, alteration, demolition, repair or maintenance (including painting and decorating) of any building or civil engineering work;
2. Renting of immovable property;
3. Services of real estate agents, auctioneers, architects, engineers and similar experts or professional people, relating to land, buildings or civil engineering works. This includes the management, survey or valuation of property by a solicitor, surveyor or loss adjuster.

Examples of services which are not land-related

- Repair and maintenance of machinery which is not permanently installed. This is a service related to goods.
- Advice or information relating to land prices or property markets because they do not relate to specific sites etc.

Rule 6 - Service relating to events

- Services in relation to admission as well as organization of events such as conventions, celebrations, conferences, exhibitions, fairs, seminars, workshops, weddings, sports and cultural, scientific, educational events are covered under this Rule. As per this rule the place of provision of service shall be the place where the event is actually held.
- Services that are pre-requisite for staging of event are the services ancillary to its organization. The location of event i.e. where the event has been actually held will be the place of provision of service.

For example

1. Provision of sound engineering for an artistic event is a prerequisite for staging of that event and should be regarded as a service ancillary to its organization.
2. Hiring of an equipment to enjoy the event at the venue is ancillary to organization of event

3. A service of courier agency used for distribution of entry tickets for an event is a service that is not ancillary to admission to the event.

4. An Indian fashion design firm hosts a show at Toronto, Canada. The firm receives the services of a Canadian event organizer. The place of provision of this service is the location of the event, which is outside the taxable territory. Any service provided in relation to this event, including the right to entry, will be non-taxable.

Rule 7 - Place of provision of service provided at more than one location

This rule covers a situation where the actual performance of a service is at more than one location which may be outside the taxable territory.

- Where the services provided under Rule 4, 5 and 6 is provided at more than one location then instead of applying rule 4, 5 or 6 rule 7 shall be applied.

- Where any service stated in rule 4, 5 or 6 is provided at more than one location, including a location in taxable territory, its place of provision shall be the location in the taxable territory where the greatest proportion of the service is provided.

For example:

An Indian firm provides a 'technical inspection and certification service' for a newly developed product of an overseas firm (say, for a newly launched motorbike which has to meet emission standards in different states or countries). Say, the testing is carried out in Maharashtra (20%), Kerala (25%), and an international location (say, Colombo 55%).

Notwithstanding the fact that the greatest proportion of service is outside the taxable territory, the place of provision will be the place in the taxable territory where the greatest proportion of service is provided, in this case Kerala. Therefore, the services provided in Delhi & Kerala is taxable in Kerala.

Earlier, the Export Rules provided that, services would qualify as exports, where partial performance is outside India without specifying the extent of partial performance. So, as per this the services provided in India and also provided outside India get exempted from service tax under the blanket of Export of services. By virtue of this rule, majority of performance based service will never qualify as exports or be considered as non taxable even if they are majorly performed outside India.

Rule 8 - Services where the Provider as well as Receiver is located in Taxable Territory

- This rule covers the situation where the service referred to in rule 4, 5 or 6 is provided in non-taxable territory whereas the service receiver and service provider is located in taxable territory. In such a cases rule 4, 5 or 6 shall not apply instead rule 8 will apply.
- The implication of this Rule is that in such cases the place of provision shall be deemed to be in taxable territory notwithstanding with earlier rules.
- The presence of both the service provider and the service receiver in the taxable territory indicates that the place of consumption of the service is in the taxable territory.

Rule 9 - Place of provision of specified service

- The place of provision of following services shall be the location of the service provider:-

  a. Services provided by a banking company, or a financial company, or a non-banking financial company to account holders;

  b. Online information and database access or retrieval services;

  c. Intermediary services;

  d. Service consisting of hiring of means of transport, up to a period of one month.

- Services provided by a banking company, or a financial company, or a non-banking financial company to account holders

  Account holder – Service provided to holders of demand deposits, term deposits, NRE (non-resident external) accounts and NRO (non-resident ordinary) accounts will be covered under this rule.

  Following are examples of services that are provided by a banking company or financial institution to an "account holder", in the ordinary course of business:-

  i. services linked to or requiring opening and operation of bank accounts such as lending, deposits, safe deposit locker etc;

  ii. transfer of money including telegraphic transfer, mail transfer, electronic transfer etc.

  Following are examples of services that are generally NOT provided by a banking company or financial institution to an account holder (holder of a deposit account

bearing interest), in the ordinary course of business. These services will not be liable to service tax under this rule, the place of provision will be determined under the default rule i.e. the Main Rule 3.:-

i. financial leasing services including equipment leasing and hire-purchase;

ii. merchant banking services;

iii. Securities and foreign exchange (forex) broking, and purchase or sale of foreign currency, including money changing;

iv. asset management including portfolio management, all forms of fund management, pension fund management, custodial, depository and trust services;

v. advisory and other auxiliary financial services including investment and portfolio research and advice, advice on mergers and acquisitions and advice on corporate restructuring and strategy;

vi. banker to an issue service.

- Online information and database access or retrieval services;

These services are essentially provided over internet or an electronic network which relies on the internet or similar network for their provision. They are completely automated and require minimal human intervention.

For example:

i. Online information generated automatically by software from specific data input by customer, such as web-based services providing trade statistics, legal and financial data, matrimonial services, social networking sites;

ii. Digitalized content of books and other electronic publications, subscription of online newspapers and journal, online news, flight information and weather reports;

iii. Web- based services providing access or download of digital content.

Following are the examples that will not be regarded under online information and database access or retrieval services:

i. Sale or purchase of goods, articles etc over the internet;

ii. Telecommunication services provided over the internet, including fax, telephony, audio conferencing, and video conferencing;

iii. A service which is rendered over the internet, such as an architectural drawing, or management consultancy through e-mail;

iv. Repair of software, or of hardware, through the internet, from a remote location;

v. Internet backbone services and internet access services.

- Intermediary Service

An 'intermediary' is a person who arranges or facilitates a supply of goods, or a provision of service, or both, between two persons, without material alteration or further processing.

For the purpose of this rule, an intermediary in respect of goods is excluded by definition. Also excludes from this sub-rule is a person who arranges or facilitates a provision of a service (referred to in the rules as 'the main service'), but provides the main service on his own account.

Factors that determine whether a person is intermediary:-

i. **Nature & Place** - An intermediary cannot alter the nature or value of the service, the supply of which he facilitates on behalf of his principal, although the principal may authorize the intermediary to negotiate a different price. Also, the principal must know the exact value at which the service is supplied (or obtained) on his behalf, and any discounts that the intermediary obtains must be passed back to the principal.

ii. **Separation of value** - The value of an intermediary's service is invariably identifiable from the main supply of service that he is arranging. It can be based on an agreed percentage of the sale or purchase price. Generally, the amount charged by an agent from his principal is referred to as "commission"

iii. **Identity and title** - The service provided by the intermediary on behalf of the principal is clearly identifiable.

On the basis of above factors following persons will qualify as 'intermediary services':

i. Travel agent (any mode of travel)

ii. Tour operator

iii. Commission agent for a service [an agent for buying and selling of goods is excluded]

iv. Recovery agent

Even in other cases, wherever a provider of any service acts as an intermediary for another person, as identified by the guiding principles outlined above, this rule will apply. Normally, it is expected that the intermediary or agent would have documentary evidence authorizing him to act on behalf of the provider of the 'main service'.

Service of hiring means of transport

This rule covers the services of providing a hire or lease, without the transfer of right to use. Normally the following will constitute means of transport:-

i. Land vehicles such as motorcars, buses, trucks;
ii. Vessels;
iii. Aircraft;
iv. Vehicles designed specifically for the transport of sick or injured persons;
v. Mechanically or electronically propelled invalid carriage;
vi. Trailers, semi-trailers and railway wagons.

Following are not means of transport:

i. Racing cars;
ii. Containers used to store or carry goods while being transported;
iii. Dredgers or the like.

Rule 10 - Place of provision of goods transportation service

- This rule cover services provided in relation to the transportation of goods, by any mode of transport (air, vessel or rail)
- However, transportation of goods by mail or courier or via road are outside the ambit of Rule 10.

  Place of provision of a service for transport of goods is the place of destination of goods except where the services are provided by a Goods Transport Agency for the transport of goods by road.

For Example :-

- A consignment of goods is consigned from Delhi to Amsterdam and hence the POP shall be the Amsterdam (destination of goods). Since it is outside the India and hence shall not be liable to service tax.
- For the transport of goods by road by GTA, the proviso to main rule 10 provides that the POP would be the location of the person liable to pay tax (as determined

in terms of rule 2(1) (d) of the Service Tax Rules, 1994 (i.e. this service is covered under reverse charge mechanism)

- Sub-rule 2(1) (d) of Service Tax Rules, 1994 provides that where a service of transportation of goods is provided by a 'goods transportation agency', and the consignor or consignee is covered under any of the specified categories prescribed therein, the person liable to tax is the person who pays, or is liable to pay freight (either himself or through his agent) for the transportation of goods by road in a goods carriage. If such person is located in non-taxable territory, then the person liable to pay tax shall be the service provider.

  If the person liable to pay tax is located in the non-taxable territory then service provider i.e. GTA shall be liable to pay tax.

For example :-

- A goods transportation agency ABC located in Delhi transports a consignment of new motorcycles from the factory of XYZ in Gurgaon (Haryana), to the premises of a dealer in Bhopal, Madhya Pradesh. Say, XYZ is a registered assessee and is also the person liable to pay freight and hence person liable to pay tax as per the provisions of reverse charge mechanism Here, the place of provision of the service of transportation of goods will be the location of XYZ i.e. Haryana.

- A goods transportation agency ABC located in Delhi transports a consignment of new motorcycles from the factory of XYZ in Gurgaon (Haryana), to the premises of a dealer in Jammu (non-taxable territory). Say, as per mutually agreed terms between ABC and XYZ, the dealer in Jammu is the person liable to pay freight. Here, in terms of amended provisions of rule 2(1)(d), since the person liable to pay freight is located in non-taxable territory, the person liable to pay tax will be ABC. Accordingly, the place of provision of the service for transportation of goods will be the location of ABC i.e. Delhi.

Rule 11 - Passenger Transportation Service

- The place of provision in respect of a passenger transportation service shall be the place where the passenger embarks on the conveyance for a continuous journey.
- Embarks means to cause to board a vessel or aircraft (The Free Dictionary by Farlex)
- Continuous Journey means a journey for which :-
  i. A single or more than one ticket or invoice is issued ***at the same time***,
  ii. either from ***one service provider*** or through ***one agent*** acting on behalf of more than one service provider,

iii. and involves no stopover between any of the legs of the journey for which one or more than one separate tickets or invoices are issued.

- Stopover means a place :-

  i. Where a passenger can disembark either to transfer to another conveyance or break his journey for a certain period in order to resume it at a later point of time.

  ii. All stopovers do not cause a break in journey only such ***stopovers will be relevant for which one or more separate tickets are issued.*** For example:-

    - Travel on Delhi-London-New York-London-Delhi on a single ticket with a halt at London on either side, or even both, will be covered by the definition of continuous journey. However, if as separate ticket is issued, say New york- Boston-New York, the same will be outside the scope of a continuous journey.

- Leg of journey means :-

  i. A part of journey that begins where passenger embarks or disembark the conveyance, or where it is stopped to allow for its servicing or refueling, and ends where it is stopped for any of those purpose.

Illustration:

S. No	Journey	Place of Provision	Taxability
Single Ticket (No Stopover)			
1.	Mumbai – Delhi	Mumbai	Yes, Mumbai is the place of embarkation as per POP so chargeable to tax.
2.	Mumbai- Delhi- Jaipur- London	Mumbai	Yes, Mumbai is the place of embarkation as per POP so chargeable to tax.
3.	Delhi-London- New York-London- New York	Delhi	Yes, Delhi is the place of provision for continuous Journey with single return ticket.
4.	Jammu- Delhi- Jammu	Jammu	No, Jammu is the POP but since it is in non-taxable territory so no service tax.
More than single ticket for a journey (issued by a single service provider, or by a single agent, for more than one service providers)			

1.	(a) Delhi-Bangkok-Delhi (b) Bangkok-Bali-Bangkok	Delhi is the place of provision for journey (a); Bangkok is place of provision for journey (b).	Journey (a) is taxable since place of provision is in taxable territory; Journey (b) is not taxable since place of provision is outside taxable territory.
2	(a) Jammu-Delhi (b) Delhi-Bangkok-Delhi (c) Delhi-Lucknow (d) Lucknow-Jammu	Jammu is place of provision for journey (a); Delhi is place of provision for journey (b); Delhi is place of provision for journey (c); Lucknow is place of provision for journey (d).	Journey (a) is not taxable since place of provision is not in taxable territory; Journeys (b), (c) and (d) are taxable since place of provision is in taxable territory for each of these.

- It may also be pertinent to mention that for flights originating from, or terminating in, the northeast region, though the place of provision will be determined in terms of this rule, there is an exemption for air transportation of passengers, embarking from, or terminating in an airport located in the state of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, or Tripura or at Bagdogra located in West Bengal. The examples in the table below illustrate some situations.

S. No	Journey	Place of Provision	Taxability
Single Ticket (No Stopover)			
1.	Dibrugarh-Kolkata-Mumbai	Dibrugarh is the place of provision	Journey is taxable, but no service tax is payable owing to the exemption (flight originates in exempted territory).
2.	Guwahati-Kolkata-Bangkok-Kolkata-Guwahati	Guwahati is the place of provision for the continuous journey	Place of provision being in the taxable territory, the service is taxable, but no service tax is payable owing to the exemption (flight originates in exempted territory) and journey is deemed continuous.
More than single ticket for a journey (issued by a single service provider, or by a single agent, for more than one service providers)			

1.	(a) Bagdogra-Kolkata (b) Kolkata-Delhi	Bagdogra is the place of provision for journey (a); Kolkata is place of provision for journey (b).	Place of provision for journey (a) is Bagdogra. Place of provision for journey (b) is Kolkata. In these cases, generally, the passenger would be required to change aircraft after exiting the airport, and is required to obtain a fresh boarding pass for the next leg. This is deemed to be a stopover. Thus, journey (b) is taxable, and service tax is payable on leg (b).
2	(a) Guwahati-Kolkata-Guwahati (b) Kolkata-Bangkok-Kolkata	Each journey is deemed to be continuous based on the assumption that two single return tickets are purchased. For journey (a) place of provision is Guwahati; for journey (b) place of provision is Kolkata	Generally, in such cases, since separate return tickets have been purchased for the two journeys, after completing journey (a), the passenger will be required to disembark from the aircraft and complete check-in formalities for journey (b). Thus, the journey will not be deemed to be continuous, and place of provision for journey (b) will be determined Kolkata.

Rule 12 - Service provided on board conveyances

- Place of provision of services provided on board a conveyance during the course of a passenger transport operation, including services intended to be wholly or substantially consumed while on board, shall be the first schedule point of departure of that conveyance for the journey. Some examples of on-board services are movies/music/video/software games on demand, beauty treatment etc.
- Conveyance includes aircraft, vessels, rail, or roadways bus.
- The services provided on board will be covered under this only when they are provided against a specific charge, and not supplied as part of the fair.

Illustration

- A video game or a movie-on-demand is provided as on-board entertainment during the Kolkata-Delhi leg of a Bangkok-Kolkata-Delhi flight. The place of provision of this service will be Bangkok (outside taxable territory, hence not liable to tax).

  If the above service is provided on a Delhi-Kolkata-Bangkok-Jakarta flight during the Bangkok-Jakarta leg, then the place of provision will be Delhi (in the taxable territory, hence liable to tax).

Rule 13 - Power to notify services or circumstances

- In order to prevent double taxation or non-taxation of the provision of a service, or for the uniform application of rules, the Central Government shall have the power to notify any description of service or circumstances in which the place of provision shall be the place of effective use and enjoyment of a service.

- The rule is an enabling power to correct any injustice being met due to the applicability of rules in a foreign territory in a manner which is inconsistent with these rules leading to double taxation. Due to the cross border nature of many services it is also possible in certain situations to set up businesses in a non-taxable territory while the effective enjoyment, or in other words consumption, may be in taxable territory. This rule is also meant as an anti-avoidance measure where the intent of the law is sought to be defeated through ingenious practices unknown to the ordinary ways of conducting business.

Rule 14 - Order of application of rules

- This rule covers the situation where the nature of a service, or the business activities of the service provider, may be such that two or more rules may appear equally applicable. In such a case the rule that occurs later among the rules that merit equal consideration shall be considered.

Illustration:

- An architect based in Mumbai provides his service to an Indian Hotel Chain (which has business establishment in New Delhi) for its newly acquired property in Dubai. If Rule 5 (Property rule) were to be applied, the place of provision would be the location of the property i.e. Dubai (outside the taxable territory). With this result, the service would not be taxable in India.

  Whereas, by application of Rule 8, since both the provider and the receiver are located in taxable territory, the place of provision would be the location of the service receiver i.e. New Delhi. Place of provision being in the taxable territory, the service would be taxable in India.

  By application of Rule 14, the later of the Rules i.e. Rule 8 would be applied to determine the place of provision.

Chapter-IV

POINT OF TAXATION RULES, 2011

Introduction

"Point of taxation" means the point of time when the service shall be deemed to have been provided.

These rules are meant to determine the time of taxability of services. Previously the services are taxed on receipt basis with introduction of Point of Taxation Rules services are taxed on accrual basis.

- Rules covered under this chapter:-
  - Rule 3 – Determination of point of taxation
  - Rule 4 – Determination of point of taxation in case of change in effective rate of tax
  - Rule 5 – Payment of tax in case of new services
  - Rule 6 – Omitted by NN 04/2012, dated 17.03.2012 (w.e.f 01-04-2012)
  - Rule 7 – Point of taxation in case of specified services or persons
  - Rule 8 – Determination of point of taxation in case of copyrights, etc
  - Rule 8A – Determination of point of taxation in other cases
  - Rule 9 – Transitional Provision

Rule 3 - Determination of point of taxation

Point of taxation when a service shall be deemed to have been provided would be –

- The date of payment, or
- The date of invoice, if the invoice is issued within 30 (45days in case of bank) days from the date of completion of service.

whichever is earlier.

If the invoice is not issued within the prescribed time of 30 (45 days in case of bank) days from the completion of service, then the point of taxation is –

- Date of payment, or
- Date of completion of the provision of service.

Continuous supply of service :

- In case of continuous supply of service, the *periodical completion of an event* in terms of contract is deemed to be the date of completion of provision of service.

Where amount received in excess of invoice amount :

- When the provider of taxable service receives a payment up to rupees one thousand in excess of the amount indicated in the invoice the point of taxation to the extent of such excess amount, at the option of the provider of taxable service shall be determined at the time when the invoice for the service provided or agreed to be provided is issued.

Illustration:

Date of completion of service	Date of payment	Date of Issue of Invoice	Point of taxation
15th May, 2012	31st August, 2012	7th June, 2012	7th June 2012
15th May, 2012	19th May, 2012	17th June, 2012	19th May, 2012
15th May, 2012	31st August, 2012	06th August, 2012	15th May, 2012
15th May, 2012	01st May, 2012	15th May, 2012	1st May, 2012
15Th May, 2012	01st May, 2012 & 02nd August, 2012	2nd August, 2012	1st May, 2012 for the part payment made & 15th May, 2012

Rule 4 - Determination of point of taxation in case of change in effective rate of tax

A. Taxable Service provided before the change in effective rate of tax –

Case I **:** Both invoice issued and payment received after change of rate – *POT would be earlier of two dates of invoice and payment.*

Case II : Invoice issued before change of rate and payment received after change of rate – *POT would be date of invoice.*

Case III : Payment received before change of rate and invoice issued after change of rate – *POT would be date of receipt of payment.*

Table I

Case	Date of change of Service Tax Rate	Date of Invoice	Date on which payment received	Point of taxation
Case I	10th May, 2012	15th May, 2012	20th May, 2012	15th May, 2012
Case II	10th May, 2012	05th May, 2012	15th May, 2012	05th May, 2012
Case III	10th May, 2012	15th May, 2012	05th May, 2012	05th May, 2012

B. When service is provided after the change of rate –

Case I : Both invoice issued and payment made before the change of rate - *POT would occur before change of rate at the earlier of two dates of invoice and payment.*

Case II : Invoice issued after change of rate and payment received before change of rate – *POT would be after change of rate, i.e. date of invoice.*

Case III : Payment received after change of rate and invoice issued before change of rate – *POT would be after change of rate i.e. date of receipt of payment.*

Table II

Case	Date of change of Service Tax Rate	Date of Invoice	Date on which payment received	Point of taxation
Case I	10th May, 2012	01th May, 2012	05th May, 2012	01th May, 2012
Case II	10th May, 2012	15th May, 2012	05th May, 2012	15th May, 2012
Case III	10th May, 2012	05th May, 2012	15th May, 2012	15th May, 2012

Rule 5 - Payment of tax in case of new services

- Prior to POT, this situation was covered by Rule 6 of Service tax Rules and as per which no service tax was leviable on the service which is provided during the period when such service was exempted.
- However, from 01-04-2011, the POT rules have provided a specific and comprehensive provision to deal with such situations, which is as under:
  - If invoice issued and payment received before the new service become taxable – No tax payable.
  - If payment received before the new service become taxable and invoice issued within 14 days of the date when service is taxed for the first time – No tax payable.
  - In all other cases service tax would be payable.

Rule 7 - Point of taxation in case of specified services or persons

- Payment under Reverse Charge Mechanism : Where service tax is payable by the recipient of service like GTA service, POT would be the date of payment of value of service, if made within 6 months from the date of invoice. In case, value of service is not paid within prescribed 6 months period, service tax would become payable as per the rule 3 of POT rules.
- In case of "associated enterprises", where the person proving the service is outside India, the point of taxation shall be the date of debit in the books of account of the person receiving the service or date of making the payment, whichever is earlier.

Rule 8 - Determination of point of taxation in case of copyrights, etc

- In case of royalties and payments pertaining to copyrights, trademarks, designs or patents, where –
  - the whole amount of the consideration for the provision of service is not ascertainable at the time when service was performed, and
  - subsequently the use or the benefit of these services by a person other than the provider gives rise to any payment of consideration,

  the POT will arise each time when a payment in respect of such use or the benefit is received by the provider in respect thereof, or an invoice is issued by the provider, whichever is earlier.

Rule 8A - Determination of point of taxation in other cases

- Where the point of taxation cannot be determined as per above rules
- The CEO may require concerned person to produce such accounts, documents or other evidence as he may deem necessary.
- After giving an opportunity of being heard, the CEO shall determine the POT to the best of his judgment.

Rule 9 - Transitional Provision

- Nothing contained In these rules shall be applicable,-
  i. where the provision of service is completed; or
  ii. where invoices are issued
  iii. prior to the date on which these rules come into force.

Chapter-V

REVERSE CHARGE

Notification No. 30/2012-Service Tax

Section 66B is the charging section for the purpose of levy of service tax. Notification 30/2012 dated 20th June, 2012 supersedes Notification 36/2004 dated 31st December, 2004 for the purpose of determining the person who shall be liable to pay Service Tax.

Under the reverse charge mechanism the service provider is not liable to pay service tax however service receiver is liable for the same and in some cases both the service provider as well as recipient shall be liable to pay Service Tax to the government.

The service providers whose services are covered under reverse charge are not even required to get themselves registered, on the other hand the service receiver are required to get themselves registered.

The general exemption of Rs. 10 Lakh is not available to the service receiver under Reverse Charge Mechanism. In other words, the service receiver have to pay the service tax even if their aggregate value of taxable services is not exceeding Rs. 10 Lakh in the preceding financial year.

The reverse charge covers ten services in it.

Following is the table depicting the percentage of service tax proportionately liable to be paid by service providers and service receivers under reverse charge:-

Table I

Sl.No.	Description of a service	Percentage of service tax payable by the person providing service	Percentage of service tax payable by the person receiving the service
1	In respect of services provided or agreed to be provided by an insurance agent to any person carrying on insurance business	Nil	100%
2	In respect of services provided or agreed to be provided by a goods transport agency in respect of transportation of goods by road. ***(See point I below in Some points to be noted)***	Nil	100%
3	In respect of services provided or agreed to be provided by way of sponsorship ***(See point II below in Some points to be noted)***	Nil	100%
4	In respect of services provided or agreed to be provided by an arbitral tribunal **(See point III below in Some points to be noted)**	Nil	100%
5	In respect of services provided or agreed to be provided by individual advocate or a firm of advocates by way of legal services. ***(See point III below in Some points to be noted)***	Nil	100%
6	In respect of services provided or agreed to be provided by Government or local authority by way of support services excluding,- (1) renting of immovable property, and (2) services specified in sub-clauses (i), (ii) and (iii) of clause (a) of section 66D of the Finance Act,1994	Nil	100%
7	In respect of any taxable services provided or agreed to be provided by any person who is located in a non-taxable territory and received by any person located in the taxable territory	Nil	100%

Some Points to be noted:

As per Sec 65(50a) GTA means any person who provides service in relation to the transport of goods by road and issues consignment note

I. In case of Goods Transport Agency (GTA), the services provided by GTA shall be covered in the reverse charge only when such services are provided to the organized sector i.e. when the recipient of the service is covered under any of the following:.

(a) any factory registered under or governed by the Factories Act, 1948

(b) any society registered under the Societies Registration Act, 1860 or under any other law for the time being in force in any part of India;

(c) any co-operative society established by or under any law;

(d) any dealer of excisable goods, who is registered under the Central Excise Act, 1944 or the rules made thereunder;

(e) anybody corporate established, by or under any law; or

(f) any partnership firm whether registered or not under any law including association of persons;

However, when services are provided to the unorganized sector the service provider i.e. the GTA shall be liable to pay service tax

However Vide Notification 25/2012 Service tax has been exempted in relation to the services provided by the GTA for the transportation of fruits, vegetables, eggs, milk, food grains or pulses.

II. In the case of Sponsorship services, the reverse charge mechanism shall apply only when services are provided to some corporate or any partnership firm and such corporate or firm is in taxable territory.

III. Services provided by Arbitral Tribunal or Individual Advocate to any person other than business entity or a business entity with a turnover upto 10 Lakhs in the preceding financial year are exempted via notification No. 25/2012 dated 20th June, 2012

Joint Charge of Service Tax

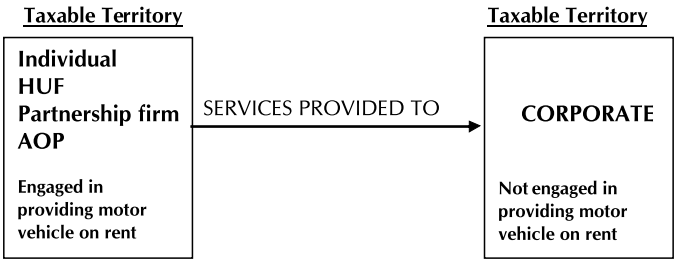
Joint charge is applicable in case of certain specified services mentioned below in the Table-II if the Service provider is Individual, HUF, Partnership Firm, whether registered or not including AOP and the recipient is an entity registered as a body corporate.

Thus in following cases both the service provider as well as the recipient shall be liable to pay service tax to the government.

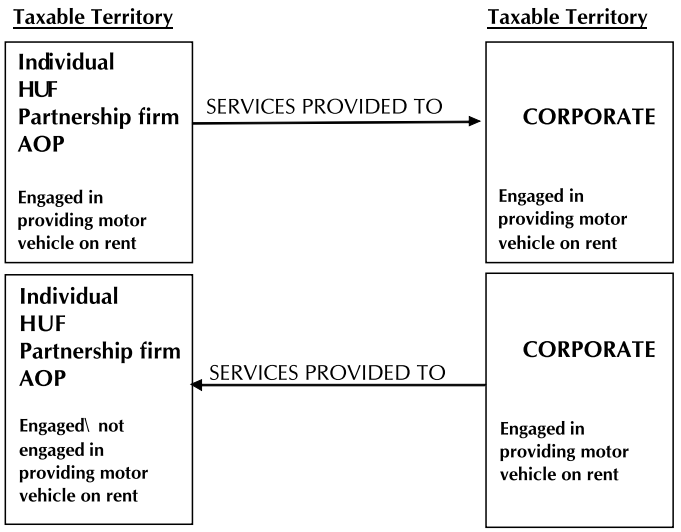
Table II

Sl.No.	Description of a service	Percentage of service tax payable by the person providing service	Percentage of service tax payable by the person receiving the service
1	(a)In respect of services provided or agreed to be provided by way of renting of a motor vehicle designed to carry passengers on abated value to any person who is not engaged in the similar line of business. **(60% abatement)**	Nil	100 %
	(b) In respect of services provided or agreed to be provided by way of renting of a motor vehicle designed to carry passengers on non abated value to any person who is not engaged in the similar line of business. ***(See point IV below in Some points to be noted)***	60%	40%
2.	In respect of services provided or agreed to be provided by way of supply of manpower for *any purpose* ***(See point V below in Some points to be noted)***	25%	75 %
3.	In respect of services provided or agreed to be provided in service portion in execution of works contract. ***(See point VI below in Some points to be noted)***	50%	50%

IV. COVERED UNDER REVERSE CHARGE



NOT COVERED UNDER REVERSE CHARGE



Illustration

A an Individual provides services to PQR ltd in relation to renting of motor vehicles and charges Rs. 100

- **Service tax on abated value shall be:**

100* 40% = 40 = abated value

40* 12.36% = ST

Service recipient shall pay Rs 5 as ST to the government.

Service tax on total value shall be:

Liability of Service Provider (Rs.100* 12.36%)* 60% = Rs. 7

Liability of Service Recipient (Rs.100* 12.36%)* 40% = Rs. 5

V. In case of supply of man power, the word *any purpose* specifies that even the service receiver as well as the service provides are engaged in same line of business the concept of reverse charge shall apply.

However the above concept shall not be applicable in the following two cases:-

Case I - if the services are provided by a company and the company shall be liable to pay 100% service tax.

Case II – if the service is provided by an individual, HUF, partnership firm or AOP to individual, HUF, partnership firm or AOP

VI. In works contract services, where both service provider and service recipient is the persons liable to pay tax

Further, *the* service recipient has the option of choosing the valuation method as per choice, independent of valuation method adopted by the provider of service.

Valuation of Works Contract (Notification No. 24/ 2012 dated 6th June, 2012)

Description of Service	% of Service tax payable on total amount charged for Contract
Original Works	40%
Maintenance or Repair or Reconditioning or Servicing of any goods	70%
Other Works Contract – Completion and Finishing services	60%

However the above concept shall not be applicable if the aforesaid services are provided by a company and the company shall be liable to pay 100% service tax.

Changes brought in Reverse Charge Mechanism w.e.f 01.07.2012

A. The following services are deleted from Reverse Charge Mechanism w.e.f 01.07.2012 –

- Insurance Auxiliary service by an agent
- Service in relation to General Insurance Business
- Services in relation to distribution of Mutual Fund by a distributor or agent of mutual fund.

B. New services which are brought under the ambit of reverse charge mechanism from 01.07.2012 are:

- Services provided or agreed to be provided by an arbitral tribunal to business entity – 100% reverse charge.
- Services provided or agreed to be provided by individual advocate or firm of advocates by way of legal services to business entity – 100% reverse charge.
- Service provided or agreed to be provided by Government or local authority by way of support service to business entity – 100%, excluding –
  - Renting of immovable property
  - Services specified in following sections:
    - 66D(a)(i): service by department of Posts to any person other than government.
    - 66D(a)(ii): services in relation to an aircraft or a vessel, inside or outside the precincts of a port or an airport
    - 66D(a)(iii): transport of goods or passengers.
- Service provided by any individual, partnership firm or an HUF whether registered or not including association of persons to a body corporate in relation to:
  - supply of manpower for any purpose – 75% reverse charge
  - service portion in execution of works contract – 50% reverse charge
  - provision of service in relation to Rent a cab service on abated value to any person who is not engaged in the similar line of business – 100% reverse charge
  - provision of service in relation to Rent a cab service on non-abated value to any person who is not engaged in the similar line of business – 40% reverse charge.

Chapter-VI

CLASSIFICATION OF SERVICES

Importance of classification of services -

- Whether the services is covered under declared list or negative list or not.
- Whether it is exempt or not.
- Whether abatement can be availed or not.
- Whether service tax is payable under reverse charge in given services or not.
- Class of services is also required for ascertainment of the place of provision of a given services under the CENVAT Credit Rules, 2004.

Principles of Interpretation of Specified Description of Services or Bundled Services [Section 66F]

(*1*) Unless otherwise specified, reference to a service (herein referred to as main service) shall **not include reference to a service** which is used for providing main service.

(*2*) Where a service is capable of differential treatment for any purpose based on its description, the **most specific description** shall be preferred over a more general description.

(*3*) Subject to the provisions of sub-section (*2*), the taxability of a **bundled service** shall be determined in the following manner, namely:––

(*a*) if various elements of such service **are naturally bundled** in the ordinary course of business, it shall be treated as provision of the single service which gives such bundle its essential character;

(*b*) if various elements of such service **are not naturally bundled** in the ordinary course of business, it shall be treated as provision of the single service which results in highest liability of service tax.

Explanation.— For the purposes of sub-section (*3*), the expression "bundled service" means a bundle of provision of various services wherein an element of provision of one service is combined with an element or elements of provision of any other service or services.'

1. Reference to the main service shall not include reference to a service which is used for providing such main service.

This rule can be understood with help of illustrations which are given below –

(i) Transportation of goods on an inland waterway is a specified entry in the negative list in section 66D of the Act, i.e. exempt from service tax.

But any services provided by an agent to book such transportation of goods on inland waterways or to facilitate such transportation would not be entitled to the negative list entry, i.e. chargeable to service tax.

(ii) 'Provision of access to any road or bridge on payment of toll' is a specified entry in the negative list in section 66D of the Act, i.e. exempt from service tax.

But any service provided in relation to collection of tolls or for security of a toll road would be in the nature of service used for providing such specified service and will not be entitled to the benefit of the negative list entry, i.e. chargeable to service tax.

2. The most specific description shall be preferred over a more general description.

This rule can be understood with help of illustrations which are given below –

- The services provided by a real estate agent are in the nature of intermediary services relating to immovable property. As per the proposed Place of Provision of Service Rule, 2012, the place of provision of services provided in relation to immovable property is the location of the immovable property. However in terms of the rule 5 pertaining to services provided by an intermediary the place of provision of service is where the intermediary is located. Since Rule 5 of the draft 'Place of Provision of Services Rules, 2012' provides a specific description of 'estate agent', the same shall prevail.

- Pandal and Shamiana is an existing service and will remain a subject of taxation. Likewise service provided by way of catering is a taxable service and entitled to abatement. There is abatement when the two are provided in combination. Since the combination is more a specific entry than the two

provided individually, there is no need to apply the later rule of bundled services, where the character could be judged by the service which provides it the essential character.

3(a). Services which are naturally bundled in the ordinary course of business –

The rule is – 'If various elements of a bundled service are naturally bundled in the ordinary course of business, it shall be treated as provision of a single service which gives such bundle its essential character'

Illustrations -

A hotel provides a 4-D/3-N package with the facility of breakfast. This is a natural bundling of services in the ordinary course of business. The service of hotel accommodation gives the bundle the essential character and would, therefore, be treated as service of providing hotel accommodation.

- A 5 star hotel is booked for a conference of 100 delegates on a lump sum package with the following facilities:

    1. Accommodation for the delegates
    2. Breakfast for the delegates,
    3. Tea and coffee during conference
    4. Access to fitness room for the delegates
    5. Availability of conference room
    6. Business centre

As is evident a bouquet of services is being provided, many of them chargeable to different effective rates of tax. None of the individual constituents are able to provide the essential character of the service. However, if the service is described as convention service it is able to capture the entire essence of the package. Thus the service may be judged as convention service and chargeable to full rate. However it will be fully justifiable for the hotel to charge individually for the services as long as there is no attempt to offload the value of one service on to another service that is chargeable at a concessional rate.

3(b). Services which are not naturally bundled in the ordinary course of business

The rule is – 'If various elements of a bundled service are not naturally bundled in the ordinary course of business, it shall be treated as provision of a service which attracts the highest amount of service tax.'

Illustrations –

A house is given on rent one floor of which is to be used as residence and the other for housing a printing press. Such renting for two different purposes is not naturally bundled in the ordinary course of business. Therefore, if a single rent deed is executed it will be treated as a service comprising entirely of such service which attracts highest liability of service tax. In this case renting for use as residence is a negative list service while renting for non-residence use is chargeable to tax. Since the latter category attracts highest liability of service tax amongst the two services bundled together, the entire bundle would be treated as renting of commercial property.

Significance of the condition of the rule relating to 'bundled service' is subject to the most specific description as laid down in sub-section (2) of section 66F.

Sub-section (2) of section 66 lays down **:** 'where a service is capable of differential treatment for any purpose based on its description, the most specific description shall be preferred over a more general description'. This rule predominates over the rule laid down in sub-section (3) of section 66 relating to 'bundled services'. In other words, if a bundled service falls under a service specified by way of a description then such service would be covered by the description so specified.

Chapter-VII

CENVAT CREDIT RULES, 2004

Topics Covered in this chapter:-

- Introduction
- Short title, extent and commencement
- Definition
- Duties and taxes for which CENVAT credit can be availed
- Rules –
  - Rule 3 & 4 - CENVAT credit & Conditions for availing CENVAT Credit
  - Rule 5 - Refund of CENVAT credit
  - Rule 5B - Refund of CENVAT credit to service providers providing services taxed on reverse charge basis
  - Rule 6 - Obligation of manufacturer of dutiable and exempted goods and provider of taxable and exempted services
  - Rule 9 - Documents and Records required for CENVAT Credit
  - Rule 9(2) - CENVAT credit on service tax shall not be denied if the following details are there on the document.
  - Rule 10 - Transfer of CENVAT credit
  - Rule 10A - Transfer of CENVAT credit of additional duty leviable under section 3(5) of the Custom Tariff Act

- Rule 11 - Transitional Provision
- Rule12 - Special exemption in respect of inputs manufactured in factories located in specified areas
- Rule 12A - Procedure and facilities for large taxpayer
- Rule 12AAA - Power to impose restriction in certain types of cases
- Rule 13 - Power of Central Government
- Rule 14 - recovery of credit wrongly taken or erroneously refunded
- Rule 15 - Confiscation and penalty
- Rule 15A - General Penalty

◆ Some Practical Issues

Introduction

The CENVAT Credit Rules, 2004 superseded erstwhile CENVAT credit rules, 2002 (applicable for availing credit of excise duty) and also Service Tax Credit Rules, 2002 (applicable for availing credit of service tax). The supersession of both the rules paved way for availing credit of service tax and excise duty across goods and services.

The changes in service tax regime have brought some changes in credit mechanism too. So these notes are prepared to summarize the CENVAT Credit Rules, 2004 along with amendment in CENVAT Credit effective from 01.04.2012.

Short title, extent, and commencement

1) These rules may be called the CENVAT Credit Rules, 2004.

2) They extend to the whole of India:

   Provided that nothing contained in these rules relating to availment and utilization of credit of service tax shall apply to the State of Jammu and Kashmir.

Definitions

Following are some changes brought in some of the definitions wef 01.07.2012 –

(A) In the definition of **"Capital Goods"** following changes are introduced –

(i) **in sub-clause (A)**, in item(viii), after the words, "their chassis" the words *"but including dumpers and tippers"* is inserted;

(ii) **for sub-clause (B)**, the following sub-clause shall be substituted, namely:

"(B) motor vehicle designed for transportation of goods including their chassis registered in the name of the service provider, when used for-

(i) providing an output service of renting of such motor vehicle; or

(ii) transportation of inputs and capital goods used for providing an output service; or

(iii) providing an output service of courier agency"

(iii) ***for sub-clause (C)****,* the following sub-clause shall be substituted, namely:

"(C) motor vehicle designed to carry passengers including their chassis, registered in the name of the provider of service, when used for providing output service of-

(i) transportation of passengers; or

(ii) renting of such motor vehicle; or

(iii) imparting motor driving skills"

(B) for clause (e), the following shall be substituted, namely:-

'(e) **"Exempted Service"** means a –

1) taxable service which is exempt from the whole of the service tax leviable thereon; or

(2) service, on which no service tax is leviable under section 66B of the Finance Act; or

(3) taxable service whose part of value is exempted on the condition that no credit of inputs and input services, used for providing such taxable service, shall be taken;

but shall not include a service which is exported in terms of rule 6A of the Service Tax Rules, 1994.'

(C) In the definition of **Inputs [clause (k)]**, for sub clause (B), the following sub-clause shall be substituted, namely:-

"(B) any goods used for -

(a) construction or execution of works contract of a building or a civil structure or a part thereof; or

(b) laying of foundation or making of structures for support of capital goods, except for the provision of service portion in the execution of a works contract or construction service as listed under clause (b) of section 66E of the Act;"

(D) in the definition of **Input Service [clause (l)]**,-

(i) for the words " taxable service", the words "output service" shall be substituted;

(ii) in sub-clause (ii), for the words " but excludes services", the words " but excludes" shall be substituted;

(iii) for sub-clause (A), the following sub-clause shall be substituted, namely:-

"(A) service portion in the execution of a works contract and construction services

including service listed under clause (b) of section 66E of the Finance Act (hereinafter referred as specified services) in so far as they are used for -

(a) construction or execution of works contract of a building or a civil structure or a part thereof; or

(b) laying of foundation or making of structures for support of capital goods, except for the provision of one or more of the specified services; or";

(iv) in sub-clause (B), for the words, brackets, letters and figures "specified in sub-clauses

(o) and (zzzzj) of clause (105) of section 65 of the Finance Act", the words "services provided by way of renting of a motor vehicle" shall be substituted;

(v) for sub-clause (BA), the following sub-clause shall be substituted, namely: —

"(BA) service of general insurance business, servicing, repair and maintenance , in so far

as they relate to a motor vehicle which is not a capital goods, except when used by -

(a) a manufacturer of a motor vehicle in respect of a motor vehicle manufactured by such person ; or

(b) an insurance company in respect of a motor vehicle insured or reinsured by such person; or";

(E) in the definition of **Output Service [clause (p)]**, the following clause shall be substituted, namely:-

"Output Service" means any service provided by a provider of service located in the taxable territory but shall not include a service,-

(1) specified in section 66D of the Finance Act; or

(2) where the whole of service tax is liable to be paid by the recipient of service.'

Duties and Taxed for which CENVAT Credit can be availed

Nature of Duty	Availability of credit against excise duty (CENVAT)	Availability of credit against service tax
Additional duty of customs levied on excisable goods as basic excise duty (i.e. BED). This duty is also levied on important goods under the Customs Tariff Act, 1975 as additional duty (also known as countervailing duty i.e. CVD) *(See the note 1 given below this table)*	Available against CENVAT	Available against service tax.
Service tax (section 66/66A/66B)	Available against CENVAT	Available against service tax.
Education Cess levied on excise duty, on CVD paid on imported goods, and on service tax.	Such credit can be utilized for payment of education cess.	Such credit can be utilized for payment of education cess.
Secondary and Higher Education Cess (SHEC) levied on excise duty, on CVD paid on imported goods, or on service tax.	From 12-05-2007 Such credit can be utilized for payment of secondary or higher education cess. Earlier, such credit can be utilised for payment of education cess or secondary or higher education cess.	From 12-05-2007 Such credit can be utilized for payment of secondary or higher education cess. Earlier, such credit can be utilised for payment of education cess or secondary or higher education cess.
Other special duties like Additional duty of excise on textile and textile articles	Available only against respective special duty.	Not available

Note 1 – The credit of additional duty of customs levied under sub-section (5) of section 3 of the Custom Tariff Act, 1975 shall not be allowed if the invoice or the supplementary invoice, as the case may be, bears an indication to the effect that no credit of the said additional duty shall be admissible.

Note 2 – CENVAT credit cannot be used for payment of service tax in respect of services where the person liable to pay tax is the service recipient.

Rule 3 & 4 - CENVAT credit & Conditions for availing CENVAT Credit

CENVAT credit is allowed on the duties and taxed paid on purchase of input goods, capital goods and services. To ensure proper use of the credit mechanism, certain conditions have been imposed by Rule 4 of the CENVAT Credit Rules subject to which such credit can be availed.

CENVAT credit on input goods may be taken immediately on receipt of the inputs in the factory of the manufacturer or by the provider of output service **[Rule 4 (1)]**

Provided that the CENVAT credit in respect of inputs may be taken by the provider of output service when the inputs are delivered to such, provider, subject to maintenance of documentary evidence of delivery and location of the inputs.

- **Case where Input credit needs to be reversed:-**

  - When input goods are removed as such from the factory of the manufacturer of the final products, or premises of the output service provider without being used in providing output services, CENVAT credit availed thereon has to be reversed. Rule 3(5) permits such removal only after the service provider make payment of an amount equal to CENVAT credit earlier availed in this respect. It is provided that removal shall be made on the basis of invoice as prescribed by Rule 9.

    This amount can be paid through CENVAT credit account maintained by the service provider. The reversal of CENVAT credit made at the time of removal of goods shall be eligible as fresh CENVAT credit in the hands of the person who takes delivery of such inputs. **[Rule 3(5)]**

  - Where on any goods manufactured or produced by an assessee, the payment of duty is ordered to be remitted under Rule 21 of the Central Excise Rules, 2002, the CENVAT credit taken on the inputs used in the manufacture or production of said goods shall be reversed. **[Rule 3(5C)]**

- **Case where Input credit needs to be write off [Rule 3(5B)]**

  a) If the input on which CENVAT credit has been taken is written off fully or partially or where any provision to write off fully or partially has been made in the books of account then the manufacturer or service provider, as the case may be, shall pay an amount equivalent to the CENVAT credit taken in respect of the said input. However, if the said input is subsequently used in the manufacture of final products or the provision of output services, the manufacturer or output service provider as the case may be, shall be entitled to take the credit of the amount equivalent to the CENVAT credit paid earlier.

- **Cases where removal of goods from the premises of output service provider does not require reversal of CENVAT credit availed thereon**

  a) When the input goods are removed from the premises of output service provider for the purpose of providing output services, the CENVAT credit need not to be paid back or reversed. [First proviso to Rule 3(5)]

b) The CENVAT credit is allowable even if any input goods are sent as such or after being partially processed to a job worker for further processing, testing, repair, re-conditioning, etc. However, CENVAT credit shall be allowed only if it is established by the output service provider taking the CENVAT credit that the input goods are received back within 180 days of their sent to a job worker. This fact may be established from records or Challans or memos or any other document produced by him.

In case such goods are not received back within 180 days., the provider of output service shall pay an amount equal to the CENVAT Credit attributable to the inputs by debiting the CENVAT credit or otherwise. However, the CENVAT Credit can be taken again when the inputs are received back in the premises of the provider of output service. [as per Rule 4(5)]

- CENVAT credit on capital goods received in the factory or in the premises of the provider of output service or outside the factory of manufacturer of the final products for generation of electricity for captive use within the factory at any point in the given financial year shall be taken only for an amount not exceeding 50% of the duty paid on such capital goods in the same financial year. The credit is available even if capital goods are acquired by the service provider on lease, hire purchase or loan agreement, from a financing company. [Rule 4(2)(a)]

- The year, in which capital good is received by the service provider, he can take credit to the extent of 50% in that financial year. The balance of CENVAT credit may be taken in any subsequent financial year. **The only condition is that the capital goods should be in the possession of the provider of output service in such subsequent years.** However, components, spares and accessories, refractories and refractory materials, moulds and dies and goods falling under CET Sch. Heading 6805, grinding wheels and the like and parts thereof falling under heading 6804 have been exempted from the condition of possession. Accordingly they need not to be in his possession in these subsequent years when balance CENVAT credit on capital goods is availed.

- Where a person is eligible to avail exemption under a notification based on the value of clearances (not exceeding Rs. 4 crores) in a financial year, the CENVAT credit in respect of capital goods received by such assessee shall be allowed for the whole amount of the duty paid on such capital goods in the same financial year.

- Cases where CENVAT credit on capital goods is to be reversed

  - CENVAT credit is not allowed for the amount of duty which has been claimed as depreciation i.e. if the duty paid on capital goods is treated as cost and depreciation is charged on duty portion also. In that case the credit of the same is not eligible. **[as per Rule 4(4)]**

- When capital goods are removed from the premises of the output service provider, CENVAT credit availed thereon has to be reversed barring the specified situations. **[as per Rule 3(5)]**

◆ Case where credit on Capital Goods needs to be write off **[Rule 3(5B)]**

If the capital good before being put to use, on which CENVAT credit has been taken is written off fully or partially or where any provision to write off fully or partially has been made in the books of account then the manufacturer or service provider, as the case may be, shall pay an amount equivalent to the CENVAT credit taken in respect of the said capital goods. However, if the said capital good is subsequently used in the manufacture of final product or the provision of output services, the manufacturer or output service provider as the case may be, shall be entitled to take the credit of the amount equivalent to the CENVAT credit paid earlier.

◆ When Capital goods are removed after being used **[Rule 3(5A)]**

- If the capital goods, on which CENVAT credit has been taken, are removed after being used, whether as capital goods or as scrap or waste, the manufacturer or provider of output services shall pay an amount equal to the CENVAT credit taken on the said capital goods reduced by the percentage points calculated by straight line method as specified below for each quarter of a year or part thereof from the date of taking the CENVAT credit namely:

a) For computers and computer peripherals:

for each quarter in the first year @ 10%
for each quarter in the second year @ 8%
for each quarter in the third year @ 5%
for each quarter in the fourth and fifth year @ 1%

b) For capital goods, other than computer and computer peripherals @ 2.5% for each quarter.

Provided that if the amount so calculated is less than the amount equal to the duty leviable on transaction value, the amount to be paid shall be equal to the duty leviable on transaction value.

- CENVAT credit on INPUT services[Rule 4(7)] - The cenvat credit in respect of input service shall be allowed, on or after the day on which the invoice/bill/ challan, is received by the service recipient.

After availing/taking the credit as above, the service recipient is required to make payment of value of service along with the service tax mentioned on

such invoice/bill/challan within three months from the date of issue thereof, otherwise the credit is required to be reversed. In case the said payment is made later, the assessee can take credit with respect to such payment at that point in time.

In case of input service tax is paid on reverse charge basis, CENVAT credit for such service is allowed on or after the day on which payment of the value of input service and the respective service tax is made.

Rule 5 - Refund of CENVAT credit

A manufacturer who clears a final product or an intermediate product for export without payment of duty under bond or letter of undertaking, or a service provider who provides an output service which is exported without payment of service tax, shall be allowed refund of CENVAT credit as determined by the following formula subject to procedure, safeguards, conditions and limitations, as may be specified by the Board by notification in the Official Gazette:

$$\text{Refund amount} = \frac{[\text{Export turnover of goods} + \text{Export turnover of services}] \times \text{Net CENVAT credit}}{\text{Total Turnover}}$$

- "Refund amount" means the maximum refund that is admissible.
- NET CENVAT credit means total CENVAT credit availed on inputs and input services by the manufacturer or the output service provider reduced by the amount reversed in terms of sub rule (5C) of rule 3, during the relevant period;
- "Export turnover of goods" means the value of final products and intermediate products cleared during the relevant period and exported without payment of Central Excise duty under bond or letter of undertaking;
- Export turnover of services means the value of the export service calculated in the following manner, namely:-

Particulars	**Amount**
payments received during the relevant period for export services	XXX
Add: Service whose provision is completed and the payment was received in advance in the prior period	XXX
Less: advance received for which provision of service has not been completed during the relevant period	(XXX)
Export Turnover of Services	**XXX**

- Total turnover means sum total of the value of –

  a) All excisable goods cleared during the relevant period including exempted goods and excisable goods exported;

  b) Export turnover of services determined in terms of clause (D) of sub-rule (1) above and the value of all other services, during the relevant period; and

  c) All inputs removed as such under sub-rule (5) of rule 3 against an invoice, during the period for which the claim is filed.

- ***Notification No. 27/2012- CE, dated 18th June, 2012*** – Refund of CENVAT credit under rule 5, shall be subjected to the following safeguards, conditions and limitations, namely:-

  a) The manufacturer or provider of output service shall not submit more than one claim of refund under this rule for each quarter.

  b) The first quarter is beginning from 1st April of every year, second beginning from 1st July, third quarter beginning from 1st October and fourth quarter from 1st January of every year.

  c) The value of goods cleared for export shall sum total of all the goods cleared by the exporters for exports during the quarter as per the monthly or quarterly return filed by the claimant.

  d) The amount of refund claimed shall not be more than the amount lying in balance at the end of quarter for which refund claim is being made or at the time of filing of the refund claim, whichever is less.

  e) The amount that is claimed as refund under rule 5 of the said rules shall be debited by the claimant from his CENVAT credit account at the time of making the claim.

  f) In case the amount of refund sanctioned is less than the amount of refund claimed, then the claimant may take back the credit of the difference between the amount claimed and amount sanctioned.

- *No refund of CENVAT credit shall be allowed if the manufacturer or provider of output service avails of drawback allowed under the Customs and Central Excise Duties and Service Tax Drawback Rules, 1995, or claims rebate of duty under the Central Excise Rules, 2002, in respect of such duty; or claims rebate of service tax under the Service Tax Rules, 1994, in respect of service tax.*

Rule 5B - Refund of CENVAT credit to service providers providing services taxed on reverse charge basis

The service provider who is providing services under reverse charge mechanism and is unable to utilize the CENVAT Credit availed on inputs and input services then he may be allowed with the refund of such CENVAT credit subject to safe guards, conditions and limitations, as may be specified by the board by notification in official gazette.

Rule 6 - Obligation of manufacturer of dutiable and exempted goods and provider of taxable and exempted services

If a manufacturer or provider of output services is providing both dutiable or taxable as well as exempted goods or services, then in order to avail CENVAT credit on the goods or services used in both dutiable or taxable as well as exempted goods or services the manufacturer or provider of output service shall maintain separate accounts for –

- The receipt, consumption and inventory of *inputs* used –

	CENVAT CREDIT NOT ALLOWED	**CENVAT CREDIT ALLOWED**
GOODS	In or in relation to exempted goods.	In or in relation to dutiable final products excluding exempted goods
SERVICES	For the Provision of exempted services.	Provision of output service excluding exempted service.

- The receipt and use of *input services* -

	CENVAT CREDIT NOT ALLOWED	**CENVAT CREDIT ALLOWED**
GOODS	in or in relation to the manufacture of exempted goods and their clearance upto the place of removal.	in or in relation to the manufacture of dutiable final products, excluding exempted goods, and their clearance upto the place of removal.
SERVICES	for the provision of exempted services	for the provision of output services excluding exempted services

- However, the manufacturer of goods or the provider of output service, opting not to maintain separate accounts, shall follow any one of the following options –

  1) ay an amount equal to *"six per cent"* of the *value* of the exempted goods and exempted services; or
  2) Pay an amount as determined under sub-rule (3A); or
  3) Maintain separate accounts for receipt, consumption and inventory of inputs as provided for in clause (a) in the above point, take CENVAT credit only on

inputs under sub clauses (ii) and (iv) of said clause (a) and pay an amount as determined under sub-rule (3A) in respect of input services. The provisions of sub-clauses (i) and (ii) of clause (b) and sub clauses (i) and (ii) of clause (c) of sub rule (3A) shall not apply to such payment.

Rule 9 - Documents and Records required for CENVAT Credit

A. The CENVAT credit can be taken by the manufacturer or provider of output service/input service distributor on the basis of following documents:

i. Invoice issued by manufacturer/ importer/ importer from his registered depot or from the registered premises of the consignment agent.

ii. Invoice issued by first stage/ second stage dealer

iii. Supplementary invoice issued by manufacturer/ by service provider

iv. Bill of entry

v, Certificate issued by appraiser of Customs in respect of goods imported through a Foreign Post Office

vi. Challan evidencing payment of service tax, by the service recipient as the person liable to pay service tax.

vii. Invoice/bill/challan issued by a provider of input service

viii. Invoice/bill/challan issued by an input service distributor under Rule 4A of the Service Tax Rules, 1994.

Rule 9(2) - CENVAT credit on service tax shall not be denied if the following details are there on the document.

- Service tax payable
- Description of the taxable service
- Assessable value
- Service tax registration number of the person issuing the invoice
- Name and address of the factory or warehouse or premises of the first or second stage dealers or provider of output service.

and AC/DC, as the case may be, is satisfied that the goods or services covered by the said document have been received and accounted for in the books of account of the receiver, he may allow the CENVAT credit.

Rule 10 - Transfer of CENVAT credit

If a manufacturer of the final products or the provider of output services

- Shifts his factory to another site; or
- If the factory is transferred
    - On account of change in ownership
    - On account of sale, merger, amalgamation, lease or transfer of the factory to a joint venture with the specific provision for transfer of liability of such factory.

Then, the manufacturer or provider of output service shall be allowed to transfer the CENVAT Credit lying unutilized in his accounts to such transferred, sold, merged, leased or amalgamated factory.

ONLY IF

- The stock of inputs (as such or in process), or the capital goods, is also transferred along with the factory to the new site or ownership and
- The inputs, or capital goods, on which credit has been availed of are duly accounted for the satisfaction of AC/DC.

Rule 10A - Transfer of CENVAT credit of additional duty leviable under section 3(5) of the Custom Tariff Act

A manufacturer or producer of final products

- Having more than one registered premises under Central Excise Rules, 2002
- The additional duty leviable under section 3(5) of the Custom tariff Act, lying unutilized in one registered premises may transfer to another registered premises on the basis of the documents maintained under rule 9.

Rule 11 - Transitional Provision

- As per Rule 11(1), any amount of credit earned by a provider of output service under Service Tax Credit Rules, 2002, as they existed prior to the 10th day of September, 2004, and remaining unutilized on that day shall be allowed as CENVAT credit, and be allowed to be utilised in accordance with these rules.

Treatment of CENVAT credit when Service Provider opts for exemption from payment of whole of Service tax. [Rule 11(4)]

Where a service provider, providing taxable services –

- Opts for exemption from whole of service tax leviable on taxable services under a notification issued under section 93
- Shall be required to pay CENVAT credit i.r.o inputs lying in stock for providing the said service or is contained in taxable service pending to be provided.
- After deducting the above amount from the CENVAT credit, balance if any amount left shall lapse.

Rule12 - Special exemption in respect of inputs manufactured in factories located in specified areas

Specified areas means –

- North-east region
- Kutch district of Gujarat
- State of Jammu & Kashmir
- State of Sikkim

If the inputs or capital goods is purchased from the manufacturer in the above areas, the CENVAT credit shall be allowed in full without considering that any portion of duty on such inputs or capital goods was exempted under the said notifications.

Rule 12A - Procedure and facilities for large taxpayer

- A large tax payer may remove inputs or capital goods, except petrol, HSD and LSD, on which credit has been taken,
- Without payment of amount referred in rule 3(5)
- But if final product is not cleared on payment of duty or capital goods are used exclusively in the manufacture of exempted goods
- THEN amount equal to credit taken on inputs or capital goods has to be paid.

Rule 12AAA - Power to impose restriction in certain types of cases

- The Central Government has the power to take some measure if it deems necessary in the public interest to do so by way of a notification in the Official Gazette.
- It may specify the nature of restrictions including restrictions on utilization of CENVAT credit and suspension of registration in case of a dealer and type of facilities to be withdrawn and procedure for issue of such order by an officer authorized by the Board.

Rule 13 - Power of Central Government

- The CG may by notification declare,
- The inputs or input service, on which duties of excise, or additional duty of custom or service tax,
- Shall be deemed to have been paid, equal to such amount as may be specified in the said notification AND allow credit of such duty or tax deemed to have been paid in such manner and subject to such condition as may be specified in the said notification.

Rule 14 - recovery of credit wrongly taken or erroneously refunded

Where the CENVAT credit has been taken and utilized wrongly or has been erroneously refunded the same along with interest shall be recovered from the manufacturer and section 73 and 75 shall apply for affecting such recoveries.

Rule 15 - Confiscation and penalty

- If any person takes or utilizes CENVAT credit in respect of input or capital goods or input services, wrongly or in contravention of any provisions of these rules, shall be liable to a penalty not exceeding service tax on such goods or services, as the case may be, or two thousand rupees, whichever is greater.
- If CENVAT credit is wrongly utilized by reason of fraud, collusion or any willful mis-statement or suppression of facts, or contravention of any of the provisions of these rules or of the Finance Act or the rules made thereunder with the intent to evade payment of service tax, then the provider of output service shall also be liable to pay penalty under section 78.

Rule 15A - General Penalty

The contraventions, for which no penalty is provided in these rules, shall be liable to pay a penalty which may extend to five thousand rupees.

Some Practical Issues

Cenvat Credit Eligibility of Input Services

- Cenvat credit on advertising and marketing services is allowed on the ground that canvassing and procuring orders are activities preceding to removal of the goods by the manufacturer. **[CCE, Ludhiana vs Ambika Overseas (2012) 22 Taxman. Com 83 (Pun& Har)]**

- There is no requirement to reverse the credit on input services of GTA when inputs are removed as such under Rule 3(5) as the said rule talks about the cenvat credit taken on input or capital goods and does not refer to the cenvat on input service. **[CCE Vs M/S Punjab Steels & Others 2011 (21) S.T.R 5 (P&H)]**

- The outward transportation of final products from the place of removal should be treated as an input service in terms of Rule 2(1)(iI) of the Cenvat Credit Rules, 2004 and thereby enabling the manufacturer to take the credit of the service tax paid on the value of such service. **[M/S Saint Gobain Vetrotex India Ltd. Vs. CCE 2010-TIOL-1717-CESTAT (Bang)]**

- The security service provided by the manufacturer to employee quarter is not eligible for cenvat credit. **[STO 2011 GUJ 288]**

- Service tax paid on catering services provided in the factory for employees of the factory is allowed to be taken as cenvat credit. **[CEO 2010 BOM 24]**

- Cenvat credit is admissible on outward transportation beyond the place of removal where the risk and reward remains with the seller until the goods are delivered at the buyers premises. **[Hindustan Coca Cola Beverages Pvt. Ltd. V. CCE 2010 (17) S.T.R 140 (TRI-Bang)]**

- The 'chartered accountants' service involved accounting and auditing of the transactions assessee. Auditing and accounting are specifically included in the definition of input service. **[STO 2011 CESTAT 219]**

Cenvat Credit for Capital Goods

- Cenvat credit is not deniable on capital goods on which depreciation which has been claimed earlier was subsequently reversed by filing a revised income tax return. **[Vizianagara Iron & Steel Products (p) Ltd. V. CCE (2007) 82 RLT 383]**

- When finished goods become exempt in subsequent year, balance 50% of cenvat credit on capital goods solely used for manufacture of exempt goods not allowable. **[Arani Agro Oil Industries Ltd. V. CCE-II, Visakhapatnam]**

- Principal is allowed to avail cenvat credit on capital goods sent directly to the job worker's premises from the vendor's premises which are subsequently received back from the job worker after the completion of the job work. **[Supreme Marble & Granite LTD. V. CCE (2007) 81 RLT 55]**

- Cenvat credit on capital goods can be claimed to the extent of 100% in the subsequent financial year if no credit is availed in the first financial year in which such capital goods were received. **[Keihin FIE (P) Ltd. V. CCE (2007) 213 ELT 637 (TRI-MUM)]**

- The restriction on availment of cenvat credit on capital goods to the extent of 50% each year applies to education cess as well. **[DCW Limited v. CCE (2009) 93 RLT 295]**

Utilisation and Distribution of Cenvat Credit

- There is no restriction on distribution of input credit relating to one unit of a manufacturer/service provider to another unit of the same manufacturer/ service provider subject to fulfillment of the prescribed conditions under rule 7 of the cenvat credit rules, 2004. **[ECOF Industries Pvt. Ltd. V. CCE 2009-TIOL-2109]**

- It was held that credit is allowed on the duty leviable and paid on the inputs- credit cannot be restricted on the ground that there is subsequent reduction in the assessable value of the inputs supplied. **[Mahaveer Surfactants (P) Ltd. V. CCE, Pondicherry (2008)-TIOL-1447-CESTAT- Mad]**

- Service tax paid by the service provider is available as credit even before rendering taxable output service and can be utilised for payment of service tax on output services and also there is no time-limit prescribed for availing cenvat credit. **[Jindal Steel & Power Ltd. V. CCE, Raipur (2008)-TIOL-1450-CESTAT-DEL]**

- Interest liability cannot be discharged through cenvat credit a/c- interest payment to be made through pla/cash only. **[CCE, Raigad v. Maharashtra Seamless Ltd. 2009-TIOL-84-CESTAT-MUM]**

- Cenvat credit cannot be disallowed if the assessee is registered at the time when they intend to utilize cenvat though, he is not registered when cenvat is available to him. **[Sutham Nylocots v. CCE, Coimbatore (2005) 188 ELT 26 (TRI-Chennai)]**

- Cenvat credit cannot be utilised for the payment of interest and penalty. **[CCE v. Shri Bhavani Distilleries (India) (P) Ltd. (2007) 81 RLT 942]**

- No amount under Rule 6 of the credit rules is payable where the cenvat credit attributable to common inputs used in exempted final product has been reversed by the assessee. **[Ruchi Soya Industries Ltd. V. CCE (2007) 82 RLT 624]**

- Cenvat credit is admissible on common inputs used in both exempted and dutiable goods if the credit attributable to inputs used in exempted goods is reversed or paid back. **[Godavari Sugar Mills Ltd. V. CCE (2007) 80 RLT 850]**

Documents Required for Availing and Utilizing Cenvat Credit

- Credit cannot be denied in respect of such invoices mainly on the ground that the same were issued in earlier name of the company. **[Showa India Pvt. Ltd. V. CCE (2012) 25 STR 152 (TRI- del)]**

- Rule 9(1) of Cenvat Credit Rules, 2004 deals with the documents that are required to avail cenvat credit and those documents are invoice, challan, supplementary invoice, and bills of entry. Thus cenvat credit on strength of debit notes is not allowed. **[Godrej Consumer Products LTD. V. CCE (2010) 20 S.T.R 609 (TRI-DEL)]**

- If a person is discharging service tax liability from his registered premises, benefit of cenvat credit cannot be denied only on the ground that the invoices are in the name of brach offices. **[Manipal Advertising Services Pvt. Ltd. V. CCE 2011-Tiol-273-CESTAT-Bang]**

- The invoice indicating the manufacturer as the consignee and the trader as the buyer is a valid document for availing cenvat credit as long as the goods are directly received in the premises of the manufacturer. **[Kunststoff Polymers Ltd. V. CCE (2009) 94 RLT 117]**

- Inputs received not under prescribed documents – when the transaction was genuine, identity of supplier of inputs is established, document showing duty payment is supported by facts and records of supplier of inputs shows that it had purchased duty paid inputs before resale and passed on the credit on duty thereon, credit cannot be denied on procedural issues. **[Maschmeijer Aromatics (India) Ltd. V. CCE Chennai (2009)-TIOL-112-CESTAT-Mad]**

- Credit cannot be denied as address given in the invoices was not registered with the revenue, however, the registration certificate was later amended and the address was corrected. **[Raaj Khosla & Co. (P) Ltd v. CST, Delhi (2008)-TIOL-1703-CESTAT-Del]**

- Cenvat credit is admissible on the basis of tR-6 challans evidencing payment of service tax. **[CCE v. Essel Pro-pack Ltd. (2007) 8 STR 609 (TRI-MUM)]**

Refund of Cenvat Credit

- Refund claim of service tax cannot be denied with respect to service tax paid on input services viz. Rent a cab service, outdoor catering service, air travel booking, telephone/mobile service, steamer agent's services used in relation to business activities, even if not directly used in relation to manufacture of final product. **[Semco Electrical (P) Ltd v CCE (2010) 24 STT 508]**

- Refund of cenvat credit is admissible even in respect of export of final product chargeable to nil duty. **[Noble Grain India Pvt. Ltd. V CCE (2009) 95 RLT 864]**

- The refund of unutilized credit under Rule 5 of Cenvat Credit Rules, 2004 is available only in respect of input services used in manufacture of export goods

and is not available for services used outside the factory of manufacture. **[CCE v. Sameer Linkages PVT. Ltd. (2009) 95 RLT 311]**

- Recipients of services were eligible to claim cenvat credit of the service taxes paid on services which, as per the department, were exempt from the tax. **[CCE v DIL Ltd. (2008) 9 STR 411 (Tri-Mum)**]

Chapter-VIII

REGISTRATION

1. Person Requiring Registration

Section 69 of Finance Act, 1994 requires following persons to make registration with the concerned Superintendent of the central Excise –

i. Every person who is liable to pay service tax [section 69(1)]
There are two categories of persons who are liable to pay service tax –

(a) Service provider – provider of taxable services.

(b) Specified persons as per Rule 2(1)(d) of service tax rule, 1994:
The Central Government has provided a list of specified persons vide Notification No. 30/2012-ST, dated- 20-06-2012 read with rule 2(1)(d), which includes LIC company, factories, a body corporate or partnership firm, a company; a person in taxable territory receiving services from a person located in non taxable territory.

Thus apart from service providers, the above persons liable to pay service tax are also required to seek registration.

ii. Such other person or class of persons, specified by the Central Government by notification in the Official Gazette, [69(2)]

The Central Government specify a special category of persons vide Notification No. 27/2005-ST, dated 07-06-2005, notified a person's who are required to make an application for registration (w.e.f 16-06-2005).

(a) An input service distributer;

(b) Any service provider whose aggregate value of taxable service in a financial year exceeds Rs. 9 lakh.

2. Procedure of Registration

i. Fill the Form ST-1 in duplicate. (Form ST-1 is available on the departmental website (www.cbec.gov.in). Enclose photocopy of PAN card, proof of address to be registered and copy of constitution /partner ship deed etc. of the firm, if any.

ii. Copy of PAN card is necessary as a PAN based code (**S**ervice **T**ax **C**ode) is allotted to every assessee.

iii. These forms are required to be submitted to the jurisdictional Central Excise office.

iv. A person liable to pay service tax should file an application for registration within **thirty days** from the date of commencement of taxable services or within thirty days from the commencement of his activity. (Refer Rule 4 (1) of Service Tax Rules, 1994)

v. Where a person, liable for paying service tax on a taxable service,

- provides such service from more than one premises or offices; or
- receives such service in more than one premises or offices; or,
- is having more than one premises or offices, which are engaged in relation to such service in any other manner, making such person liable for paying service tax,

and has centralized billing system or centralized accounting system in respect of such service, and such centralized billing or centralized accounting systems are located in one or more premises, he may, at his option, register such premises or offices from where centralized billing or centralized accounting systems are located.

The registration shall be granted by the Commissioner of Central Excise in whose jurisdiction the premises or offices, from where centralized billing or accounting is done, are located:

vi. A **single registration** is sufficient even when an assessee is providing more than one taxable services. However, he has to mention all the services being provided by him in the application for registration and the field office shall

make suitable entries/endorsements in the registration certificate. (Refer Rule 4 (4) of Service Tax Rules, 1994)

vii. An assessee should get the registration certificate (registration number) within **7 days** from the date of submission of form S.T.1, under normal circumstances. (Refer Rule 4 (5) of Service Tax Rules, 1994)

viii. A fresh registration is required to be obtained in case of transfer of business to another person. (Refer Rule 4 (6) of Service Tax Rules, 1994)

ix. Any registered assessee when ceases to provide the taxable service shall surrender the registration certificate immediately. (Refer Rule 4 (7) of Service Tax Rules, 1994). Non-surrender of certificate does not attract penalty but entails a liability to furnish return half-yearly even no service is provided and a return is NIL return.

x. In case a registered assessee starts providing any new service from the same premises, he need not apply for a fresh registration. He can simply fill in the Form S.T.1 for necessary amendments he desires to make in his existing information. The new form may be submitted to the jurisdictional Superintendent for necessary endorsement of the new service category in his Registration certificate.

xi. If there is any change in or addition to the information that has been furnished earlier, such change or addition shall be intimated to the jurisdictional Assistant Commissioner or Deputy Commissioner of Central Excise within a period of seven days of such change or addition by the assessee.

xii. The superintendent of central excise shall grant a certificate of registration or revised certificate in Form ST- 2, within seven days from the receipt of completed application. If the registration certificate or revised certificate is not granted within the said period, it shall be deemed that such registration shall be granted or changes incorporated in such certificate.

Key Note:

[Documents required for registration must be submitted to the concerned authority within a period of 15 days from the date of filing of the application for registration. Failure to do so would lead to rejection of the registration application. Vide Notification No. ***F. No. 137/120/2011 – ST, Dated 13-12-2011.]***

3. Penalty for Registration

xiii. Section 77 of the Act provides that where a person liable to take registration

under the Act fails to do so, such person shall be liable to pay penalty –

a. Rs. 10,000 or

b. Rs. 200 every day of continuous default, starting with the first day after date till the date of actual compliance,

Whichever is higher.

Chapter-IX

SERVICE TAX RETURNS

1. Person liable for filling Return

"Every person liable to pay the service tax shall furnish or cause to be furnished to the Central Excise Officer a return in such form and in such manner and in such frequency as may be prescribed". Section 70 to provide that, the people liable for seeking registration u/s 69(2) is also liable to file service tax return for the prescribed period.

W.e.f from 1-10-2011, every assessee shall submit the half-yearly return electronically" vide Notification No. 43/2011-ST dated 25-08-2011.

2. Procedure for filling service tax return

As per Rule 7(1) of service Tax Rules, 1994 every assessee shall submit a half yearly return in Form ST- 3 or ST – 3A, as the case may be along with the form of GAR- 7.

Further, as per rule 7(2) of service tax Rule, 1994 every assessee is required to submit the half-yearly return by 25th of the month following the particular half year. I.e. the service tax returns are due to filed by 25th of October and 25th of April for the half year ended 30th September and 31st March respectively.

(i) Due Date of filing of return in the case of Input Service Distributer (ISD).
As per Rule 9(10) of CENVAT Credit Rules, 2004 ISD shall submit half yearly return within one month from the close of the half year. i.e. the service tax return are due to be filed by 31st of October and 30th April for the half year ended 30th September and 31st March respectively.

(ii) Due Date of filing of return in the case of Large Tax Payers (LTP).
According to Rule 10(1) of Service Tax Rules, 1994 A Large taxpayer units shall submit the return, as prescribed under these rules, for each of the registered premises.

3. Information to be provided in the Service Tax Return

Any person who is filing the return under service tax is required to submit, the following details.

1. Gross amount billed specifying separately the amount billed for exempted services other than export, exported services without payment of tax and services on which tax is to be paid.
2. Amount received including advance towards taxable services provided or to be provided.
3. Notification number of exemption and provisional Assessment order no, if any.
4. The mount of abatement claimed and the Notification number providing such abatement.
5. Service tax and Education Cess & Secondary & Higher Education Cess payable.
6. Service tax paid in cash along with Challan number and date of payment.
7. Service tax paid through CENVAT Credit.
8. Education Cess paid in cash and paid through education Cess credit.
9. Credit availed on inputs, capital goods and input services.
10. Credit received through input service distributer.
11. Credit utilized towards payment of service tax.
12. Credit of service tax received.
13. Credit of service tax distributed.
14. Credit of service tax not eligible to be distributed.

Annexure-'A'

Contribution by CA Bimal Jain

[Containing articles on FAQ on Service provided by Directors to Company, FAQs on Reverse Charge Mechanism under Service Tax, Service tax on staff benefits and employment related transactions - Suggestions invited by TRU and Service tax on Vocational education/training courses.]

FAQ ON SERVICE PROVIDED BY DIRECTORS TO COMPANY

The CBEC has issued **Notification No. 45/2012-ST dated 7-8-2012**, amending the Notification No. 30/2012-ST dated 20-6-2012 and expanded the scope of reverse charge mechanism. With effect from 7-8-2012, services provided by the director to the company will be covered under the reverse charge mechanism. We have summarized frequently asked question(s) in this regard for easy understanding:

Query **Is service tax applicable for services provided by all Directors of a Company?**

Reply Service provided by Managing and Whole-time Directors/ Executive Directors **(those who are under employment with the Company)** are governed by the exclusion clause contained in the definition of 'service' under Section 65B (44) (b) which provides that service provided by employees to their employers in the course of or in relation to employment are exempt from service tax.

Service provided by Part-time/ Expert/ Independent/ Nominee directors, etc., **(those who are not under employment with Company)**, are in the nature of providing their professional/expert services to the company. Hence, the said Services would be chargeable to Service tax under Reverse charge by the Company w.e.f 07.08.2012.

Query **What will be the service tax liability of the Directors for the period July 1, 2012 to August 7, 2012?**

Reply Notification No. 45/2012 is effective from 07.08.2012 i.e. date of Reverse charge mechanism will be effective. In other words, Service provided by Part-time/ Expert/ Independent/ Nominee directors, etc., **(those who are not under employment with Company)** to Company will be taxable from 1st July 2012 to 6th August 2012 in the hands of said Director as there was no reverse charge mechanism for stated period.

Query **Whether the Directors have to obtain registration and pay service tax for the month of July 2012?**

Reply Yes, it looks like that such Directors providing taxable services to the company will have to obtain registration and pay service tax for the month of July, 2012 and for the six days of August, 2012.

It may be noted that services provided by the directors was not taxable up to July 1, 2012. However, if the value of other taxable services rendered by them during Financial Year 2011-12 is less than Rs. 10 lakhs, they can claim exemption up to Rs. 10 lakhs during 2012-13 if the value of services provided by them to the companies and other taxable services, if any, provided by them, is not exceeding Rs.10 lakhs. This exemption is as per Notification 33/2012 dated 20.06.2012 and subject to the conditions prescribed therein.

Query **Whether the service tax thus paid by the Company under reverse charge w.e.f 07.08.2012 can be availed as Cenvat credit?**

Reply Eligibility of Cenvat credit of service tax is to be decided with reference to the definition of input service under the Cenvat Credit Rules, 2004. Normally, the services provided by Directors should be an eligible input service for a manufacturer or a service provider and Cenvat Credit of same would normally be available subject to other conditions being fulfilled as per Cenvat Credit Rules, 2004.

Query **What is the portion of service tax payable by the Company under reverse charge?**

Reply Entire service tax liability will have to be paid by the Company receiving the services from Directors **(those who are not under employment with Company)** w.e.f 07.08.2012.

Query **What is point of taxation under reverse charge?**

Reply Rule 7 of Point of Taxation Rules, 2011 states that POT under reverse charge would be date of Payment provided payment is made within 6 months from the date of invoice otherwise POT would be Date of Invoice.

Query **What is the document on which Cenvat credit can be taken by the Company? Whether directors would also be required to issue an invoice?**

Reply In case of service provided by Directors, the tax challan evidencing payment of service tax by the service recipient would be the relevant document to avail Cenvat Credit.

It is advisable that the Directors must raise an invoice within 30 days of completion of the service as per Service tax Rules, 1994 to have clarity to decide the POT provisions.

Query **Whether Service tax paid by the Company under reverse charge will impact on remuneration to be paid to the Non-whole time directors of a Company under the Companies Act?**

Reply As per Section 309 of the Companies Act, the remuneration paid to Directors cannot exceed the limit of 1% profit of the company when the company has Managing / Whole Time Directors / Managers or 3% of the profit of the company if the company does not have a Managing / Whole Time Directors/ Managers, as the case may be. The Company can pay remuneration at a rate exceeding 1% or, as the case may be, 3% of its net profits, with the prior approval of the Central Government.

Now, non-whole time directors are not exempted from the levy of service tax and the company to which they are providing their services has been made liable to pay service tax as a service recipient. The question that arises is if the company is already paying 1% or 3% to the Directors and if they additionally pay the Service Tax, will it amount to paying more than 1% and 3%?

The Ministry of Corporate Affairs has clarified vide ***General Circular No. 24/2012*** *dated August 9, 2012* that *any increase in remuneration of Non-Whole Time Director(s) of a company solely on account of payment of service tax on commission payable to them by the company shall not require approval of Central Government under section 309 and 310 of the Companies Act even if it exceeds the limit 1% or 3% of the profit of the company, as the case may be, in the financial year 2012-13.*

FAQs UNDER REVERSE CHARGE MECHANISM

Under the Reverse Charge Mechanism the Service Recipient is liable to pay service tax directly to the Government on notified services as per **Notification No. 30/ 2012-ST** dated 20-6-2012 and as amended by **Notification No. 45/2012-ST** dated 07-08-2012 instead of Service tax is charged & deposited by Service Provider.

With effect from 1st July, 2012, there are certain services on which 100% service tax needs to be paid by Service Recipient and partial reverse charge wherein both Service Provider & Service Recipient needs to pay Service tax as per defined percentage as mentioned in the table below:-

S. No.	Description of Service	% payable by service provider	% payable by service receiver
1.	Services provided or agreed to be provided to any person carrying on insurance business	Nil	100%
2.	Goods transport Agency (Applicable to transport by road)	Nil	100%
3.	Sponsorship services, where service receiver is a body corporate or a partnership firm	Nil	100%
4.	Arbitral Tribunal, where service receiver is a business entity having turnover more than 10 lakhs in preceding financial year	Nil	100%
5.	Individual advocate or a firm of advocates, where service receiver is a business entity having turnover more than 10 lakhs in preceding financial year	Nil	100%
6.	services provided or agreed to be provided by Government or local authority by way of support services excluding,- (1) renting of immovable property, and (2) services specified in sub-clauses (i), (ii) and (iii) of clause (a) of section 66D of the Finance Act,1994	Nil	100%
7.	Hiring of motor vehicle to carry passengers on abated value (Where service provider - Individual/Proprietorship/ HUF/Partnership and service recipient - Body Corporate)	Nil	100%

8.	Hiring of motor vehicle to carry passengers on non- abated value (Where service provider -Individual/Proprietorship/ HUF/Partnership and service recipient - Body Corporate)	60%	40%
9.	Supply of manpower or security services (vide N.N. 45/2012-ST dated. 7-8-2012), Where service provider -Individual/Proprietorship/HUF/Partnership and service recipient - Body Corporate	25%	75%
10.	Works Contract -(Where service provider -Individual/ Proprietorship/HUF/Partnership and service recipient - Body Corporate)	50%	50%
11.	Services provided or agreed to be provided by any person who is located in a non-taxable territory and received by any person located in the taxable territory	Nil	100%
12.	Services provided by a Director to Company (Vide N.N. 45/2012-ST dated 7-8-2012)	Nil	100%

We have further summarised some of the frequently asked questions in respect of partial reverse charge mechanism for your easy understanding:

1. Does partial reverse charge applicable for all service providers and recipients

No. Services falling under partial reverse charge mechanism viz., Manpower supply, Security services, Works contract service and Renting of motor vehicle services. Further, the service provider shall be either any individual, Hindu Undivided Family or partnership firm, whether registered or not, including association of persons, located in the taxable territory and the service recipient shall be business entity registered as body corporate located in the taxable territory.

2. What does a Service Provider need to indicate on the invoice when he is liable to pay service tax under the partial Reverse Charge Mechanism?

The Service Provider shall issue an invoice complying with Rule 4A of the Service Tax Rules 1994. Thus the invoice shall indicate the name, address and the registration number of the service provider; Name and address of Service Recipient receiving taxable service; the description and value of taxable service provided or agreed to be provided; and the service tax payable thereon. As per clause (iv) of sub-rule (1) of the said rule 4A "the service tax payable thereon" has to be indicated.

3. If the Service Provider is exempted being a SSI (Turnover less than Rs 10 lakhs), how will the Reverse Charge Mechanism operate?

The liability of the Service Provider and Service Recipient are different and independent of each other. Thus in case the service provider is availing exemption

owing to turnover being less than Rs 10 lakhs, he shall not be obliged to pay any tax. However, Service Recipient shall have to pay service tax to the extent of his service tax under the partial Reverse Charge Mechanism.

4. Whether Service Receiver can avail SSI exemption limit?

No, the service recipient cannot avail SSI exemption while discharging service tax liability under reverse charge.

5. How is the Service Recipient required to calculate his tax liability under Partial Reverse Charge Mechanism? How will the service recipient know which abatement or valuation option has been exercised by the service provider?

It is being provided by way of Explanation that Service tax liability of the Service Provider and Service Recipient are different and independent of each other. The Service Recipient can independently avail or forgo abatement or choose a valuation option, which is independent of Service Provider.

6. What is the Point of Taxation for Service tax liability under Reverse Charge Mechanism?

Both the service provider and service recipient are governed by the Point of Taxation Rules, 2011 in respect of the service provided or received by him.

Usually, point of taxation for service provider would be earliest of following i.e. Date of invoice or Date of receipt of payment.

However for the service recipient, in terms of Rule 7 of the said rules, point of taxation is date of payment. Thus in the case where the invoice is issued, say in July 2012 and the service recipient pays for the same in August 2012 the point of taxation for the service provider will be the date of issue of invoice in July 2012. The point of taxation for the service recipient shall be the date of payment in August 2012.

7. Is CENVAT credit allowed to be taken of the service tax partially billed by the Service Provider and partially paid by a Service Recipient under the Partial Reverse Charge Mechanism?

Yes, CENVAT Credit can be availed on the entire service tax amount paid to the Service Provider as well as paid by the Service recipient directly into the Government Treasury under the partial Reverse Charge Mechanism. The credit of Service tax paid to the Service provider would be available on the basis of the invoice issued and the credit of Service tax paid by the service receiver under partial reverse charge would be available on the basis of tax payment challan as per Rule 9(1)(e) of Cenvat Credit Rules, 2004.

8. Whether Service Receiver can pay Service Tax by utilising CENVAT Credit?

No. Explanation to Rule 3(4) of CCR provides that *"CENVAT Credit cannot be used for payment of service tax in respect of services where the person liable to pay tax is the service recipient."* Therefore, Service Receiver has no option but to make payment of Service Tax in cash.

9. Whether Service Recipient paying Service tax under reverse charge needs to get registered under Service tax?

Yes, Service recipient will have to get registered under Service Tax, even if he is not providing any service. He will have to file the return even if it is a nil return.

As per Section 69 of the Finance Act, 1994, "every person liable to pay the service tax under this Chapter or the rules made there under shall, within such time and in such manner and in such form as may be prescribed, make an application for registration to the Superintendent of Central Excise."

Service tax on Staff Benefits and Employment Related Transactions - Suggestions Invited by TRU

Dear Professional Colleagues,

TRU has issued a Draft Circular F. No 354/127/2012-TRU dated July 27, 2012 clarifying certain issues in relation to leviability of service tax on staff benefits and employee related transactions and trade, industry & field formations are requested to go through the draft Circular and offer their comments, views and suggestions. We have summarized those points for your ready reference and comments, views and suggestions, if any, for our onward submission to TRU on or before 24th August, 2012:-

A. Scope of Manpower supply

Post July 1, 2012, Section 65 of Finance Act, 1994 has been withdrawn. Consequently the definition of manpower supply under Section 65 is no more applicable. Now, the words manpower supply is to be understood as per their natural meaning.

The manpower supply mean when one person provides another person with the use of one or more individuals who are contractually employed or otherwise engaged by the first person (the person providing the service of manpower supply). In other words the manpower must be employed by the provider of service and not by the service recipient.

The following situations may be noted in this regard-

- In certain cases, manpower is made available to execute another independent contract by the service provider i.e. the activity will fall under the ambit of manpower supply service if the manpower is placed operationally under the superintendence or control of the recipient of service.

- As long as such **manpower** is not placed operationally under the superintendence or control of the recipient, it shall not be a case of manpower supply, though it will continue to be judged independently whether it comprises any other taxable service.
- In case of **secondment of employees**, an organisation places its staff at the disposal of its associate/ subsidiary company. Such cases are included in the definition of manpower supply as the deputed staff is the employee of the parent company.

B. Joint Employment

In certain cases, staff may be employed by two employers who share the cost of such employment. The services provided by the employee in such cases will be outside the definition of service because the definition of service u/s 65B (44) of the Finance Act, 1994 specifically excludes the provision of service by an employee to the employer in the course of or in relation to his employment.

However, if the staff is engaged by one employer and made available to another for a consideration, such activity will be liable to service tax.

Further, in case of **joint employers**, one employer pays the salary and other benefits of the staff on behalf of other employers and later recovers the cost from other employers on actual basis then such recoveries will not be liable to service tax as it is merely a case of cost reimbursement.

C. Services by the Directors

Services provided by the directors to the Company may be in the individual capacity or they are representing any entity (including government) for a consideration, will be chargeable to service tax. If a director receives payment in his personal capacity, the same is taxed in the hands of the director. However, if any entity is charging any fee for nominating the director, such fee is also liable to service tax as it is an activity provided by one person to another for consideration.

In case of Government nominated director, if any fee is paid to the government for nominating the director, such fees is liable to service tax under the exclusion sub- (iv) of clause (a) of section 66D of the Finance Act, 1994 i.e. support services by Government to business entity. Such services are liable to be taxed on reverse charge basis by business entity.

D. Treatment of supplies made by the employer to employees

Provision of service by an employee to the employer in the course of or in relation to his employment is excluded from the definition of the "service". A number of activities are carried out by the employers for the employees for a consideration will fall within the definition of "service" and are liable to be taxed unless specified in the Negative List or otherwise exempted.

Consideration may be in the form of portion of salary foregone by the employee or any reduction from the salary i.e. where the employees' pays for such services provided by Employer e.g. a portion of money recovered by Employer on usage of Car, Telephone, Assets, etc., provided to the Employee for personal usage. However, the Cenvat credit of the inputs and input services used to provide the output services by the employer will be available to the employer as per extant Cenvat Credit Rules, 2004.

However, if any service is provided by the employer to the employee without any consideration (facilities like crèche, gymnasium or a health club, which all employees may use without any charge or reduction from the salary), it will not be chargeable to service tax. Service provided by the employer to the employee which is either covered under the Negative list or otherwise exempted will not be chargeable to service tax. For example, the services of food and catering provided by the employer in a canteen would normally fall outside the tax net unless such canteen has both the facility of air-conditioning as well as license to serve liquor (S. No. 19 of the Mega exemption). Likewise, services provided by way of guest house will also not be liable to tax if the tariff for such unit of accommodation is below Rs. 1000 per day or equivalent (S. No. 18 of the Mega exemption).

Similarly, any recovery towards providing residential accommodation would be covered under the negative list entry – Section 66D (m) and not chargeable to service tax.

E. Treatment of reimbursements made by the employer to the employee

The reimbursements of expenditure incurred by the employee on behalf of the employer in course of employment would not amount to a "service" per se and hence are non-taxable.

F. Treatment of supplies and reimbursements made by the employer to ex-employees/ pensioners

If any service is provided by the employer to the ex-employees or pensioners for consideration, it will be liable to service tax. The treatment of such services will be at par with the services by the employer to the current employees.

SERVICE TAX ON VOCATIONAL EDUCATION/TRAINING COURSES

TRU has issued a ***Circular No. 164/15/2012-ST*** dated August 28, 2012 clarifying certain issues in relation to levy of service tax on certain vocational education/training/ skill development courses (VEC) offered by the Government (Central Government or State Government) or local authority themselves or by an entity independently established by the Government under the law, as a society or any other similar body.

We have summarized the points for your ready reference:-

When a VEC is offered by the Government or a local authority, service tax is not leviable as the said Service is covered under the Negative list under section 66D of the Finance Act, 1994, i.e. not chargeable to service tax. As per Section 66D (a), most services provided by the Central Government or state government or local authorities are not chargeable to service tax except the following:

i. services by the Department of Post 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

iv. support services, other than services covered under clauses (i) to (iii) above, provided to business entities

VEC is excluded from this list of taxable services provided by Government or local authority. Hence, when VEC is provided by Central Government or local authority, it is not chargeable to service tax.

However, when a VEC is offered by an entity independently established by the Government under the law, as a society or any other similar body, service tax

treatment has to be determined in a different manner. The Circular clarifies that applicability of service tax is to be determined in terms of sub-clause (ii) or (iii) of clause (l) of section 66D of the Finance Act, 1994.

A. *Sub Clause (ii)* of clause (l) of section 66D provides that services provided by way of education as a part of a curriculum for obtaining a qualification recognised by any law for the time being in force are not chargeable to service tax.

The Circular provides that in the context of VEC, qualification implies a Certificate, Diploma, Degree or any other similar Certificate. The words "recognized by any law" will include such courses as are approved or recognized by any entity established under a central or state law including delegated legislation, for the purpose of granting recognition to any education course including a VEC.

Further Clarification regarding this has been given in the Education Guide dated June 20, 2012 issued by CBEC:

4.12.1 What is the meaning of 'education as a part of curriculum for obtaining a qualification recognized by law'?

It means that only such educational services are in the negative list as are related to delivery of education as 'a part' of the curriculum that has been prescribed for obtaining a qualification prescribed by law. It is important to understand that to be in the negative list the service should be delivered as part of curriculum. 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.

B. *Sub Clause (iii)* of clause (l) of section 66D provides that services provided by way of education as a part of an approved vocational education course are not chargeable to service tax.

Section 65B (11) of Finance Act, 1994 provides the definition of approved vocational course as-

i) a course run by an industrial training institute or an industrial training centre affiliated to the National Council for Vocational Training offering courses in designated trades notified under the Apprentices Act, 1961; or

ii) a Modular Employable Skill Course, approved by the National Council of Vocational Training, run by a person registered with the Directorate General of Employment and Training, Union Ministry of Labour and Employment; or

iii) a course run by an institute affiliated to the National Skill Development Corporation set up by the Government of India

If the entity independently established by the Government under the law, as a society or any other similar body is providing VEC which is covered under sub clause (ii) or sub clause (iii) of Clause (l) of Section 66D, then it will not be chargeable to service tax. In other cases, service tax will be leviable.

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